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MORTGAGE LENDING OUTREACH

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COMPLIANCE RESOURCE GUIDE

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Fair and Inclusive Mortgage Lending Outreach

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Section 1

Purpose and Scope

The gap in homeownership rates between White and Black families is larger today than it was in 1960, before the passage of the Fair Housing Act of 1968. Recent investigations completed by federal enforcement agencies, state banking commissioners, and fair housing advocates have uncovered racial disparities in mortgage lending, property appraisal valuations, and decisioning algorithms. A unified effort by enforcement agencies is now underway to help curb discrimination, and lessen the racial homeownership gap in America. The challenge ahead for lenders is to fully understand the risk of discrimination—as well as unintentional bias—and what steps must be taken to manage this risk. Three examples of discriminatory practices are summarized below.

Modern Day Redlining

Enforcement agencies have introduced a new vocabulary term known as modern day redlining. While historical redlining was considered an explicit, legally recognized policy, modern-day redlining looks at the activities, policies, and practices of lenders. On the surface, activities appear to not discriminate—but have a discriminatory effect. The U.S. Justice Department (DOJ) launched its new *Combatting Redlining Initiative* on October 20, 2021. The Initiative represents the DOJ's most aggressive and coordinated enforcement effort to address redlining, and expands the analyses of lending activity to both depository and non-depository institutions. As of March 2023, the department has resolved six redlining cases, and collectively, the settlements cost lenders more than $84 million.[1]

Discriminatory Effects Standard

On March 17, 2023, the U.S. Department of Housing and Urban Development (HUD) announced the restoration of the agency's *Discriminatory Effects Standard*. The rule is implemented under the Fair Housing Act, which prohibits discrimination in housing and housing-related services based on the applicant(s)' race, color, religion, national origin, sex (including sexual orientation and gender identity), familial status, and disability. The regulation applies to any creditor, its officers, agents, or employees in granting or fixing the terms of credit. The Discriminatory Effects law prohibits practices of housing-related activities which cause systemic inequality in housing, regardless of whether they were adopted with discriminatory intent.[2]

Appraisal Equality

On March 13, 2023, the Justice Department, and the Consumer Financial Protection Bureau (CFPB) filed a statement of interest to the U.S. District Court of Maryland to explain the application of the Fair Housing Act and the Equal Credit Opportunity Act (ECOA) to lenders relying on discriminatory appraisals. The statement of interest was filed in a lawsuit alleging that an appraiser and a lender violated both laws by lowering the valuation of a home because the owners were Black. The CFPB and DOJ have stated that mortgage lenders can be held liable under federal law for relying upon discriminatory appraisals from third-party appraisers.[3]

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According to the CFPB, both Fannie Mae and Freddie Mac have found appraisal disparities in communities of color. The CFPB is participating in a number of interagency rulemaking processes to address appraisal equality, automated valuation models (AVMs), and reconsideration of values (ROVs).[4]

Public HMDA Data

Fair lending investigations generally begin with a review of mortgage application data submitted by financial institutions pursuant to the Home Mortgage Disclosure Act (HMDA). Certain identifying data is redacted, and any person or entity can view public HMDA data for any geographic location or lender. For the year 2021, a total of 4,338 institutions consisting of banks, savings associations, credit unions, and non-depository mortgage lenders, reported data on approximately 23.3 million loan applications, resulting in 15.0 million originations.[5]

An example of the scope of information that is publicly available is shown in Figure 1, and is based on data reported by a group of 55 nationwide lenders known as quarterly filers. The group represents a significant share in the mortgage industry, and their combined loan applications in 2021 were greater than 15 million. The CFPB publishes certain data from quarterly filers in advance of yearly aggregate disclosure reports. For the third quarter of 2022, the group reported 1,310,951 applications, including a combined total of one million loans for FHA and conforming conventional loans. Figure 1 reflects statistical information from various CFPB graphs.[6]

HMDA Quarterly Filers – 3rd Quarter 2022
National Tables

LOAN TYPE	APPLICATIONS	DATA (Median)	ASIAN	BLACK	HISPANIC	WHITE
Conventional Conforming	724,959	Credit Scores	759	709	731	750
		CLTV	80	80	80	79.96
		DTI	40.45	41.26	42.3	38.5
		Denial Rate	10.31	21.68	16.84	10.26
		Closing Costs	$5,849.43	$5,812.95	$6,326.55	$5,288.99
FHA	286,189	Credit Scores	662	651	662	652
		CLTV	95	96.5	96.5	87.64
		DTI	48.38	47.57	48.66	44.88
		Denial Rate	19.5	23.14	17.42	19.36
		Closing Costs	$13,245.66	$10,726.71	$11,913.35	$9,856.89

Figure 1 – CFPB HMDA Quarterly Graphs

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Findings from one million nationwide applicants reveal a compelling statement—people from different cultures can have similar qualifications, but different approval rates and closing costs. Among other requirements, there are three essential factors considered for loan approval: the applicant(s)' credit score; debt-to-income (DTI) ratio; and combined loan-to-value (CLTV) percent. Similarities among all race/ethnic categories are highlighted:

- *Borrower credit scores fall within a margin of 11 points for FHA loans, and 50 points for conventional-conforming loans.*
- *The DTI range is within a 3.8% margin for both FHA and conventional loans.*
- *CLTVs are marginally the same on both FHA and conventional loans, apart from FHA loans with larger down payments from White borrowers.*

Public HMDA data include the property location's "minority population percent" on a census tract basis. According to the June 2022 *Report to Congressional Requesters* by the U.S. Government Accountability Office (GAO), bank examiners from the Office of the Comptroller of the Currency (OCC) measure the percentage of an institution's originations—as well as loan applications—in census tracts with 50% or greater minorities, referred to as Majority-Minority Tracts or MMTs. OCC examiners will also complete a peer analysis of lending activity in the assessment area originated by similarly situated lenders.[7]

Borrower Fallout

Borrower fallout represented about 8.3 million mortgage applications that were either denied, withdrawn, closed for incompleteness, or did not result in an origination for another reason. Fallout applications included more than 3.3 million borrowers who withdrew their loan applications, and nearly 1.5 million files that were closed for incompleteness.[8]

Public data also include the applicant's "tract to MSA income level." Figure 2 illustrates mortgage application outcomes segmented by MSA income level for the calendar year 2021. In this analysis, one racial category is examined for one metro area. As expected, higher fallout rates in lower income levels are likely attributed to borrower affordability. However, other statistics are perplexing. For example, in the highest income category (120% and above), 597 applicants were denied—but 898 applicants walked away. People who apply to more than one lender will ultimately withdraw an application. However, applications which are closed or withdrawn can sometimes be attributed to the lender's service standards.

Borrower Fallout
Black or African American Applicants - Newark, New Jersey MSA

INCOME LEVEL	APPLICATIONS	ORIGINATED	DENIED	WITHDRAWN	CLOSED INCOMPLETE	FALLOUT RATE
Less than 50% Median	1,662	526	585	332	146	68%
50 - 79%	3,794	1,852	850	711	269	51%
80 - 99%	1,428	739	251	307	87	48%
100 - 119%	2,997	1,590	543	574	204	47%
120% and above	3,585	1,985	597	645	253	45%
Total	13,046	6,692	2,826	2,569	959	49%

Figure 2 – FFIEC/CFPB 2021 HMDA Data: Newark MSA/MD (Newark NJ-PA)

To manage fallout, lenders need to get to the core of how customers are treated during each step of the loan cycle.

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Lost Opportunities

According to the Interagency Taskforce on Property Appraisal and Valuation Equity (PAVE), the median White family holds eight times the wealth of the typical Black family and five times the wealth of the typical Latino family. On average, homes in majority-Black neighborhoods are valued at less than half of those in neighborhoods with few or no black residents.[9]

The Federal Housing Finance Agency (FHFA) Housing Price Index (FHFA HPI®) measures changes in single-family home values for 50 states and over 400 American cities. The overall rate of appreciation nationwide for the past year is 8.4%. The FHFA Fourth Quarter 2022 report, *Top 100 Metro Area Rankings*, lists 37 MSAs where home prices rose more than 10% over the past year, and 40 MSAs with appreciation rates over 5%.[10] Every year that a family does not own a home they are losing a wealth-building opportunity, as well as other important benefits. Three types of "lost opportunities" are described below.

Healthier Homes. According to the U.S. Environmental Protection Agency (EPA), multifamily buildings have indoor air quality challenges since pollutants can move from unit to unit, and residents are unable to make changes or control the indoor air quality environment.[11] Homeownership gives families a chance to mitigate the risk of exposure to mold, radon, biological pollutants, environmental toxins, and other harmful allergens. A report completed by the International Energy Agency examined health outcomes in homes where efficiency measures were taken to improve ventilation and indoor air quality. Healthier outcomes included reduced symptoms of respiratory disease, asthma, cancer, cardiovascular disease, arthritis, and depression.[12]

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Financial Incentives. *The Inflation Reduction Act*, signed in August 2022 by President Biden, offers every homeowner in America a chance to receive bottom-line tax credits up to 30% on expenditures for energy-efficiency improvements. According to the NC Clean Energy Technology Center, there are approximately two thousand state and federal financial incentives available to homeowners for energy improvements.[13] Across the nation, municipalities and local nonprofits offer homeowners financing assistance with measures such as water testing and safety; mitigation of radon, mold, gas, and carbon monoxide; safe removal of asbestos and lead paint; weatherization; accessibility features; and steps to make the home more climate resilient.

Federal Assistance. According to the *State of the Nation's Housing 2022* report by Harvard University's Joint Center for Housing Studies, some 51.5 million households in America live in areas with at least a moderate threat from natural disasters.[14] Fannie Mae's *Disaster Response Network* offers homeowners assistance through *Project Porchlight*, and HUD-approved counselors and trained disaster recovery experts provide affected households with a needs assessment and a personalized recovery plan. Counselors provide ongoing guidance, Spanish language services, help with arranging mortgage payment deferrals or forbearance, and assistance with processing FEMA flood insurance claims.[15]

Resource Guide Scope

This guide is formatted to help institutions understand and manage discrimination risk, what steps are needed to better understand the credit needs their marketplace, and how to expand residential mortgage lending to reach low-and-moderate income and minority populations. To help institutions prepare for forthcoming amendments, this guide also addresses rulemaking currently in process such as automated valuation appraisals (AVMs) and reinstatement of values (ROVs). Guidance is provided for product enhancement, community outreach, compliance monitoring, self-evaluation, and how to prepare for a fair lending examination.

Consent Orders issued by the Department of Justice have consistently listed a stipulation requiring that the institution must complete a community credit needs assessment based on the economic and household demographics of the lending marketplace. Other stipulations include branch expansion, training, risk monitoring, fair lending policy and procedures, community outreach, and relationship development with local nonprofits and housing partnership agencies. In all DOJ Complaints, examiners completed a peer analysis of similarly situated lenders and included a comparative analysis that measured the institution's performance with peers—as well as metrics based on minority population in the assessed area.[16]

This resource guide provides instructional guidance for institutions to complete a number of directives which are expected by enforcement agencies, such as a performance analysis and community credit needs assessment. Explicit instructions are provided for researching the racial and ethnic demographics of the marketplace, as well as researching property valuations and mortgage lending statistical data. Infographic instructions focus on the utilization of government websites such as the U.S. Census Bureau, the Consumer Financial Protection Bureau (CFPB), the Federal Financial Housing Agency (FHFA), and the Federal Financial Institutions Examination Council (FFIEC). Using these free tools, compliance managers as well as members of a fair lending workgroup can complete the following tasks:

- How to research marketplace data on property appraisal valuations.
- How to research population demographics regarding race, ethnicity, median income, property values, and other economic and householder statistics.
- How to research HMDA data to measure the institution's lending performance.
- How to research public HMDA data to formulate a peer analysis of similarly situated lenders in the marketplace.
- Product enhancement, and how to use tools available from Fannie Mae and Freddie Mac.
- How to complete self-evaluation to analyze customer fallout, past lending patterns, and quality of assistance.
- Community outreach activities.
- Partnership opportunities to enhance low-to-moderate lending through local housing finance agencies and nonprofits.
- Compliance management and how to prepare for a fair lending examination.

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Section 2
Discrimination Risk

Discriminatory Effects Standard

The Discriminatory Effects Standard prohibits practices of housing-related activities which cause systemic inequality in housing, regardless of whether they were adopted with discriminatory intent. The Discriminatory Effects law was restored in March 2023, and is implemented under the Fair Housing Act, which prohibits discrimination in housing and housing-related services based on the applicant(s)' race, color, religion, national origin, sex (including sexual orientation and gender identity), familial status, and disability. The regulation applies to any creditor, its officers, agents, or employees in granting or fixing the terms of credit.[17]

Disparate impact occurs when a facially neutral policy or practice burdens certain persons on a prohibited basis. Facially neutral means that—on the surface, or face value—no one is expressly excluded, however the lender's standards are found to disproportionally exclude protected groups. Because there is no actual intent to discriminate, disparate impact is considered to be **unintentional.**

Disparate treatment is found when applicants of a protected group—when compared with white applicants with similarly-situated credit and transaction characteristics—were charged higher loan costs, less favorable loan terms, approved with stricter underwriting conditions, or received a lower level of service standards. Disparate treatment, on the other hand, is considered to be **intentional.**

According to the Office of the Comptroller of the Currency (OCC), the terms below may be referenced during a fair lending examination to identify and address a lender's deficient fair lending practices:

Overt disparate treatment occurs when a lender openly treats applicants differently on a prohibited basis, such as when a policy explicitly limits access to credit based on an applicant's age, source of income, or marital status.

Comparative disparate treatment occurs when a lender treats applicants differently on a prohibited basis in the absence of an explicit policy and without a credible nondiscriminatory reason. Examinations may conclude that the institution may have violated fair lending laws if a legitimate nondiscriminatory reason for the disparity is not provided.[18]

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Redlining

The Combatting Redlining Initiative launched by the U.S. Justice Department (DOJ) in October 2021 is a coordinated enforcement effort with the Consumer Financial Protection Bureau (CFPB) to address redlining. The Initiative expands the analyses of lending activity to both depository and non-depository institutions, and lenders are considered to be in violation of the Equal Credit opportunity Act (ECOA) by avoiding potential loan applicants who reside in majority-minority census tracts, known as MMTs. The DOJ refers to such actions as "modern-day redlining."[19]

According to the DOJ, if an institution's primary regulator has never raised a concern about redlining, it will not preclude that institution from being investigated. The DOJ further states the initiative does not necessarily involve intentional discrimination—and is more likely not intentional.[20]

> **Modern-day redlining** is a term which is used to describe the activities, policies, and practices of lenders. On the surface, activities appear to not discriminate— but have a discriminatory effect. While historical redlining was considered an explicit, legally recognized policy, modern-day redlining looks at the institution's location of branches, advertising efforts, and where loan officers are placed.[21]
>
> **Redlining** is defined as when an institution provides unequal access to credit (or unequal terms of credit) based on the applicant(s)' race, color, national origin, or other prohibited characteristics. The geographic location in question is based on the subject property of the mortgage. For second homes or investment properties, the location is based on the borrower's primary residence.[22]
>
> **Reverse redlining** refers to the practice of targeting minority borrowers (or another prohibited basis) or targeting certain geographic areas with products or services that are less advantageous to the customer.[23]

In July 2022, the CFPB and DOJ charged its first nonbank lender with redlining, alleging the lender discouraged prospective applicants from applying for mortgage and refinance loans in majority-minority neighborhoods. The $20 million settlement included $4 million in civil money penalties, and required the lender to invest $18.4 million in a subsidy fund to increase minority lending in their marketplace area, plus invest $3 million in branch expansion and outreach activities.[24]

Supervisory and administrative enforcement actions can be taken against institutions that do not comply with fair lending laws and regulations. Lenders are notified of any findings by letter or examination report, describing actions which must be taken to address fair lending deficiencies or violations of ECOA or Fair Housing Act. Under appropriate circumstances, violations may be referred to the DOJ or HUD. For banks that are exempt from reporting certain HMDA data, supervisory agencies will complete a fair lending risk assessment to identify fair lending risk, and determine whether additional fair lending supervisory activity is appropriate.

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Strategic Risk is the risk to current or projected financial condition and resilience arising from adverse business decisions, poor implementation of business decisions, or lack of responsiveness to changes in the banking industry and operating environment. A bank's strategic decisions can pose increased strategic risk. Examples include entering, exiting, or otherwise changing the bank's loan products; marketing techniques; underwriting processes; pricing decisions; and loan officer compensation structure. Strategic risk can increase if a bank deploys additional loan products, expands the geographic areas where the bank lends, or introduces new or revised lending practices without proper risk management oversight.[28]

Reputation Risk is the risk to current or projected financial condition and resilience arising from negative public opinion. This risk may impair a bank's competitiveness by affecting its ability to establish new relationships or services or continue servicing existing relationships. Inadequate policies and procedures, operational breakdowns, or general weaknesses in any aspect of the bank's fair lending activities can harm the bank's reputation. Failing to employ appropriate measures to conduct activities in compliance with fair lending laws and regulations can expose the bank to heightened adverse publicity. Given the important societal interests that the fair lending laws are designed to protect, such failures can result in enforcement actions or litigation.[29]

Interagency Procedures' Indicators of Discrimination

Indicators of discrimination are listed on the following pages and are segmented by a number of risk categories. The categories and listing of factors are adapted from the *Interagency Fair Lending Examination Procedures*. Risk factors are determined based on an examiner's review of lending policies, marketing plans, underwriting, appraisal, and pricing guidelines, broker agreements, and loan application forms for each type of residential loan product. Data collected by examiners includes racial and national origin percentages and geographic distribution of the institution's loan originations.[30]

Overt Indicators of Discrimination

- Including explicit prohibited basis identifiers in the institution's written or oral policies and procedures, such as underwriting criteria and pricing standards.
- Collecting information, conducting inquiries, or imposing conditions contrary to express requirements of ECOA.
- Including variables in a credit scoring system that constitute a basis or factor prohibited by ECOA, or (for residential loan scoring systems) the Fair Housing Act (FHAct).
- Statements made by the institution's officers, employees or agents which indicate discrimination on a prohibited basis in any aspect of a credit transaction.
- Employee or institutional statements that evidence attitudes based on prohibited basis prejudices or stereotypes.

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June 1, 2023, the CFPB announced the agency is taking another step toward accountability for automated systems and models, sometimes marketed as artificial intelligence (AI). The CFPB is proposing a rule to make home appraisals computed by algorithms fairer and more accurate. This initiative is one of many steps being taken to ensure that algorithms and AI are complying with existing law. Emerging AI-marketed technologies can negatively impact civil rights, fair competition, and consumer protection.[35] (*Note: the CFPB's proposed rulemaking is covered in Section 3, Appraisal Equality.)*

Fintech Risks

According to a September 2022 joint study completed by the Federal Reserve Bank of New York and the Federal Reserve Bank of Philadelphia, *Which Lenders are More Likely to Reach Out to Underserved Consumers, Banks vs. Fintechs vs. Other Nonbanks*, financial technology, or "fintech," companies are reaching underserved consumers. Known for having caused a digital disruption in the market, the fintech landscape has expanded quickly due to big data, data analytics, decisioning algorithms, and artificial intelligence. Fintech firms target nonprime consumers, including applicants who have been denied or filed for bankruptcy, which enable alternative lenders to better assess borrower's creditworthiness and reach historically under-served populations.[36]

In March 2023, the FDIC entered into a Consent Order with a bank to resolve FDIC charges that the bank engaged in unsafe or unsound practices related to its fair lending compliance. The institution was acting as a service provider (known as a banking-as-a-service or Baas provider), whereby loans were made through various partnerships with fintech companies. The Consent Order is considered to be a warning that bank-fintech partnerships are likely to receive increased scrutiny from regulators, and may be indicative of FDIC expectations for how banks should be addressing this risk.[37]

Third Party Risk

Common third-party relationships related to fair lending include marketing, processing of loan applications, loan servicing, and loss mitigation. Such third parties should be incorporated into the institution's third-party risk management processes. According to the OCC Fair Lending Handbook, banks are expected to practice effective risk management regardless of whether the bank performs the activity internally or through third parties. An institution's use of third parties does not diminish the responsibility of its management to determine that the activity is performed in a safe and sound manner and in compliance with applicable laws.

According to the CFPB, the key to the effective use of a third party in any capacity is for the financial institution's management to appropriately assess, measure, monitor, and control the risks associated with the relationship. While engaging another entity may assist management and the board in achieving strategic goals, such an arrangement reduces management's direct control. Therefore, the use of a third party increases the need for oversight of the process from start to finish. The CFPB provides four main elements of an effective third-party risk management process: risk assessment; due diligence in selecting a third party; contract structuring and review; and oversight.[38]

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State and Local Enforcement

There has been a growing number of legal actions taken against mortgage lenders charged with racial discrimination. In addition, fair housing alliances have conducted mortgage studies and have made accusations against lenders based on public HMDA data. Two unique examples are provided below.

In February 2021, the New York State Department of Financial Services issued its *Report on Inquiry into Redlining in Buffalo, New York.* The study found that 4.45% of all mortgages made in Majority-Minority Tracts (MMTs) were made to minorities. Throughout the Buffalo MSA, where 20% of the population is non-White, loans to minorities were 9.74%. Research was based on public HMDA data for 2016–2019.[39]

According to the report, "The Department, using HMDA data to map out and analyze patterns of mortgage lending in the Buffalo area, identified a distinct lack of lending by mortgage lenders, and, in particular, several non-depository lenders in neighborhoods with majority-minority populations and to minority homebuyers in general." The study also noted the wide discrepancies among different lenders, as well as the lack of effort made by in marketing to minority communities.

One non-depository lender was required to allocate $50,000 in marketing and outreach to MMT communities, and to provide $150,000 in discounted or subsidized financing to minority borrowers over a three-year period. The Department entered into a settlement agreement with the company, and the agreement stated:

> *"There was no evidence of intentional discrimination on the part of the mortgage company or any of its employees."* —New York State Department of Financial Services

On May 25, 2023, the New York City Banking Commission held its first-ever public hearing, where all three members voted to limit deposits to two banks after the banks refused to submit plans demonstrating their efforts to root out discrimination. The length of the freeze on new deposits is two years. Under the Charter and the Rules of the NYC Banking Commission, to comply with designation requirements, a bank must file certificates concerning its policies of non-discrimination in hiring, promotion, and delivery of banking services, and for bank closings. The Commission introduced requirements in February 2023 for banks to submit plans that demonstrate a meaningful commitment to combat discrimination in employment, services, and lending.[40]

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Section 3

Appraisal Equality

The September 2021 report by Freddie Mac, *Racial and Ethnic Valuation Gaps in Home Purchase Appraisals*, examined the outcomes for properties in Black and Latino census tracts versus those in White tracts, using 50% as a threshold to define minority tracts. The report stated that 12.5% of appraisals for home purchases in majority-Black neighborhoods and 15.4% majority-Latino neighborhoods result in a value below the contract price compared to 7.4% in predominantly White neighborhoods.[41]

In the review of appraisals, the FHFA states they have observed references to race and ethnicity in the "Neighborhood Description" and other free-form text fields in the appraisal form. According to the FHFA, appraisals are to be fair and free of bias, providing a supported value for a family's future or current home that reflects respect and equal treatment of the community and neighborhood in which the home is located. Examples of overt references to race, ethnicity, and other prohibited bases in appraisals and other property descriptions persist—indicating the continued presence of valuation bias. The FHFA advises that ongoing failure to address appraiser consideration of prohibited factors such as race, indicated within the free-text form fields of appraisals, may result in valuation bias. Market participants must ensure that appraisals and other property valuations are compliant with fair lending principles, including in free-form text commentary. The FHFA recommends that institutions and other market participants should be aware that the discretionary nature of the free-form commentary is a key risk factor that requires appropriate risk mitigation.[42]

On March 13, 2023, The Justice Department filed a statement of interest to the U.S. District Court of Maryland alleging that an appraiser and a lender violated the Fair Housing Act and the Equal Credit Opportunity Act by lowering the valuation of a home because the owners were Black. The mortgage was denied on the owners' refinance application based on that appraisal. The home was later appraised at a considerably higher value after family photos were replaced with images of White people.[43]

> *"Mortgage lenders can be held liable under federal law for relying upon discriminatory appraisals from third-party appraisers."* —U.S. Department of Justice

USPAP Standards

The Uniform Standards of Professional Appraisal Practice (USPAP) is the generally recognized ethical and performance standards for the appraisal profession in the United States. USPAP was adopted by Congress in 1989, and contains standards for all types of appraisal services, including real estate, personal property and business. Compliance is required for state-licensed and state-certified appraisers involved in federally related real estate transactions. The Uniform Residential Appraisal Report (URAR) provides—in the neighborhood section of the form —race and the racial composition of the neighborhood are not appraisal factors.

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USPAP requires that, upon completing the URAR, appraisers must certify that they did not base, either partially or completely, the analysis and/or opinion of market value in the appraisal report on the race, color, religion, sex, age, marital status, handicap, familial status, or national origin of either the prospective owners or occupants of the subject property or of the present owners or occupants of the properties in the vicinity of the subject property, or on any other basis prohibited by law.[44]

Interagency Taskforce on Property Appraisal and Valuation Equity (PAVE)

On June 1, 2023, President Biden announced a set of meaningful action plans to deliver on the Interagency Taskforce on Property Appraisal and Valuation Equity (PAVE) Action Plan, released in March 2022.[45] The PAVE Task Force, which is co-chaired by HUD Secretary Marcia Fudge and Domestic Policy Advisor Susan Rice, is directed to evaluate the causes, extent, and consequences of appraisal bias and to establish a transformative set of recommendations to root out racial and ethnic bias in home valuations. This Task Force also includes cabinet level leaders from executive departments and additional members from independent agencies, including the CFPB.[46]

According to PAVE, researchers have observed a market value gap between majority-Black and majority-white neighborhoods for decades. On average, homes in majority-Black neighborhoods are valued at less than half of those in neighborhoods with few or no Black residents. Statistical analyses from the Brookings Institute show that accounting for neighborhood and property characteristics and amenities—such as the age of the property or its proximity to public transportation—does not explain the entire disparity. Recent research has identified appraisals as one of the drivers of the gap.[47]

The CFPB serves on the PAVE Task Force, and is participating in interagency rulemaking processes that include the Federal Reserve Board, OCC, FDIC, NCUA, and FHFA to implement the amendments made by the Dodd-Frank Act concerning automated valuation models (AVMs). These standards are designed to ensure AVMs comply with nondiscrimination laws, and provide a high level of confidence in the estimates produced by the valuation models. Standards aim to protect against the manipulation of data, seek to avoid conflicts of interest, require random sample testing and reviews, and account for any other such factor that the Agencies determine to be appropriate.[48]

The CFPB is also a member of the FFIEC's Appraisal Subcommittee (ASC) that provides federal oversight of state appraiser and appraisal management company regulatory programs. ASC responsibilities include promoting fairness and equality in valuations, and serve as a monitoring framework for The Appraisal Foundation and the Federal Financial Institutions Regulatory Agencies in their roles to protect federal financial and public policy interests in real estate appraisals utilized in federally related transactions.[49]

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Automated Valuation Models

On June 1, 2023, six agencies issued a proposed rule regarding Automated Valuation Models (AVMs), to address the algorithmic and computational models used to assess the value of homes. Collectively, the agencies include the Consumer Financial Protection Bureau, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, National Credit Union Administration, and Office of the Comptroller of the Currency.

The proposed rule would establish quality control standards to help ensure AVMs are accurately and fairly assessing home values. These standards would require financial institutions, mortgage originators, and secondary market issuers that use AVMs to adopt and maintain policies and other safeguards to ensure greater confidence in valuation estimates, protect against data manipulation, avoid conflicts of interest, and conduct random sample testing and reviews. In addition, the proposed rule expressly includes a nondiscrimination quality control standard.[50]

The standards would require mortgage originators and secondary market insurers that use AVMs to determine the value of mortgage collateral adhere to quality control standards designed to:

- Ensure a high level of confidence in the estimates;
- Protect against the manipulation of data;
- Seek to avoid conflicts of interest;
- Require random sample testing and reviews; and
- Comply with applicable nondiscrimination laws.

The proposed rule would require that mortgage originators and secondary market issuers adopt policies and controls to ensure that AVMs used in certain credit decisions or covered securitization determinations adhere to quality control standards. However, to provide flexibility, the proposed rules allow for regulated institutions to adopt their own AVM policies and control systems to satisfy the statutory factors, rather than prescribing those polices and systems.

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Reinstatement of Value

On June 8, 2023, five federal banking agencies issued proposed guidance on how financial institutions may integrate Reinstatement of Value (ROV) policies and controls into their current appraisal processes. Collectively, the agencies include the Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, and the Consumer Financial Protection Bureau. The proposed guidance advises on how financial institutions may respond to consumer concerns about their appraisal and design policies and controls around ROV requests to appraisers. ROVs are requests from a financial institution to an appraiser or other preparer of a valuation report to reassess the value of residential real estate. An ROV may be warranted if a consumer provides information to a financial institution about potential deficiencies or other information that may affect the estimated value.

Deficient collateral valuations can contain inaccuracies due to errors, omissions, or discrimination that affect the value conclusion. The proposed guidance would provide examples of ROV policies and procedures that a financial institution may establish to help identify, address, and mitigate valuation discrimination risk. The proposed guidance shows how ROVs intersect with appraisal independence requirements and compliance with applicable laws and regulations, and how financial institutions may incorporate ROV processes into established risk management functions.[51]

FHFA Fair Lending Dashboard

Institutions can utilize the FHFA fair lending data tool to stay current on appraisal equality. FHFA monitors appraised valuations in minority census tracts in every state. Data can be accessed on the UAD Aggregate Statistics Fair Lending Dashboard and statistical data can be viewed by State or MSA/MD. By selecting categories from four sets of drop-down listings, users can choose up to two locations, a minority population category, and an appraisal statistic. Figure 3 below illustrates data for two states, Maryland, and Delaware.[52]

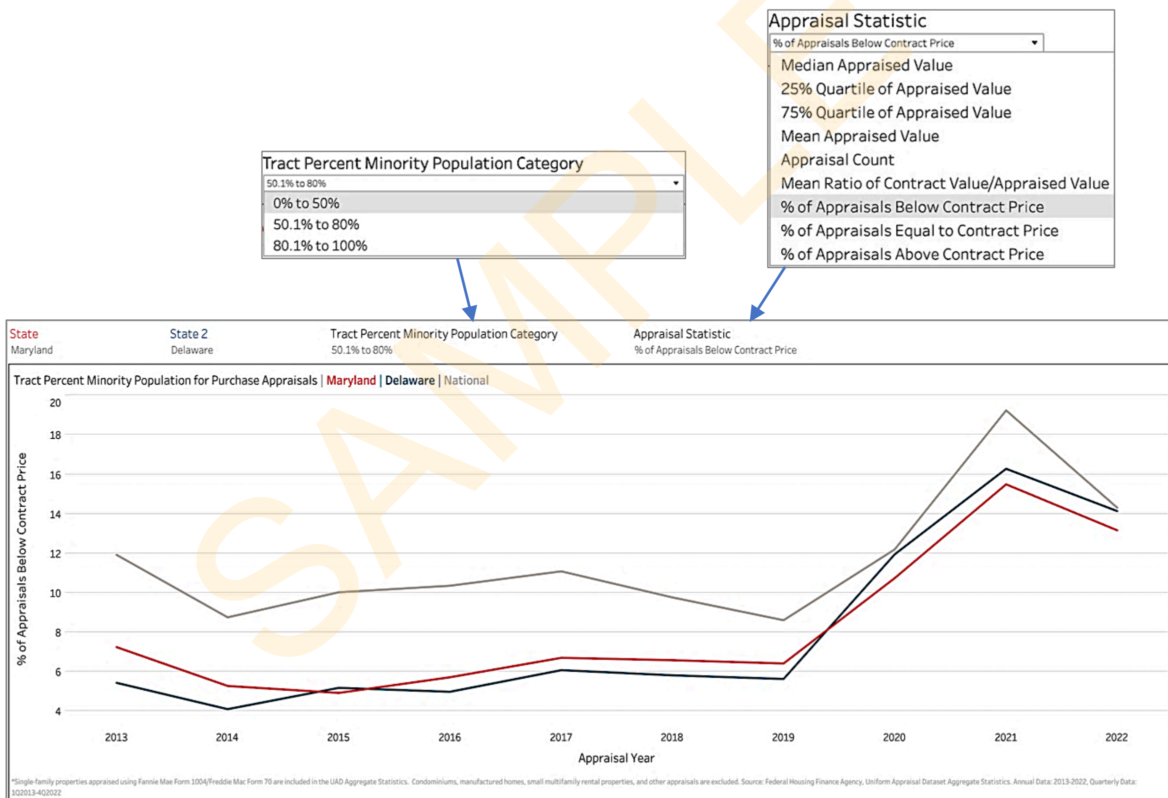

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Figure 3: FHFA UAD Aggregate Statistics Fair Lending Dashboard

Section 4
Marketplace Demographics

Reasonably Expected Market Area

The FDIC defines a market area as generally where the institution markets for credit and where it plans to conduct business. Examiners will evaluate a bank's redlining risk using what is referred to as the reasonably expected market area or "REMA." The *Interagency Fair Lending Examination Procedures* require that a bank's reasonably expected market area is where the bank actually marketed or provided credit, or where it could reasonably be expected to have marketed and provided credit. Examiners determine the REMA after considering the following two factors:

- The institution's method of attracting business, including branch or loan production office locations, mortgage subsidiaries, online applications, and use of third-party brokers or realtors; and
- Where the institution has received loan applications and originated loans.[53]

CRA Assessment Area

The geographic area covered under the Community Reinvestment Act (CRA) is defined by Metropolitan Statistical Area (MSA), Metropolitan Division (MD), or whole census tracts. Key imperatives of CRA include demonstrated efforts to ascertain the credit needs of its community, including low-to-moderate income (LMI) neighborhoods; utilization of innovative and flexible lending in a safe and sound manner; participation in community outreach and education; monitoring the geographic distribution of loan originations and credit denials; and participation in government-insured, guaranteed, or subsidized loan programs.

> *"Unlike fair lending and housing laws, CRA does not apply a racial lens to its analysis of regulated entities' activities."* —Federal Reserve Bank of Minneapolis

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According to the Federal Reserve Bank of Minneapolis, the CRA was one of several civil rights laws enacted in the 1960s and 1970s to address systemic inequities in credit access. It was intended to reinforce the other civil rights statutes by addressing redlining, a practice wherein banks declined to make loans or extend other financial services in neighborhoods made up largely of Black households, other households of color, or households of certain ethnic groups. The term "redlining" derives from maps that were created for government programs and that literally delimited these neighborhoods in red while classifying them as high credit risks.[54]

Banks are rated based on their activities within an assessment area, and a CRA examination includes an analysis of banks' lending to LMI households and neighborhoods within their assessment areas. The exact tests used to conduct the analysis vary based on a bank's size. The regulations currently categorize banks as small, intermediate small, or large, depending on their total assets. If a bank is found to be underserving LMI neighborhoods or households in its assessment area(s), its rating may suffer.[55]

How does your institution measure up?

Figure 18 is an example of a loan disposition report formulated from public HMDA data for the Boston, Massachusetts MSA/MD. This report delineates activity by loan disposition and income level. This type of report can be instrumental for self-evaluation as well as peer analysis. Report data was derived from the CFPB's HMDA data browser MSA/MD Aggregate Reports.

MASSACHUSETTS – Boston MSA

2021 Loan Disposition by Income Level, Race & Ethnicity
Boston MSA/MD 14454

	Applications	Originated	Denied	Withdrawn	Closed for Incompleteness
LESS THAN 50% OF MSA MEDIAN INCOME					
American Indian or Alaska Native	30	12	9	4	4
Asian	1051	496	371	100	73
Black or African American	1790	678	679	216	161
Native Hawaiian or Other Pacific Islander	55	15	26	8	5
White	7413	3713	2109	846	564
Hispanic or Latino	908	350	332	106	102
50-79% OF MSA MEDIAN INCOME					
American Indian or Alaska Native	89	53	18	12	6
Asian	2064	1389	292	252	106
Black or African American	3917	2225	867	491	269
Native Hawaiian or Other Pacific Islander	56	27	19	4	4
White	17105	11928	2007	1919	954
Hispanic or Latino	2149	1289	389	279	149
80-99% OF MSA MEDIAN INCOME					
American Indian or Alaska Native	23	12	7	1	3
Asian	670	468	68	87	38
Black or African American	1201	698	220	168	92
Native Hawaiian or Other Pacific Islander	16	9	1	2	3
White	6552	4800	629	685	325
Hispanic or Latino	674	419	108	74	58
100-119% OF MSA MEDIAN INCOME					
American Indian or Alaska Native	28	11	9	6	2
Asian	1883	1364	169	207	99
Black or African American	2234	1331	395	291	166
Native Hawaiian or Other Pacific Islander	32	17	7	5	3
White	15559	11835	1161	1578	735
Hispanic or Latino	1297	859	180	165	71
120% OR MORE OF MSA MEDIAN INCOME					
American Indian or Alaska Native	80	49	15	8	6
Asian	4975	3591	367	702	240
Black or African American	2107	1278	299	325	154
Native Hawaiian or Other Pacific Islander	39	21	11	6	1
White	41327	32000	2564	4278	1780
Hispanic or Latino	1531	1002	191	220	94

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Figure 18: 2021 HMDA Aggregate Report. Table excludes joint applicants, 2 or more races, other races, and racial/ethnicity not provided.

Section 6

Product Enhancements

FDIC Guidance

According to guidance from the FDIC, in evaluating the innovativeness or flexibility of an institution's lending practices, examiners will not be limited to reviewing the overall variety and specific terms and conditions of the credit product themselves. Examiners also consider whether innovative or flexible terms or products augment the success and effectiveness of the institution's loan programs that address the credit needs of low- or moderate- income geographies or individuals. Historically, many institutions have used innovative and flexible lending practices to customize loans to their customers' specific needs in a safe and sound manner. However, an innovative or flexible lending practice is not required in order to obtain a specific CRA rating. Examples of lending practices that are considered innovative or flexible include:

- Small dollar loan programs, with reasonable terms and offered in a safe and sound manner, which include evaluating an individual's ability to repay.
- Financial counseling targeted to low- or moderate-income individuals or communities.
- Mortgage or consumer lending programs targeted to low- or moderate-income geographies or individuals, consistent with safe and sound lending practices.
- Underwriting standards that utilize alternative credit histories, such as utility or rent payments.
- Use of alternative credit histories to demonstrate that consumers have a timely and consistent record of paying their obligations. [72]

Underwriting Flexibilities from Fannie Mae and Freddie Mac

Affordable mortgage programs offered through Fannie Mae and Freddie Mac (the Enterprises) are available to authorized seller/servicers, which include both depository and non-depository lenders. The Enterprises purchase conventional/conforming loans, as well as loans that are insured by the Federal Housing Administration, the U.S. Department of Veterans Affairs, USDA Rural Housing, and HUD's Native American mortgage program. In recent years, Fannie Mae and Freddie Mac launched new affordable lending initiatives, and have expanded a number of qualifying rules to boost homebuying opportunities for low- and moderate-income borrowers. Changes have been centered around the financial capacity, culture, and lifestyle of today's consumer. Featured below are examples of the Enterprises' underwriting flexibilities:

- Mortgages for homebuyers with little or no cash
- No credit score or limited credit history
- Eased qualifying rules for student loans, alimony, and self-employed borrowers
- Loans structured to include renovation costs, builder, or seller contributions
- Sweat equity for borrowers to complete certain home renovations
- Energy-efficient mortgages
- Qualifying household income from a family member or health aid
- Expansion of acceptable sources of non-salaried income

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Freddie Mac Home Possible Income and Property Eligibility Tool

The Freddie Mac Home Possible® mortgage offers numerous options and credit flexibilities to help very low- to low-income borrowers own a home with down payment requirements as little as 3%. Freddie Mac's HomeOne® mortgage also provides 3% down payment options, regardless of their income levels or geographic location.

Illustrated below is an image from a census tract location in Miami-Dade County, Florida, using the Freddie Mac Home Possible Income and Property Eligibility Tool. AMI income limits are shown for Home Possible® mortgage eligibility, along with a direct link to a listing of all eligible down payment assistance programs available in the selected location.

The down payment programs image is a partial view of the 21 available programs for the geographic region. Links are provided for each entity to obtain additional information.[80]

Home Possible Income Limits by Census Tract

See if this property qualifies for **Down Payment Assistance**

County: Miami-Dade
FIPS Code 12086005506
Home Possible Income Limit: $67,600
100% Median Income: $84,500
80% Area Median Income: $67,600
50% Area Median Income: $42,250
High Needs Rural Tract: No
Rural Tract: No
High Cost Area: No

Zoom to

Down Payment Programs

Maximum Amount	Program Name
$100,000	Miami-Dade County Homebuyer Loan Program (HLP)
$35,000	Miami-Dade County Down Payment Assistance Program
$28,500	Miami-Dade Economic Advocacy Trust (MDEAT) Homeownership Assistance Program (HAP)
$15,000	Solita's House Inc. (SHI) Purchase Renovation Opportunities (SHI PRO)
$15,000	Solita's House Inc. (SHI) Down Payment Assistance Loan (DPAL) Program
$15,000	Housing Finance Authority (HFA) of Miami-Dade County Down Payment Assistance Second Mortgage – Targeted Areas
$15,000	Housing Finance Authority (HFA) of Miami-Dade County Down Payment Assistance Second Mortgage
Up to $15,000 (5% of Purchase Price)	CBC Mortgage Chenoa Fund – FHA Repayable DPA
Up to $15,000 (5% of Purchase Price)	CBC Mortgage Chenoa Fund – FHA Forgivable DPA
Up to $14,250 (5% of Total Loan Amount)	Florida Housing Finance Corporation (FHFC) TBA Hometown Heroes Second Mortgage Temporarily Suspended

Figure 25: Freddie Mac Home Possible Income and Property Eligibility Lookup Tool and Down Payment Programs

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Section 7

Community Outreach

FDIC Guidance

Prudential regulators expect institutions to develop measurable standards for marketing, advertising, and outreach strategies. According to the FDIC, efforts must include a reasonable level of marketing and branching to ensure credit products are being offered in areas with higher concentrations of minorities. Institutions need to periodically assess marketing results to evaluate success in reaching diverse populations. Institutions are also expected to develop relationships with third parties, such as real estate agents and homebuilders who may serve as a source of customer referrals. For institutions working with third-party originators, any mortgage brokers should also provide a reasonable level of outreach to areas with diverse populations.[81] The FDIC provides three recommendations which can help reduce potential redlining risk in its marketing and outreach efforts:

- Develop measurable standards for marketing, advertising, and outreach strategies and periodically assess the results to evaluate the success of these strategies in reaching different demographic populations in the market.
- Review marketing, including branching strategies (if used to reach applicants), to ensure they offer a reasonable level of marketing of credit products in areas with concentrations of minority group residents within the bank's market area. As part of any review, banks may want to review business contacts with third parties, such as real estate agents and homebuilders that may serve as a source of applicants for the bank's credit products.
- Analyze mortgage broker relationships to ensure they provide reasonable levels of outreach and marketing to areas with concentrations of minority residents compared to markets with lower concentrations of minority residents.[82]

Guidance from the FDIC recommends that activities need to be reviewed to determine if certain populations or geographies in the market area may potentially be excluded. For example, marketing which targets areas by zip code could result in minority areas being underserved relative to non-minority areas. The guidance states that banks can review the content of advertisements to ensure they are designed to attract a range of applicants. In addition, banks can consider where promotional materials are distributed, the locations of any outreach efforts, and what geographies are served by any entities from which the bank solicits business (such as real estate agents or brokers).[83]

Community outreach is a fundamental requirement of CRA, and institutions are expected to meet with business and civic leaders in the community to hear what types of financial services and mortgage programs will benefit the needs of its residents. For fair and inclusive mortgage lending outreach, community lending officers can benefit from learning about what is currently on the state's legislative agenda with respect to affordable housing.

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Section 8

Preparing for a Fair Lending Examination

Compliance Management System (CMS)

Institutions must have a compliance management system (CMS) in place that will effectively identify, measure, monitor, and control their fair lending risk exposure. Directors, executives, managers, and all employees need to recognize the risks associated with discrimination, and adhere to the CMS and its articulated anti-discrimination policy. The CMS must address every type of residential mortgage program, and represent the institution's business marketplace, property types, demographics in income characteristics of its residents.

The CMS should extend to both retail and third-party originators, mortgage brokers, and other service delivery channels. The policy must apply to loan applications that include, but are not limited to, face-to-face, telephone, web-based, and mail. Every person representing the company in any capacity is responsible for ensuring that all applicants are given equal and impartial treatment in the marketing, origination, processing, approval, closing, and servicing of their home mortgages. A key component of the fair lending examination by supervisory agencies is the review of the CMS or other articulated fair lending policies and procedures.

FDIC Fair Lending Review

The FDIC conducts a fair lending review as part of every consumer compliance examination. The fair lending review evaluates a supervised institution's compliance with the anti-discrimination laws and regulations, including the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA). While the vast majority of FDIC-supervised institutions maintain effective compliance programs, the FDIC does occasionally identify violations related to discrimination. When the FDIC has reason to believe a creditor is engaged in a pattern or practice of discrimination in violation of ECOA, the FDIC is required by law to refer the matter to the Department of Justice (DOJ). In general, DOJ referral matters involve a range of discrimination findings relating to redlining, pricing for indirect automobile financing, and overt policies for the pricing or underwriting of credit. The redlining matters generally involved instances where the banks' levels of lending did not penetrate geographies consisting of more than 50 percent minority populations.[87]

Interagency Compliance Management Review

A compliance management review is a fair lending examination process instituted under the Interagency Fair Lending Examination Procedures. The procedures state that a compliance management review enables examiners to determine the intensity of the examination, and measure the reliability of the institution's practices and procedures for ensuring fair lending compliance. The compliance management review will help examiners determine whether the policies and procedures of the institution enable management to prevent, or to identify and self-correct, illegal disparate treatment.[88]

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