Post-Covid, 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 be a regulatory focus in 2021. Specific to federally insured credit unions, NCUA's 2021 Supervisory Priorities, 21-CU-01/January 2021, included the following statement:

"In 2021, examiners will focus on Fair Lending and areas related to the Covid-19 pandemic. Examiners will assess a credit union's Fair Lending Compliance Management System. Reviews will include areas such as board and management oversight, policies and procedures, training, monitoring, and corrective action and member complaint response."

Now is the time to check on the health of your fair lending program. Fair lending risk starts with the first customer 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 support a credit union's fair lending policy and address elements including the program scope, responsibilities, testing, reporting and corrective action in writing. 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 risks 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 is also a good practice.

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4. Underwriting

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

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 for following 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.

If your loan pricing varies based on geography or delivery channel, there should be a valid business justification for the difference. Make sure that strong controls are in place if third parties are allowed pricing discretion. Compensation, referral and incentive programs must be monitored to avoid steering risk related to rate, price, etc.

A good statistical regression analysis is also helpful to find potential risk areas and outliers in assessing fair lending risk.

6. Servicing & Collections

Servicers have had time since the servicing debacles of a few years ago to shore up processes, and coupled with the moratorium on foreclosures, to get things in order. Once the moratorium is 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.

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7. Management of Lending-Related Third Parties/Vendors

Your organization carries the responsibility for ensuring third-party partners are compliant with fair lending 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.

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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.

9. Complaint Management

Customer complaint data provides an early sign of potential issues that may cause inadvertent customer harm. Your formal complaint policy should address credit union complaints, those received by its third-party partners and complaints through 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 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 receive 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 institution monitors fair lending performance.

How does the institution know it is granting credit fairly across all customers including those in a protected class? Does it employ data analysis, including statistical and regression analysis, to help in finding areas of potential risk? Does it review outlier files (those loans approved or denied outside of underwriting guidelines or priced higher than policy) or comparative files (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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