Fair Lending

This overview provides a basic and abbreviated discussion of federal fair lending laws and regulations. It is adapted from the Interagency Policy Statement on Fair Lending issued in March 1994.

1. Lending Discrimination Statutes and Regulations

LINKS
Program
Questionnaire
Appendix A

The Equal Credit Opportunity Act (ECOA) prohibits discrimination in any aspect of a credit transaction. It applies to any extension of credit, including extensions of credit to small businesses, corporations, partnerships, and trusts.

The ECOA prohibits discrimination based on:

- Race or color
- Religion
- National origin
- Sex
- Marital status
- Age (provided the applicant has the capacity to contract)
- The applicant's receipt of income derived from any public assistance program
- The applicant's exercise, in good faith, of any right under the Consumer Credit Protection Act.

The Federal Reserve Board's Regulation B, found at 12 CFR part 202, implements the ECOA. Regulation B describes lending acts and practices that are specifically prohibited, permitted, or required. Official staff interpretations of the regulation are found in Supplement I to 12 CFR part 202.

FFIEC

The Fair Housing Act (FHAct) prohibits discrimination in all aspects of "residential real-estate related transactions," including but not limited to:

- Making loans to buy, build, repair, or improve a dwelling
- Purchasing real estate loans
- Selling, brokering, or appraising residential real estate
- Selling or renting a dwelling.

The FHAct prohibits discrimination based on:

- Race or color
- National origin
- Religion
- Sex
- Familial status (defined as children under the age of 18 living with a parent or legal custodian, pregnant women, and people securing custody of children under 18)
- Handicap.

HUD's regulations implementing the FHAct are found at 24 CFR Part 100.

Because both the FHAct and the ECOA apply to mortgage lending, lenders may not discriminate in mortgage lending based on any of the prohibited factors in either list.

Under the ECOA, it is unlawful for a lender to discriminate on a prohibited basis in any aspect of a credit transaction, and under both the ECOA and the FHAct, it is unlawful for a lender to discriminate on a prohibited basis in a residential real-estate-related transaction. Under one or both of these laws, a lender may not, because of a prohibited factor:

- Fail to provide information or services or provide different information or services regarding any aspect of the lending process, including credit availability, application procedures, or lending standards.
- Discourage or selectively encourage applicants with respect to inquiries about or applications for credit.
- Refuse to extend credit or use different standards in determining whether to extend credit.

- Vary the terms of credit offered, including the amount, interest rate, duration, or type of loan.
- Use different standards to evaluate collateral.
- Treat a borrower differently in servicing a loan or invoking default remedies.
- Use different standards for pooling or packaging a loan in the secondary market.

A lender may not express, orally or in writing, a preference based on prohibited factors or indicate that it will treat applicants differently on a prohibited basis.

A lender may not discriminate on a prohibited basis because of the characteristics of:

- An applicant, prospective applicant, or borrower.
- A person associated with an applicant, prospective applicant, or borrower (for example, a co-applicant, spouse, business partner, or live-in aide).
- The present or prospective occupants of either the property to be financed or the neighborhood or other area where property to be financed is located.

Finally, the FHAct requires lenders to make reasonable accommodations for a person with disabilities when such accommodations are necessary to afford the person an equal opportunity to apply for credit.

2. Types of Lending Discrimination

The courts recognize three methods of proof of lending discrimination under the ECOA and the FHAct:

- Overt evidence of disparate treatment.
- Comparative evidence of disparate treatment.
- Evidence of disparate impact.

Disparate Treatment

The existence of illegal disparate treatment may be established either by statements revealing that a lender explicitly considered prohibited factors (**overt** evidence) or by differences in treatment that are not fully explained by legitimate nondiscriminatory factors (**comparative** evidence).

Overt Evidence of Disparate Treatment. There is overt evidence of discrimination when a lender openly discriminates on a prohibited basis.

Example: A lender offered a credit card with a limit of up to $750 for applicants aged 21-30 and $1500 for applicants over 30. This policy violated the ECOA's prohibition on discrimination based on age.

There is overt evidence of discrimination even when a lender expresses - but does not act on - a discriminatory preference.

Example: A lending officer told a customer, "We do not like to make home mortgages to Native Americans, but the law says we cannot discriminate and we have to comply with the law." This statement violated the FHAct prohibition on statements expressing a discriminatory preference as well as Section 202.5(a) of Regulation B, which prohibits discouraging applicants on a prohibited basis.

Comparative Evidence of Disparate Treatment. Disparate treatment occurs when a lender treats a credit applicant differently based on one of the prohibited bases. It does not require any showing that the treatment was motivated by prejudice or a conscious intention to discriminate against a person beyond the difference in treatment itself. Courts consider this intentional discrimination because no credible, nondiscriminatory reason explains the difference in treatment on a prohibited basis.

Disparate treatment may more likely occur in the treatment of applicants who are neither clearly well qualified nor clearly unqualified. Discrimination may more readily affect applicants in this middle group for two reasons. First, if the applications are "close cases," there is more room and need for lender discretion. Second, whether or not an applicant qualifies may depend on the level of assistance the lender provides the applicant in completing an application. The lender may, for example, propose solutions to credit or other problems regarding an application, identify compensating factors, and provide encouragement to the applicant. Lenders are under no obligation to provide such assistance, but to the extent that they do, the assistance must be provided in a nondiscriminatory way.

Example: A nonminority couple applied for an automobile loan. The lender found adverse information in the couple's credit report. The lender discussed the credit report with the couple and determined that the adverse information, a judgment against the couple, was incorrect since the judgment had been vacated. The nonminority couple was granted its loan. A minority couple applied for a similar loan with the same lender. Upon discovering adverse information in the minority couple's credit report, the lender denied the loan application on the basis of the adverse information without giving the couple an opportunity to discuss the report.

The foregoing is an example of disparate treatment of similarly situated applicants, apparently based on a prohibited factor, in the amount of assistance and information the lender provided.

If a lender has apparently treated similar applicants differently on the basis of a prohibited factor, it must provide an explanation for the difference in treatment. If the lender's explanation is not found to be credible, the agency may find that the lender intentionally discriminated.

Redlining is a form of illegal disparate treatment in which a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located. Redlining may violate both the FHAct and the ECOA.

Disparate Impact

When a lender applies a racially or otherwise neutral policy or practice equally to all credit applicants, but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis, the policy or practice is described as having a "disparate impact."

> Example: A lender's policy is not to extend loans for single-family residences for less than $60,000. This policy has been in effect for ten years. This minimum loan amount policy is shown to disproportionately exclude potential minority applicants from consideration because of their income levels or the value of the houses in the areas in which they live.

Although the precise contours of the law on disparate impact as it applies to lending discrimination are under development, what has been clearly established is that the presence of a policy or practice that creates a disparity on a prohibited basis is not alone proof of a violation.

When the agency finds that a lender's policy or practice has a disparate impact, the next step is to seek to determine whether the policy or practice is justified by "business necessity." The justification must be manifest and may not be hypothetical or speculative. Factors that may be relevant to the justification could include cost and profitability. Even if a policy or practice that has a disparate impact on a prohibited basis can be justified by business necessity, it still may be found to be a violation if an alternative policy or practice could serve the same purpose with less discriminatory effect. Finally, evidence of *discriminatory intent* is not necessary to establish that a lender's adoption or implementation of a policy or practice that has a disparate impact is in violation of the FHAct or ECOA.

These procedures do not call for you to plan examinations to identify or focus on potential disparate impact issues. The guidance in this Introduction is intended to help you recognize potential disparate impact situations if you happen to encounter them. Guidance in the Appendix tells you how to obtain relevant information regarding such situations and how to evaluate and follow up on it, as appropriate.

GENERAL GUIDELINES

These procedures are intended to be a basic and flexible framework for use in the majority of fair lending examinations conducted by the FFIEC agencies. They are also intended to guide your judgment, not to supplant it. The procedures can be augmented by the agency, which can supply additional procedures and details as are necessary to implement them effectively.

Although these procedures will apply to most examinations, the agency may continue to use, for limited numbers of examinations, the distinct approaches it has developed that are appropriate for select classes of institutions. Such approaches include, for example, the statistical modeling that some of the agencies use in selected examinations to help determine whether race or national origin was a factor in credit decisions.

For a number of aspects of lending – for example, credit scoring and loan pricing – the "state of the art" is more likely to be advanced if the agencies have some latitude to incorporate promising innovations. These interagency procedures provide for that.

Any references in these procedures to options, judgment, etc., of "examiners" refers to discretion within the limits provided by the agency. You should use these procedures in conjunction with the agency's priorities, examination philosophy, and detailed guidance for implementing these procedures. These procedures should not be interpreted as providing you greater latitude than the agency would. For example, if the agency's policy is to review compliance management systems even in small banks, you must conduct such a review rather than interpret the Compliance Management Review section of the Program as leaving the review to your option.

The procedures emphasize racial and national origin discrimination in residential transactions, but the key principles can be applied to other prohibited bases and to nonresidential transactions.

Finally, these procedures focus on analyzing lender compliance with the broad, nondiscriminatory requirements of the ECOA and the FHAct. They do not address such explicit or technical compliance provisions as the signature rules or adverse action notice requirements in sections 202.7 and 202.9, respectively, of Regulation B.

EXAMINATION SCOPE GUIDELINES

Background

The **scope** of an examination encompasses the loan product(s), market(s), decision center(s), time frame, prohibited basis and control group(s) to be analyzed during the examination. These procedures refer to each potential combination of those elements as a "Focal Point." Setting the scope of an examination involves, first, identifying all of the potential Focal Points that appear worthwhile to examine. Then, from among those, you select the Focal Point(s) that will form the scope of the examination, based on risk factors, priorities established in these procedures or by the agency, the record from past examinations, and other relevant guidance. This phase includes obtaining an overview of an institution's compliance management system as it relates to fair lending.

When selecting Focal Points for review, you may determine that the institution has performed self-tests or self-evaluations related to specific lending products. The difference between self tests and self evaluations is discussed in the Streamlining the Examination section of the Appendix. Institutions must share all information regarding self-evaluations and certain limited information related to self-tests. Institutions may choose to voluntarily disclose additional information about self-tests. You should make sure that institutions understand that voluntarily sharing the results of self-tests will result in a loss of confidential status of these tests. Information from self-evaluations or self-tests may allow the scoping to be streamlined. Refer to the Streamlining the Examination section of the Appendix for additional details.

Scoping may disclose the existence of circumstances – such as the use of credit scoring or the amount of residential lending, which, under the agency's policy, calls for the use of regression analysis or other statistical methods of identifying potential discrimination with respect to one or more loan products. Where that is the case, you should employ the agency's specialized procedures for such loan products rather than the procedures set forth below.

Setting the **intensity** of an examination means determining the breadth and depth of the analysis that will be conducted on the selected loan product(s). This process entails a more involved analysis of the institution's compliance risk management processes, particularly related to selected products, to reach an informed decision regarding how large a sample of files to review in any transactional analyses performed and whether certain aspects of the credit process deserve heightened scrutiny.

This section provides guidance on establishing the scope of the examination. The Program provides guidance on determining the intensity of the examination. There is naturally some interdependence between these two phases. Ultimately the scope and intensity of the examination will determine the record of performance that serves as the foundation for agency conclusions about institutional compliance with fair lending obligations. You should employ these procedures and the organization of these guidelines to arrive at a well-reasoned and practical conclusion about how to conduct a particular institution's examination of fair lending performance.

In cases where information already in the possession of the agency provides you with guidance on priorities and risks for planning an upcoming examination, such information may expedite the scoping process and make it unnecessary to carry out all of the steps below. For example, the report of the previous fair lending examination may include recommendations for the focus of the next examination.

You can perform scoping off-site, onsite, or both, depending on what is most feasible. In the interest of minimizing burdens on both the examination team and the lender, requests for information from the institution should include only the information that will clearly be useful in the examination. Finally, any off-site information requests should be made sufficiently in advance of the on-site schedule to permit institutions adequate time to assemble information and provide it to the examination team. (See the

Appendix Section, Potential Scoping Information, for guidance on additional information that you should consider including in a request.)

You should focus the examination based on:

- An understanding of the credit operations of the institution.
- The risk that discriminatory conduct may occur in each area of those operations.
- The feasibility of developing a factually reliable record of an institution's performance and fair lending compliance in each area of those operations.

1. Understanding Credit Operations

Before evaluating the potential for discriminatory conduct, you should review sufficient information about the institution and its market to understand the credit operations of the institution and the representation of prohibited basis group residents within the markets where the institution does business. The level of detail obtained at this stage should be sufficient to identify whether any risk factors in the steps below are present. Relevant background information includes:

- The types and terms of credit products offered, differentiating among residential, consumer, and other categories of credit.
- The volume of, or growth in, lending for each of the credit products offered.
- The demographics (i.e., race, national origin, etc.) of the credit markets in which the institution conducts business.
- The institution's organization of its credit decision-making process, including identification of the delegation of separate lending authority and the extent to which discretion in pricing or setting credit terms and conditions is delegated to various levels of managers, employees, or independent brokers or dealers.
- The types of relevant documentation/data that are available for various loan products and the relative quantity, quality, and accessibility of such information. That is, for which loan product(s) will the information available be most likely to support a sound and reliable fair lending analysis?
- The extent to which information requests can be readily organized and coordinated with other compliance examination components to reduce undue burden on the institution. (Do not request more information than the exam team can be expected to utilize during the anticipated course of the examination.)

In thinking about an institution's credit markets, you should recognize that these markets may or may not coincide with an institution's CRA assessment area(s). Where appropriate, you should review the demographics for a broader geographic area than the assessment area.

Where an institution has multiple underwriting or loan processing centers or subsidiaries, each with fully independent credit-granting authority, consider evaluating each center and/or subsidiary separately, provided a sufficient number of loans exist to support a meaningful analysis. In determining the scope of the examination for such institutions, you should consider whether:

- Subsidiaries should be examined. The agency will hold a financial institution responsible for violations by its direct subsidiaries, but not typically for those by its affiliates (unless the affiliate has acted as the agent for the institution or the violation by the affiliate was known or should have been known by the institution before it became involved in the transaction or purchased the affiliate's loans). When seeking to determine an institution's relationship with affiliates that are not supervised financial institutions, limit the inquiry to what can be learned in the institution and do not contact the affiliate.

- The underwriting standards and procedures used in the entity being reviewed are used in related entities not scheduled for the planned examination. This will help you to recognize the potential scope of policy-based violations.

- The portfolio consists of applications from a purchased institution. If so, for scoping purposes, you should consider the applications as if they were made to the purchasing institution. (For comparison purposes, applications evaluated under the purchased institution's standards should not be compared to applications evaluated under the purchasing institution's standards.)

- The portfolio includes purchased loans. If so, you should look for indications that the institution specified loans to purchase based on a prohibited factor or caused a prohibited factor to influence the origination process.

- A complete decision can be made at one of the several underwriting or loan processing centers, each with independent authority. In such a situation, it is best to conduct a separate on-site comparative analysis at each underwriting center. If covering multiple centers is not feasible during the planned examination, you should review one during the planned examination and others in later examinations.

- Decision-making responsibility for a single transaction may involve more than one underwriting center. For example, an institution may have authority to decline mortgage applicants, but only the mortgage company subsidiary may approve them. In such a situation, you should learn which standards are applied in each entity and the location of records needed for the planned comparisons.

- Any third parties, such as brokers or contractors, are involved in the credit decision and how responsibility is allocated among them and the institution. The institution's familiarity with third party actions may be important, for a bank may be in violation if it participates in transactions in which it knew or reasonably ought to have known other parties were discriminating.

If the institution is large and geographically diverse, you should select only as many markets or underwriting centers as can be reviewed readily in depth, rather than selecting proportionally to cover every market. As needed, you should narrow the focus to the MSA or underwriting center that is determined to present the highest discrimination risk. You should use LAR data organized by the underwriting center, if available. After calculating denial rates between the control group and minorities for the underwriting centers, you should select the centers with the highest disparities. If underwriting centers have fewer than five black, Hispanic, or Native American denials, you should not examine for racial discrimination. Instead, you should shift the focus to other loan products or prohibited bases.

2. Evaluating the Potential for Discriminatory Conduct

Step One: Develop an Overview

Based on your understanding of the credit operations and product offerings of an institution, you should determine the nature and amount of information required for the scoping process and should obtain and organize that information. No single examination can evaluate compliance performance for every prohibited basis, in every product, or in every underwriting center or subsidiary of an institution. In addition to information gained in the process of Understanding Credit Operations, above, you should keep in mind the following factors when selecting products for the scoping review:

- Which products and prohibited bases were reviewed during the most recent prior examination(s) and, conversely, which products and prohibited bases have not recently been reviewed?

- Which prohibited basis groups make up a significant portion of the institution's market for the different credit products offered?

- Which products and prohibited basis groups the institution reviewed using either a voluntarily disclosed self-test or a self-evaluation?

Based on consideration of the foregoing factors, you should request information for all residential and other loan products considered appropriate for scoping in the current examination cycle. In addition, wherever feasible, you should conduct preliminary interviews with the lender's key underwriting personnel. Using the accumulated information, you should evaluate the following, as applicable:

- Underwriting guidelines, policies, and standards.

- Descriptions of credit scoring systems, including a list of factors scored, cutoff scores, extent of validation, and any guidance for handling overrides and exceptions. (Refer to Part A of the Credit Scoring Analysis section of the Appendix for guidance.)

- Applicable pricing policies and guidance for exercising discretion over loan terms and conditions.
- The institution's corporate relationships with any finance companies, subprime mortgage or consumer lending entities, or similar institutions.
- Loan application forms.
- HMDA/LAR or loan registers and lists of declined applications.
- Description(s) of databases maintained for loan product(s) to be reviewed, especially any record of exceptions to underwriting guidelines.
- Copies of any consumer complaints alleging discrimination and the related loan files.
- Descriptions of any compensation system that is based on loan production or pricing.
- Compliance program materials (particularly fair lending policies), training manuals, organization charts, as well as recordkeeping and any monitoring protocols.
- Copies of any available marketing materials or descriptions of current or previous marketing plans or programs.

Step Two: Identify Compliance Program Discrimination Risk Factors

Review information from the agency's examination work papers, institutional records, and any available discussions with management representatives in sufficient detail to understand the organization, staffing, training, recordkeeping, auditing, and policies of the institution's fair lending compliance systems. Review these systems and note the following risk factors:

C1. Overall institution compliance record is weak.

C2. Prohibited basis monitoring information is incomplete.

C3. Data and/or recordkeeping problems compromised reliability of previous examination reviews.

C4. Fair lending problems were previously found in one or more bank products.

C5. The size, scope, and quality of the compliance management program, including senior management's involvement, is materially inferior to programs customarily found in institutions of similar size, market demographics, and credit complexity.

C6. The institution has not updated compliance guidance to reflect changes in law or in agency policy.

Consider these risk factors and their impact on particular lending products and practices as you conduct the product specific risk review during the scoping steps that follow. Where this review identifies fair lending compliance system deficiencies, give them appropriate consideration as part of the Compliance Management Review in the Program.

Step Three: Review Residential Loan Products

Although home mortgages may not be the ultimate subject of every fair lending examination, this product line must at least be considered in the course of scoping every institution that is engaged in the residential lending market.

Divide home mortgage loans into the following groupings: home purchase, home improvements, and refinancings. Subdivide those three groups further if an institution does a significant number of any of the following types or forms of residential lending, and consider them separately:

- Government-insured loans.
- Mobile home or factory housing loans.
- Wholesale, indirect, and brokered loans.
- Portfolio lending (including portfolios of Fannie Mae/Freddie Mac rejections).

In addition, determine whether the lender offers any conventional "affordable" housing loan programs and whether the terms and conditions make them incompatible with regular conventional loans for comparative purposes. If so, consider them separately.

If previous examinations have demonstrated the following, then you may limit the focus of the current examination to alternative underwriting or processing centers or to other residential products that have received less scrutiny in the past:

- A strong fair lending compliance program.
- No record of discriminatory transactions at particular decision centers or in particular residential products.
- No indication of a significant change in personnel, operations, or underwriting standards at those centers or in those residential products.
- No unresolved fair lending complaints, administrative proceedings, litigation, or similar factors.

Step Four: Identify Residential Lending Discrimination Risk Factors

- Review the lending policies, marketing plans, underwriting, appraisal and pricing guidelines, broker/agent agreements, and loan application forms for each residential loan product that represents an appreciable volume of, or displays noticeable growth in, the institution's residential lending.

- Review also any available data regarding the geographic distribution of the institution's loan originations with respect to the race and national origin percentages of the census tracts within its assessment area or, if different, its residential loan product lending area(s).

- Conduct interviews of loan officers and other employees or agents in the residential lending process concerning adherence to and understanding of the above policies and guidelines as well as any relevant operating practices.

- In the course of conducting the foregoing inquiries, look for the following risk factors (factors are numbered alphanumerically to coincide with the type of factor, e.g., "O" for "overt"; "P" for "pricing", etc.):

Overt indicators of discrimination such as:

O1. Including explicit prohibited basis identifiers in underwriting criteria or pricing standards.

O2. Collecting information, conducting inquiries, or imposing conditions contrary to express requirements of Regulation B.

O3. Including variables in a credit scoring system that constitute a basis or factor prohibited by Regulation B or, for residential loan scoring systems, the FHAct. (If a credit scoring system scores age, refer to Part E of the Credit Scoring Analysis section of the Appendix.)

O4. Statements made by the institution's officers, employees, or agents which constitute an express or implicit indication that one or more such persons have engaged or do engage in discrimination on a prohibited basis in any aspect of a credit transaction.

O5. Employee or institutional statements that evidence attitudes based on prohibited basis prejudices or stereotypes.

NOTE: For risk factors below that are marked with an asterisk, you need not attempt to calculate the indicated ratios for racial or national origin characteristics when the institution is not a HMDA reporter. However, consideration should be given in such cases to whether or not such calculations should be made based on gender or racial-ethnic surrogates.

Indicators of potential disparate treatment in Underwriting such as:

U1. *Substantial disparities among the approval/denial rates for applicants by monitored prohibited basis characteristic (especially within income categories).

U2. *Substantial disparities among the application processing times for applicants by monitored prohibited basis characteristic (especially within denial reason groups).

U3. *Substantially higher proportion of withdrawn/incomplete applications from prohibited basis group applicants than from other applicants.

U4. Vague or unduly subjective underwriting criteria.

U5. Lack of clear guidance on making exceptions to underwriting criteria, including credit scoring overrides.

U6. Lack of clear loan file documentation regarding reasons for any exceptions to normal underwriting standards, including credit scoring overrides.

U7. Relatively high percentages of either exceptions to underwriting criteria or overrides of credit score cutoffs.

U8. Loan officer or broker compensation based on loan volume (especially loans approved per period of time).

U9. Consumer complaints alleging discrimination in loan processing or in approving/denying residential loans.

Indicators of potential **disparate treatment in Pricing** (interest rates, fees, or points) such as:

P1. Relationship between loan pricing and compensation of loan officers or brokers.

P2. Presence of broad discretion in pricing or other transaction costs.

P3. Use of a system of risk-based pricing that is not empirically based and statistically sound.

P4. *Substantial disparities among prices being quoted or charged to applicants who differ as to their monitored prohibited basis characteristics.

P5. Consumer complaints alleging discrimination in residential loan pricing.

P6. Substantial disparities in either the incidence or magnitude of rate spreads by prohibited basis and control groups.

Indicators of potential **disparate treatment by Steering** such as:

S1. For an institution that has one or more subprime mortgage subsidiaries or affiliates, any significant differences (by loan product) in the percentage of prohibited basis applicants between the institution and its subsidiary(ies) or affiliate(s).

S2. Lack of clear, objective standards for (i) referring applicants to subsidiaries or affiliates, (ii) classifying applicants as "prime" or "subprime" borrowers, or (iii) deciding what kinds of alternative loan products should be offered or recommended to applicants.

S3. For an institution that makes both conventional and FHA mortgages, any significant differences in the percentages of prohibited basis group applicants in each of these two loan products, particularly with respect to loan amounts of $100,000 or more.

S4. For an institution that makes both prime and subprime loans for the same purpose, any significant differences in percentages of prohibited basis group borrowers in each of the alternative loan product categories.

S5. Consumer complaints alleging discrimination in residential loan pricing.

S6. A lender with a subprime mortgage company subsidiary or affiliate that integrates loan application processing for both entities, such that steering between the prime and subprime products can occur almost seamlessly (i.e., a single loan processor could simultaneously attempt to qualify an applicant, whether to the bank or the mortgage company, under either the bank's prime criteria or the mortgage company's subprime criteria).

S7. Loan officers have broad discretion regarding whether to promote conventional or FHA loans, or both, to applicants, and the lender has not issued guidelines regarding the exercise of this discretion.

S8. A lender has most of its branches or offices in predominantly white neighborhoods. The lender's subprime mortgage subsidiary has branches or offices that are located primarily in predominantly minority neighborhoods.

Indicators of potential **discriminatory Redlining** such as:

R1. *Significant differences, as revealed in HMDA data, in the number of loans originated in those areas in the lender's market that have relatively high concentrations of minority residents compared with areas with relatively low concentrations of minority residents.

R2. *Significant differences between approval/denial rates for all applicants (minority and nonminority) in areas with relatively high concentrations of minority residents compared with areas with relatively low concentrations of minority residents.

R3. *Significant differences between denial rates based on insufficient collateral for applicants from areas with relatively high concentrations of minority residents and those areas with relatively low concentrations of minority residents.

R4. Other patterns of lending identified during the most recent CRA examination that differ by the concentration of minority residents.

R5. Explicit demarcation of credit product markets that excludes MSAs, political subdivisions, census tracts, or other geographic areas within the institution's lending market with relatively high concentrations of minority residents.

R6. Policies on any aspect of providing residential credit such as [receiving and processing applications; pricing; conditions; or appraisals and valuation] that vary between areas with relatively high concentrations of minority residents and areas with relatively low concentrations of minority residents.

R7. Employee statements that reflect an aversion to doing business in areas with relatively high concentrations of minority residents.

R8. Complaints or other allegations by consumers or community representatives that the lender excludes or restricts access to credit for areas with relatively high concentrations of minority residents. You should review complaints against the lender, the CRA public comment file, and community contact forms; the responses to questions about redlining, discrimination, and discouragement of applications; and information from prior CRA examinations about meeting the needs of racial or national origin minorities acquired as part of "obtaining local perspectives on the performance of financial lenders".

NOTE: Broad allegations or complaints are not, by themselves, sufficient justification to shift the focus of an examination from routine comparative review of applications to redlining analysis. Such a shift should be based on complaints or allegations of specific practices or incidents that are consistent with redlining, along with the existence of other risk factors.

R9. A lender that has most of its branches or offices in predominantly white neighborhoods at the same time that the lender's subprime mortgage subsidiary has branches or offices that are located primarily in predominantly minority neighborhoods.

Indicators of potential **disparate treatment in Marketing** of residential products, such as:

M1. Advertising patterns or practices that a reasonable person would believe indicate prohibited basis customers are less desirable.

M2. Advertising only in media serving nonminority areas of the market.

M3. Marketing through brokers or other agents that the lender knows (or has reason to know) would serve only one racial or ethnic group in the market.

M4. Use of marketing programs or procedures for residential loan products that exclude one or more regions or geographies within the lender's assessment or marketing area that have significantly higher percentages of minority residents than does the remainder of the assessment or marketing area.

M5. Using mailing or other distribution lists or other marketing techniques for prescreened or other offerings of residential loan products ** that:

- Explicitly exclude groups of prospective borrowers on a prohibited basis; or
- Exclude geographies (e.g., census tracts, ZIP codes, etc.) within the institution's marketing area that have significantly higher percentages of minority residents than does the remainder of the marketing area.

**** NOTE:** Prescreened solicitation of potential applicants on a prohibited basis does not violate ECOA. Such solicitations are, however, covered by the FHAct. Consequently, analyses of this form of potential marketing discrimination should be limited to residential loan products subject to coverage under the FHAct.

M6. *Proportion of monitored prohibited basis applicants is significantly lower than that group's representation in the total population of the market area.

M7. Consumer complaints alleging discrimination in advertising or marketing loans.

Step Five: Organize and Focus Residential Risk Analysis

Review the risk factors identified in Step Four and for each loan product that displays risk factors, articulate the possible discriminatory effects encountered and organize the examination of those loan products in accordance with the following guidance:

- Where **overt** evidence of discrimination, as described in factors O1-O5, has been found in connection with a product, document those findings as described in Part A of the Program, besides completing the remainder of the planned examination analysis.
- Where any of the risk factors U1-U9 are present, consider conducting an **underwriting comparative file analysis** as described in Part B of the Program.
- Where any of the risk factors P1-P5 are present, consider conducting a **pricing comparative file analysis** as described in Part C of the Program.
- Where any of the risk factors S1-S8 are present, consider conducting a **steering analysis** as described in Part D of the Program.
- Where any of the risk factors R1-R9 are present, consult your manager about conducting an analysis for **redlining** as described in Part F of the Program.
- Where any of the risk factors M1-M7 are present, consult your manager about conducting a **marketing analysis** as described in Part G of the Program.

- Where an institution uses age in any **credit scoring system**, consider conducting an examination analysis of that credit scoring system's compliance with the requirements of Regulation B as described in Part H of the Program.

Step Six: Identify Consumer Lending Discrimination Risk Factors

For credit card, motor vehicle, home equity, and other consumer loan products selected in Step One for risk analysis in the current examination cycle, conduct a risk factor review similar to that conducted for residential lending products in Steps Three through Five. Consult with your manager regarding the potential use of **surrogates** to identify possible prohibited basis group individuals.

NOTE: The term **surrogate** in this context refers to any factor related to a loan applicant that potentially identifies that applicant's race, color, or other prohibited basis characteristic in instances where no direct evidence of that characteristic is available. Thus, in consumer lending, where monitoring data is generally unavailable, an outwardly Hispanic surname could constitute a surrogate for an applicant's race or national origin because then you can assume that the lender (who can rebut the presumption) perceived the person to be Hispanic or Asian. Similarly, an applicant's given name could serve as a surrogate for his or her gender. A surrogate for a prohibited basis characteristic may be used to set up a comparative analysis with nonminority applicants or borrowers.

Using decision rules in Steps Three through Five, for residential lending products, articulate the possible discriminatory patterns encountered and consider examining those products determined to have sufficient risk of discriminatory conduct.

Step Seven: Analyze Commercial Lending Discrimination Risk

Where an institution does a substantial amount of lending in the commercial lending market, most notably small business loans (and the product has not recently been examined or the underwriting standards have changed since the last examination of the product), you should consider conducting a risk factor review similar to that performed for residential lending products, as feasible, given the limited information available. Such an analysis should generally be limited to determining risk potential based on risk factors U4-U8; P1-P3; R4-R7; and M1-M3.

If the institution makes commercial loans insured by the Small Business Administration (SBA), determine from agency supervisory staff whether SBA loan data (which codes race and other factors) are available for the institution and evaluate those data pursuant to instructions accompanying them.

For large institutions reporting small business loans for CRA purposes and where the institution also voluntarily geocodes loan denials, look for material discrepancies in ratios of approval-to-denial rates for applications in areas with relatively high concentrations of minority residents compared with areas with relatively low concentrations.

Articulate the possible discriminatory patterns identified and consider further examining those products determined to have sufficient risk of discriminatory conduct in accordance with the procedures for commercial lending described in Part F of the Program.

Step 8: Complete the Scoping Process

To complete the scoping process, you should review the results of the preceding steps and select those Focal Points that warrant examination, based on the relative risk levels identified. In order to remain within the agency's resource allowances, you may need to choose a smaller number of Focal Points from among all those selected on the basis of risk. In such instances, set the scope by first, prioritizing Focal Points on the basis of (i) high number and/or relative severity of risk factors; (ii) high data quality and other factors affecting the likelihood of obtaining reliable examination results; (iii) high loan volume and the likelihood of widespread risk to applicants and borrowers; and (iv) low quality of any compliance program and, second, selecting for examination review as many Focal Points as resources permit.

Where the judgment process among competing Focal Points is a close call, information learned in the phase of conducting the compliance management review can be used to further refine your choices.

REFERENCES

Law

15 USC 1691 et. seq.	Equal Credit Opportunity Act
42 USC 3601 et. seq.	Fair Housing Act

Regulations

12 CFR Part 202	FRB's regulation implementing Regulation B, ECOA
12 CFR Part 528	OTS's Nondiscrimination Requirements
24 CFR Part 100 et. seq.	HUD's regulation implementing Fair Housing Act

Policy Statements

Interagency Policy Statement on Fair Lending