

Fair Lending Laws and Regulations¹

Introduction

This overview provides a basic and abbreviated discussion of federal fair lending laws and regulations. It is adapted from the Interagency Policy Statement on Fair Lending issued in March 1994.

Lending Discrimination Statutes and Regulations

The Equal Credit Opportunity Act (ECOA) prohibits discrimination in any aspect of a credit transaction. It applies to any extension of credit, including extensions of credit to small businesses, corporations, partnerships, and trusts.

The ECOA prohibits discrimination based on:

- Race or color;
- Religion;
- National origin;
- Sex;
- Marital status;
- Age (provided the applicant has the capacity to contract);
- The applicant's receipt of income derived from any public assistance program; or
- The applicant's exercise, in good faith, of any right under the Consumer Credit Protection Act.

The Federal Reserve Board's Regulation B, found at 12 CFR Part 202, implements the ECOA. Regulation B describes lending acts and practices that are specifically prohibited, permitted, or required. Official staff interpretations of the regulation are found in Supplement I to 12 CFR Part 202.

The Fair Housing Act (FHA) prohibits discrimination in all aspects of "residential real-estate related transactions," including but not limited to

- Making loans to buy, build, repair or improve a dwelling;
- Purchasing real estate loans;
- Selling, brokering, or appraising residential real estate; or
- Selling or renting a dwelling.

The FHA prohibits discrimination based on:

- Race or color;
- National origin;
- Religion;
- Sex;

- Familial status (defined as children under the age of 18 living with a parent or legal custodian, pregnant women, and people securing custody of children under 18); or
- Handicap.

The Department of Housing and Urban Development's (HUD) regulations implementing the FHA are found at 24 CFR Part 100.

Because both the FHA and the ECOA apply to mortgage lending, lenders may not discriminate in mortgage lending based on any of the prohibited factors in either list.

Under the ECOA, it is unlawful for a lender to discriminate on a prohibited basis in any aspect of a credit transaction, and under both the ECOA and the FHA, it is unlawful for a lender to discriminate on a prohibited basis in a residential real-estate-related transaction. Under one or both of these laws, a lender may not, because of a prohibited factor:

- Fail to provide information or services or provide different information or services regarding any aspect of the lending process, including credit availability, application procedures, or lending standards.
- Discourage or selectively encourage applicants with respect to inquiries about or applications for credit.
- Refuse to extend credit or use different standards in determining whether to extend credit.
- Vary the terms of credit offered, including the amount, interest rate, duration, or type of loan.
- Use different standards to evaluate collateral.
- Treat a borrower differently in servicing a loan or invoking default remedies.
- Use different standards for pooling or packaging a loan in the secondary market.

A lender may not express, orally or in writing, a preference based on prohibited factors or indicate that it will treat applicants differently on a prohibited basis.

A lender may not discriminate on a prohibited basis because of the characteristics of

- An applicant, prospective applicant, or borrower.
- A person associated with an applicant, prospective applicant, or borrower (for example, a co-applicant, spouse, business partner, or live-in aide).
- The present or prospective occupants of either the property to be financed or the neighborhood or other area where property to be financed is located.

Finally, the FHA requires lenders to make reasonable accommodations for a person with disabilities when such

¹ This section fully incorporates the Interagency examinations procedures revised as of August 2004.

IV. Fair Lending – Overview

accommodations are necessary to afford the person an equal opportunity to apply for credit.

Types of Lending Discrimination

The courts have recognized three methods of proof of lending discrimination under the ECOA and the FHAct:

- Overt evidence of disparate treatment
- Comparative evidence of disparate treatment
- Evidence of disparate impact.

Disparate Treatment

The existence of illegal disparate treatment may be established either by statements revealing that a lender explicitly considered prohibited factors (**overt evidence**) or by differences in treatment that are not fully explained by legitimate nondiscriminatory factors (**comparative evidence**).

Overt Evidence of Disparate Treatment. There is overt evidence of discrimination when a lender openly discriminates on a prohibited basis.

Example: A lender offered a credit card with a limit of up to \$750 for applicants aged 21-30 and \$1500 for applicants over 30. This policy violated the ECOA's prohibition on discrimination based on age.

There is overt evidence of discrimination even when a lender expresses—but does not act on—a discriminatory preference.

Example: A lending officer told a customer, “We do not like to make home mortgages to Native Americans, but the law says we cannot discriminate and we have to comply with the law.” This statement violated the FHAct's prohibition on statements expressing a discriminatory preference as well as Section 202.5(a) of Regulation B, which prohibits discouraging applicants on a prohibited basis.

Comparative Evidence of Disparate Treatment. Disparate treatment occurs when a lender treats a credit applicant differently based on one of the prohibited bases. It does not require any showing that the treatment was motivated by prejudice or a conscious intention to discriminate against a person beyond the difference in treatment itself. It is considered by courts to be intentional discrimination because no credible, nondiscriminatory reason explains the difference in treatment on a prohibited basis.

Disparate treatment may more likely occur in the treatment of applicants who are neither clearly well-qualified nor clearly unqualified. Discrimination may more readily affect applicants in this middle group for two reasons. First, if the applications are “close cases,” there is more room and need for lender discretion. Second, whether or not an applicant qualifies may depend on the level of assistance the lender

provides the applicant in completing an application. The lender may, for example, propose solutions to credit or other problems regarding an application, identify compensating factors, and provide encouragement to the applicant. Lenders are under no obligation to provide such assistance, but to the extent that they do, the assistance must be provided in a nondiscriminatory way.

Example: A nonminority couple applied for an automobile loan. The lender found adverse information in the couple's credit report. The lender discussed the credit report with them and determined that the adverse information, a judgment against the couple, was incorrect since the judgment had been vacated. The nonminority couple was granted their loan. A minority couple applied for a similar loan with the same lender. Upon discovering adverse information in the minority couple's credit report, the lender denied the loan application on the basis of the adverse information without giving the couple an opportunity to discuss the report.

The foregoing is an example of disparate treatment of similarly situated applicants, apparently based on a prohibited factor, in the amount of assistance and information the lender provided.

If a lender has apparently treated similar applicants differently on the basis of a prohibited factor, it must provide an explanation for the difference in treatment. If the lender's explanation is found to be not credible, the agency may find that the lender intentionally discriminated.

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 characteristic(s) 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. Redlining may violate both the FHAct and the ECOA.

Disparate Impact

When a lender applies a racially or otherwise neutral policy or practice equally to all credit applicants, but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis, the policy or practice is described as having a “disparate impact.”

Example: A lender's policy is not to extend loans for single family residences for less than \$60,000. This policy has been in effect for ten years. This minimum loan amount policy is shown to disproportionately exclude potential minority applicants from consideration because of their income levels or the value of the houses in the areas in which they live.

Although the precise contours of the law on disparate impact as it applies to lending discrimination are under development,

it has been clearly established the single fact that a policy or practice creates a disparity on a prohibited basis is not alone proof of a violation.

When an Agency finds that a lender's policy or practice has a disparate impact, the next step is to seek to determine whether the policy or practice is justified by "business necessity." The justification must be manifest and may not be hypothetical or speculative. Factors that may be relevant to the justification could include cost and profitability. Even if a policy or practice that has a disparate impact on a prohibited basis can be justified by business necessity, it still may be found to be in violation if an alternative policy or practice could serve the same purpose with less discriminatory effect. Finally, evidence of *discriminatory intent* is not necessary to establish that a lender's adoption or implementation of a policy or practice that has a disparate impact is in violation of the FHAct or ECOA.

These procedures do not call for examiners to plan examinations to identify or focus on potential disparate impact issues. The guidance in this section is intended to help examiners recognize potential disparate impact situations if they happen to encounter them. Guidance in the **Appendix** tells them how to obtain relevant information regarding such situations and how to evaluate and follow up on it, as appropriate.

General Guidelines

These procedures are intended to be a basic and flexible framework to be used in the majority of fair lending examinations conducted by the FFIEC agencies. They are also intended to guide examiner judgment, not to supplant it. The procedures can be augmented by each agency, which can supply such additional procedures and details as are necessary to implement them effectively.

Although these procedures will apply to most examinations, each agency may continue to use for limited numbers of examinations the distinct approaches it has developed that are appropriate for select classes of institutions. Such approaches include, for example, the statistical modeling that some of the agencies use in selected examinations to assist in determining whether race or national origin was a factor in credit decisions.

For a number of aspects of lending—for example, credit scoring and loan pricing—the "state of the art" is more likely to be advanced if the agencies have some latitude to incorporate promising innovations. These interagency procedures provide for that.

Any references in these procedures to options, judgment, etc., of "examiners" means discretion within the limits provided by that examiner's agency. An examiner should use these procedures in conjunction with his or her own agency's priorities, examination philosophy, and detailed guidance for

implementing these procedures. These procedures should not be interpreted as providing an examiner greater latitude than his or her own agency would. For example, if an agency's policy is to review compliance management systems even in small banks, an examiner for that agency must conduct such a review rather than interpret Part II of these interagency procedures as leaving the review to the examiner's option.

The procedures emphasize racial and national origin discrimination in residential transactions, but the key principles can be applied to other prohibited bases and to nonresidential transactions.

Finally, these procedures focus on analyzing lender compliance with the broad, nondiscriminatory requirements of the ECOA and the FHAct. They do not address such explicit or technical compliance provisions as the signature rules or adverse action notice requirements in sections 202.7 and 202.9, respectively, of Regulation B.

Part I—Examination Scope Guidelines

Background

The **scope** of an examination encompasses the loan product(s), market(s), decision center(s), time frame, and prohibited basis and control group(s) to be analyzed during the examination. These procedures refer to each potential combination of those elements as a "**Focal Point**." Setting the scope of an examination involves, first, identifying all of the potential focal points that appear worthwhile to examine. Then, from among those, examiners select the focal point(s) that will form the scope of the examination, based on risk factors, priorities established in these procedures or by their respective agencies, the record from past examinations, and other relevant guidance. This phase includes obtaining an overview of an institution's compliance management system as it relates to fair lending.

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 difference between "self tests" and "self evaluations" is discussed in the Streamlining the Examination section of the Appendix. Institutions must share all information regarding "self-evaluations" and certain limited information related to "self-tests." Institutions may choose to voluntarily disclose additional information about "self-tests." Examiners should make sure that institutions understand that voluntarily sharing the results of self-tests will result in a loss of confidential status of these tests. Information from "self-evaluations" or "self-tests" may allow the scoping to be streamlined. Refer to the *Streamlining the Examination* section of the **Appendix** for additional details.