

Are You Ready for Your Next Fair Lending Exam?

Best Practices to Consider Before Your Next Exam

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If you ask any community banker about their fair lending performance, they invariably say, "Of course we lend fairly, why wouldn't we?" And they say that with conviction because it's what they believe. The majority of the time, it's true.

However, a fair lending examiner has the advantage of 20/20 hindsight. In the context of other actions taking place around that same time, an action that looks completely innocuous today, may look entirely different 6 months, 1 year or 2 years later. And unlike other areas of regulatory compliance, it doesn't take many findings to turn a routine examination into a nightmare.

The good news is that you can be better prepared for your next fair lending examination by taking a few simple steps before your examiners come looking for issues, including:

- A careful review of your lending policies and procedures
- A comprehensive risk assessment
- Training for employees, officers and directors
- Internal testing

Review Policies and Procedures – Do you have a separate Fair Lending Policy? The days of having a single paragraph buried in your general lending policy that says you won't discriminate are coming to an end. Most regulators would like to see a more robust statement from your board as to how you will ensure that your lending is fair and equitable.

You should also review the remainder of your lending policies and procedures for triggers that may cause you problems later. For instance, how much pricing discretion is given to loan officers? Are there terms and conditions buried in your policies or in your articulated lending standards that could be construed as discriminatory? How do you handle spousal guarantees?

Fair Lending Risk Assessment – Your risk assessment should cover your overall fair lending management program, your complaint function, your lending controls, and loan servicing controls.

Consider the following to fully determine your level of fair lending risk:

- How do you compensate lenders?
- Do you track your policy exceptions and report them to the board on a periodic basis?
- What are the demographics of the areas you serve?
- How much training is provided and to whom? Have you had any Reg. B, Fair Housing, or CRA violations?

- Do you have monitoring or audit processes in place?

All of these, among others, will help you determine your level of fair lending risk.

Training – Banks have been told by their examiners that fair lending training must be provided to the board of directors annually. But what about your employees? How much fair lending training have they received? Is it the same training the board gets, or is it more in depth? How frequently is that training provided? Do you change it up from time to time, or is it just the same training each year?

Internal Monitoring/Auditing – Monitoring and auditing are separate functions, and both can be useful in determining your bank's level of fair lending risk. Monitoring is something that occurs in real time right before or after action is taken. It generally takes a couple forms, depending on which way the lending decision goes. If the loan is slated for origination, pricing and fees need to be reviewed carefully. If the application is slated for denial, a second officer should be reviewing the situation to agree/disagree with the decision, and to ensure that all the reasons for denial are properly documented in the supporting file.

A fair lending audit is something encouraged by regulators on a regular basis. While we agree that this is a worthwhile endeavor, its frequency is subject to several factors. If you are located in a metropolitan statistical area (MSA), have a diverse population, have been cited for any regulatory infractions, or your risk assessment indicates you have higher than normal risk, you should probably perform a fair lending audit at least annually.

However, if you are in a rural area, with a relatively homogeneous population, and your risk assessment indicates a low level of risk, you should still perform fair lending testing, but not necessarily every year, or even every other year.

Do not leave your next fair lending examination to chance. You can take these few simple steps to determine where your risks lie and how those risks might affect your bank. Use the information you learn when you perform your own risk assessment to fill in the holes in your processes. You can perform your own testing, or hire someone to perform testing when it's warranted. If you follow through with these few simple steps you will have a much easier examination experience, and your regulators will realize that you are on top of your fair lending priorities.