Leaning Against Racial Injustice

Your Fair and Responsible Banking Program and Beyond

IN THE AFTERMATH OF THE TRAGIC KILLING OF GEORGE FLOYD in Minneapolis, a racial justice movement has commanded society's full attention. I know I'm not alone in feeling like these events made me forget that the world was and is still facing a global pandemic. Being geographically based in Minneapolis also undoubtedly affected how these events were hitting me personally and professionally. I've asked myself, "What's next?" and "How will I be a positive vehicle for change?"

Compliance professionals who manage fair lending are depended upon to uphold a commitment to fairness that all reputable banks make to their customers, communities and employees. While building a robust fair lending program and demonstrating compliance is not an easy task, merely avoiding unlawful credit discrimination doesn't need to be the final destination. There is always more to do, and compliance officers overseeing fair lending can provide unique and powerful viewpoints, even beyond the specific confines Regulation B or the Fair Housing Act. Speaking at the ABA Risk and Compliance Virtual Conference in July 2020, ABA President and CEO Rob Nichols emphasized this point, saying, "…when it comes to ensuring equal opportunity and access to financial products and services, you are the ones who speak up when you see something happening that isn't right. Never forget the critical role you play in making our industry stronger, safer and more equitable for all."

Disparate Impact

The issues and efforts of the current racial justice movement are multi-faceted and complex. One of the central themes is anti-Black racism. While much of the immediate focus surrounds police misconduct and the criminal justice system, banking is also part of the broader range of issues. Fair lending compliance practitioners are well-versed in disparate impact, which occurs when a neutral policy causes a disproportionate negative impact on a prohibited basis group that is not supported by a valid business justification or necessity.

The Color of Law by Richard Rothstein describes segregation by law and public policy (i.e. government), including housing issues and the overlap with mortgage lending such as when agencies openly refused to insure mortgages for African Americans, influenced appraisal standards by including terms like "inharmonious racial groups,"

and created the infamous color-coded maps where neighborhoods with African Americans present were colored red, designating a neighborhood with the highest risk. There was also a downstream impact on private action segregation and redlining, such as with restrictive racist covenants appearing in real estate property deeds across the country. (Learn more at www.mappingprejudice. org or by viewing the documentary *Jim Crow of the North* www.tpt.org/minnesota-experience/video/ jim-crow-of-the-north-stijws/).

Despite progress through civil rights banking laws such as the Fair Housing Act and Equal Credit Opportunity Act, indicators of the lasting effects of historical redlining and discrimination remain. Black homeownership rates are almost as low now as they were when discrimination was legal. The Census Bureau data shows that in 1968, 41 percent of Black families owned their homes, while White homeownership was 66 percent. In the first quarter of 2020, the Black homeownership rate increased slightly to 44 percent, but nearly 30 percentage points behind White households. According to a report by Zillow that examined the impacts of the long-abandoned color-coded maps, the median home value in the neighborhoods that had been designated "best" had risen 230.8 percent to $640,238 between 1996 and 2018, whereas the median value in red-colored "hazardous" areas grew only 203.1 percent, to $276,199. (www.zillow.com/research/ home-values-redlined-areas-19674/)

In addition to housing, legitimate, race-neutral credit factors such as credit score, income, and wealth continue to show racial disparities. According a 2019 report published by the Consumer Financial Protection Bureau (CFPB), "the 2018 HMDA data shows that the credit scores of Black and Hispanic White applicants, on average, are lower than those of non-Hispanic White and Asian applicants overall and across all enhanced loan types. Additionally, there

are higher percentages of Black and Hispanic White applicants whose credit scores fall on the low end of the distribution and fall below the common underwriting cutoff points." (See files. consumerfinance.gov/f/documents/cfpb_new-revised-data-points-in-hmda_report.pdf.) As for wealth, the disparities are very high. The net worth of a typical White family ($171,000) is nearly ten times greater than that of the average Black family ($17,150). (See www.brookings.edu/blog/up-front/2020/02/27/examining-the-black-white-wealth-gap/.) In a 2017 study, the Federal Reserve stated, "Wealth tends to increase with income because of higher levels of saving among higher-income families, and because of the feedback effect on higher incomes from the returns generated by accumulated assets." This same study provided findings on the income gap. It found that in 2016, median incomes for white families were $61,200, while median incomes for Black and Hispanic families were $35,400 (www.federalreserve.gov/econres/notes/feds-notes/recent-trends-in-wealth-holding-by-race-and-ethnicity-evidence-from-the-survey-of-consumer-finances-20170927.htm).

Independently, the disparities described above are concerning and problematic enough; when considered simultaneously and along with the lasting impacts of redlining, the interrelated and multiplying effect demonstrate a vicious cycle in desperate need of attention. In cases where the risk of unlawful credit discrimination is mitigated through a business justification, compliance officers may want to go further to review within the context of wider corporate social responsibility, conduct, or ethics lens.

Special Purpose Credit Programs

Regulation B §1002.8 is dedicated to Special Purpose Credit Programs, which are intended to promote access to credit through lending products and programs designed to meet special social needs and benefit economically disadvantaged groups. This includes meeting the needs of a prohibited basis group that is being underserved in the market. These programs allow the collection of prohibited basis characteristics, such as race, in order to ensure the credit programs are appropriately targeted to intended prohibited basis group applicants. While companies across various industries can make commitments through philanthropy, diversity initiatives, and/or public statements denouncing racism, a Special Purpose Credit Program is clearly one fairness-boosting opportunity unique to the banking industry.

The basic components of a Special Purpose Credit Program include demonstrating the unmet need, drafting a written plan to lay out the specifics of how the program will operate, and engaging with whichever regulator has responsibility for overseeing Regulation B for your institution. The commentary to Regulation B clarifies that, "a for-profit organization must determine that the program will benefit a class of people who would otherwise be denied credit or would receive it on less favorable terms. This determination can be based on a broad analysis using the organization's own research or data from outside sources, including governmental reports and studies."

In its Summer 2016: Supervisory Highlights, the CFPB set forth observations regarding credit decisions made pursuant to the terms of programs that for-profit institutions have described as Special Purpose Credit Programs. Two examples observed by the CFPB included:

1. Small business lending programs providing credit to minority-owned businesses that were otherwise more likely to be denied credit than non-minority owned firms; and
2. Mortgage lending programs with special rates and terms for individuals with income below certain thresholds. Or, for those buying property in areas where the median income was below certain thresholds, which otherwise would have resulted either in denial of mortgage credit or in higher-priced mortgage credit.

The CFPB stated it "generally takes a favorable view of conscientious efforts that institutions may undertake to develop special purpose credit programs to promote extensions of credit to any class of persons who would otherwise be denied credit or would receive it on less favorable terms." (See files.consumerfinance.gov/f/documents/Supervisory_Highlights_Issue_12.pdf.)

The CFPB also recently published a blog on July 31, 2020, reminding creditors of the availability and opportunity related to Special Purpose Credit Programs (www.consumerfinance.gov/about-us/blog/expanding-access-credit-underserved-communities).

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Responsible Innovation

In some ways, it's difficult for banks to make loans that meet safety and soundness standards without using commonly accepted creditworthiness factors—such as a credit score, income, net worth, or collateral value—that have been historically correlated with racial groups. Use of certain types of data have been shown to have a disparate impact on Black applicants, even though these data types can still be fair-lending compliant if accompanied by a valid business necessity. Thus, the resulting outcomes of reduced access to credit for Blacks are in effect perpetuated. Regulators have encouraged responsible use of alternative data and have highlighted a "success story" involving machine learning modeling techniques which increased access to credit while still being fair (www.occ.gov/news-issuances/news-releases/2019/nr-ia-2019-142a.pdf). A Special Purpose Credit Program, used in conjunction with alternative data (e.g. perhaps an alternative to using a traditional credit score), and/or machine learning while adding risks, complexity and uncertainty that comes from "unproven" techniques, offers an exciting possibility to explore alongside your regulators. Establishing principles regarding ethical use of data is

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Proxy Methodology: Filling a Crucial Data Void

With the intent of protecting civil rights, Regulation B prohibits a creditor from asking for, collecting, recording or otherwise retaining prohibited basis group information, except in the case of residential real estate loans and/or other limited cases (e.g. Special Purpose Credit Program, Self-Testing). Despite this prohibition, banks are still expected to oversee and manage fair lending risk across all types of credit.

To fill the void when performing data-driven fair lending analysis of disparate treatment or disparate impact for non-mortgage products with prohibited data collection, there's practically no other choice but to rely upon a proxy to designate the race of an applicant. The use of surrogates for an applicant's prohibited basis group characteristics is referenced in the long-standing Interagency Fair Lending Examination Procedures (www.ffiec.gov/PDF/fairlend.pdf). For banks regulated by the CFPB, the Bayesian Improved Surname Geocoding (BISG) proxy method—which combines geography- and surname-based information—is most commonly used for fair lending analysis (github.com/cfpb/proxy-methodology).

There is still room for some customization in how to apply a proxy to real-world situations. This makes the evaluation of your bank's proxy methodology—to ensure sound support and justification—a fair lending imperative in order to consider the scope of consumer and business credit products and activities. The CFPB's planned rulemaking under Section 1071 of the Dodd-Frank Act, will require financial institutions to collect, report, and make public certain information concerning credit applications made by women-owned, minority-owned, and small businesses.

Exploring Mystery Shopping

Another way to root out disparate treatment is by using mystery shoppers. As a part of a 2016 joint fair lending action by CFPB and Department of Justice, the CFPB disclosed its first use of "mystery shopping," and noted that other government agencies and housing organizations, "have used testers for decades as a method of identifying discrimination." (See https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-and-department-justice-action-requires-bancorpsouth-pay-106-million-address-discriminatory-mortgage-lending-practices/). In July 2020, a study was released by the National Community Reinvestment Coalition (NCRC) regarding Paycheck Protection Program loans that used matched-pair testing, and it noted past matched-pair "mystery shopper" tests were conducted by the NCRC in 2017, 2019 and earlier in 2020 (ncrc.org/despite-gaping-holes-in-government-data-tests-show-ppp-borrowers-faced-discrimination/). The twist on this study was that the mystery shopping was conducted over the phone.

Mystery shopping could be a useful tool to detect inconsistencies that point to potential fair lending risks related to racially correlated mistreatment. However, there are limitations, costs, scoping and administration complexities, and other uncontrolled

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–Martin Luther King, Jr.

factors that arguably diminish the conclusiveness of results with respect to unlawful credit discrimination. There are also limited examples of banking regulators using mystery shopping for fair lending examinations, appearing instead to be a supplemental investigative measure used only in extreme cases. Before considering whether mystery shopping may be an appropriate addition to your bank's fair lending program, you might find value in first exploring other ways to strengthen existing controls and oversight of pre-application risks, such as through review of branch procedures, banker interviews, branch visits, complaint monitoring, and/or customer experience metrics.

Final Thoughts

Over the years, I've heard people say many times that "compliance" can be a thankless job. Let me take the opportunity to say "thank you" to all the professionals who work tirelessly day-in, and day-out to achieve compliance and to do what is right. As banks continue to renew commitments and assess what more can be done to make more progress to increase fairness, let's continue to look for opportunities to strengthen our fair and responsible banking programs, as well as to take advantage of synergies with initiatives occurring among the areas of diversity, human resources, Community Reinvestment Act, ethics, conduct, innovation, and corporate social responsibility.

Regulatory agencies have multiple initiatives and efforts aimed at improving diversity, equity and inclusion, such as the CFPB's request for information (RFI) on Ways to Prevent Credit Discrimination and Build a More Inclusive Financial System. The RFI covers a lot of ground, including disparate impact, limited English proficiency, Special Purpose Credit Programs, affirma-

tive advertising, small business lending, sexual orientation and gender identity discrimination, federal preemption of state law, treatment of public assistance income, artificial intelligence and machine learning, and adverse action notices. Essentially, the CFPB asks whether it should provide additional clarity, guidance, or interpretation within the context of the Equal Credit Opportunity Act and/or Regulation B on these topics. This type of regulatory engagement is encouraging and highlights yet another opportunity for public and private sectors to work alongside one another to make positive change.

As Martin Luther King, Jr. said, "The time is always right to do what is right." ∎

ABOUT THE AUTHOR

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ABA RESOURCES

Diversity, Equity & Inclusion

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