How Healthy is Your Fair Lending Program?

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How prepared is your organization for a fair lending examination? It is clear that consumer protection, including fair lending, will continue to be a regulatory focus in 2023. Specific to federally insured credit unions, NCUA's 2023 Supervisory Priorities, 23-CU-01/January 2023, includes the following statement within the section on consumer financial protection: "Regarding fair lending, examiners will review policies and practices for steering or loan pricing discrimination risk factors. The risk factors include differences in levels of assistance, marketing, pricing, loan decisioning, redlining, and steering an applicant or potential applicant to a loan product or feature with less favorable terms because of his or her race, color, religion, sex, or other prohibited basis is illegal under the federal fair lending laws. In addition, examiners will assess a credit union's policies and practices related to residential real estate appraisals and conduct a tailored file review to evaluate the consistency, fairness, and accuracy of the appraisals a credit union obtains."

Now is the time to check on the health of your fair lending program. Fair lending risk starts with the first member interaction and is present throughout the entire loan process. A fair lending audit will provide an independent, objective assessment of whether the fair lending compliance program is working as management, the board of directors (board), and regulators expect.

The internal audit program should examine how the credit union proves that it has not engaged, knowingly or unknowingly, in disparate treatment of protected consumers and that policies and practices do not result in disparate impact on any of the prohibited bases set forth in the Equal Credit Opportunity and Fair Housing Acts.

At a minimum, a fair lending audit program should address the following areas:

1. Fair Lending Program, Policies and Procedures

The fair lending program needs to be documented and it needs to support a credit union's fair lending policy and address elements including the program scope, responsibilities, testing, reporting and corrective action. Procedures that support the program should be sufficiently detailed and designed to ensure consistent outcomes and prevent discrimination on any of the prohibited bases.

Management should communicate policies and procedures and ensure all applicable personnel receive training.

2. Fair Lending Risk Assessment

An instrumental part of any fair lending program is the risk assessment. The factors considered in assessing risk are listed in the Interagency Fair Lending Examination Procedures (Interagency Exam Procedures) and the Consumer Financial Protection Bureau (CFPB) Supervision and Exam Manual.

For the products and services you offer, consider these risk factors as they apply to marketing, pre-application, application, underwriting, pricing, closing and servicing. Analysis of lending data will also help find potential fair lending risk.

3. Marketing & Advertising

Marketing and advertising of loan products are highly scrutinized for fair lending. To make sure your advertisements and campaigns do not present unintentional risk, your marketing policy should address fair lending at the start.

All marketing materials, including new products, should be reviewed for potential discriminatory outcomes that may negatively impact borrowers on a prohibited basis. Advertisements should be representative of different races, ethnicities, genders and ages. The attributes used to develop campaigns should be free of potential bias and discriminatory impact. Media selections and solicitations should be screened by marketing, compliance, and legal to ensure that they reach all in a community and do not inadvertently exclude minority census tracts.

It is also a good practice to review your website and social media policies for acceptable use and required content on an ongoing basis to monitor for potential discriminatory issues. If advertising on social media or other digital platforms, ensure the distribution of the advertisement does not pose digital redlining risk. Keep in mind that you are responsible for your third-party vendor's actions as it relates to fair lending.

4. Underwriting

Lending procedures and underwriting guidelines must provide sufficient direction to ensure consistent treatment and levels of assistance for all members. Underwriting decisions must be based on specific, objective, and defined criteria.

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Ensure that documentation is clear on loan approvals, denials, counteroffers, withdrawals and exceptions. Ideally, a second reviewer should come to the same decision.

Also, review all third parties involved in the underwriting process such as appraisers, brokers and correspondent lenders to assess their compliance with fair lending requirements.

5. Pricing

Pricing policies and procedures should address terms, conditions, approval and communication of changes, responsibilities for loan pricing (centralized pricing desk), etc. If exceptions to the pricing policy are allowed, they should be tracked and analyzed to determine if a borrower has been treated differently on a prohibited basis or if exceptions are made only for white applicants.

If your loan pricing varies based on geography or delivery channel, there should be a valid business justification for the difference. Third parties should rarely, if ever, be allowed pricing discretion. Compensation, referral and incentive programs must be monitored to avoid steering risk related to rate, price, etc.

The credit union should conduct statistical and regression analysis (usually performed in the second line compliance function) on a periodic basis to uncover potential fair lending risk areas and identify outlier transactions in assessing fair lending risk.

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6. Servicing & Collections

Servicers have had time since the servicing debacles of 2011 - 2014 to shore up processes, and coupled with the moratorium on foreclosures, to get things in order. With the moratoriums from the pandemic now lifted, activities are expected to increase, and regulators will not hand out any free passes.

Servicing procedures must be detailed and clear. Most importantly, practices must be consistent and fair around forbearance, loss mitigation efforts, bankruptcy and foreclosure.

7. Management of Lending-Related Third Parties/Vendors

Your organization bears the responsibility for ensuring third-party partners are compliant with fair lending and consumer laws, regulations, policies and procedures. Make sure fair lending principles, training and monitoring requirements are incorporated into third-party contracts.

It is important to perform periodic audits to ensure fair lending is embedded in the third party's culture. Review complaints received by and about the third parties for trends and potential fair lending issues.

8. Fair Lending Training

Fair lending training must be specific to job responsibilities. From the receptionist to the internal auditors to senior management and the board, fair lending training should be an annual requirement.

All new employees with lending responsibilities should receive fair lending training within a reasonable period of starting, typically within 30 days of hire. Review training records for the topic covered, attendance (including exemptions) and results of required tests.

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9. Complaint Management

Member complaint data provides an indicator of inadvertent member harm and fair lending issues. Your formal complaint policy should address complaints received by the credit union, those received by its third-party partners, and complaints received by regulatory agencies.

All complaints should be risk-rated, with discrimination complaints rated high risk and escalated, as necessary. Performing root cause analysis of complaints can help assess whether policies, procedures or practices need enhancement. Complaints alleging discrimination and their resolution should be reported to the board.

10. Board and Management Oversight

The board needs to understand the level of fair lending risk to effectively exercise its oversight responsibilities. It is imperative that it receives relevant, timely information to fulfill its mandate. Meeting minutes should document fair lending discussions at a proper level of detail.

11. Fair Lending Monitoring and Testing Activities

In addition to auditing the technical requirements of fair lending regulations, the audit should also cover how the credit union monitors fair lending performance.

How does the credit union know it is granting credit fairly across all members including those in a protected class? Does it employ data analysis, including statistical and regression analysis, to help diagnose areas of potential risk? Does it review outlier transactions (those loans approved or denied outside of underwriting guidelines or priced higher than policy) or comparative transactions (similarly situated borrowers where a protected class borrower receives a different, less advantageous outcome)?

In conclusion, be mindful that fair lending is complex, and internal audit plays a critical role in the governance structure. Auditing for technical compliance with fair lending and other related regulations, and testing loan data integrity are imperative. Internal audit's holistic view of the fair lending program will help ensure the program is healthy and the credit union is treating its loan applicants fairly and responsibly.

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