



BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: National Bank Fair Lending Efforts

TO: Chief Executive Officers and Directors of National Banks and All Examining Personnel

PURPOSE

This issuance is intended to strongly encourage national banks to continue exploring ways to ensure that all mortgage loan applicants receive fair and equal treatment in the lending decision process. It provides encouragement and suggestions that may help bank management and boards of directors fulfill their responsibility to comply with fair lending laws and regulations. It is not intended to provide a blueprint for compliance.

BACKGROUND

The 1991 Home Mortgage Disclosure (HMDA) data released in October continue to reveal considerable racial and ethnic disparities in mortgage loan denial rates. Although the OCC recognizes that those disparities are caused in part by differences in applicant credit qualifications, two recently completed studies conclude that illegal lending discrimination does occur. Those studies, one by the Department of Justice and the other by the Federal Reserve Bank of Boston, found that nonminority applicants for home mortgage loans receive preferential treatment not always given to minority applicants.

After a three-year investigation of an Atlanta mortgage lender, the Department of Justice alleged that "white applicants who failed to meet certain underwriting standards have been extended special considerations" not extended to black applicants. It also alleged that "the lender counseled white applicants about their deficiencies and reworked their applications in order to help them qualify with underwriting guidelines, but did not consistently supply comparable assistance to black applicants." In a settlement of the suit in September 1992, the lender agreed to certain corrective actions, including the creation of a \$1 million fund to provide relief to 48 black creditseekers.

In October 1992, the Federal Reserve Bank of Boston published the results of a detailed review of about 130 Boston lenders, which found that some lending showed differences in approval rates that were unwarranted by economic factors. Since the Boston study found that 80 percent of applicants had some flaw in their credit qualifications but only 15 percent of applications were denied, it is clear that most applicants benefit from some judgment or initiative that neutralizes



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the flaws. The study found, however, that minority applicants benefitted less frequently than nonminority applicants.

The study suggested that differential treatment may begin with the presumption that nonminority applicants are creditworthy, but that minority applicants need to prove their creditworthiness to the lender. The positive presumption about nonminority applicants leads lenders to justify many kinds of judgments, accommodations, and efforts to help them qualify for loans in spite of shortcomings. However, when one group of customers benefit from considerations not given to another group, or benefit to a different degree, antidiscrimination laws are violated.

SUGGESTED ACTIONS FOR LENDERS

Management and boards of directors of national banks should take steps to eliminate any illegal discrimination from their lending practices. In that effort, they need to determine the reasons for any disparities in the way their institutions review and decide home mortgage applications. The thorough analysis of the bank's HMDA data outlined in the OCC's December 11, 1991, Advisory Letter (attached) is a valuable start in making that determination. Further, we suggest you:

Ensure Equality in Customer Service -- All applicants should receive the same beneficial presumptions and equal measures of assistance, diligence, patience, and flexibility. Similarly qualified applicants should benefit equally from those discretionary and dynamic aspects of bank lending processes.

This effort should begin in training programs for lending officers. Training should anticipate and address participants' stereotyped assumptions, and describe options that should be offered equally to borrowers who do not meet conventional lending standards. Internal bank compliance programs should be designed to monitor these elements of customer service.

An application checklist can help banks ensure that compensating factors, unconventional documentation of creditworthiness, and explanations of negative information are considered equally for every applicant. The checklist the Department of Justice required in its Atlanta settlement is a good example of a tool that can make sure that information that might overcome apparent deficiencies in an applicant's credit qualifications is not solicited selectively. The settlement documents filed in the Atlanta case are highly detailed and can provide valuable guidance to lenders.



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Record and Evaluate the Reasons for Denials -- National banks should record the "reasons for denial" on their HMDA loan application registers. Many financial institutions already maintain this voluntary information, which allows them to determine whether reasons for denial are equally distributed among applicants. For example, a pattern of higher rejections for "lack of verification" or "incomplete information" for a minority group might indicate that lending personnel are not working as diligently to qualify those applicants.

A complete tabulation of reasons for denial can show if an overall disparity in denial rates reflects a disproportionate use of one or two reasons with respect to minority applicants. That information allows the lender to focus on minority denials for those reasons to identify the flaws they contain. If the bank then performs a parallel review of nonminority approvals, it can determine if those approvals included deficiencies comparable to those in the denied minority applications. When a bank finds such a pattern, it should determine why similar flaws were treated differently.

Establish Review Systems -- A system of review underwriters and a mortgage review board can help banks make sure that applicants receive equal treatment. The Atlanta settlement included a requirement for a review underwriter, but often lenders voluntarily establish reviews that provide a second consideration of denied minority applications. Other lenders have review systems that also consider a sample of nonminority applications, both approved and rejected, to ensure that their lending standards are being applied consistently. In some cities, financial institutions have established joint mortgage review boards. Such boards are composed of lending personnel from the participating financial institutions who reviewed rejected applications from all members.

To be valuable, second reviews must provide the reviewer with a sense of how frequently and why nonminority applicants with deficiencies are granted loans. A review that only verifies that denied applicants have deficiencies in their credit qualifications does not answer the crucial question of equality of treatment. A good review must discover whether rejected minority applicants' deficiencies were worse than those of successful nonminority applicants and whether the lender made equal efforts to help all customers qualify.

Well designed and operated review systems help banks comply with nondiscrimination laws, provide them with valuable information, and can result in the banks making more loans. One lender recently reported that on second review it approved 35 percent of initially rejected applications.



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Initiate Testing Programs -- When a bank's best efforts to prevent discrimination with training, procedures, and accountability are not fully successful, it should consider the use of "shoppers." The additional documentation and information from self-testing can help identify and dislodge subtle and even unintentional discriminatory attitudes and practices.

Professional testers can conduct paired tests to determine if treatment of equally qualified loan applicants with different racial, ethnic, or other characteristics is substantially the same. In addition to identifying situations in which treatment is not equal, self-testing can find situations in which established lending practices are not followed, and can provide management with valuable customer service data.

SUMMARY

Eliminating discrimination in mortgage lending depends on the commitment of bank management and boards of directors. It is their responsibility to establish the systems and procedures necessary to comply with fair lending laws and regulations and to monitor those systems. Examiners will evaluate banks' efforts to comply and to review and monitor their compliance.

The approaches in this issuance are suggestions that may be useful additions to measures already in place. They do not constitute a checklist of required activities or steps that guarantee compliance.

RESPONSIBLE OFFICE

If you have any questions concerning this issuance or fair lending, you should contact your supervisory office or the Compliance Management Department in Washington, D.C.

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