

BANKING ISSUANCE

RESCINDEDComptroller of the Currency
Administrator of National Banks

Type: Banking Bulletin

Subject: Guide to Fair Mortgage Lending

Any attachments to this document are rescinded only as they relate to national banks and federal savings associations.

TO: The Chief Executive Officers and Compliance Officers of All National Banks, Deputy Comptrollers, Department and Division Heads, and all National Bank Examiners

Attached is a Federal Financial Institutions Examination Council (FFIEC) pamphlet entitled "Home Mortgage Lending and Equal Treatment."

The pamphlet outlines a preventive approach for financial institutions to help ensure their compliance with the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA). It should assist financial institutions in performing self-assessments to ensure that no unlawful policies, procedures, or standards exist. The pamphlet's aim is to make home mortgage lenders aware of the possible unintended consequences of policies and practices.

Topics discussed in the pamphlet as possible sources of unlawful discrimination are:

- Policies, procedures, and underwriting standards that are assumed, without justification, to be necessary and that have disproportionate effects along racial lines.
- Ambiguous and subjective lending criteria.
- Waiving standards, granting exceptions to standards, and adjusting standards.
- Interpreting certain secondary market standards as inflexible. (The Federal Home Loan Mortgage Corporation's Seller-Servicer Bulletin 92-2, issued in January 1992, clarifies a number of Freddie Mac's underwriting standards to remove the potential for such misinterpretation.)
- Dealings with appraisers, realtors, and private mortgage insurance companies.

The Office of the Comptroller of the Currency (OCC), as a member of the FFIEC, recommends the use of this pamphlet. The pamphlet does not, however, state OCC policy or mandate particular approaches or initiatives by lenders for avoiding discrimination in home mortgage lending. Examiners will continue to base their determinations of compliance with ECOA and FHA on the presence or absence of unlawful discrimination and on the lender's



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performance of statutory procedural requirements, rather than on the degree to which a lender has implemented recommendations in the pamphlet.

The pamphlet may be reproduced without restriction. A camera-ready copy of the pamphlet is also attached.

Stephen R. Steinbrink
Acting Comptroller of the Currency

Related Link

- [Home Mortgage Lending and Equal Treatment Pamphlet](#)

RESCINDED

Home Mortgage Lending and Equal Treatment

A Guide for Financial Institutions

Does your financial institution treat all credit applicants equally, regardless of race?

Do you have a policy of providing the types of credit authorized by your board of directors to all qualified applicants, regardless of race?

Without a moment's hesitation, your answer to both questions was probably an emphatic "yes." A "no" answer to either question might indicate that your institution engages in illegal discriminatory practices.

Do you underwrite and appraise homes offered as collateral on purely financial terms, without considering the color or nationality of neighbors or shifts in racial composition going on in the neighborhood?

Your answer to this question was probably also "yes," but it was probably more of a "yes, but what are you getting at?"

Indeed there is an allusion, and it refers to inadvertent discriminatory practices. Long before 1968 when Federal law made discrimination in housing illegal, lenders took steps to remove overtly discriminatory practices from mortgage lending. Despite these efforts, some practices not intended as discriminatory may still remain and may have that effect.

One reason is that some institutions continue to use traditional standards and practices, unaware that these may result in subtle differential treatment of applicants. Unwittingly, some lenders may have carried forward common standards that, with time, have lost their race-specific wording but retained their original effects. Lenders may be using loan origination, underwriting, and appraisal standards that have been handed down for many decades and are simply assumed to be there for reasons of safety and soundness.

Purpose

This guide highlights some lending standards and practices that may adversely affect the ability of credit applicants, on the basis of race, sex, or certain other factors, to obtain home mortgages. It alerts mortgage lenders to less obvious forms of discrimination and suggests ways for lenders to avoid them. While the principles that are outlined apply to all forms of discrimination, this guide focuses on discrimination based on race.

In many cases, the lending standards and practices that adversely affect minorities can simply be eliminated. However, where appropriate, alternative standards or practices are offered.

Lending Standards and Practices That May Have Unintended Discriminatory Effects

Property Standards and Minimum Loan Amounts

Some institutions set lending standards, such as maximum property age, minimum unit or building lot size, or minimum property value or loan amount, that could have the effect of excluding minority areas from lending activity. This may occur because in many areas, especially urban centers, minority residents occupy areas characterized by older or smaller

homes. Sometimes property age and size standards are not explicitly keyed to the year a house was built or its square footage, but instead, requirements such as a specific number of bathrooms, bedrooms, or even the number of cars that a garage must accommodate are imposed. Those requirements can also have the effect of excluding minority areas from lending activity.

Unrealistically high minimum loan amounts or minimum property values also can curtail the availability of credit in low-income and minority areas. Such standards can deter an institution from serving the credit needs of its entire community. Neither the Federal National Mortgage Association (Fannie Mae) nor the Federal Home Loan Mortgage Corporation (Freddie Mac) has a minimum loan-amount standard that would prevent their purchase from institutions of smaller mortgage loans in the secondary market.

Nonspecific and Subjective Lending Criteria

Nonspecific and subjective lending criteria for neighborhoods, property, and loan applicants may have the unintended effect of excluding minority applicants or properties in minority areas. Examples of lending criteria that are too subjective include:

- o The property should be in a "stable" or "rising" area, or the property should be well maintained and have an "attractive appearance" or "good curb appeal";
- o The neighborhood should be "desirable"; there should be "homogeneity of residents and structures"; or the neighborhood should reflect "satisfactory pride of ownership"; or
- o Applicants must not be of "questionable" character; must have an "excellent" credit rating, or must have "adequate" longevity on the job.

Such subjective criteria allow lending personnel to arrive at differing interpretations of what they mean. They may discourage creditworthy members of the public from applying for loans. The simplest way to remedy this situation is to include more specific and objective terms in the underwriting standards.

Differential Terms

Even though a lender offers credit to all creditworthy applicants in its market area, the terms of that credit offer may vary among neighborhoods as to (1) the length of amortization periods; (2) interest rates; (3) special fees; (4) higher fees on smaller loans; or (5) the amount of required downpayments. The application of such differential terms to specific geographic areas should be reviewed to make sure it does not have the effect of illegal discrimination based on the race of applicants or any of the other prohibited bases covered by the antidiscrimination regulations.

Employment Stability

Standards, such as "at least two years on the job" or "frequent job changes should suggest upward mobility" are used in considering the borrower's source of repayment, but they can also have an unintended negative impact on some groups. This may be especially true for those hired into positions that offer few prospects of upward mobility, are "last hired, first fired," or experience forms of employment discrimination. Although the employment histories of women, minorities,

and those without English-language proficiency may not conform to general standards, these individuals may be fully capable of meeting housing expense obligations associated with home ownership.

Alternative and effective measures of employment stability might include: consistency of employment, or demonstrated ability to meet financial and housing obligations, even during periods of employment instability.

Generally, lenders should be willing to recognize that paying rent regularly, even during periods of employment instability, reflects positively on the applicant's ability and willingness to meet mortgage commitments.

Credit Record

Although a good credit record is essential to qualify for a loan, how is "good" to be defined? To provide necessary guidance for lending personnel who apply standards, the criteria for an acceptable credit record should be as specific as possible. In addition, the types of documentation that a lender will consider should be explicit and explained to loan applicants.

For example, some applicants may have excellent credit performance, but have little or no record on standard credit reports. Their credit histories may include years of regular payments for rent, utilities, doctors, and even the local grocer.

Consequently, lenders should consider adopting credit standards that focus attention on data that indicate a current ability and willingness to meet financial obligations. This requires recognizing unique circumstances and difficulties that may now be corrected and are not likely to recur. For example, the fact that an applicant's accounts are now current could mean more in the credit decision than three late payments a year ago that were related to unforeseen medical expenses.

Guidance on Applying Exceptions to Standards

There are almost always exceptions to a standard. At many institutions, waiving standards (or even making small adjustments) may have become so routine that lenders may not even be aware of how many exceptions they currently make. It is not only the standards, but the manner in which exceptions to those standards are made, that may adversely affect one group or area. For example, when standards for the maximum age of a house were created, they were often justified on the risk-related premise that unexpected expenditures for maintenance or systems replacements might be beyond the financial capacity of the borrower and thus threaten the value of the collateral. However, exceptions to these standards may be routinely granted for properties in preferred areas, having the result of excluding certain other geographic areas from consideration. Exceptions made according to an unwritten rule may represent a source of disparities in lending and could result in unlawful discrimination.

To overcome old habits, some lenders have established committees to review all exceptions made and rejected applications. Through this review, lenders can find and eliminate unnecessary standards and provide uniform guidance on exceptions. These lenders can make sure that they are not continuing old, or creating new, patterns of discrimination, while also making sure that they are maintaining loan quality.

For example, the guidance provided to lending personnel for exceptions in analyzing an applicant's credit record may stress credit recovery and may

include nontraditional sources of credit information. Both Fannie Mae and Freddie Mac accept loans underwritten using considerations of demonstrated credit recovery and nontraditional sources of information such as rental and utility bill payment histories.

As another example, lenders may consider debt-to-income ratios as flexible underwriting tools, rather than absolutely fixed standards. Reliance on fixed numerical standards may reduce minority mortgage and home-ownership participation by limiting low-income homebuyers to mortgage payments that are less than they have been paying for rent. In developing guidelines for exceptions, lenders may give favorable consideration to factors such as a substantial history of rental payments in excess of the standard level for mortgage payments. Lenders strictly following secondary market standards should determine whether the maximum ratios are really fixed, or rather are guidelines that may be exceeded with documentation of prudent underwriting.

Lenders should be aware that exceptions frequently applied to existing standards may, in effect, become standards themselves and should be acknowledged as such.

Loan Origination Process

The traditional loan origination process may invite opportunities to treat persons differently based on race. This is especially true during the initial stages of the process before the lender receives a written loan application. The lender's representative who is dealing directly with the applicant has considerable opportunity to let personal or perceived organizational bias enter the picture.

Minorities, for example, may be routinely steered away from a particular lender and directed to other sources of financing, such as Federal Housing Administration (FHA) programs or other lenders. Lenders should determine that their loan origination practices are not directing prospective applicants elsewhere because of race.

To assure that lending personnel are applying standards appropriately, it is recommended that the following be considered:

- o Developing a simple "equal opportunity in lending" policy statement and periodically discussing it with the lending staff and customer contact personnel who field questions from the public on loan terms. These employees, in particular, must realize that equal opportunity is part of the corporate philosophy, and that it comes from the board.
- o Identifying practical implications of implementing an equal opportunity in lending policy, such as how to make it a part of the origination process.
- o Printing detailed information about mortgage loan terms and qualifications and making it easily available to loan officers and the general public. Information about steps applicants can take to help them qualify, such as monetary gifts from others to meet a down-payment, can be made available, especially to all those who do not "fit the profile."
- o Investigating credit practices for possible prescreening when disproportionately low application levels are found for particular groups or areas. Unusually low rates of credit denials may also indicate the possibility of improper prescreening practices.

Discrimination is less likely to occur if information regarding qualifications, rules, common exceptions, and helpful hints is clearly spelled out in writing, made available in the lobby and explained to all applicants.

Appraisal Practices

For the better part of this century, words and phrases with racial inferences were found throughout appraisal manuals and lending policies. Although negative references to race had been removed from professional appraisal and lending training materials by the mid-1970s, some appraisers, lenders, and other real estate professionals were trained using concepts that have since been rejected as discriminatory.

In preparing a Fair Housing Act suit in 1976 against several housing industry organizations, the U.S. Justice Department documented the evolution from obvious to more subtle racial discrimination in the concepts and materials used by the appraisal industry. From the 1930s to the 1970s, references like "the infiltration of colored people into white residential districts" were gradually replaced by expressions such as "the gradual displacement of the present residents by social forces creating the environment." As late as 1975, at least one widely used appraisal textbook included the concept of "neighborhood infiltration of inharmonious groups" in the definition of "depreciation."

As consideration of race became less obvious, some terms found in the Neighborhood Analysis section of the appraisal report were code terms for alerting the lender that a neighborhood was, or was likely to become, a minority neighborhood. By now, references to the "desirability" of a neighborhood, or the "pride of ownership" exhibited by residents should be either excluded from appraisal reports, or fully supported and demonstrated to have an impact on market value. In contrast to appraisal practices during the 1950s and 1960s, professional appraisal organizations now state as a matter of policy that racial, religious, and ethnic factors are unreliable predictors of value trends or price variance, and that the notion of racial or ethnic homogeneity, as a requirement for maximum value, is without empirical support.

Substantial changes in policy require changes in practice as well. Lenders should determine that their appraisers have recently received effective fair housing training. Similarly, lenders should be certain that their appraisers are aware of, and ascribe to, the current fair housing standards of the Appraisal Foundation, or other appraisal organizations.

Today, lenders should be alert to two appraisal practices most likely to cause equal opportunity problems:

- o In the cost approach to value, racial bias may be reflected in unsupported adjustments for "functional and economic obsolescence." Lenders should not assume that, because a home or neighborhood is over a certain age, large adjustments are appropriate.
- o In the comparable sales approach, racial bias may cause the appraiser to select comparables or make adjustments that are inappropriate.

If appraised values appear to play a substantial role in rejections or reductions of loan amounts for properties in minority areas, lenders should review their appraisals with careful attention to the Valuation by Cost and Valuation by Comparable Sales sections. In doing so, lenders

could compare the work of different appraisers, and look for consistency among different appraisers and between minority and nonminority neighborhoods. Rather than performing a review specifically for nondiscrimination in appraisals, many financial institutions have incorporated nondiscrimination considerations into their regular appraisal quality control process.

Marketing Practices

Lenders also should be sensitive to potential discriminatory effects of their marketing practices. The way in which a lender markets its mortgage products and structures its initial contacts with potential applicants could easily serve to discourage minority applicants and thereby reduce an institution's ability to make loans to minorities.

For example, many lenders focus on contacts with realtors as a primary marketing strategy to help generate loan originations. Where lender strategies fail to include contact with minority realtors and other realtors serving predominantly minority areas, there is almost always a low level of minority applicants. Lenders who aggressively pursue mortgage business through realtor networks, but avoid contacts with realtors serving minority areas or borrowers, are often viewed negatively in the minority community. At best, such lenders are seen as inattentive to the minority market. At worst, these lenders may be perceived in the minority community as willfully discriminatory, to be avoided by minority loan applicants.

Similarly, lender advertising can have dramatic effects on the way minority borrowers view lenders. Failure to advertise, where available, in publications and electronic media aimed at minority markets, or media known to appeal to minorities, can limit the ability of an institution to attract minority applicants and borrowers. Ultimately, avoidance of minority media can serve to create or enhance the perception that lenders are reluctant, or unwilling, to serve minorities.

Private Mortgage Insurance

In addition to reviewing and revising their own standards and practices, lenders can also attempt to influence the standards of private mortgage insurers. Rejections of individual loans by private mortgage insurance companies may indicate that these companies are using standards that lenders have eliminated or changed after re-evaluating their own underwriting standards. Lenders may be able to select companies that are more receptive to ideas for changes, or select those with standards that most closely reflect the types of considerations the lenders employ in credit underwriting.

Large lenders and consortia of smaller lenders have successfully negotiated changes in mortgage insurance standards. In a notable example, several banks negotiated an agreement with a private mortgage insurer to remove restrictions in order to reach what they considered to be underserved neighborhoods. They did this by raising housing payment ratios, and by permitting a combination of gifts, grants, secondary financing, and sweat equity to be considered as part of downpayments.

In Conclusion... .

There are many places to begin; the challenge is to do so. You may begin by reading your loan underwriting and appraisal standards with a new perspective or keeping a listing, by race of neighborhood or applicant, of

even the slightest "exceptions." You may begin by discussing with lending staff their ideas about how originations can be expanded, especially in minority neighborhoods. You may begin by reviewing your latest Home Mortgage Disclosure Act report or reviewing your rejection rates for minorities and the reasons for rejections.

Regardless of how you begin, we urge you to use this guide to start the review process; it could lead to change. It will help renew or continue your commitment to finding and eliminating both overt and subtle forms of illegal discrimination.

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