Remarks by
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Thank you for that introduction, and good morning. I'm delighted to be here with you today, and to have this opportunity to share some thoughts on fair lending, and more specifically on the role of statistical tools and models.

Why here?

I suspect that many of you were getting nervous last week when Hurricane Gustav hit this area. But I'm glad that you all chose to put aside any uncertainty you might have felt, and come to the conference anyway. As bad as natural disasters like hurricanes can be, longer-term damage can come through the impact on a local economy like this one if potential visitors allow fear to keep them away.

This brush with Gustav has brought many comparisons to Hurricane Katrina. The experience with Katrina is one of the reasons New Orleans is an ideal location for a conference like this. Post-Katrina recovery efforts have helped highlight the critical role of credit in restoring economic health. Although successful revitalization of this city and other parts of the Gulf Coast depends on the hard work and optimistic spirit of members of these communities, they only can succeed if there is an adequate supply of credit for rebuilding. As Comptroller, I've made four trips here since Hurricane Katrina, and have repeatedly emphasized the role that national banks and the OCC must play to support the vitality of this area.

But true restoration of this unique city requires not just credit, but fair access to that credit. In that sense, New Orleans an especially good choice of venue for this conference. This has long been one of the more advanced U.S. cities in its race relations, and its diversity has arguably has been one of the keys to its economic and cultural success. Indeed, one of the signal events in the fight against racial discrimination has notable local roots. More than a hundred years ago, a group of citizens here in New Orleans arranged for a man named Homer Plessy to challenge, through an act of civil disobedience, a state law that required separate rail cars for blacks and whites on trains. The resulting legal case, Plessy v. Ferguson, went to the Supreme Court, producing the Court's now-infamous decision supporting "separate but equal" facilities. But the citizens of New Orleans ultimately prevailed when that decision was finally repudiated by the Court in Brown v. Board of Education in 1954.

Thankfully we, like this city, have come a long way from the world of Homer Plessy. "Separate but equal" now seems like a strange idea from the distant past. But even though we live in a very different world, it's not a perfect world – that's why we need fair lending laws, and that's why those laws need to be enforced. The imperative of fair access to financial services and availability of credit to qualified borrowers, free of unlawful discrimination, is one of the principal reasons the OCC is so pleased to have organized this conference.

Why now?

This is also a particularly apt time for a conference on fair lending. We are all working our way through a period of unusual turmoil in financial markets, notably including mortgage markets. The turmoil has created challenges and distractions for

bankers and for regulators. But there is a risk that the emphasis on market disruption could so dominate the attention of bankers and regulators that we lose focus on other still-important priorities – such as the treatment of individual consumers, and in particular their ability to access credit. We simply cannot allow that to happen.

In fact, a time of change like this may require extra diligence in areas like fair lending, because there is the potential for new and important risks to arise. Retail lending markets are going through some major changes, notably in residential mortgage lending. Products are being altered; business practices are shifting; and some market players are retrenching while others are emerging. Whenever changes of this magnitude occur at this pace, there are potential risks. Changes in underwriting terms, reductions in credit lines, modifications to the characteristics of credit products, the elimination of certain products and creation of others – unless proper care is taken in design and execution, the results might be unexpected, even if the intent is good. Markets and products have changed, but the law has not; through all of this change, lenders must maintain an appropriate focus on fair lending.

The role of statistics and models

This conference focuses specifically on the role of statistical analysis and modeling. There's a good reason for that focus. As residential mortgage lending has become a business of scale, operations at some lenders have become enormous. Even though mortgage origination volumes have declined recently, HMDA data show that there were still roughly ten million loans originated last year. Lenders supervised by the OCC handled more than seven million residential mortgage applications last year, with several of the largest institutions processing more than one million applications.

The use of statistical analysis and model-based approaches becomes essential for firms operating at such scale. Nobody can realistically expect to review millions of loan applications one file at a time for compliance with laws and regulations; to be efficient and effective, bankers and regulators need automated tools. That's the way to view the use of models in this area – they are the tools for large-scale automated file review, helping to target resources at the areas of highest risk and greatest effect.

Analytics related to discrimination and fair lending have become increasingly rigorous. HMDA data are a valuable starting point for this analysis, but one thing we all have learned is that HMDA data alone are not enough, and can even be misleading unless interpreted carefully. As everyone in this room probably would agree, fairness and potential discrimination can't be assessed by comparing simple denial rates or average rate spreads across groups. A valid assessment requires the hard work of applying more sophisticated methods from probability and statistics, so that relevant factors are considered in a rigorous and systematic way. In a recent book called *The Drunkard's Walk,* about the importance of having a clear grasp of probability, the author notes that in areas of law such as fair lending, "the understanding of randomness can reveal hidden layers of truth, but only to those who possess the tools to uncover them."[1] Regression analysis is one of the widely accepted methods for doing this; it helps disentangle real disparities from those that appear only by chance or as a result of the influence of legitimate business factors. Regression analysis and similar techniques are extremely important.

Their wide use does raise other issues, though, and I want to add a note of caution here. There can be instances in which initial disparities are uncovered by the OCC, then

[1] Leonard Mlodinow, *The Drunkard's Walk*, Pantheon Books, 2008, page 40.

more variables are introduced by the bank's underwriters, and more, and more, until the measured disparity is eliminated. As long as variables are valid, and reflect legitimate nondiscriminatory underwriting practices, they should be included in the analysis. However, when relevant variables have not been identified up front or reflected in the documentation of decision processes, and are instead offered up, first one, then another, as possible explanations for lending disparities, bank examiners have good reason to be skeptical. To put it more broadly, there is an art to all of this science; there always will be a need for good judgment in modeling and analysis, as well as in the interpretation of results.

Statistical tools have become so important, for banks and for regulators, that all of us – and yes, even Comptrollers of the Currency – need to have at least some understanding of what these tools do, and what the results mean. And beyond simply understanding them, banks and regulatory agencies also need people – like many of you here today – who can explore potential improvements in these methods and the data on which they depend. As new analytical directions and new ways to use results become viable, we should embrace them and reap the benefits that come from better tools. This conference aims at doing both: enhancing general understanding, and fostering improvement in methods and analysis.

From the regulatory perspective

Fair access to credit and fair treatment of customers are key parts of the OCC mission, and use of these analytical tools is crucial to how we get our job done in this area. The national banks we supervise are major lenders to consumers, and consumer lending is a significant part of the business of many national banks. National banks have

more than $2 trillion of retail credit on their books. This is roughly half of their total loan portfolio, and of course at some banks the share of retail credit is much higher.

In part because of this emphasis on the consumer at national banks, we take our fair lending responsibilities very seriously. The banks supervised by the OCC have received that message very clearly for many years, and we find that they generally do a good job on their side; in recent years, actual problems have been relatively few. However, where we do find potential issues, we act promptly to address them before they become big problems, through advice and direction provided as part of our ongoing supervision. In my view, that is how an effective program of supervision and regulation is supposed to work.

During this conference, you've heard some of the details of the OCC approach to fair lending. You've also seen how statistical analysis and modeling comprise a key facet of that approach. Economists from the OCC's Risk Analysis Division – the ones you've heard on various panels at this conference – participate in fair lending exams and work closely with other OCC supervisory staff, some of whom you've also heard from.

But those economists also engage in research to develop new and better techniques for conducting analysis, and to address emerging new issues. Indeed, some of that work is reflected in the discussions by the two panels on the program this morning. We are always looking to improve, and to ensure that the OCC remains among the leaders in this area. We do this in part by hiring excellent economists, and by making sure that they have the tools and resources they need to be able to be leaders within their profession.

I'm proud of the work our OCC economists do, in fair lending as well as in other aspects of consumer compliance. Part of the reason they can be so effective is that the OCC has a process that leverages their skills in a highly productive way. A defining feature of that process is the integration of their analysis with the ongoing supervision of national banks. That integration depends on close collaboration between economists and examiners, with each drawing on the expertise of the other as appropriate.

As in other aspects of OCC supervision, we tailor our approach to fair lending and other compliance risks to the nature of the bank. Strategies adjust to reflect the size of a bank, its complexity, and its overall business profile. The specific forms of analysis and the tools brought to bear vary from case to case, as I believe they should. In some cases, simpler techniques are appropriate, and in others, modeling may not be used at all; we don't apply models just for the sake of using models.

One thing the OCC is considering right now is a potential change to the fair-lending screening process we use for the largest national banks. As you have heard in this conference, our current process relies heavily on HMDA data. Our experience at the OCC has been that we need additional factors that aren't part of regular HMDA reporting, such as loan-to-value ratios, credit scores, or debt service ratios, to do a more targeted analysis of each lender's underwriting and pricing decisions. Currently, those other relevant factors are incorporated during later stages of the supervisory process. But with improvements in data capabilities at large banks and at the OCC, we think there may be a way to bring these factors into the process much earlier than we do now, during screening. In the coming year, through a pilot at some of the largest national banks, we intend to test the feasibility and value of collecting that kind of information from lenders

at the same time that they report as required under HMDA. Getting this information – call it "HMDA Plus" – early enough to use in screening could help us do an even better job of targeting our supervisory resources where they can bring the most benefit for fair lending.

Naturally, the more advanced analytical methods are used primarily at the larger, more complex banks, because these are banks that have the information systems and the scale of operations that make automated tools the clear and sensible solution. At smaller banks, the process is less likely to be automated, because it doesn't need to be. But the OCC carefully assesses fair lending at every bank, big or small. And even at smaller banks, it pays to be alert for potential application of statistical approaches to aspects of fair lending.

What should the industry do?

For those of you here from banks and other parts of the financial industry, I'm sure that there will be many valuable takeaways from the presentations at this conference, and perhaps many more from the opportunities to discuss and share ideas during the breaks between sessions. But let me suggest a few I think you should particularly bear in mind.

Probably the most important is, don't lose focus on fair lending during these challenging times. As I suggested a few minutes ago, I think there are two dangerous cross-currents at work right now as a result of market turmoil: distraction, and rapid change. With regard to distraction, I don't think anyone would deny that we're all being pulled in many directions and face some unusual pressures. But as I've already noted, we

can't afford to let that become an excuse for a lack of attention to fair lending compliance.

It's equally important to recognize the potential for an increase in compliance risk at a time like this, when the business – the product mix, and the way business is conducted – is undergoing some wrenching changes. Areas like loan modifications or other loss mitigation efforts for troubled mortgage loans provide a good example. These are important initiatives, but they are being done on an unprecedented scale, and in many cases through programs that are being designed "on the fly" to meet urgent needs. Institutions should take a good hard look at how decisions are being made and the impact they're having. They should ensure that the way these programs are operating is not unintentionally creating potential fair lending concerns.

That's an example of a second and more general point, which has to do with the integration of fair lending into new product design and approval, and into product modification decisions. With mature and stable products, a lender usually has had enough time to identify any potential problems and address them. But this may not always be true in newer areas or when the design or features of products change, and compliance risks may rise in those cases. The way to address that potential problem is to ensure that staff with relevant expertise and experience, and with a focus on fair lending, are appropriately involved in thinking about product modifications, new products, and new activities at an early stage. Institutions that do this are much more likely to effectively manage the compliance risks.

Another area that some of the panels have touched on is the importance for any lender of conducting a thorough self-assessment of fair lending risk. We expect this from

the banks we supervise, largely because we think it's a good business practice that just makes sense, as part of a comprehensive risk management program. Over the course of this conference, you've heard how we assess fair-lending risk at the OCC. In my view, each lender should be doing such assessment for itself, not waiting for us to do it. When those self-assessments reveal potential problems, corrective actions should be taken promptly. Of course, a good risk assessment program should encompass active risk monitoring on an ongoing basis, as business is conducted. Ongoing assessment means collecting good data, and the right data. If you haven't collected information on the factors that you believe explain risk patterns and potential disparities, you can't be doing much monitoring.

Finally, I think it's clear that there is an aspect of all of this that goes beyond doing analysis and following the rules. Institutions that are top performers in the area of fair lending do so because fair treatment of customers is fundamental to how they do business. So make fair lending a part of the culture of your institution. When fair treatment is integral to the way a business operates, rather than an afterthought or a "compliance exercise," compliance risks – and the reputation risk and financial exposure that can so easily accompany them – fall dramatically. Perhaps more importantly, when fair lending is part of institutional culture, it won't get brushed aside when times get tough, or overlooked when innovative products come along.

Concluding thoughts

In fair lending, as in many other aspects of banking these days, models and statistical methods are valuable tools. I believe this conference has done a great deal to

illustrate good practices and potential uses for those tools, both for banks and for regulators.

But be careful not to lose sight of the real purpose of the panels and presentations here at this conference. The tools are not the point – fair lending is the point. As I have already said, at the OCC we take our fair-lending oversight responsibility very seriously. We expect the banks we regulate to approach their fair lending compliance responsibilities with corresponding seriousness. We are not looking to “catch” banks doing bad things, but we intend and do make very sure that everyone abides by the law.

Some people seem to believe that emphasis on consumer issues is a fashion that comes and goes with the political tides. But that view is certainly wrong. The importance of fair lending doesn’t depend on who is in the White House, or on which party controls Congress. Fair lending is the law. Active and willing compliance not only makes good business sense, it’s also just the right thing to do.

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