



# **FAIR LENDING TRAINING**

## **OCTOBER 26, 2011**

**REGULATORY COMPLIANCE TRAINING**  
**MORTGAGE LENDING**



# FAIR LENDING OVERVIEW

## INTRODUCTION

**Welcome** to **Aura Mortgage Advisors, LLC's** *Fair Lending Compliance Training* Session. Several federal and state fair lending regulations impact mortgage loans. This program is designed to provide you with a summary of the core requirements and the implications to your role.

Boston Community Capital and Aura Mortgage Advisors are strongly committed to maintaining a successful regulatory lending compliance program. This training is designed to support your efforts and contribution to this important goal.



# THE FAIR LENDING LAWS

The **best defense** in ensuring that fair lending is balanced with sound lending practices is to have proactive procedures and staff training that highlight best practices and common pitfalls to avoid in ensuring that no discriminatory practices or policies exist.

## About Fair Lending

There are five laws that create the framework for fair lending. Test your knowledge and try to identify as many of the five regulations included under the Fair Lending Umbrella below:

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_



Please Note: HMDA is the 5<sup>th</sup> Fair Lending Law. BCC has determined that AURA Mortgage Advisors is a bona-fide non-profit and therefore is exempted from HMDA requirements.

# PROTECTED CLASSES AND FAIR LENDING

Two of the *Fair Lending Laws* included in the five identify protected classes or prohibited factors for which we cannot base any lending decision or provide different treatment or terms.

The two laws are: \_\_\_\_\_ and  
\_\_\_\_\_.

The list of Prohibited Bases Include (three examples have been provided, work with the group to complete the list):

- ☐ Race
- ☐ Color
- ☐ Religion

# THREE TYPES OF DISCRIMINATION IDENTIFIED BY REGULATORY AGENCIES AND THE COURT SYSTEM

The courts have recognized three possible types of lending discrimination (where treatment to a borrower or prospective borrower is different based on one of the protected bases).

Type of Discrimination (fill in the blanks)	Definition Occurs when...	Example
<b>Overt Discrimination</b>	A lender openly and blatantly discriminates on a prohibited basis.	
<b>Disparate Treatment</b>	A lender treats an applicant differently based on one of the prohibited bases.	
<b>Disparate Impact</b>	A policy or practice applied equally to all applicants has a disproportionate adverse impact on applicants in a protected group.	

Use the examples below (and place them in the appropriate column on the far right above).

- Our minimum mortgage loan amount is \$200,000.
- We only lend up to 90% of appraised value for borrowers under the age of 25.
- We don't lend to customers unless their primary language is English.

# CREATING AND ENVIRONMENT THAT PROMOTES FAIR LENDING



**Provide ongoing training  
and file reviews**

**Consider fair lending  
implications of any policy  
changes**

**Ensure policies and practices are well  
thought through**



# EQUAL CREDIT OPPORTUNITY ACT

The Equal Credit Opportunity Act (ECOA) of 1974, which is implemented by the Board's Regulation B, applies to all creditors. The statute requires financial institutions and other firms engaged in the extension of credit to “make credit equally available to all creditworthy customers without regard to sex or marital status.” Moreover, the statute makes it unlawful for “any creditor to discriminate against any applicant with respect to any aspect of a credit transaction

ECOA (Regulation B) includes provisions that require creditors to notify applicants of action taken on their applications within specific time frames; to report credit history in the names of both spouses on an account; to retain records of credit applications; to collect information about the applicant's race and other personal characteristics in applications for certain dwelling-related loans; and to provide applicants with copies of appraisal reports used in connection with credit transactions.

# ECOA REQUIREMENTS AT EACH PHASE OF THE APPLICATION

## Pre-application Phase Requirements

- No applicants should be discouraged from applying for a loan.
- Understand when an inquiry becomes an application.

### **Compliance Challenge - Inquiry or Application?**

**A.** A prospective client calls with an interest in applying to Aura Mortgage Advisors. They have received notice that foreclosure proceedings have been initiated on their home, which is located in Florida. The receiver of the call explains that Aura presently does not lend in Florida but their information will be retained in case the program expands to that area in the future.

**Circle one:**

Inquiry

Application

**B.** A prospective client calls Aura/SUN and explains to the receiver of the call that he is presently self-employed. He provides his income figures for the past two years as well as his year-to-date income for 2011. The representative recommends that the client apply after year-end when they can provide 2011 tax returns to strengthen the application and when they have more of an income track record.

**Circle one:**

Inquiry

Application

**Has Adverse Action been triggered by either case? What must happen next?**



# ECOA REQUIREMENTS AT APPLICATION

## Intent to Apply Jointly

It is very important to document a co-applicant's intent to apply at the time of application. The Residential Mortgage Loan Application (1003 URLA) has a section at the very top of the form that must be completed when the application is being completed jointly. In cases where an additional borrower decides to apply, be sure their intent to apply jointly is documented via a written statement to the file.

Uniform Residential Loan Application

Borrower: \_\_\_\_\_

Co-Borrower: \_\_\_\_\_

Joint Applicant: \_\_\_\_\_

Signature of Borrower: \_\_\_\_\_

Signature of Co-Borrower: \_\_\_\_\_

Signature of Joint Applicant: \_\_\_\_\_

Date: \_\_\_\_\_

# SIGNATURE REQUIREMENTS AND PROHIBITIONS UNDER ECOA

## **Signature of spouse or other person:**

A creditor shall not require the signature of an applicant's spouse or other person, other than a joint applicant, on any credit instrument if the applicant qualifies under the creditor's standards of creditworthiness for the amount and terms of the credit requested.

A lender may not consider the submission of a joint financial statement or other evidence of jointly held assets as an application for joint credit.

Lenders must be careful not to obligate a \_\_\_\_-\_\_\_\_ spouse on a note. It is okay to ask a non-applicant spouse to sign the mortgage or security instrument, but not the \_\_\_\_\_. Also, when an applicant needs additional support, banks should indicate such, but should by no means suggest who the co-applicant, co-borrower or co-signor should be.

# REQUESTS FOR AND EVALUATION OF APPLICANT INFORMATION

Regulation B prohibits creditors from requesting and collecting specific personal information about an applicant that has no bearing on the applicant's ability or willingness to repay the credit requested and could be used to discriminate against the applicant.

The regulation impacts all lending staff in each phase of the loan application, processing, underwriting, closing and servicing.



# REQUESTS FOR AND EVALUATION OF APPLICANT INFORMATION

## Collecting Applicant Information

**Marital Status:** For secured credit, the creditor may inquire about the applicant's marital status, but shall use only the terms married, unmarried, and separated.

**Sex:** An applicant may be requested to designate a title on an application form (such as Ms., Miss, Mr., or Mrs.) if the form discloses that the designation of a title is optional. An application form shall otherwise use only terms that are neutral as to sex.

Information about a **spouse or former spouse**--(1) General rule. Except as permitted below, a creditor may not request any information concerning the spouse or former spouse of an applicant:

- ☐ The spouse will be permitted to use the account;
- ☐ The spouse will be contractually liable on the account;
- ☐ The applicant is relying on the spouse's income as a basis for repayment of the credit requested;
- ☐ The applicant is relying on alimony, child support, or separate maintenance payments from a spouse or former spouse as a basis for repayment of the credit requested.

# REQUESTS FOR AND EVALUATION OF APPLICANT INFORMATION

Generally, a creditor may not

- Consider any of the prohibited bases, including age (providing the applicant is old enough, under state law, to enter into a binding contract) and the receipt of public assistance
- Use childbearing or childrearing information, assumptions, or statistics to determine whether an applicant's income may be interrupted or decreased
- Consider whether there is a telephone listing in the applicant's name (but the creditor may consider whether there is a telephone in the applicant's home)
- Discount or exclude part-time income from an applicant or the spouse of an applicant

Permanent residency and immigration status: A creditor may inquire about the permanent residency and immigration status of an applicant or any other person in connection with a credit transaction.

A Creditor must:

- Evaluate credit scores for all borrowers and guarantors equally.
- Do not evaluate married or unmarried applicants according to different standards

# RECENT INTERPRETATION RELATED TO CREDIT REPORT FEES

- Recently, the FDIC referred a bank to the Department of Justice (DOJ) for an ECOA violation. The bank charged married applicants for a single merged report, but charged un-married joint applicants for two separate reports.
- It is important to use practical judgment in trying to address this interpretation when making changes to credit report procedures. Ensure internal procedures reflect steps and credit report fee schedules that do not discriminate applicants on a prohibited basis, including marital status while ensuring that the quality of information isn't disrupted based on the type of report ordered.
- Many lenders have addressed this area of ECOA compliance by charging every applicant the same price (e.g. every applicant is charged for a single credit report and credit reports are ordered for individuals rather than ordering some as joint reports).





# NOTIFICATION OF LOAN DECISION

- A lender must notify an applicant of action taken on the applicant's request for credit, whether favorable or adverse, within \_\_\_\_\_ days after receiving a completed application.
- The lender must notify an applicant of adverse action within \_\_\_\_\_ days after making a counteroffer unless the applicant accepts or uses the credit during that time.
- The lender may not have to notify an applicant of adverse action if the application was incomplete and the bank sent the applicant a notice of \_\_\_\_\_ that met certain requirements set forth in section 202.9(c).



# TELEPHONE APPLICATIONS (E.G. PRE-QUALIFICATIONS)



Denial of a telephone application. When an application is made by telephone and adverse action is taken, the creditor must request the **applicant's name and address in order to provide written notification under this section.** If the applicant declines to provide that information, then the creditor has no further notification responsibility.

# INCOMPLETE APPLICATIONS

- When a lender receives an incomplete application, it may send one of two alternative notifications to the applicant.
  - ☐ One is a notice of adverse action;
  - ☐ the other is a notice of incompleteness. The notice of incompleteness must be in writing and must specify the information the bank needs if it is to consider the application; it must also provide a reasonable period of time for the applicant to furnish the missing information.



# DISCLOSURE OF CREDIT SCORES USED IN MAKING LOAN DECISIONS

## Credit Score Disclosures



The Federal Reserve Board (FRB) and Federal Trade Commission (FTC) issued a final rule on July 6, 2011 requiring creditors to provide additional information in adverse action notices if a credit score is used in making the credit decision.

If a credit score is used in taking any adverse action, in addition to the previously required disclosures, the creditor must also provide:

- 1 - The numerical credit score used;
- 2 - The range of possible scores under the model used;
- 3 - Key factors that adversely affected the credit score;
- 4 - The date on which the score was created; and
- 5 - The name of the person or entity that provided the score.

Recognizing that creditors may use a consumer report but not an actual credit score in taking adverse action, the rule provides that if no credit score is used in making the decision, then no credit score or related information needs to be included in the Notice of Adverse Action.

NOTE: BCC's Compliance Attorney has provided an opinion that the credit scores need not be disclosed if they did not impact the loan decision. However, If the credit report was used (e.g. loans denied for high DTI ratio, the disclosure related to the credit bureau, must be included in the Adverse Action Notice.

# INADVERTENT ERRORS WITH NOTIFICATIONS

A lender is not liable for failure to comply with the notification requirements of section 202.9 if the failure was caused by an inadvertent error and the lender, after discovering the error, (1) corrects the error as soon as possible and (2) begins compliance with the requirements of the regulation. “Inadvertent errors” include mechanical, electronic, and clerical errors that the lender can show (1) were not intentional and (2) occurred despite the fact that the bank maintains procedures reasonably adapted to avoid such errors.





# MASSACHUSETTS 2<sup>ND</sup> TIER REVIEW AND MORTGAGE REVIEW BOARD REQUIREMENTS

- Prior to the issuance of an adverse action notice, mortgage lenders should have an independent internal process to review the application to determine whether the mortgage lender's application procedures were followed fairly and consistently. In addition, denied applications should be compared with approved applications to determine whether or not compensating factors were applied fairly and consistently.
- All mortgage lenders in Massachusetts are required to refer denied applicants to the Mortgage Review Boards. These boards provide a second review process for denied applicants who believe that they were unfairly turned down.



# ECOA (REG B) AND APPRAISAL REQUIREMENTS

Regulation B requires that banks provide a copy of the appraisal report used in connection with an application for credit to be secured by a lien on a dwelling. A bank may provide the copy either routinely (whether or not credit is granted or the application is withdrawn) or upon an applicant's written request. If the bank provides an appraisal report only upon request, it must inform the applicant in writing of the right to receive a copy of the report.

# ECOA AND DOCUMENTATION RETENTION

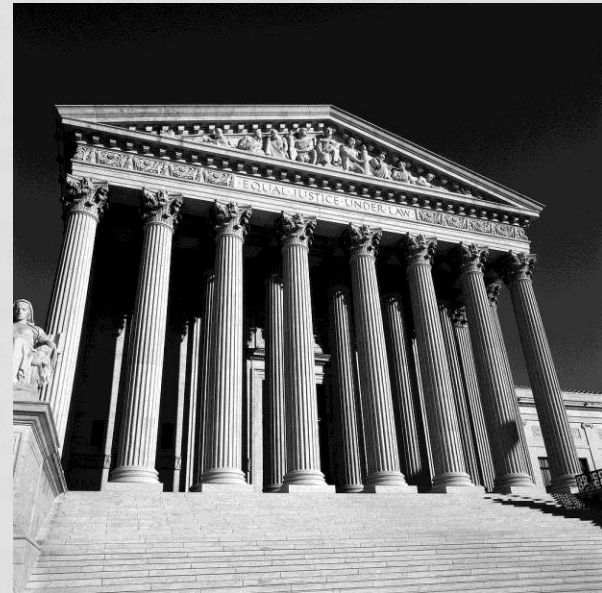


How long must you retain documentation after the Bank has notified a loan customer that an application has been denied?

Residential Loan Applications: \_\_\_\_ Months

# ENFORCEMENT PENALTIES AND LIABILITIES

In addition to actual damages, Regulation B provides for punitive damages of up to \$10,000 in individual lawsuits and up to the lesser of \$500,000 or 1 percent of the lender's net worth in class action suits.



# FAIR HOUSING ACT

## BACKGROUND AND PURPOSE

The Fair Housing Act was created as part of the Civil Rights Act of 1968. The law has been amended and clarified several times since its origination as a result of numerous court cases.

The purpose of the law is to prevent discrimination in housing, including the process related to financing and/or rental of housing. The Act prohibits financial institutions from denying a housing loan or providing different terms or treatment based on any of the protected class bases. The FHA prohibits discrimination based on race, color, religion, sex, national origin, handicaps, or family status, which is defined as children under 18 living with a parent or legal guardian, pregnant women, and people securing custody of children under 18.

The Fair Housing Act (FHA) prohibits discrimination in all aspects of residential real-estate related transactions, including:

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

# FAIR HOUSING ACT

The FHA can affect lending practices in several ways, including:

→Advertising: Requirement that the Fair Housing Icon be included on any home financing advertisement.

→New Loans: Prohibits discrimination in any aspect of housing, such as the sale, rental or financing process. This includes owner and non-owner 1-4 unit residential properties and mixed-use properties, apartment buildings and housing developments.

→Discrimination is prohibited based on the borrower or associates of the borrower (seller, purchaser, employees) and the location of the property.





# FAIR CREDIT REPORTING ACT

The Fair Credit Reporting Act was enacted by Congress in 1971 to address concerns about the adverse impact of inaccurate credit information on the financial system.

The FACT Act amended the Fair Credit Reporting Act in December 2003. It included many provisions that impact credit reporting and the prevention of identity theft. These provisions include appropriate handling of Fraud Alerts and/or Active Duty alerts on their credit reports.

More recently, the Dodd Frank Act imposed new requirements for the Fair Credit Reporting Act.



# FCRA OBJECTIVES

One objective of the FCRA is to ensure that users request and consumer reporting agencies provide consumer reports only for permissible purposes

Permissible Purpose = \_\_\_\_\_

Other Objectives:

- To ensure the accuracy and confidentiality of consumer credit information
- To require that consumers be provided with disclosure notifications when certain **triggering events** occur.

# FCRA AND RISK-BASED PRICING RULES

- Pursuant to the FCRA, a consumer must receive a Risk-Based Pricing Notice (RBPB) if a consumer report is used in connection with an application for credit and, based in whole or in part on the consumer report, the credit is granted, extended, or provided on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers.
- The rule was further amended in July 2011, as required by Dodd-Frank, to include additional disclosures in the RBPB if a consumer's credit score is used in setting the material terms of credit.
- In lieu of providing the RBPB to some consumers as set forth above, for credit that is or will be secured by one to four units of residential real property, the creditor may opt to provide an exception notice to every consumer requesting a product for which the creditor uses risk-based pricing, even if the consumer would not otherwise receive a risk-based pricing notice

# CREDIT SCORE DISCLOSURES AND THE FCRA

- The Dodd Frank Act imposed revision requirements to the model forms contained in Regulation B which satisfy adverse action notice requirements under both FCRA and ECOA. Specifically, Dodd Frank requires adverse action notices issued under FCRA to disclose the credit score used in taking the adverse action and additional information relating to the score.
- NOTE: The FCRA requirement to provide the credit score and additional information is independent from the ECOA requirement to provide specific reasons for the adverse action. Thus, where creditors opt to provide Borrowers with a Notice of Adverse Action taken and a notice of the Borrower's right to request specific reasons for the denial, the credit score and related information must also be included. It is not permissible to wait until a Borrower exercises his or her right to request specific reasons for the credit denial to provide the credit score used, if any, and additional information

# WHAT TRIGGERS FCRA'S ADVERSE ACTION NOTIFICATION REQUIREMENTS?

- When credit is \_\_\_\_\_;
- When a counter-offer for a \_\_\_\_\_ loan amount is made;

OR

- When the \_\_\_\_\_ of credit is increased

..... based on Information from the credit bureau report.



# REQUIRED CONTENT FOR ADVERSE ACTION NOTIFICATION UNDER FCRA

NOTE: The FCRA notification requirements are provided on the same form as the ECOA (Adverse Action). When FCRA Disclosure requirements are triggered, the following information must be provided?

- The fact that the loan decision was made in whole or in part based on information from the credit report.
- Name, Address and phone number for the credit reporting agency.
- The fact that the \_\_\_\_\_ did not make the loan decision.
- The fact that the customer has a right to a free credit report and may dispute the information on the credit report.



# FCRA AND FACTA REQUIREMENTS

The FACT Act is a Consumer Protection law that protects consumers against identity theft and provides consumers the right to place a Fraud Alert or an Active Duty Alert on their Credit Report. Red Flag Rules stipulate that financial institutions and creditors establish a written identity theft prevention program to detect, prevent and mitigate identity theft in connection with the opening of certain accounts or existing accounts. Red Flag Provisions of the FACT Act require that financial institutions follow the red flag guidelines to prevent and detect fraud and identity theft. The basic elements that must be included in the program include identifying, detecting and responding to red flags. Red Flags consists of

- A.
- B.
- C.
- D.



Medical Rules of the Fact Act prohibit medical information from being used in determining a consumer's credit worthiness. Under these rules, the creditor may NOT take any of the following into consideration when making a credit decision:

The consumer's:

- ☐ physical
- ☐ mental
- ☐ behavioral health
- ☐ medical condition/history of medical condition or treatment
- ☐ type of treatment
- ☐ prognosis



# FCRA – FACTA AND THE DISPOSAL OF CUSTOMER INFORMATION

Under the FACTA, Lenders are required to develop, implement, and maintain, as part of its information security program, appropriate measures to properly dispose of customer information and consumer information in accordance with FACTA.

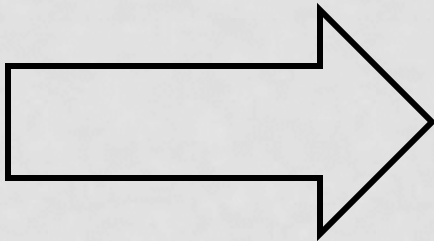


# COMMUNITY REINVESTMENT ACT

- Background: The Community Reinvestment Act was enacted in 1977 to encourage banks and non-bank lenders to help meet credit needs of entire community, including low- and moderate-income neighborhoods, consistent with safe and sound lending practices.
- In Massachusetts, Under the CRA for Mortgage Lenders Program, (also known as Mortgage Lender Community Investment, or MLCI), the Division of Banks (Division) examines licensed mortgage lenders making 50 or more home mortgage loans in the previous calendar year, to assess their record of helping to meet the mortgage credit needs of the Commonwealth, including low- and moderate-income neighborhoods and individuals, consistent with safe and sound lending practices. Upon conclusion of the examination, the Division prepares a written evaluation of the mortgage lender's record of meeting the mortgage credit needs of the Commonwealth.

# DIVISION OF BANK'S CRA FOCUS

The Division of Bank's written evaluation is public information and can be obtained through the mortgage lender or the Division. The public portion of the evaluation generally contains the following information:



- The mortgage lender's MLCI rating.
- A description of the mortgage lender.
- Conclusions regarding the mortgage lender's MLCI performance, including the facts, data, and analyses that were used to form such conclusions.

# CRA EXAM SCOPE – 3 TESTS

Components (tests) of a CRA Exam:

- Lending Test
- Services Test
- Investment Test



The **Lending Test** is typically the most heavily weighted. Five criteria:

- Geographic distribution of loans,
- Lending to borrowers of different incomes and borrower characteristics.
- Innovative and flexible lending practices (offering a number of flexible lending products, which are provided in a safe and sound manner to address the credit needs of low-and moderate-income individuals).
- Fair Lending, and
- Loss of affordable housing (lending practices or products that showed an undue concentration or a systematic pattern of lending, including a pattern of early payment defaults, resulting in the loss of affordable housing units. Further, delinquency rates were found to be consistent with industry averages).

# OTHER FAIR LENDING DEVELOPMENTS

## UNFAIR, DECEPTIVE AND ABUSIVE PRACTICES

**Dodd Frank  
Introduces an  
Emphasis on Unfair  
Deceptive and  
Abusive Practices at  
the Federal Level**



**Abusive is defined the Dodd Frank Act as any act that:**

- (1) Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or**
- (2) Takes unreasonable advantage of –**
  - (A) A lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;**
  - (B) The inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or**
  - (C) The reasonable reliance by the consumer on a covered person to act in the interests of the consumer**

**Based on this definition, the UDAP doctrine may be widely expanded and may be the cause for new enforcement actions.**



# STATE AND FEDERAL REGULATORY FOCUS ON BORROWER'S ABILITY TO REPAY



## Unfair and Deceptive Practices Act (Federal and State)



**Massachusetts Predatory Home Loan Practices Act:** At the time a high-cost home mortgage loan is closed, the lender must reasonably believe that the borrower will be able to make the payments on the loan based on current and expected income, current obligations, employment status, and financial resources other than equity in the property. There is an automatic presumption that a borrower will be able to make payments if at the time the loan is closed, and based on payments calculated with the index plus the margin if there is an introductory rate, the borrower has a DTI of 50% or less and sufficient residual income under VA guidelines.

**Dodd Frank:** The Federal Reserve Board has proposed a Rule to implement a provision of the Dodd-Frank Act that prohibits lenders from originating mortgages without regard to the borrower's ability to repay the loan. Creditors must make a reasonable and good faith determination of that repayment ability, based on verified and documented evidence (such as reasonable expectation of income, employment status, qualifying ratios and credit history).