CRA and Fair Lending: Equal Partners

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CRA and Fair Lending – how do we ever tell them apart? Well, for banking compliance officers, the answer is that you better tell them apart, because strict adherence to both regulations is crucial to a positive CRA Performance evaluation. "It is?" you ask. The answer is a resounding: "Yes!"

Of all the changes in the Community Reinvestment Act (CRA) since its beginning in 1977, recent strategies to enforce anti-discrimination by tying the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act to CRA are the most compelling. No change in Interagency Q&A guidance has the impact of downgrading a CRA Performance Evaluation, but a poor Fair Lending review could put on hold a bank's merger or acquisition plans, even though the bank received a "Satisfactory" CRA Rating.

THE GROUND RULES

CRA is <u>all about income</u> – serving low- and moderate-income persons as well as low- and moderate-income neighborhoods. The entire legislation focuses on providing equal levels of service to lower-income persons and neighborhoods by way of loans, investments and services. In other words, CRA is "colorblind;" there is no mention of any personal characteristic, except what percentage of Area Median Income the person or neighborhood falls within.

Fair Lending is <u>all about personal characteristics</u>. Called "protected bases," these all-inclusive characteristics are Race, Color, Religion, National Origin, Sex, Marital Status, Age, Receipt of Public Assistance and Consumer Credit Protection (if the person has in good faith exercised any right under the Consumer Credit Protection Act). As a bank employee, it is illegal to treat people differently based upon these prohibited bases.

Fair Lending related to credit decisions is governed by the ECOA and specifically defines instances where lenders must not discriminate including:

- Varying the terms of credit offered, amount, interest rate, duration or type of loan;
- Using different standards to evaluate collateral;
- Treating a borrower differently in servicing a loan or invoking default remedies; or
- Using different standards for pooling or packaging a loan in the secondary market.

HMDA – THE HOLY GRAIL

A bank's lending performance for both CRA and Fair Lending is measured by a single data source reported in compliance with the Home Mortgage Disclosure Act (HMDA). Regulators take accuracy in HMDA reporting very seriously. Prior to a Fair Lending and CRA Exam, a data validation review is conducted. During this review, an institution is allowed no more than two errors per year on a sample of 40 applications. If the institution's error rate is exceeded, the initial sample is expanded to 60 additional applications and there can be no more than 10 percent overall or 5 percent in any key data field. If this expanded error rate is exceeded, a total scrub of all applications for the period being reviewed must commence. This process can add up to hundreds of staff hours and thousands of overtime dollars.

THE EXAMS

Community Reinvestment

Bank Examiners conduct the CRA Exam on-site at the bank, after reviewing very detailed information provided prior to arriving. During this examination, the examiners are looking at three community development key factors for a large bank – lending, service and investment.

The **Lending** Test counts twice the weight in the overall CRA Ratings. It looks at the home mortgage data including the percent of LMI borrowers; the income level of the location of the loans made by the bank; and innovative or flexible products used to serve LMI populations or areas. It also looks at loans that meet the definition of community development. Small business loans are also reviewed as defined by the revenue size of the business and the income level of the location where the loans were made.

The **Service** Test takes into consideration the bank's retail services, including the bank hours. It evaluates if the bank's locations demonstrate accessibility for low- and moderate-income customers to banking services. It also reviews bank community services that must be "financial in nature" and must meet the definition of community development activities.

The **Investment** Test evaluates bank donations that meet the definition of community development as well as other investments made by the bank that meet the community development definition.

Fair Lending

Once the annual HMDA data is released, examiners analyze and identify institutions that may exhibit a greater risk of fair lending violation. Disparities in applications of the protected bases may exist in pricing, originations, denials or fallout rates. A criteria interview may be held to gather more detail on the bank's application and underwriting practices. If matters remain unresolved, a full file review will be conducted. (This can result in expense in staff time and overtime hours.)

A DYNAMIC STRATEGY

So, what should a bank do to offset risk of a lower CRA Rating because of a poor Fair Lending review? There are three components of a dynamic strategy: Analyze, Communicate and Adjust.

Analyze

Shakespeare wrote "to thine own self be true," and this certainly applies to finding out exactly what is a going on in your organization as it pertains to CRA and Fair Lending performance. Look hard at the numbers – they tell the story. Start with the current HMDA Disclosure and then keep an in-house quarterly reporting analysis.

Analysis should take two forms: one based upon Income Distribution for CRA monitoring and the other on Personal Characteristics for Fair Lending monitoring. The analyses will be based upon comparisons.

Income Distribution

Analyze what percentage of loans is made to low- and moderate-income applicants and in low- and moderate-income areas. How do the results compare to your peers (other similar-sized financial institutions)? Make sure that you review your bank's lending levels by income for every assessment area. Even assessment areas with just one banking center must show that credit is extended to all income levels.

Don't forget to analyze loans to small businesses. Determine where the businesses are located and which of those loans meet the definition of a small business. Again, compare your bank's performance to your peers.

Personal Characteristics

When conducting your review of personal characteristics of loans for fair lending, analyze:

- The number and percentage of applications taken by Race, Gender, Age and Marital Status of the applicants;
- The number of originations by Race, Gender, Age and Marital Status of the applicants;
- The number and percentage of denials by Race, Gender, Age and Marital Status of the applications; and
- The number and percentage of "fall outs" (withdrawn and incomplete applications) by Race, Gender, Age and Marital Status of the applicants.

Your analysis of lending patterns should be based upon personal characteristics comparisons of those loans made to an opposite groups (e.g., loan originations to applicants over age 62 compared to loan originations to those under age 62).

Take a close look at what you discovered. For example,

- Is lending to low- and moderate-income individuals in some of your bank's assessment areas above your peers, while other assessment areas lag behind?
- What were the denial rates among certain protected classes or ethnic groups? Are they higher than white applicants?
- Are more loans made to male applicants than female applicants?
- Are applicants over age 62 being denied financing more than younger applicants?

Communicate

Once the data is compiled and positive impacts, as well as challenges, to CRA and Fair Lending are noted, the news must be communicated throughout the financial institution to senior management, loan officers, business bankers, underwriters, processors, etc. All have a role in making changes to improve CRA and Fair Lending performance.

First, they have to "know the numbers." This can be accomplished by regular meetings with bank staff at all levels in your institution. Creating and communicating with a senior level CRA and Fair Lending review group will be a good start, but the momentum can't stop there. It is important to involve all players in the lending process.

Involving staff in finding answers to specific questions raised by the data analysis can be a learning experience for staff, as well as senior management. For example, if a significant percentage of applications "fall out" or are never completed, staff could be assigned to investigate and tabulate the reasons why. This will involve conversations with loan officers and processors. Even if the "fall outs" show no fair lending concerns, the research and results could lead to better file documentation and stronger follow-up with applicants.

Presenting case studies of specific loans for discussion is a powerful tool in communicating facts regarding performance. For example: what if you identify a minority loan applicant who applied for a home mortgage with a low debt-to-income ratio, low loan-to-value on their home and a high credit score, however, the applicant was semi-retired and therefore denied because they did not have a current two-year job history? You could discuss what could have been done to help this applicant. Asking questions like this can lead to greater awareness on the part of your bank staff to "go the extra mile" in reviewing a file or look at policy and procedure adjustments, if necessary.

Adjust

Once analysis of CRA and Fair Lending performance is current and ongoing, and bank staff is briefed, the question arises, "What more can we do to create and maintain commitment to CRA and Fair Lending?" How can change occur in the culture of the bank so that service and inclusion are closely held values?

Several best practices can be implemented:

- Engage all staff in discussions of CRA and Fair Lending responsibilities via lunch time talks or presentations by local community groups;
- Provide bank staff with service opportunities that qualify for CRA credit and address needs of a diverse population;
- Encourage senior management to allow paid service hours for time away from the office to support community projects; or
- Create a matching program for staff donations to philanthropic organizations.

Even though CRA and Fair Lending are very different from a compliance perspective, in today's regulatory environment they must be treated as "equal partners" if a bank is to achieve a positive CRA rating. By knowing the numbers, communicating to staff and working to create an all-staff awareness of the issues, the bank will be in a strong position to achieve not only "satisfactory," but an even higher CRA Rating.

ABOUT THE AUTHORS

NANCY PRESNELL, Managing Director of Compliance, and **SHEILA ETCHEN**, CRA Officer, both at Republic Bank of Louisville, Kentucky, have survived countless Fair Lending and CRA examinations. They have learned a thing or two and continue to fight the good fight.

ABOUT THE BOOK

This article first appeared in **CRA at 40: Views on the Present and Future of Community Reinvestment**, published by findCRA in November 2017. The book was created in celebration of the 40th anniversary of the Community Reinvestment Act. It tells the stories of community development, from the perspective of those working in our communities who bring their knowledge and passion to bear every day in confronting the most critical problems facing communities in need. The book is about real-world experiences told in plain language by those who live them to provide a lens for readers to see CRA at work, ideas for its future and most importantly, what it means in people's lives. To access the full text or order copies of the book, please visit www.findCRA.com/CRAat40.