Alternative Examination Approach for "Low-Risk" Banks

The fair lending scoping process for some banks clearly indicates there is a low level of discrimination risk. This situation is evident when a stable community bank is located in an area with a low minority population. These banks usually offer standard products and are often predominately a commercial or agricultural lender. These banks also have a history of no compliance management concerns in the fair lending area, and have stable staffing with no changes in policies or procedures.

When this situation is encountered, the use of the following procedures will allow an examiner to verify whether the bank's practices are consistent with what has been represented to the examiners during the scoping process. This will permit the examiner to conclude the discrimination analysis without expending resources on an extensive file review.

The success of this approach is dependent upon the integrity of the scoping process. It is important to ensure that all appropriate areas of credit operations are considered in the scoping process, including commercial and agricultural lending. If no risk factors are identified during scoping, proceed with the following steps.

1. Select a judgmental sample of loans for review to test how the lending criteria are actually applied. The sample should be representative of the major product lines of the institution, and should include denials as well as approvals that were processed in the preceding twelve months.

2. The transactions should be reviewed to determine if they were underwritten according to the bank's articulated lending criteria. The transactions should not, therefore, be compared to each other as they are in the benchmark/overlap analysis. Deviations in underwriting should be investigated and documented. This review will verify the actual underwriting practices and may result in the identification of risk factors.

3. Use the same sample to review the bank's pricing practices (it may be necessary to add a few more approvals to take the place of the denials in the original sample). Loan pricing should be compared to the bank's pricing methodology that was described to the examiners during the scoping process. The transactions should not be compared to each other as they are in the terms and conditions analysis. Pricing deviations should be investigated and documented. This review will verify the actual pricing practices, and may result in the identification of risk factors.

4. If no risk factors are identified using these alternative procedures, then the low-risk conclusion drawn in the scoping process is validated. At this point, the discrimination analysis is complete.

5. If risk factors are identified through either the underwriting or pricing reviews, a focal point should be established and the sample expanded for that particular product line to do a full analysis using either the benchmark/overlap or terms and conditions examination procedures. Sample sizes should correspond to those in the sample size tables, and should be focused on marginal applicants.

6. The fair lending scoping for the next examination should not assume the bank remains low-risk. The scoping process should make a new determination of the risk level of the bank.

The fair lending scope memo should document the reasons the bank was determined to be low-risk. The fair lending section of the Report of Examination should state that the alternative examination approach was used because the bank exhibited low discrimination risk. Any appropriate comments should be included about the bank's underwriting or pricing practices.