MEETING THE CREDIT NEEDS OF THE COMMUNITY THROUGH SPECIAL PURPOSE CREDIT PROGRAMS

BY KEENAN NEAL, Manager, CrossCheck Compliance, LLC

Meeting the credit needs of the communities a bank serves is an ever-evolving challenge. Even financial institutions with strong fair lending compliance management programs can have lending disparities in minority communities when compared to non-minority communities. For decades, discrimination in mortgage lending has led to unequal access to credit for minorities. As financial institutions look for innovative ways to meet the credit needs of minority communities, focusing on recent interagency statements and enforcement actions could prove beneficial in addressing current lending disparities. In 2021, the Department of Justice (DOJ) launched a Combatting Redlining Initiative aimed at addressing modern-day redlining by aggressively enforcing fair lending laws.[1] In the majority of redlining consent orders brought forward by the DOJ, financial institutions have been required to conduct a credit needs assessment to inform management of specific credit needs in Black and Hispanic communities. In concert with the Combatting Redlining Initiative, federal regulators recently issued an interagency statement[2] encouraging financial institutions to explore opportunities to develop Special Purpose Credit Programs (SPCPs) to meet the credit needs of the communities they serve. Both actions — the requirement of a credit needs assessment and the encouragement of SPCPs — can be construed as what federal regulators perceive are the best solutions to address the reverberating effects of historical discrimination in minority communities.

SPCPs are programs established and administered to extend credit to a class of persons who, under the organization's customary standards of creditworthiness, probably would not receive such credit or would receive it on less favorable terms than are ordinarily available to other applicants.[3] Through careful planning, institutions can proactively evaluate the need for SPCPs in their market areas and implement programs to meet the community credit needs. To establish an SPCP, Regulation B requires financial institutions to produce a written plan that outlines the implementation of the program. The written plan requires financial institutions to identify the demographic characteristics of the population the SPCP intends to serve, as well as conduct needs assessments to understand the barriers keeping underserved groups from accessing credit. Using publicly available market data as well as internal mortgage lending data, financial institutions can identify the demographic groups that would benefit the most from an SPCP, the barriers to credit access for these demographics, and the best way to market the SPCP to the community. The challenges financial institutions face when developing an SPCP program are many. Understanding the groundwork and the intricacies is paramount. Below are key steps to ensure an SPCP meets the credit needs of the community.

Setting Up a Special Purpose Credit Program

1. **Identify the Need**
   Conduct thorough market research to identify the special needs within the community. Through internal research or the use of a third party to conduct a research-based market study, financial institutions can better understand the demographic and socio-economic conditions of the market area, what barriers residents face in accessing credit, other lending products in the market and what government programs are available, and then develop strategies to provide residential mortgage services to the community.

2. **Engage Legal Counsel**
   Involving legal experts early in the process is important to ensure full compliance with applicable laws and

regulations. Although the legality of an SPCP is confirmed under the Equal Credit Opportunity Act (ECOA) and Regulation B, institutions should still ensure fair lending and Unfair Deceptive and Abusive Acts or Practices (UDAAP) compliance are followed for all aspects of program development.

3. **Draft a Written Plan**
Based on the identified needs, draft a clear and concise objective for the program. It should articulate the intended beneficiaries and the desired outcomes. This objective will be foundational in shaping the program's parameters and guidelines. ECOA and Regulation B provide specific details that should be included in the written plan:

    a. The class of persons that the program is designed to benefit;
    b. The procedures and standards for extending credit pursuant to the program;
    c. Either (i) the time period during which the program will last, or (ii) when the program will be re-evaluated to determine if there is a continuing need for it; and
    d. A description of the analysis the organization conducted to determine the need for the program.

    Items four through six below should be included in the written plan as well.

4. **Develop Assessment Criteria**
While SPCPs aim to make credit available to a class of persons who, under the organization's customary credit underwriting criteria, probably would not be approved for credit, it does not mean institutions should make loans that are counter to safe and sound lending practices. Developing tailored underwriting criteria that account for unique circumstances while still ensuring creditworthiness is key.

5. **Determine Funding Sources**
Determine if the program will be funded through the institution or if partnerships with other financial entities or government bodies are appropriate. Some cities and states have established SPCPs that allow financial institution participation. Clearly defining the funding source ensures the program's financial sustainability.

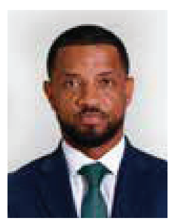
6. **Establish Monitoring and Determine Program Duration**
Continuous oversight is essential for the success of an SPCP. Establish a mechanism to monitor loan distribution, repayment rates and overall program impact. As mentioned in Regulation B, there should be a defined timeframe for which the program is intended to last. This will aid in iterative refinement over time and allow management to evaluate program success.

7. **Train Staff and Engage Stakeholders**
Key stakeholders within the organization should be informed and trained on the requirements of the SPCP. In addition, engaging community leaders, potential beneficiaries and other stakeholders, such as your prudential regulator, provide invaluable feedback. Their input can shed light on potential blind spots and ensure the program truly meets the community's needs.

8. **Marketing and Financial Education**
Ensuring the intended applicants are made aware of the program and its benefits is crucial to the success of the program. Offering financial literacy alongside the SPCP allows applicants to make informed decisions, thus reducing default risks.

9. **Launch a Pilot**
Before rolling out the program on a large scale, consider launching a pilot. This trial phase will provide insights into the effectiveness of the program and offer an opportunity to adjust based on actual outcomes. At the conclusion of the pilot, gather feedback from all stakeholders. Analyze the data, understand the successes and challenges and refine your approach for the full-scale launch.

Establishing an SPCP requires thoughtful planning and an understanding of community needs. With the right approach, institutions can develop SPCPs that truly bridge socio-economic disparities, fostering a more inclusive financial landscape. Homeownership can provide pathways to upward mobility through home equity, credit and asset-building.[4] Purchasing a home is often the main way American families can build wealth, experience upward mobility, invest in their children's well-being and long-term outcomes and improve mental and physical health. All are byproducts associated with increased homeownership. This issue is especially important for Black families, who, because of decades of discrimination in the housing market, now have homeownership rates that are 30 percentage points lower than white families.[5] Slight adjustments to underwriting criteria or creating a down-payment assistance program for first-time homebuyers could help hundreds of thousands of families buy their first home.[6] Proactively assessing the need for an SPCP in the community can strengthen your financial institution's fair lending compliance management program and, ultimately, meet the credit needs of the community.



Keenan is a Manager at CrossCheck Compliance, LLC and is a risk management and regulatory compliance leader with over 10 years of experience in banking and as a regulator. Most recently, he was a Senior Examiner with the Federal Reserve Bank of Atlanta, where he served as a Fair Lending Specialist, leading regulatory examinations of state member banks. Keenan can be reached at kneal@crosscheckcompliance.com.

1. Office of Public Affairs | Justice Department Announces New Initiative to Combat Redlining | United States Department of Justice. https://www.justice.gov/opa/pr/justice-department-announces-new-initiative-combat-redlining.

2. Interagency Statement on Special Purpose Credit Programs Under the Equal Credit (fdic.gov). https://www.fdic.gov/news/financial-institution-letters/2022/fil22008a.pdf.

3. https://www.consumerfinance.gov/rules-policy/regulations/1002/8/#a-1

4. Why Housing Matters for Upward Mobility: Evidence and Indicators for Practitioners and Policymakers | Urban Institute. https://www.urban.org/research/publication/why-housing-matters-upward-mobility-evidence-and-indicators-practitioners-and-policymakers.

5. Racial Differences in Economic Security: Housing | U.S. Department of the Treasury. https://home.treasury.gov/news/featured-stories/racial-differences-in-economic-security-housing#_ftn3.

6. https://www.jec.senate.gov/public/_cache/files/a4c22e73-6752-4014-9404-5a5771b2e19a/social-mobility-brief-final.pdf.