In mid-March the Office of the Comptroller of the Currency (OCC) announced a consent order for an institution’s failure to ensure adequate risk management of a relationship pricing program. They cited that the lack of risk management led to inconsistent execution of loan pricing discount programs which adversely impacted customers based on their race, color, national origin, and/or gender in violation of the Fair Housing Act. Although the institution self-reported the issue, it was not identified as a problem until well into the life cycle of the product resulting in costly restitution of twenty-four million dollars ($24,000,000). Add in the OCC civil money penalty of twenty-five million dollars ($25,000,000) and the failure of fair lending risk management was a costly mistake.

Lessons learned from this, and past fair lending consent orders, are that adequate fair lending risk management requires not only awareness of potential fair lending risk, but an understanding of how that risk is affected by the institution's programs and how those programs are executed. Only then can adequate controls be developed to mitigate the risk and monitoring be developed to gauge the effectiveness of those controls.

**Fair Lending Risk Indicators**

Understanding how internal processes for underwriting, pricing, and servicing affect the level of fair lending risk is a challenge. This is especially true in today’s environment where competition is high among lending institutions and new products and services are being introduced to consumers to remain competitive. Prudential regulators and state attorneys general continue to make fair lending a priority and are applying its principles to all aspects of the lending process. Fair lending programs that simply check the box may miss areas that present the highest fair lending risk. Recent focus on market penetration, pricing, and loss mitigation help illustrate that fair lending risk is about more than the application and underwriting decision process and that risk outcomes are dependent on the whole process throughout the life cycle of a product.

Successful fair lending compliance programs bridge the relationship between process risks that require controls and gaps in controls based on results. A comprehensive fair lending risk review should assess the risk factors and identify the indicators of successful control and focused monitoring.

This most recent consent order based on gaps in fair lending controls for loan pricing is good example. Relationship pricing is a common, accepted practice that offers positive benefits for established customers. Unforeseen risk may lie in the implementation of the product and the processes that will be used or developed as a result. Fair lending risk is heightened if procedures do not address the following: consistent use of a pricing model; discretion in the application of available pricing; varying application of pricing policies based on customer base; incomplete prohibited basis monitoring, inadequate file documentation to support pricing and training on the loan pricing process. Developing controls that align to these risks is only the first step. Once those are developed to successfully mitigate risk, the indicators of control success should be considered. These include identifying disparities among quoted and actual pricing; effects on the number of and disposition of rate spreads; and changes or increases in complaints. In addition to regularly scheduled fair lending monitoring, pricing models that increase fair lending risk should be evaluated on not only an ongoing basis, but, also early in the process once early data indicators are available. Additionally, understanding historical data and trends can help with the development of key risk indicators. Business line partners, including areas like credit risk, are more than likely reviewing outcomes at various stages of product development and can offer access to data and actual vs. anticipated outcomes.

Key risk indicators should not be the only avenue to monitor control adequacy. Monitoring programs should be focusing on outliers and verifying that applications align to product features to ensure consistent application of program elements, including pricing, is occurring. Early identification of control gaps will help mitigate issues quickly and result in fewer customers impacted and less costly remediation. Pay special attention to exceptions. High exception rates can indicate that policy is not set to meet the credit needs and/or that high incidences of discretion is occurring. Exceptions are and will always be a significant risk factor for fair lending.

**What’s on the Horizon for 2019: Understand the Data**

The additional data fields collected with the 2018 HMDA changes presents new challenges to fair lending risk. On the one hand, formal reporting enhances integrity of the data points that were already used in fair lending analysis. This should help some institutions reduce the risk of creating analysis that is based on inaccurate data. However, the analysis may still result in false positives that are based on the data that is publicly available, lacking the complete analysis that is achieved with more detailed reviews, like regression. Internal data analysis should be completed ensuring that each stage of data analysis is understood as the institution works to refine any disparities through regression and predictive margins.

**Pricing**

In today’s competitive environment, the costs associated with lending are under continued scrutiny. Be careful not to limit which costs are associated with fair lending reviews. Annual percentage rates (APRs), discounts, closing fees and points, and add on services that drive up the costs of a loan for the consumer should be reviewed for consistent application and negative impact to prohibited groups. Begin by understanding what costs are associated with loan products. Determine where the most risk lies based on how the cost is determined and how it is applied to the customer's loan.
considerations for risk include discretion and use of pricing models and automated systems pricing systems. Monitoring should concentrate on ensuring both people and systems are behaving as expected by reviewing for expected outcomes, outliers, and disparities through fair lending testing.

Market Penetration/Distribution
The risk of redlining continues to be at the forefront of regulatory reviews. Market distribution has always been a component of any redlining review, but with the growth of online lending, applications are sourced from a broader geography and fair lending risk is no longer limited to just the traditional branch location. There needs to be a holistic approach to effectively mitigate fair lending risk. Institutions should consider not only where they are lending, but how those areas compare to overall lending including consideration of where majority-minority and high-minority census tracts are located. Considerations should be made for both application penetration and approval of those applications. Make sure that if there are high percentages of lending (whether there is a in person location or not) that there is no pattern indicating unequal distribution of lending in areas with minority concentrations. Don’t forget to consider both marketing efforts and pricing.

Targeted marketing is a high-risk activity and can result in either a disparity in products offered or less desirable products offered in areas with high minority concentrations. If disparities are indicated in lending distribution analysis, marketing practices may be one of the first practices to look. Pricing has already made the list of items to watch for in 2019, but, don’t forget when evaluating market penetration that pricing is a key risk that should also be reviewed. This is especially important if the institution offers market pricing that differs throughout regional footprints. Fair lending pricing analysis should consider these differences, including all costs of an application or loan, and how the different pricing falls within the bank’s defined market area. If high minority concentration areas are paying more for loans it may be viewed as redlining or a way for the institution to deter applications from protected classes. Additionally, don’t forget about costs. Cost for services, like application fees or discounts need to be reviewed alongside rate and APR costs.

Servicing
Servicing is often the forgotten element in fair lending programs. Recent focus on fair servicing, with consent orders flooding in for mortgage, student loan and collection servicing, has the risk of a fair lending finding on the rise. Servicing has many of the same elements as lending, with payment program and loss mitigation decisions and rate reduction and fee waivers paving the

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Build Awareness, it's the Key to Successful Fair Lending Compliance

Awareness is key to ensuring continued success in mitigating fair lending risk. The days of worrying that monitoring may create risk are long gone, outlived by the understanding that focused monitoring and data testing enables institutions to remain diligent in ensuring fair lending violations do not occur and if they do, that complete and quick corrective action is implemented.

Additionally, creating awareness is a mandatory element to ensure that the regulatory landscape is considered when focusing fair lending efforts. While disparities in lending decisions will always hold significant fair lending risk, recent changes to data collection and focus on servicing shine a light on areas of fair lending risk that institutions should ensure are included in testing and focused monitoring.

In essence, institutions need to take a comprehensive look at how loan programs are implemented and the cost of applications and loans to ensure that the correct controls and testing are in place to mitigate market fair lending risk.

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A day/month for everything
April is National Fair Housing Month and National Financial Literacy Month. HUD's website is focusing on sexual harassment in HUD-assisted housing. The Council for Economic Education has resources and information at its website on financial literacy training. April is also National Poetry Month, National Soft Pretzel Month and National Straw Hat Day!

Fair Lending: Murky Issues (continued from page 2)

lower court, ruling that the policy had a disparate impact on the Latino plaintiffs. Ignoring this impact by falling back on the legal status consideration would “eviscerate” the effects test and allow any facially neutral criterion to break the connection to the prohibited basis. In short, we cannot ever overlook impact but must instead evaluate the importance of the factor to the business decision.

The case goes back to the lower court for consideration of the second and third tests for disparate impact. This will involve consideration of the defendant’s justifications for the policies. Waples required lessees and applicants to produce either a Social Security card or an original passport, original U.S. Visa and original Arrival/Departure Form. Their justification for the requirement was so that they could confirm lessees’ identities, perform credit and criminal background checks, to minimize loss from eviction and to avoid potential criminal liability for harboring illegal aliens. Plaintiffs presented Taxpayer Identification Numbers but Waples refused to consider this as adequate documentation.

What Now?
The Fourth Circuit’s ruling takes clear steps on the first test for disparate impact. The lower court is now confronted with some very difficult questions. Is it permissible to require proof of legal presence? Is potential loss from eviction a legitimate concern when the policy may cause eviction? Are the identity documents required necessary in order to conduct background checks? And finally, what about refusing to rent to a household including a person not legally present? Stay tuned.

Fair Lending: Understand Where Your Data and Programs Meet to Control Risk (continued from page 6)

way for increased fair lending risk. Institutions should be flexible with monitoring approaches, looking for trends in data, review of a statistical sample if possible, and consider similarly situated accounts for consistent application of process when data elements are not available for traditional statistical testing.

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