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Secondary Marketing Strategies for Fair Lending and Compliance

Identifying & Controlling the Risk

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Agenda

- Recent fair lending enforcement focus

- Some things that increase fair lending risk in pricing

- What you can do to control fair lending risk

Recent U.S. Government Fair Lending Settlements

- Cases alleging disparate impact in the pricing of consumer loans resulting from the exercise of pricing discretion *(see handout for details)*

Case	Settlement Amount
U.S. v. Countrywide Financial Corporation (2012)	$335 million
U.S. v. Wells Fargo Bank, N.A. (2012)	$175 million for wholesale, plus potential liability for retail
U.S. v. SunTrust Mortgage, Inc. (2012)	$21 million
U.S. v. GFI Mortgage Bankers Inc. (2012)	$3.555 million
U.S. v. PrimeLending (2011)	$2 million
FTC v. Gateway Funding (2009)	$2 million (deferred)
FTC v. Golden Empire Mortgage (2010)	$1.5 million
U.S. v. Texas Champion Bank (2013)	$700,000
U.S. v. C&F Mortgage Corp. (2011)	$140,000
U.S. v. Nixon State Bank (2011)	$100,000

- Most relate to conduct prior to the 2011 loan originator compensation rules, but similar issues persist under the new regime

Common threads in settlements

- Broad discretion allegedly resulted in "disparate impact"
- "Subjective and unguided pricing adjustments … not based on a borrower's objective credit characteristics"
- Lack of clear policies and/or controls governing exercise of discretion
- Little or no documentation of business rationale for discretionary pricing adjustments
- Financial incentives for loan originators to charge higher rates or fees, or to steer borrowers to higher-cost products
- Lack of effective fair lending monitoring or corrective action
- Liability extending to multiple years in the past
- Liability for actions of third-party originators

CFPB: The "new cop on the beat"

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- Key focus is "risk to consumers" -- "the potential for consumers to suffer economic loss or other legally-cognizable injury as a result of a violation of Federal consumer financial law."

- *"The CFPB will focus on risk to consumers when it evaluates the policies and practices of a financial institution. We expect that institutions will offer consumer financial products and services in accordance with Federal consumer financial law and will maintain* ***effective systems that focus on an institution's ability to detect, prevent, and correct practices*** *that present a significant risk of violating the law and causing consumer harm."* -- CFPB Supervision Manual

- In exam reports and enforcement orders, CFPB has ordered lenders to implement a "Compliance Management System"

Some things that increase fair lending risk in pricing

- Unclear policies/procedures and inconsistent execution
- Concessions that are granted less often to one protected class group than another (whatever the reason)
- Branches with different pricing levels that sell into the same market
- Higher pricing levels or fees in markets with high minority concentrations
- Overlays to investor pricing not supported by a demonstrable business justification/need
- Pricing criteria/LLPAs that are not customary
- Lack of monitoring
- Failure to take action based on monitoring

Controlling fair lending risk in pricing: *preventive measures*

- Consistency, discipline and documentation are key
- Clear fair lending policy statement
- Clear operational policies and procedures designed to avoid discrimination, regularly reviewed, and reinforced by regular training
- Manage pricing discretion as you would exceptions
  - Defined limits on discretion
  - Tiered authority for approving discretionary adjustments
  - Document business reasons for discretionary adjustments (e.g., concessions, waivers, lock renegotiations … anything subject to negotiation) – preferably as data
  - Involve Compliance in the process
- Document rate reductions provided in exchange for discount points

Controlling fair lending risk in pricing: *preventive measures*

- System controls to enforce policies and procedures, and limit errors
- Pre-funding review or system controls to prevent funding of loans that do not comply with policy
- Consider refunds if non-compliant loans fund inadvertently
- Maintain documentation and/or data supporting the pricing for each loan and options offered to the consumer
  - Rate sheet in loan file, or
  - Data in LOS or pricing engine
- Develop and document analytical support showing the business justifications for pricing strategy decisions

Controlling fair lending risk in pricing: *preventive measures*

- Involve compliance/legal specialists in significant decisions about pricing strategy
- Capture data needed to monitor and justify pricing
  - Credit and program attributes that affect the rate/price
  - Relevant measure(s) of discretionary pricing
  - Historical pricing available on alternative products
- Accountability mechanisms
  - Monitor and enforce adherence to the rules (which means you must have the data to support the monitoring)
  - Scorecard linked to fair lending metrics, possibly tied to compensation
  - Defined path for corrective/disciplinary action
- Document your controls, monitoring and overall compliance program
- Reporting to board/executive management

Controlling fair lending risk in pricing: *detective measures*

- Establish a statistical fair lending monitoring program
  - Monitor pricing outcomes regularly in relation to race, ethnicity & gender
    - Regression analysis and outlier review
    - Examine rate/APR and overage/underage
    - Frequency and size of concessions/exceptions
    - Broker compensation (including cross-broker differences, and lender- vs. borrower-paid), aggregate and by broker
    - Differences in profit margins across products
    - Aggregate plus by market, channel, region/division, branch and originator
  - Corrective action
    - Restrict discretion for branches/LOs that are generating disparities
    - Adjust policies and procedures as necessary
    - Consider possible refunds in the event of “unjustified” disparities

Controlling fair lending risk in pricing: *detective measures*

- Audit to ensure that policies and procedures are being followed
- Pay attention to consumer complaints
- Evaluate whether pricing factors raise potential disparate impact concerns
- Evaluate whether pricing levels can be adjusted to reduce the need for concessions
- Evaluate whether fees are justifiable (UDAAP risk)
  - Note: UDAAP enforcement is being used as an alternative route for fair lending enforcement

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