



Marquis 2019 User's Conference

Redlining – Implications on Fair Lending and CRA

October 22, 2019

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Fair Lending Acronyms and Jargon

- CFPB = Consumer Financial Protection Bureau
- CT = census tract (U.S. Census Bureau-defined geography)
- CYR = consult your regulator
- DOJ = U.S. Department of Justice
- *IFLEP* = *Interagency Fair Lending Examination Procedures*
- LMI = low- or moderate-income (individuals or CTs)
- LPO = loan production office
- MMCT = Majority-minority census tract
- NMCT = Non-minority census tract
- REMA = reasonably expected market area
- Risk Factor = a source of fair lending risk (see *IFLEP*)
- Prohibited Basis Group (PBG, or Target Group) = a protected class that may have been a victim of illegal discrimination
- Control Group (CG) = group used to identify discrimination via comparative or statistical evidence

Discussion Items

- Fair Lending Overview
- Recent DOJ cases
- Redlining Overview
- Risk Factors: Redlining and Marketing
- The Four Prongs
- Best Practices
- Resources

Fair Lending Overview

Fair Lending laws and regulations were enacted to ensure that financial institutions do not engage in discrimination on a prohibited basis – Equal Credit Opportunity Act (ECOA) and Fair Housing Act.

Intent to discriminate is not required.

ECOA has two principal theories of liability:

- Disparate Treatment (most common examination analysis)
 - Comparative Evidence (most common among disparate treatment analyses)
 - Overt Discrimination
- Disparate Impact

Recent Fair Lending Cases

Summary of Department of Justice Consent Orders

DOJ Consent Orders Since 2015	
Type	Number of Consent Orders
Redlining	5
Mortgage Pricing – Brokers	1
Mortgage Pricing – Wholesale	1
Mortgage Pricing – In-house	2
Auto Manufacturer Pricing	2
Indirect Auto Pricing	2
Unsecured Pricing	1
Vehicle-secured Pricing	1 (10 Total Pricing Settlements)
Loan Modification Services	1
Disability and Receipt of Public Assistance	1
Familial Status	1
Underwriting	1

Redlining

Redlining is a form of disparate treatment (or disparate impact) whereby a lender restricts access to credit or imposes more onerous terms on applications that derive from geographies with a concentration of minority residents (majority-minority census tracts) relative to non-minority geographies.

Redlining (cont.)

Majority-minority Census Tracts (MMCT)

- A census tract with a concentration of minority residents, generally 50% or greater
- Regulators use various default definitions:
 - All minorities
 - African American/Hispanics
- Recent DOJ settlements have also focused on minority concentrations of 80% or more

Redlining Risk Factors

- R1* – HMDA application and originations disparities in MMCTs
- R9 – Assessment area(s) or market area(s) [for LPOs] exclude MMCTs
- R12 – Branches or LPOs are concentrated in NMCTs (disregard risk factor language)
- R7 – Services or hours of operation differ by offices and minority concentration
- R11 – Complaints of excluded or restricted access to credit in MMCTs
- R4* – Reverse redlining

- **IFLEP* = HMDA calculations

Redlining Risk Factors

- R10 – Employee statements reflecting an aversion to doing business in MMCTs
- R8 – Policies, pricing, conditions, appraisals/evaluations, or any other aspect of providing credit that varies for MMCTs
- R6 – Explicit demarcation of credit product markets excluding MMCTs
- R5 – CRA examination patterns
- R2* – Approval/denial rate differences for MMCTs
- R3* – Insufficient collateral denial rate difference for MMCTs

Marketing Risk Factors

- M1 – Advertising patterns or practices a reasonable person would believe indicate prohibited basis customers are less desirable
- M2 – Advertising in media serving non-minority areas
- M4 – Marketing programs that exclude MMCTs
- M3 – Marketing through brokers or other agents that serve only one racial or ethnic group [reference Outreach discussion]
- M7 – Consumer complaints
- M5 – Direct mail and pre-screened solicitations in NMCTs
- M6* – PBG applicants significantly lower than representation in assessment area/market area

The Four Prongs of Redlining

- Assessment Area Delineation
- Branching Strategy
- Lending
- Marketing and Outreach

Redlining – Assessment Area Delineation

- Assessment Area Delineation
 - Considers whether MMCTs have been excluded (common DOJ settlement thread)
 - LMI CTs from a CRA perspective
 - Use caution when delineating less than a full county
 - Evaluate full MSAs
 - Reasonably expected market areas (REMA)
 - Evaluate assessment areas annually per § ____.41 and § ____.43 of the CRA regulations
 - Market areas are considered for LPO activity
 - Consider impact of Census changes

Redlining – Branching Strategy

- Branching Strategy
 - Location of retail offices (main office and branches) and LPOs
 - Large Bank CRA Service Test impacts
 - Branch or LPO openings, closings, or relocations in NMCT relative to MMCTs
 - Distribution of locations compared to percentage of census tracts that are MMCTs
 - With activity in MMCTs, document minority concentration for historical reference

Redlining – Lending

- Lending
 - Statistical test evaluates applications and originations in MMCTs relative to similarly-situated peer institutions (typically for HMDA)
 - Lending activity is compared to a similarly-situated peers culled out from aggregate lenders for each assessment area or market area
 - Volume-based adjusted aggregate lenders generally have origination volume between 50-200% of the subject bank
 - Other filters may be used by regulators
 - Other products can be reviewed, including commercial and agricultural (typically only for originations – large bank CRA reporting requirements)
 - Consumer loans may be plotted on maps, but no aggregate information exists

Redlining – Marketing and Outreach

- Marketing
 - Marketing distribution
 - Use of human images (including bank staff)
 - Digital marketing concerns
- Caution regarding direct mail and pre-approved solicitations
 - Marketing with limited geographic distribution
 - ZIP codes have associated demographics
 - Marketing deposit products in MMCTs and mortgages in NMCTs
 - Marketing through statement stuffers when customer base is largely in NMCTS
 - Especially troubling when there are lending disparities
 - Compare application levels from minority groups relative to demographics in determining the effectiveness of marketing [reference risk factor M6]
 - Ex: Hispanics comprise 23% of the population but only 2% of HMDA applications

Redlining – Marketing and Outreach (cont.)

- Outreach
 - Outreach: efforts to increase applications and originations in MMCTs
 - How are applications generated?
 - Brokers, real estate agents, referrals
 - Financial education
 - Partnerships with community groups

Redlining Best Practices

- Assessment Area Delineation: simply put, use *extreme caution* if excluding MMCTs (or LMI CTs for CRA)
- Evaluate lending patterns on an annual basis, including adjacent counties within MSAs
- Branching: develop a branching strategy that considers both fair lending and CRA
 - Include LPOs
 - Consider openings, closings, and relocations

Redlining Best Practices (cont.)

- Lending: monitor lending activity over *at least* a rolling 3-year period to identify trends (even when that extends beyond the prior exam)
- Marketing & Outreach:
 - Document marketing mediums, distribution, frequency, and human images
 - Outreach can be a lifeline with lending disparities
 - Review current CRA community development activities for evidence of outreach

Resources

- IFLEP and Appendix

<https://www.fdic.gov/regulations/examinations/fairlend.pdf>

- DOJ Website

<https://www.justice.gov/crt/housing-and-civil-enforcement-section-cases-1#lending>

- Federal Reserve's Consumer Compliance Outlook

<https://consumercomplianceoutlook.org/>

- Attorney General's Annual Report to Congress Pursuant to ECOA

<https://www.justice.gov/file/1097396/download>

- Fair Lending Report of the Bureau of Consumer Financial Protection

https://files.consumerfinance.gov/f/documents/201906_cfpb_Fair_Lending_Report.pdf

- Uniform Interagency Consumer Compliance Rating System

https://www.ffiec.gov/press/PDF/FFIEC_CCR_SystemFR_Notice.pdf

- Federal Reserve's Consumer Compliance Supervision Bulletin – July 2018

<https://www.federalreserve.gov/publications/2018-july-consumer-compliance-supervision-bulletin.htm>

- Email blasts with search words of “fair lending” or “CRA”

FAIR LENDING BEST PRACTICES

- FAIR LENDING RISK ASSESSMENTS
- COMPARATIVE FILE REVIEWS (AUDITS)
- STATISTICAL TESTING (HMDA, SMALL BUSINESS, AND CONSUMER)
- REDLINING ANALYSES
- MERGER/ACQUISITION ANALYSES (FAIR LENDING & CRA)
- CUSTOMIZED TRAINING (COMPLIANCE/AUDIT, STAFF, BOARD OF DIRECTORS)
- RESPONSES TO EVIDENCE OF DISCRIMINATION

CRA BEST PRACTICES

- CRA SELF-EVALUATIONS (LOANS, INVESTMENTS, SERVICES)
- LOAN ACTIVITY MONITORING/ASSESSMENT AREA ANALYSES
- CRA TRAINING, INCLUDING COMMUNITY DEVELOPMENT
- VALIDATE CRA PUBLIC FILE
- CRA DATA VERIFICATIONS
- MERGER/ACQUISITION ANALYSES (CRA & FAIR LENDING)
- CRA RATINGS APPEALS & STRATEGIC PLANS

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