

Federal Fair Lending Regulations and Statutes Examination Procedures

The fair lending examination procedures detailed here emphasize discrimination in residential transactions on the basis of race and national origin. However, the key principles can be applied to other prohibited bases and to nonresidential transactions. The procedures focus on analyzing lender compliance with the broad nondiscrimination requirements of the ECOA and the FHAct. Explicit and technical compliance provisions, such as the signature rules and adverse action notice requirements set forth in sections 202.7 and 202.9 of Regulation B, respectively, are not addressed.

The procedures are grouped to reflect major phases of the examination process:

- Establishing the scope of the examination (discussed in part I of this chapter)
- Reviewing the institution's compliance management program (part II)
- Conducting the examination (part III)
- Closing the examination (part IV)

Following the procedures is an appendix containing a checklist for reviewing compliance management programs, additional procedures, and other supplemental material.

I. GUIDELINES FOR SCOPING THE EXAMINATION

Background

A fair lending examination encompasses several elements—the prohibited-basis and control groups to be analyzed during the examination, along with the loan products, markets, decision centers, and applicable time frame. In these examination procedures, each potential combination of these elements is referred to as a “focal point.” *Establishing the scope of an examination* involves first identifying all the potential focal points that appear worthwhile to examine and then selecting—on the basis of risk factors, the bank's record from past examinations, priorities established in these procedures or by the Federal Reserve, and other relevant guidance—the focal points that will constitute the scope of the examination. Planning for the examination also includes reviewing an institution's compliance management system as it relates to fair lending.

Note: These examination procedures are adapted, with a few minor format, stylistic, and wording changes where appropriate, from the Interagency Fair Lending Examination Procedures revised in August 2004 and distributed as an attachment to CA Letter 04-8.

When selecting focal points for review, examiners may determine that the institution has performed “self-tests” or “self-evaluations” related to specific lending products. The institution must share all information related to self-evaluations and certain limited information related to self-tests with examiners. It may voluntarily disclose additional information about self-tests. Examiners should make sure that the institution understands that voluntarily sharing the results of self-tests will result in a loss of confidential status of those tests. Using information from self-evaluations and self-tests may make it possible to streamline the scoping phase of an examination. (For details, see the section “Streamlining Examinations” at the end of the appendix to these procedures.)

Scoping may disclose the existence of circumstances—such as the use of credit scoring or a large volume of residential lending—that require the use of regression analysis or other statistical methods of identifying potential discrimination with respect to one or more loan products. When that is the case, the Board's specialized procedures should be used for those loan products, rather than the procedures set forth below.

Setting the intensity of an examination means determining the breadth and depth of the analysis that will be conducted in connection with the selected loan products. This process entails a more involved analysis of the institution's compliance risk management processes that relate to selected products. Part of this analysis involves determining the appropriate number of files and whether certain aspects of the credit process deserve heightened scrutiny.

This part of these examination procedures (that is, part I) provides guidance on establishing the scope of the examination. Part II, which addresses the compliance management review, provides guidance on determining the intensity of the examination. There is naturally some interdependence between these two phases. Ultimately, the scope and intensity of the examination will help determine the record of performance, which serves as the foundation for the examiner's conclusions about the institution's compliance with its fair lending obligations. Examiners should use these procedures and guidelines to arrive at a well-reasoned and practical conclusion about how to conduct a particular institution's fair lending examination.

Information already available may suggest examination priorities and institutional risks; such

information may expedite the scoping process and make it unnecessary to work through all the steps detailed in this chapter. For example, the report of the previous fair lending examination may have included recommendations for the focus of the next examination.

The scoping process may be performed either off-site or on-site, or both, depending on whatever is determined to be most feasible. In the interest of minimizing burdens on both the examination team and the lender, requests for information from the institution should be carefully thought out so as to include only the information that will clearly be useful in the examination process. Also, any requests for information to be reviewed off-site should be made sufficiently in advance of the on-site visit to give the institution adequate time to assemble and provide the information to the examination team. (See the section “Potential Scoping Information” in the appendix to these procedures for guidance on additional information that examiners might wish to consider including in a request.)

Examiners should focus the examination on the basis of

- An understanding of the credit operations of the institution
- The risk that discriminatory conduct may occur in each area of those operations
- The feasibility of developing a factually reliable record of an institution’s performance and fair lending compliance in each area of those operations

Understanding Credit Operations

Before evaluating the potential for discriminatory conduct, examiners should review sufficient information about the institution and its market to understand the credit operations of the institution and the representation of prohibited-basis-group residents within the markets in which the institution does business. The level of detail of the information should be sufficient to determine whether any of the risk factors in the steps described in the next section are present. Relevant information includes

- The types and terms of credit products offered, differentiating among residential, consumer, and other categories of credit
- The volume of, or growth in, lending for each of the credit products offered
- The demographics (for example, race and national origin) of the credit markets in which the institution is doing business
- The organization of the institution’s credit-decision-making process, including the delega-

tion of separate lending authorities and the extent to which discretion in pricing or setting credit terms and conditions is delegated to various levels of managers, employees, or independent brokers or dealers

- The types of relevant documentation or data that are available for various loan products, and the relative quantity, quality, and accessibility of such information (For which loan products will the information available be most likely to support a sound and reliable fair lending analysis?)
- The extent to which information requests can be readily organized and coordinated with other compliance examination components to reduce undue burden on the institution (Do not request more information than the exam team can be expected to use during the anticipated course of the examination.)

In thinking about an institution’s credit markets, examiners should recognize that these markets may or may not coincide with the institution’s CRA assessment area(s). When appropriate, examiners should review the demographics of a broader geographic area than the assessment area.

If an institution has multiple underwriting or loan processing centers or subsidiaries, each with fully independent credit-granting authority, examiners should consider evaluating each center or subsidiary separately, provided that a sufficient number of loans exists to support a meaningful analysis. In determining the scope of the examination for such an institution, examiners should consider

- Whether subsidiaries should be examined—An institution will be held responsible for violations by its direct subsidiaries, but typically not for violations by its affiliates (unless the affiliate has acted as the agent for the institution or the violation by the affiliate was known, or should have been known, to the institution before it became involved in the transaction or purchased the affiliate’s loans). When seeking to determine an institution’s relationship with affiliates that are not supervised financial institutions, examiners should limit the inquiry to what can be learned at the institution and should not contact the affiliate.
- Whether the underwriting standards and procedures used by the entity being reviewed are used by related entities not scheduled for the planned examination—This will help examiners recognize the potential effect of policy-based violations.
- Whether the institution’s portfolio consists of applications from a purchased institution—If it does, examiners should, for scoping purposes, consider the applications as if they were made to the purchasing institution. (Applications evalu-

ated under the purchased institution's standards should not be compared with applications evaluated under the purchasing institution's standards.)

- Whether the portfolio includes purchased loans—If it does, examiners should look for indications that the institution chose which loans to purchase on the basis of a prohibited factor or caused a prohibited factor to influence the origination process.
- Whether a complete decision can be made at one of the several underwriting or loan processing centers, each with independent authority—In such a situation, it is best to conduct a separate comparative analysis, on-site, at each underwriting center. If covering multiple centers during the planned examination is not feasible, examiners should review one center during the planned examination and others in later examinations.
- Whether decision-making responsibility for a single transaction may involve more than one underwriting center—For example, it may be that an institution has authority to decline mortgage applicants but only the mortgage company subsidiary may approve them. In such a situation, examiners should learn which standards are applied by each entity and the location of records needed for the planned comparisons.
- Whether any third parties, such as brokers or contractors, are involved in the credit decision, and how responsibility is allocated among them and the institution—The institution's familiarity with third-party actions may be important, for a bank may be in violation if it participates in credit transactions in which it knew, or reasonably ought to have known, that other parties were discriminating.

If the institution is large and geographically diverse, examiners should select only as many markets or underwriting centers as can be readily reviewed in depth, rather than selecting proportionally to cover every market. As needed, examiners should narrow the focus to the metropolitan statistical area or underwriting center that is determined to present the greatest risk of discrimination. Examiners should use HMDA-LAR data that are organized by underwriting center, if available. After calculating denial rates for the control group and minorities for each underwriting center, examiners should select the centers with the highest disparities. If underwriting centers have fewer than five black, Hispanic, or Native American denials, examiners should not examine for racial discrimination but instead should shift the focus to other loan products or prohibited bases.

Evaluating the Potential for Discriminatory Conduct

Step 1. Develop an overview

On the basis of an understanding of the institution's credit operations and product offerings, examiners should determine the nature and amount of information required for the scoping process and should obtain and organize that information. No single examination can reasonably be expected to evaluate compliance performance relative to every prohibited basis, every product, or every underwriting center or subsidiary of an institution. In addition to considering the information gathered in order to understand the institution's credit operations (see preceding section), examiners should keep in mind the following factors when selecting products for the scoping review:

- Which products and prohibited bases were reviewed during the most recent examinations and, conversely, which products and prohibited bases have not been reviewed recently
- Which prohibited-basis groups make up a significant portion of the institution's market for the different credit products offered
- Which products and prohibited-basis groups the institution reviewed using either a voluntarily disclosed self-test or a self-evaluation

Having considered the foregoing factors, examiners should request information for all residential and other loan products considered appropriate for scoping in the current examination cycle. In addition, when feasible, examiners should conduct preliminary interviews with the lender's key underwriting personnel. Using the accumulated information, examiners should evaluate the following, as applicable:

- Underwriting guidelines, policies, and standards
- Credit scoring systems, including factors scored, cutoff scores, extent of validation, and any guidance for handling overrides and exceptions (see part A of "Procedures for Credit Scoring Analysis" in the appendix to these examination procedures for guidance)
- Applicable pricing policies, and guidance for exercising discretion over loan terms and conditions
- The institution's corporate relationships with any finance companies, subprime mortgage or consumer lending entities, or similar institutions
- Loan application forms
- Either HMDA-LARs or other loan registers, and lists of declined applications

- Descriptions of databases maintained for the loan products to be reviewed, especially any records of exceptions to underwriting guidelines
- Copies of any consumer complaints alleging discrimination, and related loan files
- Descriptions of any compensation system based on loan production or pricing
- Compliance program materials (particularly fair lending policies), training manuals, and organization charts, as well as recordkeeping and monitoring protocols
- Copies of marketing materials or descriptions of current or previous marketing plans or programs

Step 2. Identify compliance program discrimination risk factors

Review information from agency examination workpapers, institutional records, and discussions with management representatives in sufficient detail to understand the organization, staffing, training, recordkeeping, auditing, and policies of the institution's fair lending compliance systems. Review these systems and note whether any of the following risk factors are present:

- C1. Overall institution compliance record is weak
- C2. Prohibited-basis monitoring information is incomplete
- C3. Data or recordkeeping problems compromised reliability of previous examination reviews
- C4. Fair lending problems were previously found in one or more bank products
- C5. The size, scope, and quality of the compliance management program, including senior management's involvement, is materially inferior to programs customarily found in institutions of similar size, market demographics, and credit complexity
- C6. The institution has not updated its compliance guidance to reflect changes in law or in agency policy

These risk factors and their impact on particular lending products and practices should be considered as the product-specific risk review is being conducted during scoping steps 3–8 (immediately below). If the review identifies fair lending compliance system deficiencies, the factors should be given appropriate consideration as part of the compliance management program review described in part II of these procedures.

Step 3. Review residential loan products

Although home mortgages may not be the ultimate subject of every fair lending examination, this product line must at least be considered in the

course of scoping every institution that is engaged in residential lending.

Divide home mortgage loans into three groups: home purchase, home improvement, and refinances. Subdivide those groups further if the institution does a significant amount of residential lending of any of the following types or forms, and consider those loans separately:

- Government-insured loans
- Mobile home or factory housing loans
- Wholesale, indirect, and brokered loans
- Portfolio lending (including portfolios of Fannie Mae or Freddie Mac rejections)

In addition, determine whether the institution offers any conventional "affordable" housing loan programs and whether the terms and conditions of those loans make them incompatible, for comparative purposes, with regular conventional loans. If so, consider them separately.

Examiners may limit the focus of the current examination to alternative underwriting or processing centers, or to other residential products that have received less scrutiny in the past, if previous examinations have demonstrated the following:

- A strong fair lending compliance program
- No record of discriminatory transactions at particular decision centers or in particular residential products
- No indication of a significant change in personnel, operations, or underwriting standards at those centers or in those residential products
- No unresolved fair lending complaints, administrative proceedings, litigation, or similar factors

Step 4. Identify residential lending discrimination risk factors

- Review the lending policies, marketing plans, underwriting, appraisal, and pricing guidelines, broker–agent agreements, and loan application forms for each residential loan product that represents an appreciable proportion of the institution's residential lending or that has grown noticeably since the most recent examination.
- Review any available data on the geographic distribution of the institution's loan originations with respect to the racial and national origin makeup of the census tracts in the institution's assessment areas—or its residential loan product lending areas, if different from its CRA assessment areas.
- Interview loan officers and other employees or agents in the residential lending process concerning adherence to and understanding of lending policies and appraisal and pricing

guidelines, as well as any relevant operating practices.

In the course of conducting the foregoing inquiries, look for the following risk factors. The factors are identified by an alphanumeric code, with the letter relating to the type of factor:

- O Overt indicator of discrimination
- U Indicator of potential disparate treatment in underwriting
- P Indicator of potential disparate treatment in pricing
- S Indicator of potential disparate treatment by steering
- R Indicator of potential discriminatory redlining
- M Indicator of potential disparate treatment in the marketing of residential products

Overt indicators of discrimination

- O1. Including explicit prohibited-basis identifiers in underwriting criteria or pricing standards
- O2. Collecting information, conducting inquiries, or imposing conditions contrary to the express requirements of Regulation B
- O3. Including variables in a credit scoring system that constitute a basis or factor prohibited by Regulation B or, for residential loan scoring systems, the FHAct (If a credit scoring system scores age, refer to part E of “Procedures for Credit Scoring Analysis” in the appendix to these examination procedures.)
- O4. Statements made by the institution’s officers, employees, or agents that constitute an express or implicit indication that one or more such persons have engaged in or do engage in discrimination on a prohibited basis in any aspect of a credit transaction
- O5. Employee or institutional statements that evidence attitudes based on prohibited-basis prejudices or stereotypes

For the risk factors in the following lists that are marked with an *asterisk*, examiners need not attempt to calculate the indicated ratios for racial or national origin characteristics if the institution is not a HMDA reporter. However, consideration should be given in such cases to whether or not such calculations should be made on the basis of gender or racial–ethnic surrogates.

Indicators of potential disparate treatment in underwriting

- *U1. Substantial disparities among the approval or denial rates for applicants by monitored prohibited-basis characteristic (especially within income categories)

- *U2. Substantial disparities among the application processing times for applicants by monitored prohibited-basis characteristic (especially within denial-reason groups)

- *U3. Substantially higher proportion of withdrawn or incomplete applications from prohibited-basis-group applicants than from other applicants

- U4. Vague or unduly subjective underwriting criteria

- U5. Lack of clear guidance on making exceptions to underwriting criteria, including credit scoring overrides

- U6. Lack of clear loan file documentation regarding reasons for any exceptions to normal underwriting standards, including credit scoring overrides

- U7. Relatively high percentages of either exceptions to underwriting criteria or overrides of credit score cutoffs

- U8. Loan officer or broker compensation based on loan volume (especially loans approved per period of time)

- U9. Consumer complaints alleging discrimination in loan processing or in the approval or denial of residential loans

Indicators of potential disparate treatment in pricing (interest rates, fees, or points)

- P1. Relationship between loan pricing and compensation of loan officers or brokers

- P2. Presence of broad discretion in pricing or other transaction costs

- P3. Use of a system of risk-based pricing that is not empirically based and statistically sound

- *P4. Substantial disparities among prices being quoted or charged to applicants who differ as to their monitored prohibited-basis characteristics

- P5. Consumer complaints alleging discrimination in residential loan pricing

Indicators of potential disparate treatment by steering

- S1. For an institution that has one or more subprime mortgage subsidiaries or affiliates, any significant differences, by loan product, in the percentage of prohibited-basis applicants of the institution compared with the percentage of prohibited-basis applicants of any subsidiary or affiliate

- S2. Lack of clear, objective standards for (1) referring applicants to subsidiaries or affiliates, (2) classifying applicants as “prime” or

“subprime” borrowers, or (3) deciding what kinds of alternative loan products should be offered or recommended to applicants

- S3. For an institution that makes both conventional and FHA mortgages, any significant differences in the percentages of prohibited-basis-group applicants for each of these two loan products, particularly with respect to loan amounts of \$100,000 or more
- S4. For an institution that makes both prime and subprime loans for the same purpose, any significant differences in percentages of prohibited-basis-group borrowers in each of the alternative loan product categories
- S5. Consumer complaints alleging discrimination in residential loan pricing
- S6. A lender with a subprime mortgage company subsidiary or affiliate that integrates loan application processing for both entities in such a way that steering between the prime and subprime products can occur almost seamlessly—that is, a single loan processor could simultaneously attempt to qualify any applicant, whether to the bank or the mortgage company, under either the bank’s prime criteria or the mortgage company’s subprime criteria
- S7. Loan officers having broad discretion regarding whether to promote conventional or FHA loans, or both, to applicants but the lender has not issued guidelines for the exercise of this discretion
- S8. A lender that has most of its branches in predominantly white neighborhoods and whose subprime mortgage subsidiary has branches located primarily in predominantly minority neighborhoods

Indicators of potential discriminatory redlining

- *R1. Significant differences, as revealed in HMDA data, between the number of loans originated in areas in the lender’s market that have relatively high concentrations of minority group residents and the number originated in areas with relatively low concentrations of minority residents
- *R2. Significant differences between approval and denial rates for *all* applicants (minority and nonminority) in areas with relatively high concentrations of minority group residents and rates in areas with relatively low concentrations of minority residents
- *R3. Significant differences between denial rates based on insufficient collateral for applicants from areas with relatively high concentrations

of minority residents and rates for applicants from areas with relatively low concentrations of minority residents

- R4. Other patterns of lending identified during the most recent CRA examination that differ by the concentration of minority residents
- R5. Explicit demarcation of credit product markets that excludes MSAs, political subdivisions, census tracts, or other geographic areas within the institution’s lending market and having relatively high concentrations of minority residents
- R6. Policies on receipt and processing of applications, pricing, conditions, or appraisals and valuation, or on any other aspect of providing residential credit, that vary between areas with relatively high concentrations of minority residents and those with relatively low concentrations
- R7. Employee statements that reflect an aversion to doing business in areas with relatively high concentrations of minority residents
- R8. Complaints or other allegations by consumers or community representatives that the lender excludes or restricts access to credit for areas with relatively high concentrations of minority residents. Examiners should review complaints against the lender filed with their agency; the CRA public comment file; community contact forms; and responses to questions about redlining, discrimination, and discouragement of applications and about meeting the needs of racial or national origin minorities, asked as part of “obtaining local perspectives on the performance of financial lenders” during prior CRA examinations.

Note: Broad allegations or complaints are not, by themselves, sufficient justification to shift the focus of an examination from the routine comparative review of applications to a redlining analysis. Such a shift should be based on complaints or allegations of specific practices or incidents that are consistent with redlining, along with the existence of other risk factors.

- R9. A lender that has most of its branches in predominantly white neighborhoods at the same time the lender’s subprime mortgage subsidiary has branches located primarily in predominantly minority neighborhoods

Indicators of potential disparate treatment in marketing of residential products

- M1. Advertising patterns or practices that a reasonable person would believe indicate that prohibited-basis customers are less desirable

- M2. Advertising only in media serving nonminority areas of the market
- M3. Marketing through brokers or other agents that the lender knows (or has reason to know) would serve only one racial or ethnic group in the market
- M4. Using marketing programs or procedures for residential loan products that exclude one or more regions or geographies within the lender's assessment or marketing area that have significantly higher percentages of minority group residents than does the remainder of the assessment or marketing area
- M5. Using mailing or other distribution lists or other marketing techniques for prescreened or other offerings of residential loan products that
- Explicitly exclude groups of prospective borrowers on a prohibited basis or
 - Exclude geographies (for example, census tracts or ZIP codes) within the institution's marketing area that have significantly higher percentages of minority group residents than does the remainder of the marketing area
- Note: Prescreened solicitations of potential applicants on a prohibited basis does not violate the ECOA. Such solicitations are, however, covered by the FHAct. Consequently, analyses of this form of potential marketing discrimination should be limited to residential loan products subject to coverage under the FHAct.
- *M6. Proportion of monitored prohibited-basis applicants is significantly lower than that group's representation in the total population of the market area
- M7. Consumer complaints alleging discrimination in the advertising or marketing of loans

Step 5. Organize and focus residential risk analysis

Review the risk factors identified in step 4, above. For each loan product that displays risk factors, articulate the possible discriminatory effects encountered and organize the examination of those loan products in accordance with the following guidance:

- When overt evidence of discrimination, as described in risk factors O1–O5, has been found in connection with a product, document those findings, as described in part III-A, below, and complete the remainder of the planned examination analysis.

- When any of the risk factors U1–U9 are present, consider conducting an underwriting comparative file analysis, as described in part III-B.
- When any of the risk factors P1–P5 are present, consider conducting a pricing comparative file analysis, as described in part III-C.
- When any of the risk factors S1–S8 are present, consider conducting a steering analysis, as described in part III-D.
- When any of the risk factors R1–R9 are present, consult Reserve Bank management about conducting an analysis for redlining, as described in part III-F.
- When any of the risk factors M1–M7 are present, consult Reserve Bank management about conducting a marketing analysis, as described in part III-G.
- When an institution uses age in any credit scoring system, consider conducting an examination analysis of that credit scoring system's compliance with the requirements of Regulation B, as described in part III-H.

Step 6. Identify consumer lending discrimination risk factors

For credit card, motor vehicle, home equity and other consumer loan products selected in step 1 (above) for risk analysis in the current examination cycle, conduct a risk factor review similar to that conducted for residential lending products in steps 3–5 (above). Consult with Reserve Bank management regarding the potential use of surrogates to identify possible prohibited-basis-group individuals.

Note: The term "surrogate" in this context refers to any factor related to a loan applicant that potentially identifies that applicant's race, color, or other prohibited-basis characteristic in instances in which no direct evidence of that characteristic is available. Thus, for consumer lending, for which monitoring data is generally unavailable, an outwardly Hispanic or Asian surname could constitute a surrogate for an applicant's race or national origin, because examiners can assume that the lender (who can rebut the presumption) perceived the person to be Hispanic or Asian. Similarly, an applicant's given name could serve as a surrogate for his or her gender. A surrogate for a prohibited-basis characteristic may be used to set up a comparative analysis with nonminority applicants or borrowers.

Using decision rules in steps 3–5, above, for residential lending products, articulate the possible discriminatory patterns encountered and consider examining those products determined to have sufficient risk of discriminatory conduct.

Step 7. Analyze commercial lending discrimination risk

If an institution does a substantial amount of lending in the commercial lending market, most notably small business lending (and the product has not recently been examined or the underwriting standards have changed since the last examination of the product), examiners should consider conducting a risk factor review similar to that performed for residential lending products, as feasible given the limited information available. Such an analysis should generally be limited to determining risk potential based on risk factors U4–U8, P1–P3, R4–R7, and M1–M3.

If the institution makes commercial loans insured by the Small Business Administration (SBA), determine from Reserve Bank supervisory staff whether SBA loan data (which codes race and other factors) for the institution are available, and evaluate those data pursuant to instructions accompanying them.

For large institutions reporting small business loans for CRA purposes, if the institution also voluntarily geocodes loan denials, look for material discrepancies in ratios of approval to denial for applications in areas with relatively high concentrations of minority residents compared with applications in areas with relatively low concentrations.

Articulate the possible discriminatory patterns identified, and consider further examining those products determined to have sufficient risk of discriminatory conduct in accordance with the procedures for commercial lending described in part III-E.

Step 8. Complete the scoping process

To complete the scoping process, examiners should review the results of the preceding steps and, on the basis of the relative risk levels identified, select those focal points that warrant examination. To remain within the Reserve Bank's resource allowances, examiners may need to choose a smaller number of focal points from among all those selected on the basis of risk. In such instances, examiners should set the scope by first prioritizing focal points on the basis of (1) high number and/or relative severity of risk factors, (2) high data quality and other factors affecting the likelihood of obtaining reliable examination results, (3) high loan volume and the likelihood of widespread risk to applicants and borrowers, and (4) low quality of any compliance program—and then selecting for examination review as many focal points as resources permit.

If the judgment among competing focal points is a close call, information gathered during the compliance management program review, dis-

cussed in part II, can be used to further refine the selection.

II. REVIEW OF THE INSTITUTION'S COMPLIANCE MANAGEMENT PROGRAM

The compliance management review enables the examination team to determine

- The intensity of the current examination, on the basis of an evaluation of the compliance management measures employed by an institution
- The reliability of the institution's practices and procedures for ensuring continued fair lending compliance

Generally, the review should focus on

- Determining whether the institution's policies and procedures enable management to prevent, or identify and self-correct, illegal disparate treatment in the transactions that relate to the products and issues identified for further analysis in part I of these procedures
- Obtaining a thorough understanding of the manner in which management addresses its fair lending responsibilities with respect to (1) the institution's lending practices and standards, (2) training and other application-processing aids, (3) guidance to employees or agents in dealing with customers, and (4) its marketing or other promotion of products and services

To conduct this review, examiners should consider information from institutional records and interviews with appropriate management personnel in the lending, compliance, audit, and legal functions. Examiners should also refer to the "Checklist for Compliance Management Analysis" in the appendix to these procedures to evaluate the strength of the compliance programs in terms of their capacity to prevent, or identify and self-correct, fair lending violations in connection with the products or issues selected for analysis. Based on this evaluation, examiners should

- Set the intensity of the transaction analysis by minimizing sample sizes within the guidelines established in part III of these procedures and illustrated by the sample size tables in the appendix, to the extent warranted by the strength and thoroughness of the compliance programs applicable to those focal points selected for examination
- Identify any compliance program or system deficiencies that merit correction or improvement, and present these to management in accordance with part IV of these procedures

If the institution performs a self-evaluation or has voluntarily disclosed the report or results of a self-test of any product or issue that has been selected for analysis pursuant to part I of these procedures, examiners may streamline the examination, consistent with Reserve Bank instructions, provided that the self-test or self-evaluation meets the requirements set forth in the section “Streamlining Examinations” at the end of the appendix to these procedures.

III. EXAMINATION PROCEDURES

Once the scope and intensity of the examination have been determined, examiners should assess the institution’s fair lending performance by applying the following procedures, as appropriate, to each examination focal point selected.

A. Documentation of Overt Evidence of Disparate Treatment

If the scoping process or any other source identifies overt evidence of disparate treatment, assess the nature of the policy or statement and the extent of its impact on affected applicants by conducting the following analysis:

Step 1. When an indicator of overt discrimination is found in or based on a written policy (for example, a credit scorecard) or communication, determine and document

- a. The precise language of the apparently discriminatory policy or communication and the nature of the fair lending concerns that it raises
- b. The lender’s stated purpose in adopting the policy or communication, and the identity of the person on whose authority it was issued or adopted
- c. How and when the policy or communication was put into effect
- d. How widely the policy or communication was applied
- e. Whether, and to what extent, applicants were adversely affected by the policy or communication

Step 2. When any indicator of overt discrimination was an oral statement or unwritten practice, determine and document

- a. The precise nature of the statement or practice and the fair lending concerns that it raises
- b. The identity of (1) the persons making the statement or applying the practice and their descriptions of the reasons for it and (2) the persons authorizing or directing the use of the statement or practice

- c. How and when the statement or practice was disseminated or put into effect
- d. How widely the statement was disseminated or the practice applied
- e. Whether, and to what extent, applicants were adversely affected by the statement or practice

Assemble findings and supporting documentation for presentation to management in connection with part IV of these procedures.

B. Transactional Underwriting Analysis—Residential and Consumer Loans

Step 1. Set sample size

- a. For each focal point selected for this analysis, use two samples: (1) prohibited-basis-group denials and (2) control group approvals—both identified either directly from monitoring information (in the case of residential loan applications) or through the use of application data or surrogates (in the case of consumer applications)
- b. Refer to fair lending sample size table A in the appendix to these procedures and determine the size of the initial sample for each focal point, based on the number of prohibited-basis-group denials and the number of control group approvals by the lender during the twelve-month (or calendar-year) period of lending activity preceding the examination. In the event that the number of denials and/or approvals acted on during the preceding twelve-month period substantially exceeds the maximum sample size shown in table A, reduce the time period from which that sample is selected to a shorter period. (In doing so, make every effort to select a period in which the lender’s underwriting standards are most representative of those in effect during the full twelve-month period preceding the examination.)
- c. If the number of prohibited-basis-group denials or control group approvals for a given focal point during the twelve-month period referenced in step 1b (immediately above) does not meet the minimum standards set forth in the sample size table, examiners need not attempt a transactional analysis for that focal point. If other risk factors favor analyzing such a focal point, consult with Reserve Bank management on possible alternative methods of judgmental comparative analysis.
- d. If System policy calls for a different approach to sampling (for example, a form of statistical analysis or a mathematical formula) for a limited

class of institutions, examiners should follow that approach.

Step 2. Determine sample composition

- a. To the extent that the institution maintains records of loan outcomes resulting from exceptions to its credit underwriting standards or other policies (for example, overrides to credit score cutoffs), request such records for both approvals and denials, sorted by loan product and branch or decision center if the lender can do so. Include in the initial sample for each focal point all exceptions or overrides applicable to that focal point.
- b. Using HMDA-LAR data or, for consumer loans, comparable loan register data to the extent available, choose approved and denied applications on the basis of selection criteria that will maximize the likelihood of finding marginally approved and denied applicants, as discussed below.
- c. To the extent that the above factors are inapplicable, or other selection criteria are unavailable or do not facilitate selection of the entire sample size of files, complete the initial sample selection by making random file selections from the appropriate sample categories in the sample size table.

Step 3. Compare approved and denied applications

Although a creditor's written policies and procedures may appear to be nondiscriminatory, lending personnel may interpret or apply policies in a discriminatory manner. To detect any disparate treatment among applicants, examiners should first eliminate all but "marginal transactions" (see step 3b, below) from each selected focal point sample. Then they should record a detailed profile of each marginal applicant's qualifications, the level of assistance received during the application process, the reasons for denial, the loan terms, and other information on an "applicant profile spreadsheet." Once the target and control groups are profiled, examiners can compare the groups for evidence that similarly qualified applicants have been treated differently as to either the institution's credit decision or the quality of assistance provided.

- a. Create applicant profile spreadsheet—Based on the lender's written or articulated credit standards and loan policies, identify categories of data that should be recorded for each applicant and provide a field for each of these categories on a worksheet or computerized spreadsheet. Certain data (for example, income, loan amount, and debt) should always be included in the spreadsheet, while the other

data selected should be tailored for each loan product and lender on the basis of applicable underwriting criteria and such issues as branch location and underwriter. If credit bureau scores and/or application scores are an element of the lender's underwriting criteria (or if such information is regularly recorded in loan files, whether expressly used or not), include a data field for this information in the spreadsheet.

To facilitate comparisons of the quality of assistance provided to target and control group applicants, every worksheet should provide a "comments" block, appropriately labeled, as the site for recording observations from the file or interviews regarding how an applicant was, or was not, assisted in overcoming credit deficiencies or otherwise qualifying for approval.

- b. Complete applicant profiles—From the application files sample for each focal point, complete applicant profiles for the denied and approved applications selected, as follows:
 - A principal goal is to identify cases in which similarly qualified prohibited-basis and control group applicants had different credit outcomes. As the supervisory agencies have found, discrimination, including differences in granting assistance during the approval process, is more likely to occur with respect to applicants who are neither clearly qualified nor clearly unqualified, that is, are "marginal" applicants. The examiner-in-charge should, during the following steps, judgmentally select from the initial sample only those denied and approved applications that constitute marginal transactions. (See the section "Marginal Transactions" in the appendix to these procedures for guidance.)
 - If few marginal control group applicants are identified from the initial sample, review additional files of approved control group applicants. This review will either increase the number of marginal approvals or confirm that marginal approvals are so infrequent that the marginal denials are unlikely to involve disparate treatment.
 - The judgmental selection of marginal-denied and marginal-approved applicant loan files should be done together, in a "back and forth" manner, to facilitate close matches and provide a more consistent definition of "marginal" between these two types of loan files.
 - Once the marginal files have been identified, extract and note the data elements called for on the profile spreadsheet.
 - At the same time, examiners should simultaneously look for, and document on the spreadsheet, any evidence found in marginal files regarding the following:

- The extent of any assistance, including both affirmative aid and waivers or partial waivers of credit policy provisions or requirements, that appears to have been provided to marginal-approved control group applicants and enabled them to overcome one or more credit deficiencies, such as excessive debt-to-income ratios
- The extent to which marginal-denied target group applicants with similar deficiencies were, or were not, provided similar affirmative aid, waivers, or other forms of assistance

c. Review and compare profiles

- For each focal point, review all marginal profiles to determine if the underwriter followed institution lending policies in denying applications and whether the reason(s) for denial was supported by facts documented in the loan file and properly disclosed to the applicant pursuant to Regulation B. If any (1) unexplained deviations from credit standards, (2) inaccurate reasons for denial, or (3) incorrect disclosures are noted (whether in a judgmental underwriting system, a scored system, or a mixed system), examiners should obtain an explanation from the underwriter and document the response on an appropriate worksheet.

Note: In constructing the applicant profiles to be compared, examiners must adjust the facts compared so that assistance, waivers, or acts of discretion are treated consistently between applicants. For example, if a control group applicant's debt-to-income ratio was lowered to 42% because the lender decided to include short-term overtime income and a prohibited-basis-group applicant who was denied because of "insufficient income" would have had his ratio drop from 46% to 41% had his short-term overtime income been considered, then examiners should consider 41%, not 46%, in determining the benchmark.

- For each reason for denial identified within the target group, rank the denied prohibited-basis applicants, beginning with the applicant whose qualifications related to that reason for denial were least deficient. (The top-ranked denied applicant in each such ranking is referred to below as the "benchmark" applicant.)
- Compare each marginal control group approval with the benchmark applicant in each reason-for-denial ranking developed in step 3b, above. If there are no approvals who are equally or less qualified, then there are no instances of disparate treatment for the

lender to account for. For all such approvals that appear no better qualified than the denied benchmark applicant

- Identify the approved loan on the worksheet or spreadsheet as an "overlap approval" and
- Compare that overlap approval with other marginal prohibited-basis denials in the ranking to determine whether additional overlaps exist. If they do, identify all overlapping approvals and denials as above.
- If the focal point involves use of a credit scoring system, the analysis for disparate treatment is similar to the procedures set forth in step 3c, above, and should focus primarily on overrides of the scoring system itself. For guidance on this type of analysis, refer to part C of "Procedures for Credit Scoring Analysis" in the appendix to these examination procedures.

Step 4. If there is some evidence of violations in the underwriting process but not enough to clearly establish the existence of a pattern or practice, expand the sample as necessary to determine whether a pattern or practice does or does not exist

Step 5. Discuss all findings resulting from the above comparisons with bank management, and document both the findings and all conversations on an appropriate worksheet

C. Analyzing Potential Disparities in Terms and Conditions

Step 1. Set sample size

For each focal point selected for this analysis, use two samples: (1) prohibited-basis-group approvals and (2) control group approvals—both sets identified either directly from monitoring information (in the case of residential loan applications) or through the use of application data or surrogates (in the case of consumer or commercial applications). Refer to fair lending sample size table B in the appendix and determine the size of the initial sample for each focal point. Sample selections should be based on (1) the number of prohibited-basis-group approvals and the number of control group approvals received by the lender during the twelve months preceding the examination and (2) the outcome of the compliance management program review conducted in part II.

Step 2. Determine sample composition

Note: A sample drawn for the purpose of comparing price and other terms and conditions should

initially be based on controlling for two nondiscriminatory variables that can have a significant impact on loan terms: whether the loan was sold, and the loan closing date. Other variables, such as household income and loan amount, will be accounted for on a case-by-case basis during the file comparison process.

- a. Disposition of loan—Determine whether the approved loans from which the sample is to be drawn have been consistently sold to the secondary market or held in portfolio. If both, determine the proportion for each category and use that proportion in selecting loans for the sample. If the number of loans in either the sold or portfolio category is too small to complete the minimum proportional sample for that category, ignore loans in that category and complete the sample using loans solely from the larger category.
- b. Period of review—Sort loans selected in step 1, above, by date of loan closing, and match batches of prohibited-basis and control group loans that closed either on the same date or within a range of dates during which the lender's pricing policies were the same. If dates of loan closing are not consistently available, consider substituting the application date for the closing date.

Step 3. Create applicant profile spreadsheet

Identify data that should be recorded for each loan to allow for a valid comparison of terms and conditions, and enter the data on a spreadsheet. Certain data must always be included in the spreadsheet, while the other data selected will be tailored for each loan product and lender on the basis of loan terms offered and such issues as branch location and underwriter.

Step 4. Review terms and conditions, and compare them with applicant outcomes

- a. Determine which loan terms and conditions (rates, points, fees, maturity variations, loan-to-value ratios (LTVs), collateral requirements, and so forth) are left, in whole or in part, to the discretion of loan officers or underwriters. For each such term or condition, identify (1) any approved prohibited-basis-group applicants in the sample who appear to have been treated unfavorably with respect to that term or condition and (2) any approved control group applicants who appear to have been treated favorably with respect to that term or condition. The analysis should be thoroughly documented in the workpapers.
- b. Identify from the sample any approved control group applicants who appear to have been

treated more favorably than one or more of the above-identified prohibited-basis-group applicants and who have negative creditworthiness factors (under the lender's standards) that are equal to or worse than those of the prohibited-basis-group applicant(s).

- c. Obtain explanations from the appropriate loan officer or other employee for any differences that exist, and re-analyze the sample for evidence of discrimination.
- d. If there is some evidence of violations in the imposition of terms and conditions but not enough to clearly establish the existence of a pattern or practice, examiners should expand the sample as necessary to determine whether a pattern or practice does or does not exist.
- e. Discuss differences in comparable loans with the institution's management, and document all conversations on an appropriate worksheet. For additional guidance on evaluating management's responses, refer to part A, responses 1–5, in the section "Evaluating Responses to Evidence of Disparate Treatment" in the appendix following this chapter.

D. Steering Analysis

Institutions that make FHA and conventional loans, as well as those that lend in both prime (or "A") and subprime markets (either directly or through subsidiaries or affiliates), present opportunities for loan officers to refer or "steer" applicants from one product or market to another. Steering is not unlawful per se, and in many instances the availability of a more expensive form of credit may enable an applicant with credit problems to obtain a loan that might otherwise be unavailable. Steering can, however, raise fair lending issues if it occurs differently and less advantageously for prohibited-basis-group applicants than for similarly situated nonminority applicants. If the scoping analysis reveals the presence of one or more risk factors S1–S8 for any selected focal point, consult with managers about conducting a steering analysis as described below.

From the perspective of fair lending analysis, all steering scenarios involve a decision by the lender's personnel to guide an applicant's choice between a more favorable loan and one or more less favorable alternatives (for example, referral to a more expensive subprime mortgage subsidiary). As a result, a steering analysis should be directed to the following activities:

Step 1. Clarify which of the options available to customers are the more favorable and the less favorable

Through interviews with appropriate personnel of the institution and a review of policy manuals, procedure guidelines, and other directives, obtain and verify the following information for each product–alternative product pairing or grouping identified above:

- a. All underwriting criteria for the product and for alternative products that are offered by the institution or by a subsidiary or affiliate
- b. Pricing or other costs applicable to the product and alternative products, including interest rates, points, and all fees

Step 2. Document the policies, conditions, or criteria that have been adopted by the lender for determining how referrals are to be made and choices are to be presented to customers

- a. Obtain not only information regarding the product offered by the lender and alternative products offered by subsidiaries or affiliates, but also information on products and alternatives offered solely by the lender itself—for example, conventional and FHA loans, secured and unsecured home improvement loans, prime and subprime mortgages.
- b. Obtain any information regarding a subsidiary of the lender directly from that entity, but seek information regarding an affiliate or holding company subsidiary only from the lender itself.
- c. Obtain all appropriate documentation, and document all discussions with loan personnel and managers.
- d. Obtain documentation or employee estimates as to the volume of referrals made from or to the institution, for each product, during a relevant time period.
- e. Resolve to the extent possible any discrepancies between information found in the lender's documents and information obtained in interviews, by conducting appropriate follow-up interviews.
- f. Identify any policies and procedures established by the institution and its subsidiary or affiliate for (1) referring a person who applies to the institution, but does not meet its criteria, to a subsidiary or affiliate; (2) offering to a person who applies to the institution for a *specific product*, but does not meet its criteria, one or more alternative loan products; or (3) referring to the institution a person who applies to a subsidiary or affiliate for its product but who appears to be qualified for a loan from the institution.
- g. Determine whether loan personnel are encouraged, through monetary incentives or other-

wise, to make referrals, either from the institution to a subsidiary or affiliate or vice versa.

Step 3. Determine how both the decisions and the lender's policies, conditions, or criteria are supposed to be documented in loan files, policy manuals, directives, and so forth.

Determine how, if at all, a referral from the institution to a subsidiary or affiliate, or vice versa, *and the reason for it*, would be documented in the loan files or in any other records of either the referring or the receiving entity.

Step 4. Determine to what extent individual loan personnel are able to exercise personal discretion in deciding what loan products or other credit alternatives will be made available to a given applicant

Step 5. Determine whether the lender's stated policies, conditions, or criteria are adhered to by individual decision makers. If they are not, does it appear that different policies or practices are actually in effect?

Enter data from the prohibited-basis-group sample on the spreadsheets, and determine whether the lender is, in fact, applying its criteria as stated. For example, if one announced criterion for receiving a "more favorable" prime mortgage loan was a back-end debt ratio of no more than 38%, review the spreadsheets to determine whether that criterion was adhered to. If the lender's actual treatment of prohibited-basis-group applicants appears to differ from its stated criteria, document such differences for subsequent discussion with management.

Step 6. To the extent that individual loan personnel have any discretion in deciding what credit alternatives to offer applicants (for example, conventional vs. FHA/VA), conduct a comparative analysis to determine whether that discretion has been exercised in a nondiscriminatory manner

Compare the lender's, or its subsidiary or affiliate's, treatment of control group and prohibited-basis-group applicants by adapting the "benchmark" and "overlap" technique discussed in part III-B of these procedures. For purposes of this steering analysis, that technique should be applied as follows:

- a. For each focal point to be analyzed, select a sample of prohibited-basis-group applicants who received "less favorable" treatment (for example, applicants referred to a finance company or a subprime mortgage subsidiary or those who received counteroffers of less favorable product alternatives).

Note: In selecting the sample, follow the guidance of sample size table B in the appendix and select “marginal applicants” as instructed in part III-B.

- b. Prepare a spreadsheet for the sample that contains data entry categories for those underwriting and referral criteria that the lender identified in step 1b as being used in reaching underwriting and referral decisions between the pairs of products.
- c. Review the “less favorably” treated prohibited-basis-group sample and rank this sample from least qualified to most qualified.
- d. From the sample, identify the most qualified prohibited-basis-group applicant, based on the criteria identified for the control group, above. This applicant will be the “benchmark” applicant. Rank order the remaining applicants from most to least qualified.
- e. Select a sample of *control group applicants*. Identify those who were treated “more favorably” with respect to the same product-alternative product pair as the *prohibited-basis group*. (Again, refer to sample size table B and the marginal applicant processes noted above in selecting the sample.)
- f. Compare the qualifications of the benchmark applicant with those of the control group applicants, beginning with the least qualified member of that sample. Any control group applicant who appears less qualified than the benchmark applicant should be identified on the spreadsheet as a “control group overlap.”
- g. Compare all control group overlaps with other, less qualified prohibited-basis-group applicants to determine whether additional overlaps exist.
- h. Document all overlaps as possible disparities in treatment. Discuss all overlaps and related findings (for example, any differences between stated and actual underwriting criteria) with management, documenting all such conversations.

E. Transactional Underwriting Analysis—Commercial Loans

Unlike consumer credit, for which loan products and prices are generally homogenous and underwriting involves the evaluation of a limited number of credit variables, commercial loans are generally unique, and underwriting methods and loan pricing may vary depending on a large number of credit variables. The additional credit analysis that is involved in underwriting commercial credit products entails additional complexity in the sampling and discrimination analysis process. Although the ECOA prohibits discrimination in all the commercial

credit activities of a covered institution, the supervisory agencies recognize that small businesses (sole proprietorships, partnerships, and small, closely held corporations), including those operated by prohibited-basis-group members, may have less experience in borrowing. Therefore, in implementing these procedures, examiners should generally focus on small business credit (commercial applicants that had gross revenues of \$1,000,000 or less in the preceding fiscal year), absent some evidence that a focus on other commercial products would be more appropriate.

Step 1. Understand commercial loan policies

For the commercial product line selected for analysis, first review credit policy guidelines and interview appropriate commercial loan managers and officers to obtain written and articulated standards used by the lender in evaluating commercial loan applications.

Step 2. Conduct initial sampling

- a. Select all (up to a maximum of ten) denied applications that were acted on during the three-month period prior to the examination. To the extent feasible, include denied applications from businesses that (1) are located in minority or integrated geographies or (2) appear, on the basis of the names of the principals shown on applications or related documents, to be owned by women or minority group members. (In the case of banks that do a significant volume of commercial lending, consider reviewing more than ten applications.)
- b. For each of the denied commercial applications selected, record specific information gathered from loan files and through interviews with the appropriate loan officers—information about the principal owners, the purpose of the loan, and the specific financial information about the commercial enterprise (including type of business, such as retail, manufacturing, or service)—that was used by the lender to evaluate the credit request. In addition, inquire with the loan officer as to the gender and race, if known, of the principals of the business.
- c. Select ten approved loans that appear to be similar, with regard to business type, purpose of loan, loan amount, loan terms, and type of collateral, to the denied loans sampled. For example, if the denied loan sample includes applications for lines of credit to cover inventory purchases for retail businesses, select approved applications for lines of credit from retail businesses.
- d. For each approved commercial loan application selected, obtain and record information parallel

to that obtained for denied applications, including the gender and race of the principals.

- e. Compare the credit criteria considered in the credit process for each of the approved and denied applications with established underwriting standards, rather than comparing files directly.
- f. Identify any deviations from credit standards for both approved and denied credit requests, and identify differences in loan terms granted for approved credit requests.
- g. Discuss each instance in which deviations from credit standards and terms were noted, but were not explained in the file, with the commercial credit underwriter, and document each discussion.

Step 3. Conduct targeted sampling

- a. If deviations from credit standards or pricing are not sufficiently explained by other factors documented in the credit file, or if the commercial underwriter was not able to provide a reasonable explanation for the difference, determine if deviations were detrimental to any protected classes of applicants.
- b. Consider employing the same techniques for determining the race and gender characteristics of commercial applicants as those outlined in the consumer loan sampling procedures.
- c. If it is determined that there are members of one or more prohibited-basis groups among commercial credit requests that were not underwritten according to established standards or received less favorable terms, select additional commercial loans for which applicants are members of the same prohibited-basis group and then select similarly situated control group credit requests. These additional files should be chosen on basis of any specific applicant circumstances that appear to have been viewed differently by lending personnel on a prohibited basis.
- d. If the original sample period does not provide enough similarly situated applicants from which to draw a reasonable conclusion, expand the sample period. The expanded sample period should generally not extend back beyond the date of the prior examination.

Sampling Guidelines

- a. Generally, the task of selecting an appropriate expanded sample of prohibited-basis and control group applications for commercial loans will require examiner judgment. The sample should be large enough to allow examiners to draw a reasonable conclusion.

- b. First, select from the applications that were acted on during the initial sample period but were not included in the initial sample. Then, select applications from prior time periods as necessary.
- c. The expanded sample should include both approved and denied prohibited-basis and control group applications in which similar credit was requested by similar enterprises for similar purposes.

F. Analysis of Potential Discriminatory Redlining

For purposes of this analysis, *redlining* is a form of illegal disparate treatment in which a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristics of the residents of the area in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located.

The redlining analysis may be applied to determine whether, on a prohibited-basis,

- A lender fails or refuses to extend credit in such an area;
- A lender makes loans in such an area but at a restricted level or on less favorable terms or conditions relative to contrasting areas; or
- A lender omits or excludes such an area from efforts to market residential loans or solicit customers for residential credit.

This guidance focuses on possible discrimination against racial or national origin minorities. The same analysis could be adapted to evaluate relative access to credit for areas of geographical concentration on other prohibited bases—for example, age.

Note: It is true that neither the Equal Credit Opportunity Act nor the Fair Housing Act specifically uses the term “redlining.” However, federal courts, as well as agencies that have enforcement responsibilities for the FHOAct, have interpreted that act as prohibiting lenders from having different marketing or lending practices for certain geographic areas, compared with others, if the purpose or effect of such differences would be to discriminate on a prohibited basis. Similarly, the ECOA would prohibit treating applicants for credit differently on the basis of the racial or ethnic composition of their respective neighborhoods.

Like other forms of disparate treatment, redlining can be proved by overt or comparative evidence. If

any written or oral policy or statement of the lender (see risk factors R5, R6, and R7 in part I, above) suggests that the lender links the racial or national origin character of an area to limits on the access to or terms of credit, examiners should refer to the guidance in section A of this part (part III), on documenting and evaluating overt evidence of discrimination.

Overt evidence includes not only explicit statements, but also a lender's use of geographical terms that would, to a reasonable person familiar with the community in question, suggest a specific racial or national origin character. For example, if the principal information conveyed by the phrase "north of 110th Street" is that the indicated area is principally occupied by Hispanics, then a policy of not making credit available "north of 110th Street" is overt evidence of potential redlining on the basis of national origin.

Overt evidence is relatively uncommon. Consequently, the redlining analysis will usually focus on comparative evidence (similar to analyses of possible disparate treatment of individual customers), comparing the lender's treatment of areas having contrasting racial or national origin characteristics.

When the scoping process (including consultation within the Federal Reserve System as called for by the procedures) indicates that a redlining analysis should be initiated, examiners should complete the following steps of comparative analysis:

- Identify and delineate any areas within the lender's CRA assessment area or market area for residential products that are of a racial or national origin minority character.
- Determine whether any minority area identified in step 1 (see "Comparative Analysis for Redlining," below) appears to be excluded, underserved, selectively excluded from marketing efforts, or otherwise treated less favorably in any way by the lender.
- Identify and delineate any areas within the lender's CRA assessment area or market area for residential products that are nonminority in character and that the lender appears to treat more favorably.
- Obtain the lender's explanation for the apparent difference in treatment between the areas, and evaluate whether the explanation is credible and reasonable.
- Obtain and evaluate other information that may support or contradict an interpretation of identified disparities as the result of intentional illegal discrimination.

These steps are discussed in detail below.

Using Information Obtained during Scoping

Although the five tasks listed below are listed as examination steps in the order presented above, examiners should recognize that a different order may be preferable in any given examination. For example, the lender's explanation (step 4) for one of the policies or patterns in question may already be documented in the CRA materials reviewed (step 2), and the CRA examiners may already have verified the explanation, which may be sufficient for purposes of the redlining analysis.

As another example, as part of the scoping process, examiners may have reviewed an analysis of the geographic distribution of the lender's loan originations with respect to the racial and national origin composition of census tracts within its CRA assessment or residential market area. The analysis may have documented the existence of significant discrepancies between areas, by degree of minority concentration, in loans originated (risk factor R1), approval/denial rates (risk factor R2), and/or rates of denials because of insufficient collateral (risk factor R3). In such a situation, one in which the scoping process has produced a reliable factual record, examiners could begin with step 4 (obtaining an explanation) of the redlining analysis described below.

In contrast, when the scoping process yields only partial or questionable information, or the risk factors on which the redlining analysis is based are complaints or allegations against the lender, steps 1, 2, and/or 3 must be addressed.

Comparative Analysis for Redlining

Step 1. Identify and delineate any areas within the lender's CRA assessment area or market area for residential products that are of a racial or national origin minority character

Note: The CRA assessment area can be a convenient unit for redlining analysis because information about it typically is already in hand. However, the CRA assessment area may be too limited. The redlining analysis focuses on the lender's decisions about how much access to credit to provide to different geographical areas. The areas for which those decisions can best be compared are areas in which the lender actually marketed and provided credit and in which it could reasonably be expected to have marketed and provided credit. Some of those areas might be beyond or otherwise different from the CRA assessment area.

If there are no areas identifiable for their racial or national origin minority character within the lender's

CRA assessment area or market area for residential products, a redlining analysis is not appropriate. (If there is a substantial but *dispersed* minority population, potential disparate treatment can be evaluated by a routine comparative file review of applicants.)

This step may have been substantially completed during scoping, but unresolved matters may remain. (For example, several community spokespersons may allege that the lender is redlining but disagree in defining the area.) Examiners should

- a. Describe as precisely as possible why a specific area is recognized in the community (perceptions of residents, and so forth) or is objectively identifiable (on the basis of census or other data) as having a particular racial or national origin minority character.
 - The most obvious identifier is the predominant race or national origin of the residents of the area. Examiners should document the percentages of racial or national origin minorities residing within the census tracts that make up the area. However, they should bear in mind that it is illegal for the lender to consider a prohibited factor *in any way*. For example, an area might be only 20% black, but if a lender refuses to extend credit there because the lender believes the area is “changing to black,” that, too, is a violation. Contacts with community groups can be helpful in learning whether there are such subtle features of racial or ethnic character.
 - Geographical groupings that are convenient for CRA may obscure racial patterns. For example, an underserved, low-income, predominantly minority neighborhood that lies within a larger low-income area that consists primarily of *nonminority* neighborhoods may seem adequately served when the entire low-income area is analyzed as a unit. However, a racial pattern of underservice to minority areas might be revealed if the low-income minority neighborhood shares a border with an underserved, *middle*-income minority area and those two minority areas were grouped together for purposes of analysis. Review the analysis from prior CRA examinations of whether the assessment area appears to have been influenced by prohibited factors. If there are minority areas that the lender improperly excluded from the assessment area, consider whether those areas ought to be included in the redlining analysis.
- b. Describe how the racial or national origin character changes across the suspected redlining area’s various boundaries.

- c. Document or estimate the amount, within the minority area, of types of housing for which the lender offers residential credit. If the minority area does not have a significant amount of such housing, the area is not appropriate for a redlining analysis.

Step 2. Determine whether any minority area identified in step 1 is excluded, underserved, selectively excluded from marketing efforts, or otherwise less favorably treated in any way by the lender

Examiners should begin with the risk factors identified during the scoping process. The unfavorable treatment may have been substantially documented during scoping and need only to be finished in this step. If not, this step will verify and measure the extent to which HMDA data show the minority areas identified in step 1 to be underserved and how the lender’s explicit policies treat them less favorably.

- a. Review prior CRA lending test analyses to learn whether they have identified any excluded or otherwise underserved areas or other significant geographical disparities in the institution’s lending. Determine whether any of those are the minority areas identified in step 1.
- b. Learn from the lender itself whether, as a matter of policy, it treats any separate or distinct geographical areas within its marketing or service area differently from other areas. This information may have been gathered completely or partially during scoping analysis related to risk factors R5, R6, and R7. The differences in treatment can be in marketing, branch operations, appraisal practices, application processing, approval requirements, pricing, loan conditions, evaluation of collateral, or any other policy or practice materially related to access to credit. Determine whether any of those less-favored areas are the minority areas identified in step 1.
- c. Obtain from the lender (1) its reasons for such differences in policy, (2) how the differences are implemented, and (3) any specific conditions that must exist in an area for it to receive the particular treatment (more favorable or less favorable) that the lender has indicated.

Step 3. Identify and delineate any areas within the lender’s CRA assessment area or market area for residential products that are nonminority in character and that the lender appears to treat more favorably

To the extent not already completed during scoping,

- a. Document the percentages of whites and of racial or national origin minorities residing within

the census tract(s) that make up the *nonminority* area.

- b. Document the nature of the housing stock in the area.
- c. Describe, to the extent known, how the lender's practices, policies, or rate of lending change from less to more favorable as one leaves the minority area at its various boundaries. (Examiners should be particularly attentive to instances in which the boundaries between favored and disfavored areas deviate from boundaries the lender would reasonably be expected to follow, such as political boundaries or transportation barriers.)
- d. Examiners should particularly consider whether, within a large area that is composed predominantly of racial or national origin minority households, there are enclaves that are predominantly *nonminority* or whether, along the area's borders, there are irregularities where the *nonminority* group is predominant. As part of the overall comparison, examiners should determine whether credit access within those small *nonminority* areas differs from credit access in the larger minority area.

Step 4. Obtain the lender's explanation for the apparent difference in treatment between the areas, and evaluate whether the explanation is credible and reasonable

This step completes the comparative analysis by soliciting from the lender any additional information not yet considered by examiners that might show that there is a nondiscriminatory explanation for the apparent disparate treatment based on race or ethnicity.

For each matter that requires explanation, provide the lender full information about apparent differences in the treatment of minority and nonminority areas and how examiners reached their preliminary conclusions at this stage of the analysis.

- a. Evaluate whether the conditions identified by the lender in step 2 as justifying *more* favorable treatment pursuant to institutional *policy* existed in minority neighborhoods that did *not* receive the favorable treatment called for by institutional policy. If there are minority areas for which those conditions existed, ask the lender to explain why the areas were treated differently despite the similar conditions.
- b. Evaluate whether the conditions identified by the lender in step 2 as justifying *less* favorable treatment pursuant to institutional *policy* existed in *nonminority* neighborhoods that received favorable treatment nevertheless. If there are *nonminority* areas for which those conditions existed, ask the lender to explain why those

areas were treated differently despite the similar conditions.

- c. Obtain explanations from the lender for any apparent differences in treatment observed by examiners but not called for by the lender's policies.
 - If the lender's explanation cites any specific conditions in the nonminority areas to justify more favorable treatment, determine whether the minority areas identified in step 1 satisfied those conditions. If there are minority areas for which those conditions existed, ask the lender to explain why the areas were treated differently despite the similar conditions.
 - If the lender's explanation cites any specific conditions in the minority areas to justify less-favorable treatment, determine whether the nonminority areas had those conditions. If there are *nonminority* areas for which those conditions existed, ask the lender to explain why those areas were treated differently despite the similar conditions.
- d. Evaluate the lender's responses by applying appropriate principles selected from the section "Evaluating Responses to Evidence of Disparate Treatment" in the appendix to these procedures.

Step 5. Obtain and evaluate specific types of other information that may support or contradict an interpretation of identified disparities as the result of intentional illegal discrimination

As a legal matter, discriminatory intent can be inferred simply from the lack of a legitimate explanation for clearly less favorable treatment of racial or national origin minorities. That might be the situation after step 4. Nevertheless, if the lender's explanations do not adequately account for a documented difference in treatment, examiners should consider additional information that might support or contradict the interpretation that the difference in treatment was intended.

- a. Comparative file review—If a comparative file review was conducted in conjunction with the redlining examination, review the results; or, if it is necessary and feasible to do so to clarify what appears to be discriminatory redlining, compare denied applications from within the suspected redlined area with approved applications from the contrasting area.
 - Determine whether there were any denials of fully qualified applicants from the suspected redlined area. If so, that tends to support the view that the lender wanted to avoid doing business in the area.
 - Determine whether the file review identified instances of illegal disparate treatment against

applicants of the same race or national origin as the suspected redlined area. If so, that tends to support the view that the lender wanted to avoid doing business with applicants of that group, such as the residents of the suspected redlined area. Learn whether any such identified victims applied for transactions in the suspected redlined area.

- If there are instances of either of the above, identify any denied *nonminority* residents, if any, of the suspected redlined area and review their application files to learn whether they appear to have been treated in an irregular or less favorable way. If so, that tends to support the view that the character of the area, rather than of the applicants themselves, appears to have influenced the credit decisions.
- Review withdrawn and incomplete applications for the suspected redlined area, if those can readily be identified from the HMDA-LAR, and determine whether there are reliable indications that the lender discouraged those applicants from applying. If so, that tends to support the view that the lender did not want to do business in the area and may constitute evidence of a violation of section 202.5(a) of Regulation B.

Conversely, if the comparisons of individual transactions show that the lender treated minority and nonminority applicants within and outside the suspected redlined area similarly, that tends to contradict the conclusion that the lender avoided the area because it had minority residents.

- b. Interviews of third parties—The perspectives of third parties will have been taken into account to some degree through the review of available materials during scoping. Later in the examination, in appropriate circumstances, information from third parties may help in interpreting whether the lender's apparent differences in treatment of minority and nonminority areas were intended.
 - Identify persons (such as housing or credit counselors, home improvement contractors, or real estate and mortgage brokers) who may have extensive experience dealing with credit applicants from the suspected redlined area.
 - After obtaining appropriate authorization and guidance from the Board, interview those persons to learn of their *first-hand experiences* related to
 - Oral statements or written indications by a lender's representatives that loan applica-

tions from a suspected redlined area were discouraged

- Whether the lender treated applicants from the suspected redlined area as called for in its own procedures (as the examiners understand them) or whether it treated them similarly to applicants from nonminority areas (as the examiners are familiar with those transactions)
- Any unusual delays or irregularities in loan processing for transactions in the suspected redlined area
- Differences in the lender's pricing, loan conditions, property valuation practices, and so forth, in the suspected redlined area compared with contrasting areas

Also, learn from the third parties the names of any consumers they described as having experienced the questionable behavior recounted by the third party, and consider contacting those consumers.

If third parties witnessed specific conduct by the lender that indicates that the lender wanted to avoid business from the area or prohibited-basis group in question, this would tend to support an interpretation that the difference in treatment was intended. Conversely, if third parties report proper treatment or positive actions toward such an area or prohibited-basis group, this would tend to contradict the view that the lender intended to discriminate.

- c. Marketing—A clear exclusion of the suspected redlined area from the lender's marketing of residential loan products supports the view that the lender did not want to do business in the area. Marketing decisions are affirmative acts to include or exclude areas. Disparities in marketing between two areas may reveal that the lender prefers one to the other. If sufficiently stark and supported by other evidence, a difference in marketing to racially different areas could itself be treated as a redlining violation of the Fair Housing Act. Even below that level of difference, marketing patterns can support or contradict the view that disparities in lending practices were intentional.
 - Review materials that show how the lender has marketed in the suspected redlined area and in nonminority areas. Begin with available CRA materials and discuss the issues with CRA examiners, then review other materials as appropriate. The materials may include, for example, the lender's guidance for the geographical distribution of preapproved solicitations for credit cards or home equity lines of credit, advertisements in local media or business or telephone directories, business

development calls to real estate brokers, and calls by telemarketers.

- d. Peer performance—Market share analysis and other comparisons with competitors are insufficient by themselves to prove that a lender engaged in illegal redlining. By the same token, a lender cannot justify its own failure to market or lend in an area by citing other lenders' failures to lend or market there.

However, a lender's inactivity in an underserved area where its acknowledged competitors are active would tend to support the interpretation that it intends to avoid doing business in the area. Conversely, if it is as active as other lenders, that would suggest that it intends to compete for, rather than avoid, business in the area.

- Develop a list of the institution's competitors.
 - Determine the level of lending in the suspected redlined area by competitors. Check any public evaluations of similarly situated competitors obtained by CRA examiners as part of evaluating the performance context, or obtain such evaluations independently.
- e. Institution's record—Request from the lender information about its overall record of serving or attempting to serve the racial or national origin minority group with which the suspected redlined area is identified. The record may reveal an intent to serve that group that tends to contradict the view that the lender intends to discriminate against the group.

Step 6. For any information that supports interpreting the situation as illegal discrimination, obtain and evaluate an explanation from the institution as called for in part IV

Note: If the lender's explanation is that the disparate results are the consequence of a specific, neutral policy or practice that the lender applies broadly, such as not making loans on homes below a certain value, review the guidance on disproportionate adverse impact in the "Special Analyses" section of the appendix to these procedures and consult Reserve Bank management.

G. Analysis of Potential Discriminatory Marketing Practices

If scoping identifies significant risk factors related to marketing (M1–M7), examiners should consult their managers and experts about a possible marketing discrimination analysis. If the managers agree to proceed, examiners should collect information as follows:

Step 1. Identify the bank's marketing initiatives

a. Preapproved solicitations

- Determine whether the bank sends out pre-approved solicitations
 - For home purchase loans
 - For home improvement loans
 - For refinance loans
- Determine how the bank selects recipients for such solicitations.
 - Learn from the bank its criteria for such selections.
 - Review any guidance or other information the bank provided credit reporting companies or other companies that supply such lists.

b. Media use

- Determine in which newspapers and broadcast media the bank advertises.
 - Identify any racial or national origin identity associated with those media.
 - Determine whether those media focus on geographical communities of a particular racial or national origin character.
- Determine the bank's strategies for geographic and demographic distribution of advertisements.
- Obtain and review copies of the bank's printed advertising and promotional materials.
- Determine what criteria the bank communicates to media about what is an attractive customer or an attractive area in which to cultivate business.
- Determine whether advertising and marketing are the same to racial and national origin minority areas as to nonminority areas.

c. Self-produced promotional materials

- Determine how the bank distributes its own promotional materials, both methods and geographical distribution.
- Determine what the bank regards as the target audience(s) for those materials.

d. Realtors, brokers, contractors, and other intermediaries

- Determine whether the bank solicits business from specific realtors, brokers, home improvement contractors, and other conduits.
 - Learn how the bank decides which intermediaries it will solicit.
 - Identify the parties contacted, and determine the distribution between minority and nonminority areas.
 - Obtain and review the types of information the bank distributes to intermediaries.

- Determine how often the bank contacts intermediaries.
- Determine what criteria the bank communicates to intermediaries about the type of customers it seeks or the nature of the geographic areas in which it wishes to do business.

Step 2. Determine whether the bank's activities show a significantly lower level of marketing effort toward minority areas or toward media or intermediaries that tend to reach minority areas

Step 3. If there is any such disparity, document the bank's explanation for it. For additional guidance, refer to part C of the "Special Analyses" section of the appendix to these procedures.

H. Credit Scoring

If the scoping process results in the selection of a focal point that includes a credit or mortgage scored loan product, refer to part B of "Procedures for Credit Scoring Analysis" in the appendix to these examination procedures.

If the institution uses a credit scoring program that scores age for any loan product selected for review in the scoping stage, either as the sole underwriting determinant or only as a guide to making loan decisions, refer to part D of "Procedures for Credit Scoring Analysis" in the appendix.

I. Disparate-Impact Issues

These procedures have thus far focused on examining comparative evidence for possible unlawful disparate *treatment*. Disparate *impact* was described briefly in the "Overview" on federal fair lending regulations and statutes. If a particular lender policy or practice appears to have a *disparate impact* on a prohibited basis, examiners should refer to part A of the "Special Analyses" section of the appendix to these procedures or consult with Reserve Bank management for further guidance.

IV. OBTAINING AND EVALUATING RESPONSES FROM THE LENDER AND CONCLUDING THE EXAMINATION

Step 1. Present to the institution's management for explanation

- a. Any overt evidence of disparate treatment on a prohibited basis

- b. All instances of apparent disparate treatment (for example, overlaps) in either the underwriting of loans or in loan prices, terms, or conditions
- c. All instances of apparent disparate treatment in the form of discriminatory steering, redlining, or marketing policies or practices
- d. All instances in which a denied prohibited-basis applicant was not afforded the same level of assistance or the same benefit of discretion as an approved control group applicant who was no better qualified with regard to the reason for denial
- e. All instances in which a prohibited-basis applicant received conspicuously less-favorable treatment by the lender than was customary for the lender or was required by the lender's policy
- f. Any statistically significant average difference in either the frequency or the amount of pricing disparities between control group and prohibited-basis-group applicants
- g. Any evidence of neutral policies, procedures, or practices that appear to have a disparate impact or effect on a prohibited basis

Explain that unless there are legitimate, nondiscriminatory explanations (or in the case of disparate impact, a compelling business justification) for each of the preliminary findings of discrimination identified in this part, the Reserve Bank could conclude that the lender is in violation of the applicable fair lending laws.

Step 2. Document all responses that have been provided by the institution, not just its "best" or "final" response

Document each discussion with dates, names, titles, questions, responses, any information that supports or undercuts the lender's credibility, and any other information that bears on the issues raised in the discussion(s).

Step 3. Evaluate whether the responses are consistent with previous statements, information obtained from file review, documents, reasonable banking practices, and other sources and satisfy commonsense standards of logic and credibility

- a. Do not speculate or assume that the institution's decision maker had specific intentions or considerations in mind when he or she took the actions being evaluated. Do not, for example, conclude that because you have noticed a legitimate, nondiscriminatory reason for a denial (such as an applicant's credit weakness), no discrimination occurred, unless it is clear that at the time of the denial the lender actually based the denial on that reason.

- b. Perform follow-up file reviews and comparative analyses, as necessary, to determine the accuracy and credibility of the lender's explanations.
- c. Refer to the section "Evaluating Responses to Evidence of Disparate Treatment" in the appendix to these procedures for guidance as to common types of responses.
- d. Refer to "Disproportionate-Adverse-Impact Violations" in the "Special Analyses" section of the appendix for guidance on evaluating the institution's responses to apparent disparate impact.

Step 4. If, after completing steps 1–3, above, you conclude that the institution has failed to demonstrate adequately that one or more apparent violations had a legitimate nondiscriminatory basis or were otherwise lawful, prepare a documented list or discussion of violations, or a draft examination report, as prescribed by System policy

Step 5. Consult with Reserve Bank management and the Board regarding (1) whether any violations should be referred to the Department of Justice or the Department of Housing and Urban Development and (2) enforcement action that should be undertaken

Federal Fair Lending Regulations and Statutes Examination Procedures: Appendix

This appendix contains supplementary materials to be used in conjunction with the fair lending examination procedures presented in the preceding chapter:

- Checklist for conducting a compliance management analysis
- Procedures for conducting a credit scoring analysis
- Guidance for evaluating lender responses to evidence of disparate treatment
- Tables for determining sample sizes for fair lending exams
- Explanation of “marginal transactions”
- List of potential scoping information
- Procedures for conducting “special analyses” in the event of apparent disproportionate-adverse-impact violations, discriminatory pre-application screening, or discriminatory marketing
- Procedures for streamlining examinations using lender self-examinations

CHECKLIST FOR COMPLIANCE MANAGEMENT ANALYSIS

This checklist is for use in conjunction with part II of the fair lending examination procedures and focuses on an institution’s compliance management program. It is intended as a tool for evaluating the quality of preventive and corrective measures, identifying worthwhile innovations, and offering suggestions for improvement. The checklist is not intended to be an absolute test of a lender’s compliance management program. Lender programs containing all or most of the features described in the checklist may nonetheless be flawed for other reasons; conversely, a compliance program that encompasses only some of the features may nonetheless adequately support a strong program under appropriate circumstances. In short, examiners must exercise their best judgment in using the checklist and in assessing the overall quality of a lender’s efforts to ensure fair lending compliance.

If the transactions included in the proposed scope of the examination are covered by a self-compliance measure shown on the checklist, check the box in the left column (labeled “Within proposed scope”). Reduce the intensity (mainly the sample size) of the planned comparative file review to the degree that the self-compliance measures cover transactions within the proposed scope. Document findings in sufficient detail to justify any resulting reduction in the intensity of the examination.

Examiners are not required to determine whether self-compliance measures apply to specific products outside the proposed scope. However, if the information obtained shows that the self-compliance measure is a general practice of the lender, check the box in the right column (labeled “Lender-wide”) to assist with future examination planning.

A. Preventive Measures

Determine whether policies and procedures exist that help to prevent illegal disparate treatment in the transactions you plan to examine. There is no legal or System requirement for institutions to incorporate preventive activities, and the absence of any of these policies and practices is never, by itself, a violation.

	Within proposed scope	Lender- wide
1. Lending practices and standards		
a. Principal policy issues		
Are underwriting practices clear and similar to industry standards?	<input type="checkbox"/>	<input type="checkbox"/>
Is pricing within reasonably confined ranges, with guidance linking variations to risk and/or cost factors?	<input type="checkbox"/>	<input type="checkbox"/>

Note: This appendix is adapted, with a few minor format, stylistic, and wording changes where appropriate, from the Interagency Fair Lending Examination Procedures Appendix revised in August 2004 and distributed as an attachment to CA Letter 04-8.

	Within proposed scope	Lender- wide
Does management monitor the nature and frequency of exceptions to its standards?	<input type="checkbox"/>	<input type="checkbox"/>
Are denial reasons accurately and promptly communicated to unsuccessful applicants?	<input type="checkbox"/>	<input type="checkbox"/>
Note: The preceding four items are not compliance measures, but they are fundamental features of lending that tend to work against disparate treatment.	<input type="checkbox"/>	<input type="checkbox"/>
b. Do training, application-processing aids, and other guidance correctly and adequately describe		
Prohibited bases under the ECOA, Regulation B, and the Fair Housing Act (FHAAct)	<input type="checkbox"/>	<input type="checkbox"/>
Other substantive credit access requirements of Regulation B (for example, spousal signatures, improper inquiries, protected income)	<input type="checkbox"/>	<input type="checkbox"/>
c. Is it specifically communicated to employees that they must not, on a prohibited basis,		
Refuse to deal with individuals inquiring about credit	<input type="checkbox"/>	<input type="checkbox"/>
Discourage inquiries or applicants by delays, discourtesy, or other means	<input type="checkbox"/>	<input type="checkbox"/>
Provide different, incomplete, or misleading information about the availability of loans, application requirements, and processing and approval standards or procedures (including selectively informing applicants about certain loan products while failing to inform them of alternatives)	<input type="checkbox"/>	<input type="checkbox"/>
Encourage or more vigorously assist only certain inquirers or applicants	<input type="checkbox"/>	<input type="checkbox"/>
Refer credit seekers to other lenders	<input type="checkbox"/>	<input type="checkbox"/>
Waive or grant exceptions to application procedures or credit standards	<input type="checkbox"/>	<input type="checkbox"/>
State a willingness to negotiate	<input type="checkbox"/>	<input type="checkbox"/>
Use different procedures or standards to evaluate applications	<input type="checkbox"/>	<input type="checkbox"/>
Use different procedures to obtain and evaluate appraisals	<input type="checkbox"/>	<input type="checkbox"/>
Provide certain applicants opportunities to correct or explain adverse or inadequate information, or to provide additional information	<input type="checkbox"/>	<input type="checkbox"/>
Accept alternative proofs of creditworthiness	<input type="checkbox"/>	<input type="checkbox"/>
Require cosigners	<input type="checkbox"/>	<input type="checkbox"/>
Offer or authorize loan modifications	<input type="checkbox"/>	<input type="checkbox"/>
Suggest or permit loan assumptions	<input type="checkbox"/>	<input type="checkbox"/>
Impose late charges, reinstatement fees, etc.	<input type="checkbox"/>	<input type="checkbox"/>
Initiate collection or foreclosure proceedings	<input type="checkbox"/>	<input type="checkbox"/>
d. Has the institution taken specific initiatives to prevent forms of unintentional discrimination, including		
Basing credit decisions on assumptions derived from racial, gender, and other stereotypes, rather than facts	<input type="checkbox"/>	<input type="checkbox"/>
Seeking customers from a particular racial, ethnic, or religious group, or of a particular gender, to the exclusion of other types of customers, on the basis of how "comfortable" the employee may feel in dealing with those different from himself or herself	<input type="checkbox"/>	<input type="checkbox"/>

	Within proposed scope	Lender- wide
Limiting the exchange of credit-related information or the institution's effort to qualify the applicant because of its discomfort or unease in dealing with customers who are of a particular race, ethnicity, religion, or sex	<input type="checkbox"/>	<input type="checkbox"/>
Is the institution's CRA assessment area drawn without unreasonably excluding minority areas?	<input type="checkbox"/>	<input type="checkbox"/>
e. Does the institution have procedures to ensure that it does not		
State racial or ethnic limitations in advertisements	<input type="checkbox"/>	<input type="checkbox"/>
Employ code words in advertisements that convey racial or ethnic limitations	<input type="checkbox"/>	<input type="checkbox"/>
Place advertisements that a reasonable person would regard as indicating that minority individuals are less-desirable customers	<input type="checkbox"/>	<input type="checkbox"/>
Advertise only in media serving nonminority areas of the market	<input type="checkbox"/>	<input type="checkbox"/>
Conduct other forms of marketing only in nonminority areas of the market	<input type="checkbox"/>	<input type="checkbox"/>
Market only through brokers known to serve only one racial or ethnic group in the market	<input type="checkbox"/>	<input type="checkbox"/>
Use a prohibited basis in any prescreened solicitation	<input type="checkbox"/>	<input type="checkbox"/>

2. Compliance audit function: Does the institution attempt to detect prohibited disparate treatment by self-test or self-evaluation?

Note: A self-test is any program, practice, or study that is designed and specifically used to assess the institution's compliance with the ECOA and the FHAct statute or regulation and that creates data or factual information that is not otherwise available and cannot be derived from loan, application, or other records related to credit transactions (12 CFR 202.15(b)(1) and 24 CFR 100.141). The report, results, and many other records associated with a self-test are privileged unless an institution voluntarily discloses the report or results or otherwise forfeits the privilege. See 12 CFR 202.15(b)(2) and 24 CFR 100.142(a) for a complete listing of the types of information covered by the privilege. A self-evaluation, while generally having the same purpose as a self-test, does not create any new data or factual information, but uses data readily available in loan or application files and other records used in credit transactions, and therefore does not meet the self-test definition. See the section "Streamlining Examinations" at the end of this appendix for more information about self-tests and self-evaluations.

While examiners may request the results of self-evaluations, they should not request the results of self-tests or any of the information listed in 12 CFR 202.15(b)(2) and 24 CFR 100.142(a). If an institution discloses the self-test report or results to its regulator, it will lose the privilege. The following items are intended to obtain information about the bank's approach to self-testing and self-evaluation, not the findings. Complete the checklist below for each self-evaluation and each self-test for which the institution voluntarily discloses the report or results. Evaluating the results of self-evaluations and voluntarily disclosed self-tests is described in the section "Streamlining Examinations" at the end of this appendix.

For transactions within the proposed scope of the examination, check the "Lender-wide" box if the answer to the following questions is "yes."

a. Are the transactions reviewed by an independent analyst who		
Is directed to report objective results	<input type="checkbox"/>	<input type="checkbox"/>
Has an adequate level of expertise	<input type="checkbox"/>	<input type="checkbox"/>
Produces written conclusions	<input type="checkbox"/>	<input type="checkbox"/>

	Within proposed scope	Lender-wide
b. Does the bank's approach to self-testing or self-evaluation call for		
Attempting to explain major patterns shown in the HMDA or other loan data	<input type="checkbox"/>	<input type="checkbox"/>
Determining whether actual practices and standards differ from stated ones, and basing the evaluation on the actual practices	<input type="checkbox"/>	<input type="checkbox"/>
Evaluating whether the reasons cited for denial are supported by facts relied on by the decision maker at the time of the decision	<input type="checkbox"/>	<input type="checkbox"/>
Comparing the treatment of prohibited-basis-group applicants with the treatment of control group applicants	<input type="checkbox"/>	<input type="checkbox"/>
Obtaining explanations from decision makers for any unfavorable treatment of the prohibited-basis group that departed from policy or customary practice	<input type="checkbox"/>	<input type="checkbox"/>
Covering significant decision points in the loan process where disparate treatment or discouragement might occur, including		
The decision to approve or deny	<input type="checkbox"/>	<input type="checkbox"/>
Pricing	<input type="checkbox"/>	<input type="checkbox"/>
Other terms and conditions	<input type="checkbox"/>	<input type="checkbox"/>
Covering at least as many transactions as examiners would independently cover if they were using the fair lending sample size tables for a product having the application volumes of the product to be evaluated	<input type="checkbox"/>	<input type="checkbox"/>
Maintaining information concerning personal characteristics collected as part of a self-test separately from application or loan files	<input type="checkbox"/>	<input type="checkbox"/>
Providing timely analysis of the data	<input type="checkbox"/>	<input type="checkbox"/>
Taking appropriate and timely corrective action	<input type="checkbox"/>	<input type="checkbox"/>
c. In the bank's plan for comparing the treatment of prohibited-basis-group applicants with that of control group applicants,		
Are control and prohibited-basis groups based on a prohibited basis found in the ECOA or the FHAct and defined clearly to isolate that prohibited basis for analysis?	<input type="checkbox"/>	<input type="checkbox"/>
Are appropriate data required to document treatment of applicants and the relative qualifications vis-à-vis the requirement in question?	<input type="checkbox"/>	<input type="checkbox"/>
Are the data required the data on which decisions were based, not later or irrelevant information?	<input type="checkbox"/>	<input type="checkbox"/>
Are the denied applicants' qualifications related to the stated reason for denial compared with the corresponding qualifications of approved applicants?	<input type="checkbox"/>	<input type="checkbox"/>
Are comparisons designed to identify instances in which prohibited-basis-group applicants were treated less favorably than control group applicants who were no better qualified?	<input type="checkbox"/>	<input type="checkbox"/>
Is the evaluation designed to determine whether control and prohibited-basis-group applicants were treated differently in the processes by which the bank helped applicants overcome obstacles and by which their qualifications were enhanced?	<input type="checkbox"/>	<input type="checkbox"/>

	Within proposed scope	Lender- wide
Are responses and explanations required for any apparent disparate treatment on a prohibited basis or other apparent violations of credit rights?	<input type="checkbox"/>	<input type="checkbox"/>
Are reasons cited by credit decision makers to justify or explain instances of apparent disparate treatment verified?	<input type="checkbox"/>	<input type="checkbox"/>
d. For self-tests under the ECOA that involved the collection of applicant personal characteristics, did the institution		
• Develop a written plan that describes or identifies the		
Specific purpose of the self-test	<input type="checkbox"/>	<input type="checkbox"/>
Methodology to be used	<input type="checkbox"/>	<input type="checkbox"/>
Geographic areas to be covered	<input type="checkbox"/>	<input type="checkbox"/>
Types of credit transactions to be reviewed	<input type="checkbox"/>	<input type="checkbox"/>
Entity that will conduct the test and analyze the data	<input type="checkbox"/>	<input type="checkbox"/>
Timing of the test, including start and end dates or the duration of the self-test	<input type="checkbox"/>	<input type="checkbox"/>
Other related self-test data that are not privileged	<input type="checkbox"/>	<input type="checkbox"/>
• Disclose at the time applicant characteristic information is requested that		
The applicant will not be required to provide the information	<input type="checkbox"/>	<input type="checkbox"/>
The creditor is requesting the information to monitor its compliance with the ECOA	<input type="checkbox"/>	<input type="checkbox"/>
Federal law prohibits the creditor from discriminating on the basis of this information or on the basis of an applicant's decision not to furnish the information	<input type="checkbox"/>	<input type="checkbox"/>
If applicable, certain information will be collected based on visual observation or applicant surname if not provided by the applicant	<input type="checkbox"/>	<input type="checkbox"/>
3. Correcting discriminatory conduct		
a. Determine whether the lender has provisions to take appropriate corrective action and provide adequate relief to victims for any violations in the transactions planned for review.		
• Who is to receive the results of a self-evaluation or voluntarily disclosed self-test?		
• What decision process is supposed to follow delivery of the information?		
• Is feedback to be given to staff whose actions are reviewed?		
• What types of corrective action may occur?		
• Are customers to be		
Offered credit if they were improperly denied	<input type="checkbox"/>	<input type="checkbox"/>
Compensated for any damages, both out-of-pocket and compensatory	<input type="checkbox"/>	<input type="checkbox"/>
Notified of their legal rights	<input type="checkbox"/>	<input type="checkbox"/>

	Within proposed scope	Lender- wide
b. Other corrective action		
Are institutional policies or procedures that may have contributed to the discrimination to be corrected?	<input type="checkbox"/>	<input type="checkbox"/>
Are employees involved to be trained and/or disciplined?	<input type="checkbox"/>	<input type="checkbox"/>
Is the need for community outreach programs and/or changes in marketing strategy or loan products to better serve minority segments of the lender's market to be considered?	<input type="checkbox"/>	<input type="checkbox"/>
Are audit and oversight systems to be improved in order to ensure that there is no recurrence of any identified discrimination?	<input type="checkbox"/>	<input type="checkbox"/>

PROCEDURES FOR CREDIT SCORING ANALYSIS

The procedures in this section are intended to assist examiners in arriving at supportable conclusions with respect to an institution's record of nondiscrimination when the focal point involves a product for which the institution uses automated underwriting or when credit scoring risk factors make such a product the focal point.

A. Structure and Organization of the Scoring System

Determine the use of credit scoring at the institution, including

1. For each customized credit scoring model or scorecard for any product, or for any credit scoring model used in connection with a product held in portfolio, identify
 - a. The number of models or scorecards applied to a particular product, and how the modules relate to each other
 - b. The purposes for which each scorecard is employed (for example, to arrive at an approval decision, set credit limits, set pricing, determine processing requirements)
 - c. The developer of each scorecard used (for example, in-house department, affiliate, independent vendor) and the development population used
 - d. The types of monitoring reports generated (including front-end, back-end, account management, and any disparate-impact analyses), the frequency of generation, and recent copies of each report
 - e. All policies applicable to the use of credit scoring
 - f. Training materials and programs on credit scoring for employees, agents, and brokers involved in any aspect of retail lending
 - g. Any action taken to revalidate or recalibrate any model or scorecard used during the exam period, and the reasons for the action
 - h. The number of all high-side and low-side overrides for each type of override occurring during the exam period, and any guidance given to employees on their ability to override
 - i. All cutoffs used for each product scorecard throughout the exam period, and the reasons for any change made during the period
 - j. All variables scored by each product scorecard, and the values that each variable may take

- k. The method used to select for disclosure those adverse action reasons arising from application of the model or scorecard
2. For each judgmental underwriting system that includes as an underwriting criterion a standard credit bureau or secondary-market credit score, identify
 - a. The vendor of each credit score, and any vendor recommendation or guidance on the use of the score relied upon by the institution
 - b. The institution's basis for using the particular bureau or secondary-market score, the cutoff standards for each product's underwriting system, and the reasons for any changes to these during the exam period
 - c. The number of exceptions or overrides made to the credit score component of the underwriting criteria, and the basis for those exceptions or overrides, including any guidance given to employees on their ability to depart from credit score underwriting standards
 - d. The types of monitoring reports generated on the judgmental system or its credit scoring component (including front-end, back-end, differential processing, and disparate-impact analysis), the frequency of generation, and recent copies of each report

B. Adverse Action Disclosure Notices

1. Determine the methodology used to select the reasons for denial based on the applicant's credit score. Compare the methodology used with the examples cited in the commentary to Regulation B and determine acceptability against that standard. Identify any consumer requests for reconsideration of credit score denial, and review the action taken by management for consistency across applicant groups.
2. When a credit score is used to differentiate application processing and an applicant is denied for failure to attain a judgmental underwriting standard that would not be applied if the applicant had received a better credit score (thereby being considered in a different—presumably less stringent—application-processing group), ensure that the adverse action notice also discloses the bases on which the applicant failed to attain the credit score required for consideration in the less-stringent processing group.

C. Disparate Treatment in the Application of Credit Scoring Programs

1. Determine what controls and policies management has implemented to ensure that the institution's credit scoring models or credit score criteria are not applied in a discriminatory manner. In particular,
 - a. Examine institution guidance on using the credit scoring system, on handling overrides, and on processing applicants. Determine how well that guidance is understood and followed by the targeted employees and whether management monitors compliance with the guidance.
 - b. Examine institution policies that permit overrides or that provide for different processing or underwriting requirements based on geographic identifiers or borrower score ranges, to ensure that they do not treat protected-group applicants differently from other, similarly situated applicants.
2. Determine whether any of the reasons for granting credit to control group applicants who are low-side overrides apply to any prohibited-basis denials whose credit score was equal to or greater than the lowest score among the low-side overrides. If such cases are identified, obtain and evaluate management's explanation for the different treatment and determine whether a fair lending violation exists.
3. Determine whether any of the bases for denying credit to any prohibited-basis applicants who are high-side overrides apply to any control group approvals whose credit score was equal to or less than the highest score among the prohibited-basis high-side overrides. If such cases are identified, obtain and evaluate management's explanation of why such different treatment is not a fair lending violation.
4. If credit scores are used to sort applicants into groups that receive different processing or are required to meet additional underwriting requirements (for example, "tiered-risk underwriting"), perform a comparative file review that evaluates whether all applicants within each group are treated equally, or confirm the results and adequacy of management's comparative file review.

D. Credit Scoring Systems That Include Age

Regulation B does not require initial validation or periodic revalidation of a credit scoring system

unless it considers age. There are two ways a credit scoring system can consider age: (1) the system can be split into different scorecards depending on the age of the applicant or (2) age may be directly scored as a variable. Both features may be present in some systems. Regulation B requires all credit scoring systems that consider age in either of these ways to be validated (in the language of the regulation, empirically derived, demonstrably and statistically sound (EDDSS)).

1. Age-split scorecards—If a system is split into only two cards and one card covers a wide age range that encompasses elderly applicants (applicants 62 or older), the system is treated as considering, but not scoring, age. Typically, the younger scorecard in an age-split system is used for applicants under a specific age between 25 and 30. It de-emphasizes factors such as the number of trade lines and the length of employment and increases the negative weight of any derogatory information on the credit report. Systems such as these do not raise the issue of assigning a negative factor or value to the age of an elderly applicant. However, if age is directly scored as a variable (whether or not the system is age-split), or if elderly applicants are included in a card with a narrow age range in an age-split system, the system is treated as scoring age.
2. Scorecards that score age directly, in addition to meeting the EDDSS requirement, the creditor must ensure that the age of an elderly applicant is not assigned a negative factor or value. (See staff commentary about 12 CFR 202.2(p) and 202.6(b)(2).) A negative factor or value means using a factor, value, or weight that is less favorable than the creditor's experience warrants *or* is less favorable than the factor, value, or weight assigned to the most favored age group below the age of 62 (12 CFR 202.2(v)).

E. Examination for Empirical Derivation and Statistical Soundness

Regulation B requires credit scoring systems that use age to be empirically derived *and* demonstrably and statistically sound. This means that a system must fulfill the requirements of section 202.2(p)(1)(i)–(iv). Obtain documentation provided by the developer of the system and consult the Board's most recent guidance for making that determination.

EVALUATING RESPONSES TO EVIDENCE OF DISPARATE TREATMENT

A. Responses to Comparative Evidence of Disparate Treatment

The following are responses that a lender may offer—separately or in combination—to explain that the appearance of illegal disparate treatment is misleading and that no violation has in fact occurred. The responses, *if true*, rebut the appearance of disparate treatment. Examiners must carefully evaluate the validity and credibility of the responses.

1. The lender's personnel were unaware of the prohibited-basis identity of the applicant(s)—If the lender claims to have been unaware of the prohibited-basis identity (race, etc.) of an applicant or neighborhood, ask it to show that the application in question was processed in such a way that the institution's staff that made the decisions could not have learned the prohibited-basis identity of the applicant.

If the product is one for which the institution maintains prohibited-basis monitoring information, assume that all employees could have taken those facts into account. Assume the same if there was face-to-face contact between any employee and the customer.

If there are other facts about the application from which an ordinary person would have recognized the applicant's prohibited-basis identity (for example, the surname appears to be Hispanic), assume that the institution's staff drew the same conclusions. If the racial character of a community is in question, ask the institution to provide persuasive evidence why its staff would *not* know the racial character of any community in its service area.

2. The difference in treatment was justified by differences in the applicants (applicants not "similarly situated")—Ask the lender to account for the difference in treatment by pointing out a specific difference between the applicants' qualifications. This difference may include some factor that was not captured in the application but that legitimately makes one applicant more or less attractive to the lender, or some nonprohibited factor related to the processing of their applications. The difference identified by the lender must be one that is important enough to justify the different treatment in question, not a meaningless difference.

The factors commonly cited to show that applicants are not similarly situated fall into two groups: those that can be evaluated by how consistently they are handled in other transac-

tions and those that cannot be evaluated in that way.

- a. Verifying "not similarly situated" explanations by consistency—If a factor cited by the lender to justify favorable treatment for a control group applicant also exists for an otherwise similar prohibited-basis applicant who was treated *unfavorably*, the appearance of disparate treatment remains. Similarly, the appearance of disparate treatment remains if a factor cited by the lender to justify *unfavorable* treatment for a prohibited-basis applicant also exists for a control group applicant who received favorable treatment. If this is not so, ask the lender to demonstrate that the factor cited in its explanation was used consistently for control group and prohibited-basis applicants.

Among the responses that should be evaluated this way are

- *Customer relationship*—Ask the lender to document that a customer relationship was also sometimes considered to the benefit of prohibited-basis applicants or that its absence worked against control group customers.
- *"Loan not saleable or insurable"*—If the file review is still in progress, be alert for loans approved despite the claimed fatal problem. At a minimum, ask the lender to produce the text of the secondary-market or insurer's requirement in question.
- *Difference in standards or procedures between branches or underwriters*—Ask the lender to provide transactions documenting that the two branches or underwriters consistently applied its standards or procedures to the prohibited-basis and control group applications it processed, and that each served similar proportions of the prohibited-basis group.
- *Difference in applying the same standard (difference in "strictness") between underwriter, branches, or similar group*—Ask the lender to provide transactions documenting that the stricter employee, branch, or similar group was strict for both prohibited-basis and control group applicants and that the other was lenient for both, and that the two entities served similar proportions of the prohibited-basis group. The best support for this "same standard" approach would be evidence that prohibited-basis applicants received favorable treatment from the "lenient" branch and control group applicants received less-favorable treatment from the "strict" branch.

- *Standards or procedures changed during period reviewed*—Ask the lender to provide transactions documenting that during each period the standards were applied consistently to both prohibited-basis and control group applicants.
 - *Employee misunderstood standards or procedures*—Ask the lender to provide transactions documenting that the misunderstanding influenced both prohibited-basis and control group applications. If such documentation is not available and if the misunderstanding is a reasonable mistake, conclude that no violation exists.
- b. Evaluating “not similarly situated” explanations by other means—If consistency cannot be evaluated, *consider* an explanation *favorably* even without examples of its consistent use if
- The factor is documented to exist in (or be absent from) the transactions, as claimed by the institution
 - The factor is one a prudent lender would consider
 - A file review found no evidence that the factor is applied selectively on a prohibited basis (in other words, the lender’s explanation is “not inconsistent with available information”)
 - The lender’s description of the transaction is generally consistent and reasonable

Some factors that may be impossible to compare for consistency are
 - *An unusual underwriting standard*—Ask the lender to show that the standard is prudent. If the standard is prudent and not inconsistent with other information, accept this explanation even though there is no documentation that it is used consistently.
 - *“Close calls”*—The lender may claim that underwriters’ opposite decisions on similar applicants reflects legitimate discretion that examiners should not second guess. This explanation is *not* acceptable for *identical* applicants with different results, but it is acceptable when the applicants have differing strengths and weaknesses that different underwriters might reasonably weigh differently. However, do not accept the explanation if other files reveal that these “strengths” or “weaknesses” are counted or ignored selectively on a prohibited basis.
 - *“Character loan”*—Expect the lender to identify a specific history or specific facts that make the applicant treated favorably
 - a better risk than those treated less favorably.
- *“Accommodation loan”*—There are many legitimate reasons that may make a transaction appealing to a lender apart from the familiar qualifications demanded by the secondary market and insurers. For example, a customer may be an employee of an important business customer, related to or referred by an important customer, or a political or entertainment figure who would bring prestige to the institution. It is not illegal discrimination to make a loan to an otherwise unqualified control group applicant who has such attributes, while denying a loan to an otherwise similar prohibited-basis applicant who does not. However, be skeptical when the lender cites reasons for “accommodations” that an ordinary prudent lender would not value.
 - *“Gut feeling”*—Be skeptical when lenders justify an approval or denial by a general perception or reaction to the customer. Such a perception or reaction may be linked to a racial or other stereotype that legally must not influence credit decisions. Ask whether any specific event or fact generated the reaction. Often, the lender can cite something specific that made him or her confident or uncomfortable about the customer. There is no discrimination if it is credible that the lender indeed considered such a factor and did not apply it selectively on a prohibited basis.
- c. Following up with customer—If the lender’s explanation of the handling of a particular transaction is based on customer traits, actions, or desires not evident from the file, consider obtaining Board authorization to contact the customer to verify the lender’s description. Such contacts need not be limited to possible victims of discrimination but may include control group applicants or other witnesses.
3. The different results stemmed from an inadvertent error—If the lender claims that an *identified* error, such as miscalculation or misunderstanding, caused the favorable or unfavorable result in question, evaluate whether the facts support the assertion that such an event occurred.
- If the lender claims that an *unidentified* error caused the favorable or unfavorable result in question, expect the lender to provide evidence that discrimination is inconsistent with its demonstrated conduct, and therefore that discrimination is the less logical interpretation of the

situation. Consider the context (as described below).

4. The apparent disparate treatment on a prohibited basis is a misleading portion of a larger pattern of random inconsistencies—Ask the institution to provide evidence that the unfavorable treatment is not limited to the prohibited-basis group and that the favorable treatment is not limited to the control group. Without such examples, do not accept a lender's unsupported claim that otherwise inexplicable differences in treatment are distributed randomly.

If the lender can document that similarly situated prohibited-basis applicants received the favorable treatment in question approximately as frequently as, and in comparable degree to, the control group applicants, conclude that there is no violation.

Note: "Random inconsistency" may be a reasonable explanation only if "similarly situated" control group applicants were also treated unequally.

5. Loan terms and conditions—The same analyses described in the preceding sections with regard to decisions to approve or deny loans also apply to pricing differences. Risks and costs are legitimate considerations in setting prices and other terms and conditions of loan products. However, generalized reference by the lender to "cost factors" is insufficient to explain pricing differences.

If the lender claims that specific borrowers received different terms or conditions because of cost or risk considerations, ask the lender to identify the specific risk or cost differences between them.

If the lender claims that specific borrowers received different terms or conditions because they were not similarly situated as negotiators, consider whether application records might provide relevant evidence. If the records are not helpful, consider seeking authorization to contact customers to learn whether the lender in fact behaved comparably toward prohibited-basis and control group customers. The objective of the contacts would be to obtain such information as the lender's opening quote of terms to the customer and an account of the progress of the negotiations.

If the institution responds that an average price difference between the control and prohibited-basis groups is based on cost or risk factors, ask the lender to identify specific risk or cost differences that are significant enough to justify the pricing differences between individual control group applicants that received the lowest rates and prohibited-basis-group applicants that received the highest rates. If the distinguishing factors cited by the institution are

legitimate and verifiable as described in the sections above, remove those applications from the average price calculation. If the average prices for the remaining control group and prohibited-basis-group members still differ more than minimally, consult with an economist at the Reserve Bank or the Board about obtaining an analysis of whether the difference is statistically significant. Conclude that a violation exists only if (1) there is evidence of disparate treatment of similarly situated borrowers or (2) there is a particular risk factor that meets all the criteria for a disproportionate-adverse-impact violation.

B. Responses to Overt Evidence of Disparate Treatment

1. Descriptive references vs. lending considerations—A reference to race, gender, or other prohibited basis does not constitute a violation if it is merely descriptive—for example, "the applicant was young." In contrast, when the reference reveals that the prohibited factor influenced the lender's decisions or customer behavior, treat the situation as an apparent violation to which the lender must respond.
2. Personal opinions vs. lending considerations—If an employee involved with credit availability states unfavorable views regarding a racial group, gender, or other prohibited basis but does not explicitly relate those views to credit decisions, review that employee's credit decisions for possible disparate treatment of the prohibited-basis group described unfavorably. If there are no instances of apparent disparate treatment, treat the employee's views as permissible private opinions. Inform the lender that such views create a risk of future violations.
3. Stereotypes related to credit decisions—When a prohibited factor influences a credit decision through a stereotype related to creditworthiness, there is an apparent violation, even if the action based on the stereotype seems well intended—for example, a loan denial because "a single woman could not maintain a large house." If the stereotyped beliefs are offered as "explanations" for unfavorable treatment, regard such unfavorable treatment as apparent illegal disparate treatment. If the stereotype is only a general observation unrelated to particular transactions, review that employee's credit decisions for possible disparate treatment of the prohibited-basis group in question. Inform the lender that such views create a risk of future violations.
4. Indirect reference to a prohibited factor—If negative views related to creditworthiness are described in non-prohibited terms, consider

whether the terms would commonly be understood as surrogates for prohibited terms. If so, treat the situation as if explicit prohibited-basis terms were used. For example, a lender's statement that "It's too risky to lend north of 110th Street" might be reasonably interpreted as a refusal to lend because of race if that portion of the lender's lending area north of 110th Street was predominantly black and the area south was predominantly white.

5. Lawful use of a prohibited factor

a. Special-Purpose Credit Program (SPCP)—If a lender claims that its use of a prohibited factor is lawful because it is operating an SPCP, ask the lender to document that its program conforms to the requirements of Regulation B. An SPCP must be defined in a written plan that existed before the lender made any decisions on loan applications under the program. The written plan must

- Demonstrate that the program will benefit persons who would otherwise be denied credit or receive credit on less favorable terms and
- State the time period the program will be in effect, or when it will be re-evaluated.

No provision of an SPCP should deprive people who are not part of the target group of rights or opportunities they otherwise would have. Qualified programs operating on an otherwise-prohibited basis will not be cited as a violation.

Note: Advise the lender that even though examiners found that a program is a lawful SPCP, this finding is not absolute security against legal challenge by private parties.

Suggest that an institution concerned about legal challenge from other quarters use exclusions or limitations that are not prohibited by the ECOA or the FHAct, such as "first-time homebuyer."

b. Second-review program—Such programs are permissible if they do no more than ensure that lending standards are applied fairly and uniformly to all applicants. For example, it is permissible to review the proposed denial of applicants who are members of a prohibited-basis group by comparing their applications with the approved applications of similarly qualified individuals who are in the control group to determine if the applications were evaluated consistently.

Ask the lender to demonstrate that the program is a safety net that merely attempts to prevent discrimination and does not involve underwriting terms or practices that are preferential on a prohibited basis.

Statements indicating that the mission of the program is to apply different standards or efforts on behalf of a particular racial or other group constitute overt evidence of disparate treatment. Similarly, there is a violation if comparative analysis of applicants who are processed through the second review and those who are not discloses dual standards related to the prohibited basis.

c. Affirmative marketing and advertising programs—Affirmative marketing and advertising efforts that do not involve application of different lending standards are permissible under both the ECOA and the FHAct. For example, special outreach to a minority community is permissible.

TABLES FOR DETERMINING SAMPLE SIZES FOR FAIR LENDING EXAMINATIONS

A. Underwriting (Accept/Deny) Comparisons

	Sample 1 Prohibited-basis denials Number of denials			Sample 2 Control group approvals Number of approvals		
	5–50	51–150	More than 150	20–50	51–250	More than 250
Minimum to review	All	51	75	20	51	100
Maximum to review	50	100	150	5× prohibited-basis sample (up to 50)	5× prohibited-basis sample (up to 125)	5× prohibited-basis sample (up to 300)

B. Terms-and-Conditions Comparisons

	Sample 1 Prohibited-basis denials Number of approvals			Sample 2 Control group approvals Number of approvals		
	5–25	26–100	More than 100	20–50	51–250	More than 250
Minimum to review	All	26	50	20	40	60
Maximum to review	25	50	75	5× prohibited-basis sample (up to 50)	5× prohibited-basis sample (up to 75)	5× prohibited-basis sample (up to 100)

Explanatory notes for sample size tables

1. If both underwriting and terms-and-conditions comparisons are being conducted, use the same control group approval sample for both tasks.
2. If there are fewer than five prohibited-basis denials or fewer than twenty control group approvals, refer to the instructions regarding sample size in the “Examination Procedures” chapter.
3. “Minimum” and “maximum” sample sizes—Select a sample size between the minimum and maximum based on the outcome of the compliance management review conducted as described in part II of the examination procedures. Once the sample size has been determined, select individual transactions judgmentally. Refer to the procedures.
4. If two prohibited-basis groups (for example, black and Hispanic) are being compared with one control group, select a control group that is five times larger than the larger prohibited-basis-group sample, up to the maximum.
5. If the institution’s discrimination risk profile identifies significant differences in withdrawal or incomplete activity between the control and prohibited-basis groups, or if the number of marginal prohibited-basis-group files available for sampling is small, consider supplementing samples by applying the following rules:
 - Determine whether the applications from the prohibited-basis group are characterized correctly. Applications classified as withdrawn or incomplete *after* the applicant received an offer of credit that includes pricing should have been reported under Regulation C as approved but not accepted. As a result, these applications should be included as prohibited-basis-group approvals in a terms-and-conditions comparative file analysis.
 - Consider whether applications classified as incompletes should be reclassified as denials. Determine if the “incomplete” classification for the prohibited-basis group occurred because the applicants failed to answer a question on the application that would have resulted in a denial. If so, include those group incompletes as denials for that reason when conducting an underwriting comparative file analysis.

MARGINAL TRANSACTIONS

A. Marginal Denials

Denied applications with any or all the following characteristics are “marginal.” Such denials are compared with marginal approved applications. Marginal denials include those that

- Were close to satisfying the requirement that the adverse action notice said was the reason for denial
- Were denied by the lender’s rigid interpretation of inconsequential processing requirements
- Were denied quickly for a reason that normally would take a longer time for an underwriter to evaluate
- Involved an unfavorable subjective evaluation of facts that another person might reasonably have interpreted more favorably (for example, whether late payments actually showed a “pattern,” or whether an explanation for a break in employment was “credible”)
- Resulted from the lender’s failure to take reasonable steps to obtain necessary information
- Received unfavorable treatment as the result of a departure from customary practices or stated policies. For example, if it is the lender’s stated policy to request an explanation of derogatory credit information, a failure to do so for a prohibited-basis applicant would be a departure from customary practices or stated policies, even if the derogatory information seems to be egregious.
- Were similar to approved control group applications that received unusual consideration or service but were not provided such consideration or service
- Received unfavorable treatment (for example, were denied or given various conditions or more processing obstacles) but appeared to meet the lender’s stated requirements for favorable treatment (for example, approval on the terms sought)
- Received unfavorable treatment related to a policy or practice that was vague, or lacked file documentation of the applicant’s qualifica-

tions related to the reason for denial or other factor

- Met common secondary-market or industry standards even though failing to meet the lender’s more-rigid standards
- Had a strength that a prudent lender might believe outweighed the weaknesses cited as the basis for denial
- Were submitted by applicants who had a history of previously meeting a monthly housing obligation equivalent to or higher than the proposed debt
- Were denied for an apparently “serious” deficiency that might easily have been overcome. For example, an applicant’s total debt ratio of 50%, which grossly exceeds the lender’s guideline of 36%, may be easily corrected if the application lists sufficient assets to pay off nonhousing debts and reduce the ratio to the guideline, or if the lender were to count excluded part-time earnings described in the application.

B. Marginal Approvals

Approved applications with any or all of the following characteristics are “marginal.” Such approvals are compared with marginal denied applications. Marginal approvals include those

- Whose qualifications satisfied the lender’s stated standard, but very narrowly
- That bypassed stated processing requirements (such as verifications or deadlines)
- For which stated creditworthiness requirements were relaxed or waived
- That fell short of common secondary-market or industry lending standards because the lender’s own standards were not clear
- That a prudent, conservative lender might have denied
- Whose qualifications were raised to a qualifying level by assistance, proposals, counteroffers, favorable characterizations or questionable qualifications, or similar means
- That in any way received unusual service or consideration that facilitated obtaining the credit

POTENTIAL SCOPING INFORMATION

Listed below is a full range of documentation and other information that might be reviewed in an examination. In that sense, the list is a “menu” of resources to be considered and selected from, depending on the nature and scope of the examination being conducted. The selection of one or more particular items from the list for review in a particular examination should, of course, be based on consideration of any burdens to the Reserve Bank and the lender in assembling and providing the selected item.

A. Internal Agency Documents and Records

1. Previous examination reports and related workpapers for the most recent compliance, CRA, and safety and soundness examinations
2. Demographic data for the institution’s community
Comment. Examiners should review the most recent agency demographic data to obtain information on the characteristics of the institution’s assessment or market areas.

B. Information from the Institution

Comment. Before beginning a compliance examination, examiners should request that the institution provide the information outlined below. This request should be made far enough in advance of the on-site phase of the examination to facilitate compliance by the institution. For some institutions, examiners may not be able to review some of this information until the on-site examination.

1. Institution’s compliance program (for examinations that will include analysis of the lender’s compliance program)
 - a. Organization charts identifying those individuals who have lending responsibilities or compliance, HMDA, or CRA responsibilities, together with job descriptions for each position
 - b. Lists of any pending litigation or administrative proceedings concerning fair lending matters
 - c. Results of self-evaluations or self-tests if the institution chooses to share the report or results; and copies of audit or compliance reviews of the institution’s program for compliance with fair lending laws and regulations, including both internal and independent audits
 Note: The request should advise the lender that it is not required to disclose the report or results of any self-tests of the type

protected under amendments to the ECOA and the FHAct.

- d. Complaint file
 - e. Any written or printed statements describing the lender’s fair lending policies or procedures
 - f. Training materials related to fair lending issues, including records of attendance
2. Lending policies and loan volume
 - a. Internal underwriting guidelines and lending policies for all consumer and commercial loan products
Comment. If guidelines or policies differ by branch or other geographic location, request copies of each variation.
 - b. A description of any credit scoring systems in use now or during the exam period
Comment. Inquire as to whether a vendor or in-house system is used; the date of the last verification; the factors relied on to construct any in-house system; and, if applicable, any judgmental criteria used in conjunction with the scoring system.
 - c. Pricing policies for each loan product and for both direct and indirect loans
Comment. The lender should be specifically asked whether its pricing policies for any loan products include the use of “overages.” The lender should also be asked whether the lender offers any “subprime” loan products for “B,” “C,” or “D” risk-level customers or otherwise uses any form of risk-based pricing. A similar inquiry should be made regarding the use of any cost-based pricing. If any of these three forms are or have been in use since the last exam, the lender should provide pricing policy and practice details for each affected product, including the lender’s criteria for differentiating between each risk or cost level. Regarding indirect lending, the lender should be asked to provide any forms of agreement (including compensation) with brokers or dealers, together with a description of the roles that both the lender and the broker or dealer play at each stage of the lending process.
 - d. A description of each form of compensation for all lending personnel and managers
 - e. Advertising copy for all loan products
 - f. The most recent HMDA-LAR, including unreported data if available (Information should be provided on diskette, if possible.)
Comment. The integrity of the institution’s HMDA-LAR data should be verified prior to the pre-examination analysis. Verification should take place approximately two to

three months before the on-site phase of the examination.

- g. Any existing loan registers for each non-HMDA loan product
Comment. Loan registers for the three-month period preceding the date of the examination, together with any available lists of declined loan applicants for the same period, should be requested. Registers and lists should contain, to the extent available, the complete name and address of loan applicants and applicable loan terms, including loan amount, interest rate, fees, repayment schedule, and collateral codes.
- h. A description of any databases maintained for each loan product, including a description of all data fields within the database
- i. Forms used in the application and credit evaluation process for each loan product
Comment. At a minimum, this request should include all types of credit applications, forms requesting financial information, underwriter worksheets, any form used for the collection of monitoring information, and any quality-control or second-review forms or worksheets.
- j. Lists of service providers
Comment. Service providers may include realtors, real estate developers, apprais-

ers, home improvement contractors, and private mortgage insurance companies. Request the full name and address and geographic area served by each provider. Also request documentation as to any fair lending requirements imposed on, or commitments required of, any of the lender's service providers.

- k. Addresses of any Internet site(s)
Comment. Internet "home pages" or similar sites that a lender may install on the Internet may provide information concerning the availability of credit or the means of obtaining it. All such information must comply with the nondiscrimination requirements of the fair lending laws. Moreover, future enhancements to the Internet may include the capacity to conduct partial or complete credit transactions via that medium. Accordingly, it is important for examiners to review a lender's Internet sites to ensure that all the information or procedures found at the sites are in compliance with applicable provisions of the fair lending statutes and regulations.
3. Community information
- a. Demographic information prepared or used by the institution
 - b. Any fair lending complaints received, and lender responses to these complaints

SPECIAL ANALYSES

A. Disproportionate-Adverse-Impact Violations

When all five conditions listed below exist, discuss with Reserve Bank management whether to present the situation to the lender and solicit an explanation of the lender's business justification for the policy or criterion that appears to cause the disproportionate adverse impact. Note that condition 5 can be satisfied by either of two alternatives.

The contacts between examiners and lenders described in this section are information-gathering contacts within the context of the examination and are not intended to serve as the formal notices and opportunities for response that an agency's enforcement process might provide. Also, the five conditions are not intended as authoritative statements of the legal elements of a disproportionate-adverse-impact proof of discrimination; they are paraphrases intended to give examiners practical guidance on situations that call for more scrutiny and on what additional information is relevant.

Note: Even if it appears likely that a policy or criterion causes a disproportionate adverse impact on a prohibited basis (condition 3), do not proceed with this analysis if the policy or criterion is obviously related to predicting creditworthiness or to some other basic aspect of prudent lending and if there appears to be no equally effective alternative for it. Examples are reliance on credit reports and use of debt-to-income ratios.

Conditions

1. A specific policy or criterion is involved—The policy or criterion suspected of producing a disproportionate adverse impact on a prohibited basis must be clear enough that the nature of the action to correct the situation can be determined.

Note: Gross HMDA denial or approval rate disparities are not appropriate for a disproportionate-adverse-impact analysis because they typically cannot be attributed to a specific policy or criterion. Similarly, a lender's policies of allowing employees to exercise discretion and to negotiate terms or conditions of credit can better be described as the absence of policies or criteria than as a situation in which a policy or criterion generates a disproportionate adverse impact. Although broad discretion and vague standards raise concerns about discrimination, examiners should focus on possible disparate treatment.

2. The stated terms of the policy or criterion are

neutral with respect to the prohibited bases of discrimination.

3. The disparity on a prohibited basis is significant—The difference between the rate at which prohibited-basis-group members are harmed or excluded by the policy or criterion and the rate for control group members must be large enough that it is unlikely that it could have occurred by chance. If there is reason to suspect that a significant disproportionate adverse impact may exist, consult with the Board.
4. There is a causal relationship between the policy or criterion and the adverse result—The link between the policy or criterion and the harmful or exclusionary effect must not be speculative. It must be clear that changing or terminating the policy or criterion would reduce the disproportion in the adverse result.
5. Either a or b:
 - a. The policy or criterion has no clear rationale, appears to exist merely for convenience or to avoid a minimal expense, or is far removed from commonsense or standard industry underwriting considerations or lending practices.

The legal doctrine of disproportionate adverse impact says that the policy or criterion that causes the impact must be justified by "business necessity" if the lender is to avoid a violation. There is very little authoritative legal interpretation of that term with regard to lending, but that should not stop examiners from making the preliminary inquiries called for in these examination procedures. For example, the rationale is not clear for basing credit decisions on factors such as location of residence, income level (per se rather than relative to debt), and accounts with a finance company. If black applicants were denied loans significantly more frequently than white ones because they failed a lender's minimum income requirement, it would appear that the first four conditions plus 5a existed; therefore, examiners should consult with Reserve Bank management about obtaining the lender's response, as described in the next section.

- b. Alternatively, even if there is a sound justification for the policy, it appears that there may be an equally effective alternative for accomplishing the same objective with a smaller disproportionate adverse impact.

The law does not require a lender to abandon a policy or criterion that is clearly the most effective method of accomplishing a business objective. However, if an alternative that is approximately as effective is

available that would cause a less-severe impact, the policy or criterion in question will be a violation.

At any stage of the analysis of possible disproportionate adverse impact, if there appears to be such an alternative and the first four conditions exist, consult with the Board about how to evaluate whether the alternative would be equally effective and would cause a less-severe impact. If the conclusion is that it would, solicit a response from the lender, as described in the next section.

Obtaining the Lender's Response

If the first four conditions plus either 5a or 5b appear to exist, consult with Reserve Bank management about whether and how to inform the lender of the situation and solicit the lender's business justification. The communication with the lender should explain

- The specific neutral policy or criterion that appears to cause a disproportionate adverse impact
- How the examiners learned about the policy
- How widely the examiners understand the policy to be implemented
- How strictly the examiners understand the policy to be applied
- The prohibited basis on which the impact occurs
- The magnitude of the impact
- The nature of the injury to individuals
- The data from which the impact was computed

The communication should state that no violation exists if the policy or criterion is used because of business necessity *and* there is no alternative that would accomplish the lender's objective with a smaller disproportionate adverse impact. It should inform the lender that cost and profitability are factors the Reserve Bank will consider in evaluating the lender's business necessity. It should ask the lender to describe any alternatives it considered before adopting the policy or criterion at issue.

Evaluating and Following Up On the Response

Analyses of "business necessity" and "less-discriminatory alternative" tend to converge because of the close relationship between the purpose the policy or criterion serves and the most effective means to accomplish that purpose.

Evaluate whether the lender's response persuasively contradicts the existence of the significant disparity or establishes a business justification. Consult the Reserve Bank and Board as appropriate.

B. Discriminatory Pre-Application Screening

Obtain an explanation for any

- Withdrawals by applicants in prohibited-basis groups without documentation of customer intent to withdraw,
- Denials of applicants in prohibited-basis groups without any documentation as to whether the applicants were qualified, or
- On a prohibited basis, selectively quoting *strongly unfavorable* terms (for example, high fees or high down-payment requirements) to prospective applicants or quoting *strongly unfavorable* terms to all prospective applicants but waiving such terms for control group applicants (evidence of this might be found in withdrawn or incomplete files).

If the lender cannot explain the situations satisfactorily, examiners should consider obtaining authorization to contact customers to verify the lender's description of the transactions. Information from customers may help determine whether a violation occurred.

In some instances, such as possible "prescreening" of applicants by lender personnel, the results of the procedures discussed so far, including interviews with customers, may be inconclusive in determining whether a violation has occurred. In those cases, examiners should, if authorized by the Board, consult with management regarding the possible use of "testers" to compare how the lender treats them in the application process. These testers would pose as apparently similarly situated applicants, differing only as to race or other applicable prohibited-basis characteristic.

C. Possible Discriminatory Marketing

1. Obtain full documentation of the nature and extent of, together with management's explanation for, any
 - Prohibited-basis limitations stated in advertisements
 - Code words in advertisements that convey prohibited limitations
 - Advertising patterns or practices that a reasonable person would believe indicate that prohibited-basis customers are less desirable
2. Obtain full documentation as to the nature and extent of, together with management's explanation for, any situation in which the lender, despite the availability of other options in the market,

- Advertises only in media serving nonminority areas of the market
- Markets through brokers or other agents that the lender knows, or could reasonably be expected to know, to serve only one racial or ethnic group in the market
- Uses mailing or other distribution lists or marketing techniques for prescreened or other offerings of residential loan products that
 - Explicitly exclude groups of prospective borrowers on a prohibited basis or
 - Exclude geographies (for example, census tracts or ZIP codes) within the institution's marketing area that have demonstrably higher percentages of minority group residents than does the remainder of the marketing area but that have

income and other credit-related characteristics similar to the geographies that were targeted for marketing.

Note: Prescreened solicitation of potential applicants on a prohibited basis does not violate the ECOA. Such solicitations are, however, covered by the FHAct. Consequently, analyses of this form of potential marketing discrimination should be limited to residential loan products subject to the FHAct.

3. Evaluate management's response particularly with regard to the credibility of any nondiscriminatory reasons offered as explanations for any of the foregoing practices. Refer to the section "Evaluating Responses to Evidence of Disparate Treatment" earlier in this appendix for guidance.

STREAMLINING EXAMINATIONS

Institutions may find it advantageous to conduct self-tests or self-evaluations to measure or monitor their compliance with the ECOA and Regulation B. A *self-test* is any program, practice, or study that is designed and specifically used to assess the institution's compliance with fair lending laws and that creates data not available or derived from loan, application, or other records related to credit transactions (12 CFR 202.15(b)(1) and 24 CFR 100.140–100.148). For example, using testers to determine whether there is disparate treatment in the pre-application stage of credit shopping is a self-test. The information set forth in 12 CFR 202.15(b)(2) and 24 CFR 100.142(a) is privileged unless an institution voluntarily discloses the report or results or otherwise forfeits the privilege. A *self-evaluation*, while generally having the same purpose as a self-test, does not create any new data or factual information, but uses data readily available in loan or application files and other credit transaction records, and therefore does not meet the self-test definition.

Examiners should not request any information related to self-tests that is privileged. If the institution discloses the results of any self-tests, or has performed any self-evaluations, and examiners can confirm the reliability and appropriateness of the self-tests or self-evaluations (or even parts of them), they need not repeat those tasks.

Note: In the following discussion, the term “self-evaluation” also includes self-tests if the institution has voluntarily disclosed the report or results.

If the institution has performed a self-evaluation involving any of the products selected for examination, obtain a copy of that self-evaluation and proceed through the remaining steps in this section. If the institution has conducted a self-evaluation involving a product not selected for inclusion in the examination, consider whether the product evaluated by the institution is appropriate under the scoping guidelines as a substitute for another product that was selected. If such a substitution is considered appropriate, obtain the results of the self-evaluation for the substituted product and proceed through the remaining steps in this section.

Determine whether the research and analysis of the planned examination would duplicate the institution's own efforts. If the answers to questions A and B below are “yes,” then each successive “yes” answer to questions C through L indicates that the institution's work up to that point can serve as a basis for eliminating examination steps.

If the answer to either question A or B is “no,” the

self-evaluation cannot serve as a basis for eliminating examination steps. However, examiners should still evaluate the self-evaluation to the degree possible in light of the remaining questions and communicate the findings to the lender so that it can improve its self-evaluation process.

- A. Did the transactions covered by the self-evaluation occur not longer ago than two years prior to the examination? If the self-evaluation extended back more than two years prior to the examination, incorporate into the examination findings only the results from transactions in the most recent two years.
- B. Did the self-evaluation cover the same product, prohibited basis, decision center, and stage of the lending process (for example, underwriting or the setting of loan terms) as the planned examination?
- C. Did the self-evaluation include comparative file review? (Note: One type of “comparative file review” is statistical modeling to determine whether similar control group and prohibited-basis-group applicants were treated similarly. If a lender offers self-evaluation results based on a statistical model, consult appropriately with an economist at the Reserve Bank or the Board.)
- D. Were control and prohibited-basis groups defined accurately and consistently with the ECOA and/or the FhAAct?
- E. Were the transactions selected for the self-evaluation chosen so as to focus on marginal applicants or, in the alternative, selected randomly?
- F. Were the data abstracted from files accurate? Were those data actually relied on by the credit decision makers at the time of the decisions?
To answer questions E–G, for the institution's control group sample and each of its prohibited-basis-group samples, request to review 10% (but not more than 50 files for each group) of the transactions covered by the self-evaluation. For example, if the institution's self-evaluation reviewed 250 transactions by whites and 75 by blacks, plan to verify the data for 25 white and 7 black transactions.
- G. Did the 10% sample reviewed for question F also show that customer assistance and lender judgment that aided or enabled applicants to qualify were recorded systematically and accurately and were compared for differences on any prohibited bases?
- H. Were prohibited-basis-group applicants' qualifications related to the underwriting factor reviewed compared with corresponding qualifications of control group approvals? Specifically, for self-evaluations of approve or deny deci-

sions, were the denied applicants' qualifications related to the stated reason for denial compared with the corresponding qualifications for approved applicants?

- I. Did the self-evaluation sample cover at least as many transactions at the initial stage of review as examiners would initially have reviewed using the sampling guidance in these procedures?

If the lender's samples were significantly smaller than those in the sampling guidance but its methodology otherwise was sound, review additional transactions until the numbers of reviewed control group and prohibited-basis-group transactions equal the minimums for the initial stage of review in the sampling guidance.

- J. Did the self-evaluation identify instances in which prohibited-basis-group applicants were treated less favorably than control group applicants who were no better qualified?
- K. Were explanations for such instances solicited from the persons responsible for the decisions?
- L. Were the reasons cited by credit decision makers to justify or explain instances of apparent disparate treatment supported by legitimate, persuasive facts or reasoning?

If all of the questions are answered "yes," incorporate the findings of the self-evaluation (whether supporting compliance or violations) into the examination findings. Indicate that those findings are based on verified data from the institution's self-evaluation. In addition, consult appropriately with Reserve Bank management about whether or not to conduct corroborative file analyses in addition to those performed by the lender.

If not all of the questions are answered "yes," resume the examination procedures at the point where the lender's reliable work would not be duplicated. In other words, use the reliable portion of the self-evaluation and correspondingly reduce independent comparative file review by examiners. For example, if the institution conducted a comparative file review that compared applicants' qualifications without taking account of the reasons they were denied, examiners could use the qualification data abstracted by the institution (if accurate) but would have to construct independent comparisons structured around the reasons for denial.