

Fair-lending exams grow riskier (August 20, 2009)

If you needed any more hints that fair-lending is becoming the new hot topic, the latest "news" that the FFIEC has revised and expanded the Interagency Fair-lending Examination Procedures is one giant clue.

I put the term "news" in quotations, because it wasn't exactly a loud pronouncement from the regulatory agencies that the revision had been made. Nothing in the Federal Reserve Board or OCC or FDIC or FFIEC announcements about it. The Federal Reserve Board issued a Consumer Affairs Letter on Aug. 4 to officers and managers in charge of Consumer Affairs sections of the Federal Reserve System. If you just look at the agencies' "What's New" or press releases for happenings, you would have missed it.

The revised exam procedures update the fair-lending exam procedures that were originally issued by the agencies in 1999. According to the Fed's Consumer Affairs letter, the revised procedures particularly clarify procedures relating to pricing; the practices of steering and redlining; and broker relationships. They reflect the current environment and fair-lending concerns especially relating to subprime lending and nontraditional mortgage products.

In the previous exam procedures, there were 49 risk factors in the categories of Compliance Program, Overt Discrimination, Underwriting, Pricing, Redlining, Steering, and Marketing of Residential Products. In the new exam procedures, there are 55 risk factors in these same categories. In addition to new risk factors, many of the existing risk factors have been expanded and clarified.

An institution's compliance program, for example, represents seven fair-lending risk factors—or places where an institution has potential risk of fair-lending criticism. That's one more than before. The new risk factor focuses on an institution's training program. A weak or nonexistent fair-lending training program presents a fair-lending risk to the institution. The size, scope, and quality of the compliance program, including senior management involvement, was a fair-lending risk. That has now been expanded to also include the designation of a compliance officer and staffing. Have the regulators been noticing that financial institutions have been short-changing the staff count for fair-lending compliance lately? Maybe they all got re-assigned to the Bank Secrecy Act Department in recent years? Fair-lending problems previously found in an institution's products was a compliance program risk factor. That risk factor has now been expanded to include fair-lending problems found in any of the institution's subsidiaries as well.

Some of the other new and expanded risk factors in the categories of redlining, steering, and pricing introduce the concept of significant differences in higher-priced loans and nontraditional mortgage loans with negative effects (negative amortization, prepayment penalties, no escrows) in minority populations or areas with higher concentrations of minority populations. These aren't new concepts, however. The regulators have been issuing warnings and advisories about such practices for years. They are now in the examination procedures.

Some of the new risk factors under the Redlining category pull in Community Reinvestment Act concepts. This makes sense because fair-lending performance has a strong correlation with CRA performance. How an institution's assessment area is defined can be a fair-lending risk. A CRA assessment area drawn to exclude areas with relatively high concentrations of minority residents is a fair-lending risk factor. Having branch locations in minority neighborhoods that are opened for fewer hours a week than branch locations in non-minority neighborhoods is a risk factor.

That's just a sampling of what's new and improved in the fair-lending exam procedures. I highly recommend taking the new list of fair-lending risk factors (even those that aren't new) and conducting a risk assessment to see where your institution has risk. Make it a priority. The regulators certainly are.

About Nancy Derr-Castiglione

"Lucy and Nancy's Common Sense Compliance" is blogged by both Lucy Griffin and Nancy Derr-Castiglione, both ABA Banking Journal contributing editors on compliance.

Nancy, a Certified Regulatory Compliance Manager, is owner of D-C Compliance Services, an independent regulatory compliance consulting services business that has provided expertise in compliance training, monitoring, risk assessment, and policies and procedures to financial institutions since 2002.

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