WATCH - DON'T WAIT

Is Your Fair Lending CMS Up-to-Date?

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While it may be easy to put fair lending compliance initiatives on hold given recent challenges to the CFPB's constitutionality and leadership changes at the prudential regulators, doing so may increase risk for institutions down the road. Developing and implementing an effective fair lending compliance management system (fair lending CMS) continues to be a challenge in our evolving state and federal regulatory landscape. Are you ready for the new HMDA rules? Have you read the recent enforcement actions relating to redlining? What is a "credit needs assessment?" And what is this "REMA" that everyone has been talking about?

We will address these and other issues in this article, with the goal of helping you and your institution focus on developing a fair lending CMS that will mitigate fair lending risk and impress even the most skeptical of examiners when they next visit.

FAIR LENDING CMS – THE BASICS

Compliance professionals know that a well-documented and board-approved fair lending CMS is the foundation of any effective fair lending risk management program. It requires collaboration from every part of your institution—from compliance and legal to marketing, sales, and credit administration.

Even if your fair lending CMS is well documented, it is only as effective as it is "current," meaning that it must address recent fair and responsible lending issues and look ahead to new risks that may be on the horizon. However, maintaining a current fair lending CMS can be difficult, because regulators are not always transparent about the issues that they will focus on next.

For mortgage professionals, this uncertainty can lead to relentless stress.

But, as long as you are monitoring enforcement actions, reviewing regulatory guidance, and updating your fair lending CMS accordingly, the risk to your institution can be mitigated significantly. In our experience, the most effective fair lending CMS document describes "WHAT" you will do, "HOW" you will do it, and "WHEN" it will be done. To that end, we describe below some of the risks that are affecting mortgage companies today and how your institution can address those risks in its fair lending CMS.

HMDA

To be sure, three of the most important compliance issues facing mortgage companies today are HMDA, HMDA, and HMDA. On January 1, 2018, some institutions will be required to report HMDA data for the first time, some institutions will no longer be required to report, and all covered institutions will be required to report new data. The new data will include age, credit score, automated underwriting information, debt-to-income ratio, property value, points and fees, borrower-paid origination charges, discount points, lender credits, and loan term (among numerous other fields). Regulators will expect every mortgage lender to document how the new fields will be captured and verified, and to develop mechanisms for identifying and correcting errors in systems and processes. Moreover, coverage under HMDA will change from a purpose-based test (i.e., purchase, refinance or home improvement), to a test that considers simply whether the loan is dwelling secured.

The expanded data will be used by regulators to perform new analyses to address fair lending concerns with individual institutions, oftentimes without the knowledge or participation of the institution. Currently, regulators must request additional, non-HMDA data from institutions whenever they perform pricing or underwriting fair lending analyses. The new HMDA fields will enable regulators to assess fair lending compliance for individual institutions behind the scenes and to use aggregate data to conduct comparative analyses of mortgage lending activity across multiple lenders or groups of lenders.

The new fields and their ready availability to regulators and community groups make ensuring HMDA accuracy extremely important. Institutions can be held accountable for disparities in pricing or underwriting without any knowledge that they were the subject of a review. In that respect, the fair lending CMS can be an effective tool to ensure that your institution knows the steps for preparing the HMDA loan application register (LAR) and making sure that data integrity is a priority.

REMA AND REDLINING

Another fair lending topic that has taken on increased significance recently is the Reasonably Expected Market Area, or "REMA," which may be used by regulators to assess redlining risk. However, regardless of whether your regulator uses the term REMA or performs an analysis of where your predominant lending activity is, it is possible (if not likely) that regulators will focus on redlining issues during your next exam.

The REMA or predominant lending activity concepts typically work as follows: Before conducting a redlining analysis, regulators will determine which geographies will be the focus of analysis, including analysis of statistical disparities between an institution's lending performance and that of other institutions or "peers." In making this determination, regulators will review lending channels such as retail branches, broker and correspondent relationships, and ultimately maps showing the distribution of applications and/or loan originations.

Historically, institutions have often assumed that an entire Metropolitan Statistical Area (if a non-bank) or their assessment area (if a bank) are the appropriate geographies for redlining analysis. But these geographic borders are no longer always applicable, as a regulator can establish the REMA for a specific examination without respect to any existing classifications. Given the increased regulatory focus on redlining, institutions are well advised to document their own REMAs in fair lending CMS documents, if for no other reason than to demonstrate that they are conscious of their marketing, branching and lending trends.

Likewise, given the focus by regulators on comparisons to "peers" during redlining examinations, institutions may choose to enhance their fair lending CMS by identifying specific competitors that the institution expects to be included in the analysis (or the types of peer institutions that should be included), and the reasons that they are considered peers. For example, institutions that recently entered a particular market may identify as their peers other institutions with little to no history in the market. Alternatively, institutions that focus on particular products (e.g., second lien products) may choose to compare themselves to other institutions that specialize in those products. In either case, identifying or describing the peer institutions in the fair lending CMS could influence the regulator's own peer classifications during your next compliance examination.

CREDIT NEEDS ASSESSMENT

With the recent focus on redlining enforcement has come increased emphasis on "Credit Needs Assessments." Indeed, all the most recent CFPB and DOJ redlining enforcement actions have included a requirement for the institution to perform a credit needs assessment. As the name implies, the credit needs assessment asks, "where are mortgage loans most needed?" and "what types of loans are needed in selected geographies?" Your assessment should additionally answer "where are applications coming from and where are loans being made?" Answering these questions will help your institution develop a plan for identifying communities where its applications or originations lag behind other institutions or where demand is most significant.

Credit needs assessments can take a variety of different forms. However, the most important consideration is to identify and address demographic, socioeconomic, and competitive risks associated with individual markets. Indeed, mortgage credit needs may vary from geography to geography. For example, certain areas may have a greater demand for affordable rental properties than one-to-four family owner occupied properties—a situation that a credit needs assessment may assist your institution in discovering.

While credit needs assessments can be helpful in generating business based on demand, reliance on them also presents some fair lending risk. For example, if the credit needs assessment identifies the greatest demand in communities with low minority populations, focusing on those areas could actually increase redlining risk. In light of that risk, your fair lending CMS should clearly describe how your credit needs assessment will be conducted, who will conduct it, when it will be conducted, and how the results of the analyses will be used.

CONCLUSION

A comprehensive fair lending CMS can sometimes be the difference between a successful examination outcome and an examination that takes unexpected twists and turns. For each of the areas described above (and many others), regulators will generally expect your institution's fair lending CMS to describe "WHAT" you will do, "HOW" you will do it, and "WHEN" it will be done. When each of these elements is documented in the fair lending CMS, your institution will have a roadmap for performing the right reviews at the right times, and you will be well on your way to anticipating the next issue on the horizon and mitigating the related risk.

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