Section 1071/Small Business Lending Rule
Fair Lending

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Overview

- Section 1071/Small Business Lending Rules
  - Background
  - Compliance Date Tiers
  - Discouragement Provisions
  - Hot Topics
- Fair Lending
  - Reg B Violations 2022
  - Best Practices
  - Appraisal Bias
  - Fair Lending Enforcement Update
  - 2020 Census Data Updates

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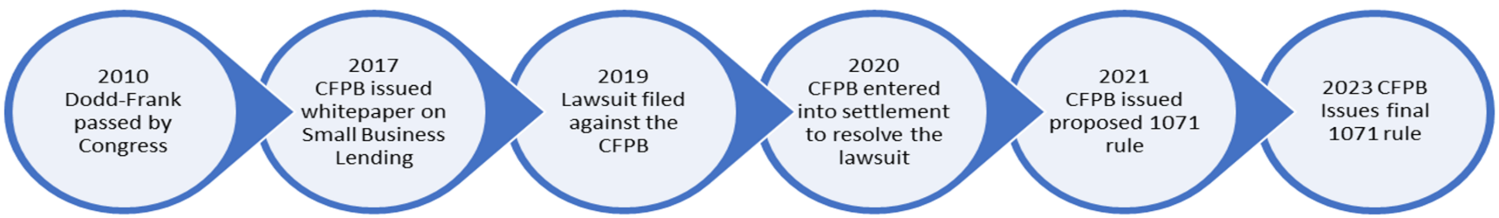
Section 1071/Small Business Lending Rule –Background

- On March 30, 2023 the Consumer Financial Protection Bureau (“CFPB”) issued its final rule implementing Section 1071 of the Dodd-Frank Act.
- The existing Regulation B as we know it will now become Subpart A and the new rule will become Subpart B with 14 different sections.
- The rule is intended to facilitate enforcement of fair lending laws and assist in identifying needs and opportunities for small businesses.
- The rule requires covered lenders to collect and report data about their lending activities to small businesses (with less than $5 million in annual revenues), including information on the race, sex, and ethnicity of the principal owners of the small business applicant.



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Section 1071/Small Business Lending Rule –Compliance Date Tiers

- Depending on the number of originations for covered credit transactions the covered financial institution has, the deadlines for collecting data from covered applications and reporting to the CFPB as follows:

Compliance Date Tier	2024	2025	2026	2027
Tier 1- originated at least 2,500 covered transactions in both 2022 and 2023	10/1 to 12/31 covered financial institutions collect 2024 data No data to report this year	1/1 to 12/31 covered financial institutions collect 2025 data 6/1- deadline to report data collected in 2024	1/1 to 12/31 covered financial institutions collect 2026 data 6/1- deadline to report data collected in 2025	1/1 to 12/31 covered financial institutions collect 2027 data 6/1- deadline to report data collected in 2026
Tier 2- originated at least 500 covered credit transactions in both 2022 and 2023	Not required to collect data or report data	4/1 to 12/31 covered financial institutions collect 2025 data No data to report this year	1/1 to 12/31 covered financial institutions collect 2026 data 6/1 deadline to report data collect in 2025	1/1 to 12/31 covered financial institutions collect 2027 data 6/1- deadline to report data collected in 2026
Tier 3- originated at least 100 covered credit transactions in both 2022 and 2023	Not required to collect data or report data	Not required to collect data or report data	1/1 to 12/31 covered financial institutions collect 2026 data No data to report this year	1/1 to 12/31 covered financial institutions collect 2027 data 6/1- deadline to report data collected in 2026

CFPB Small Business Lending Rule Key Dates for Collecting and Reporting Data

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Section 1071/Small Business Lending Rule –Discouragement Provisions *(1002.107(c) (3) and (4))*

Requires a covered financial institution to maintain procedures designed to identify and respond to indications of potential discouragement of applicants from providing responsive demographic information, including low response rates. Official Commentary outlines the following set of 6 procedures that will need to be developed to monitor for discouragement:

- Monitoring for low response rates, i.e., the percentage of covered applications for which the institution has obtained some type of response to its request for applicant provided data.
- Monitoring for irregularities in responses that might indicate steering, improper interference, or some other potential discouragement.
- Monitoring for response rates by product, division, location, loan officer, etc. to ensure there is no discouragement in any part of the institution's lending practices.
- Providing adequate training to employees, particularly loan officers, to ensure that no discouragement is taking place with regard to applicant-provided data.
- Investigating any indications of potential discouragement that might become evident from the monitoring, testing, and auditing process.
- Taking remedial action in response to any discouragement or other improper conduct.

Section 1071/Small Business Lending Rule – Hot Topics

- July 28, 2023: The House Financial Services Committee approved a resolution to block the CFPB's Section 1071 / Small Business Lending Rule.

- July 31, 2023: A federal judge in Texas placed an injunction barring the CFPB from requiring Rio Bank of McAllen, Texas, members of the Texas Bankers Association and members of the American Bankers Association (ABA) to comply with the small business lending rule until the U.S. Supreme Court rules on the CFPB's funding.

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Fair Lending- Reg B Violations 2022

Regulation B Violations: 2022	Agencies Reporting
Discrimination	NCUA, FRB, OCC & CFPB
Inquiring about protected class	FDIC
Specific rules concerning use of information	FDIC, NCUA, OCC, FRB & CFPB
Adverse Action	FDIC, NCUA, OCC, FRB & CFPB
Record Retention	OCC
Appraisal and Valuations	FDIC, OCC & FRB

Source: CFPB's 2022 Fair Lending Annual Report to Congress
June 2023 https://www.consumerfinance.gov/about-us/blog/the-cfpbs-2022-fair-lending-annual-report-to-congress/

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Fair Lending Referrals to DOJ

ALL REFERRALS	**2021**	**2020**	**2019**	**2018**	**2017**
Bank regulatory agencies					
CFPB	2	4	3	0	2
FDIC	2	3	2	1	4
FRB	1	2	1	0	3
NCUA	2	3	1	1	2
OCC	0	1	2	1	1
Other partners					
HUD	0	0	0	1	0
FTC	0	0	0	0	0
Total	**7**	**13**	**9**	**4**	**12**

Source: DOJ's Attorney General Annual Report to Congress on ECOA, November 2022 https://www.justice.gov/crt/page/file/1551806/download

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Fair Lending-Best Practices

- Training
  - New hires and annual thereafter
  - Commensurate with specific role
  - Implement a comprehension or certification measurement
  - Obtain documentation/attestation from third party service providers
- Policy and Pricing Exceptions
  - Define exceptions
  - Loan officer discretion
  - Guidelines for approval
  - Monitor and analyze for fair lending trends
  - Timely reporting to the Board and/or committee thereof
- Complaints
  - Training - new hires and annual thereafter
  - Monitor and analyze for fair lending trends (including third party service providers)
  - Timely reporting to the Board and/or committee thereof
- Appraisals
  - Update policy and procedures to address appraisal bias, related complaints or disputes, and requests for reconsiderations of value
  - Monitor and analyze appraisal related complaints (including third party service providers)

Fair Lending- Appraisal Bias

- A form of discrimination in the property valuation process which occurs when an appraiser considers illegal or irrelevant factors, such as:
  - race or ethnicity of the homeowner or the neighborhood,
  - the owner’s asking price, or
  - the buyer’s offer price.
- The Fair Housing Act (FHA) and the Equal Credit Opportunity Act (ECOA) prohibit discrimination in appraisal valuation.
- In June 2021, the Property Appraisal and Valuation Equity Interagency Task Force (PAVE) was created, and it is composed of 13 federal agencies and offices. PAVE’s action plan includes the following:
  - Strengthen guardrails against unlawful discrimination in all stages of residential valuation
  - Enhance fair housing/fair lending enforcement and driving accountability in the industry
  - Build a well trained, accessible, and diverse appraiser workforce
  - Empower consumers to take action
  - Give researchers and enforcement agencies better data to study and monitor valuation bias.
- In March 2022, the Action Plan to Advance Property and Valuation Equity was introduced and serves as a guide for how consumers can benefit fairly from the equity of home ownership.
- In June 2023, 5 regulatory agencies issued proposed guidance for addressing reconsiderations of value (ROV) for real estate transactions.

Indirect Automobile Lending

- While banks do not know the demographics of a borrower involved in the indirect automotive transaction (because the dealer—not the bank—deals with the borrower), the bank has a responsibility to ensure policies and practices do not violate state and federal fair lending laws.

- Historically, enforcement actions have been severe for banks that have been criticized for pricing loans to minorities higher, by as little as 20 to 59 basis points, when compared to similarly situated non-minorities.

- Banks are receiving enforcement actions related to the markup charged to customers, regardless of the bank's lack of discriminatory intent.
  - October 2022 - New York State Department of Financial Services (DFS) vs Rhinebeck Bank. $950,000 CMP plus restitution.
  - June 2021 – DFS vs Adirondack Trust Company ($275,000 CMP) and Chemung Canal Trust Company ($350,000 CMP)

Recent Fair Lending Issuances

OCC revises "Fair Lending" booklet of the Comptrollers Handbook, January 2023 *– first revision since 2010.*

CFPB Supervisory Highlights Issue 30, 2023

- More Pricing Discrimination in mortgage lending

CFPB Supervisory Highlights Issue 25, 2021

- Pricing Discrimination in mortgage lending
- Religious Discrimination in business lending

CFPB Supervisory Highlights Issue 22, 2020

- Redlining / Marketing

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Redlining

Redlining = A form of illegal disparate treatment in which an institution provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the **residents of the area** in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located

Reverse redlining = the practice of **targeting** certain borrowers or areas with **less advantageous products or services** based on prohibited characteristics

Oct 2021 – DOJ Announces New Combatting Redlining Initiative

- Through the Initiative, the Department is partnering with U.S. Attorney's Offices and coordinating with financial regulators to ensure that banks and lenders will be held accountable as we work to combat discriminatory race and national origin-based lending practices.

- **Redlining enforcement has been on the rise since the U.S. Justice Department (DOJ) launched the Combatting Redlining Initiative.**

  - *August 2021, Cadence Bank (joint with OCC) : $9 million*
  - *October 2021, Trustmark (joint with CFPB and OCC): $8.5 million*
  - *July 2022, Trident Mortgage Company (joint with CFPB): $20 million*
  - *September 2022, Lakeland Bank: $13 million*
  - *January 2023, City National Bank: $31 million*
  - *February 2023, Park National Bank: $9 million*

Source: Justice News | DOJ | Department of Justice

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Redlining Enforcement Actions

Common Complaint Allegations:

- Engaged in unlawful redlining by avoiding predominantly Black and Hispanic neighborhoods because of the race, color and national origin of the people living in those neighborhoods,
- Branches were concentrated in majority-white neighborhoods,
- Loan officers did not serve the credit needs of majority-Black and Hispanic neighborhoods,
- Outreach and marketing avoided those neighborhoods,
- Internal fair-lending policies and procedures were inadequate to ensure that the bank provided equal access to credit to communities of color.

Redlining Enforcement Actions

Settlements include Provisions to Ensure Equal Home Loan Opportunities

- Loan subsidy fund for residents of Black and Hispanic neighborhoods
- Fund advertising, outreach and consumer education;
- Invest in development of community partnerships to provide services that increase access to residential mortgage credit;
- Open new branches in neighborhoods of color;
- Adding new mortgage loan officers to service neighborhoods of color;
- Employ a full-time Community Development Officer who will oversee the continued development of lending in neighborhoods of color

Recent updates…. What does your market look like now?

- Lenders should consider the implications of MMT and LMI tract reclassifications that took effect for activity years 2022 and forward.
- Most metropolitan areas are affected by reclassifications based on the most recent population estimates. Additionally, most areas saw changes in census tract delineations from the 2020 census.

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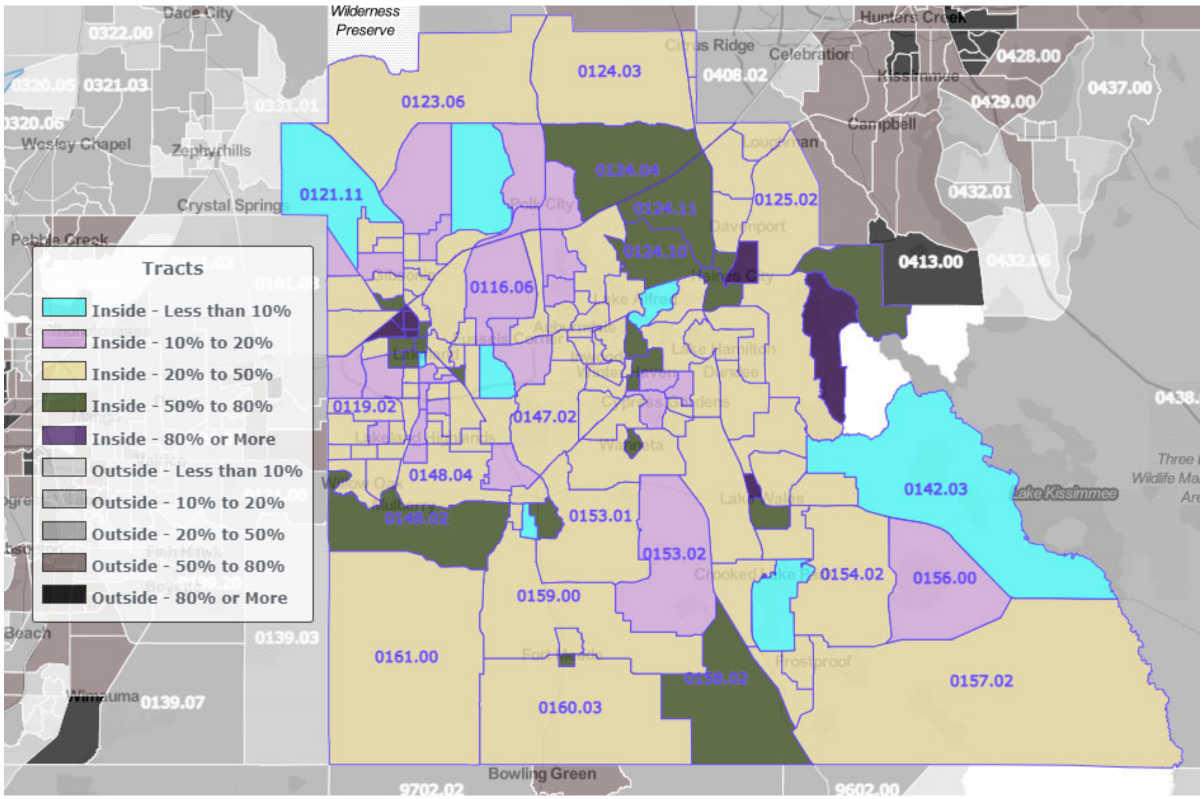
Polk County – Activity year 2021 (before 2020 Census data updates)



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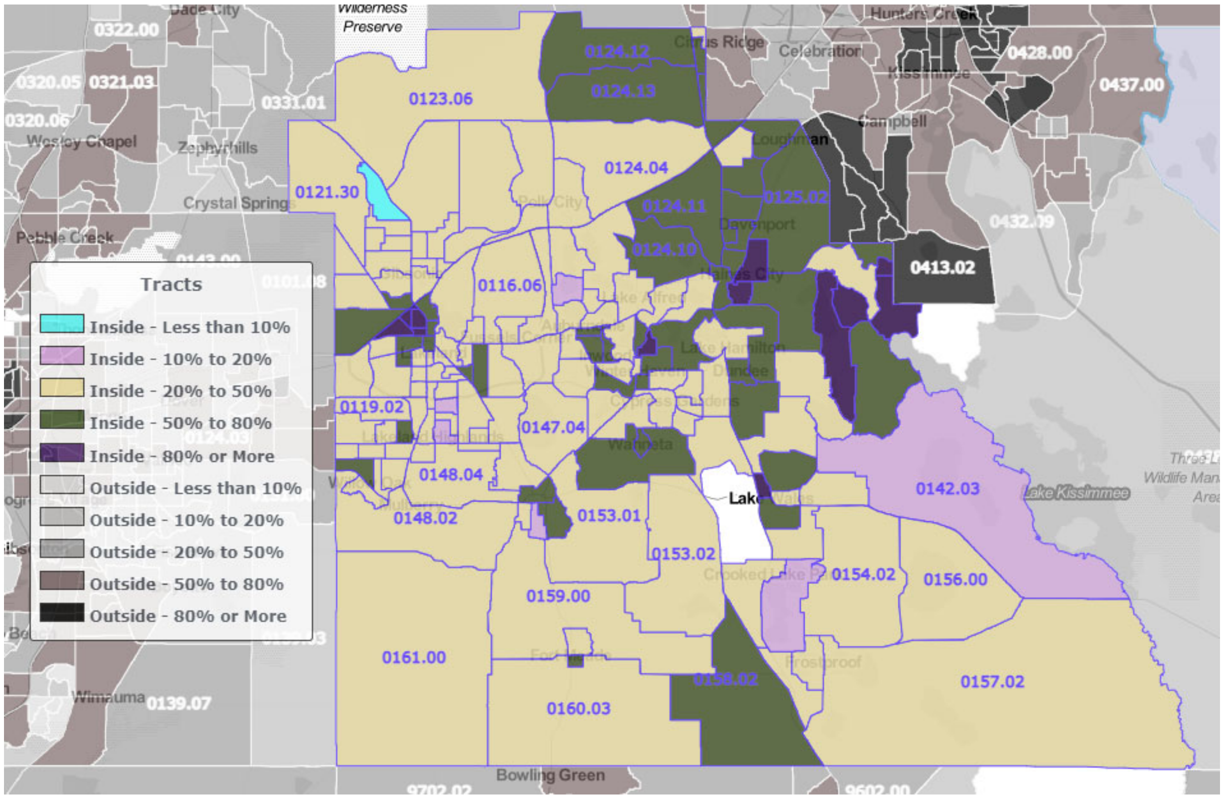
Polk County – Activity year 2022 (after 2020 Census data updates)



	2021 Activity Year	2022 Activity Year
Black population	14.61%	13.92%
Hispanic population	19.23%	25.89%
50%-80% Tract Minority population	20.55%	38.61%
Total # Tracts	154	174
# MMCTs (50% to <80%)	8	47
# HMCTs (80% -100%)	22	13
% of Owner Occupied Housing Units in MMCT or HMCT	18.21%	31.36%

Identifying Redlining

County Code	Tract Code	Tract Income Level	Distressed or Under -served Tract	Tract Median Family Income %	2018 FFIEC Est. MSA/MD non-MSA/MD Median Family Income	2018 Est. Tract Median Family Income	2015 Tract Median Family Income	Tract Population	Tract Minority %	Minority Population	Owner Occupied Units	1- to 4- Family Units
015	9601.00	Moderate	No	75.55	$73,200	$55,303	$50,170	3742	2.73	102	1228	1792
015	9602.00	Moderate	No	68.99	$73,200	$50,501	$45,814	6274	5.44	341	1689	2662
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

- High Minority Neighborhood/Census Tract (HMCT) - census tract with a minority population greater than 80%
- Majority Minority Neighborhood/Census Tract (MMCT) - census tract with a minority population greater than 50%
- Could also focus on specific minorities, e.g., majority Black, Hispanic, Asian, etc.
- https://www.ffiec.gov/%5C/census/default.aspx

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Identifying Redlining

- Exam teams use publicly available HMDA data, as compared to census data “demographic Profiles”
- as compared to other lenders in the same MSA … to identify institutions that received significantly fewer applications relative to other lenders in the MSA
- Underserving, not total avoidance

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Identifying Redlining

Section G (Analysis of Potential Discriminatory “Redlining”), Step 6 (d) (Peer Performance) of the Interagency Fair Lending Exam Procedures:

Market share analysis and other comparisons to competitors are insufficient by themselves to prove that an institution engaged in illegal redlining. By the same token, an institution cannot justify its own failure to market or lend in an area by citing other institutions’ failures to lend or market there.

However, an institution’s inactivity in an underserved area where its acknowledged competitors are active would tend to support the interpretation that it intends to avoid doing business in the area. Conversely, if it is as active as other institutions that would suggest that it intends to compete for, rather than avoid, business in the area.

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Identifying Redlining – Peer Benchmarking

- Consider differences between the subject institution and **other lenders** in the percentage of their applications or originations that come from minority areas, both in absolute terms (for example, 10% vs. 20%) and relative terms (for example, the subject institution is half as likely to have applications or originations in minority areas as other lenders)

Peer Comparisons (50%-200% of Bank)	**Corpus Christi MSA AA (Nueces and San Patricio Counties)**				
	2021 BANK		**2021 Aggregate Peer Group**		
Tract Minority %	**# Apps**	**% Apps**	**# Apps**	**% Apps**	***Disparity***
50-80% (MMCT)	86	32.1%	4,258	51.8%	***61.9%***
80-100% (HMCT)	7	2.6%	1,198	14.6%	***17.9%***
Total	268	100.0%	8,216	100.0%	

Significant Disparity <85% of Peers
Severe Disparity <50% of Peers

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Redlining – FFIEC Assessment Factors

1. Geographic area's demographics, credit profiles, housing
2. Community Reinvestment Act (CRA) AA and REMA
3. Physical presence & services offered *(full service branches, ATM-only branches, brokers, correspondents, loan production offices, online apps)*
4. Marketing & outreach
5. Lending patterns: applications, originations
6. Mapping against census data
7. Peer and market comparisons
8. Strength of CMS; underwriting & pricing guidelines and policies
9. Complaints, whistleblower tips, loan officer diversity, testing evidence, comparative file reviews
10. An institution's explanations for apparent differences in treatment

Interagency Fair Lending Exam Manual lists 12 Indicators of potential discriminatory Redlining, R1-R12, at pages 10-11

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Identifying Redlining – Refining Peers

Per CFPB, examinations and enforcement matters have relied on **multiple peer comparisons.** ***Institution may make suggestions about appropriate peers in specific markets.*** Similar:

- Mix of lending products – i.e., FHA originators
- Loan purpose – i.e., focusing only on home purchase loans
- Action taken – i.e., incorporating purchased loans
- Size – i.e., lenders that received a similar number of applications or originated a similar number of loans in the MSA (*I would add: banks vs. non-banks; and national lenders vs. community banks* See e.g., https://www.asurity.com/news/the-4-fundamentals-of-mortgage-redlining-reviews/)

Excellent Article on the effect of peer selection: ABA Compliance Magazine "How to Assess Redlining Risk by Analyzing Peers" http://magazines.aba.com/bcmag/november_december_2017?pg=28#pg28

Identifying Redlining - REMA

- The FFIEC defines a REMA as *"an expected market area where the institution* ***actually marketed and provided credit*** *and where it* ***could reasonably be expected to have marketed and provided credit****"…*

  …based on institution's distribution of applications and loans as well as its marketing and outreach efforts (10/16 FDIC Banker Call)

- REMAs do not always coincide with CRA assessment areas
- REMA is not defined in fair lending laws
- REMA would not be written in report of examination unless there was a redlining issue

Identifying Redlining - REMA

- CRA Assessment Area is determined by the institution
  - includes whole geographies where an institution has its main office and branches and deposit-taking ATMs
  - may not extend substantially outside of these
  - consists of one metropolitan statistical area (MSA); metropolitan divisions; census tracts; or one or more contiguous political subdivisions, such as counties, cities, or towns
  - risk is arbitrarily excluding low- or moderate-income geographies from your AA

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Identifying Redlining - REMA

REMA is determined by the examiner and considers:

- Where institution received applications, originated loans, **took deposits**
- All assessment factors, *i.e., history of mergers and acquisitions; market/trade area as defined in policies; branching structure and history (closures & relocations); relationships with realtors and brokers; advertising and marketing; significant geographic barriers;*

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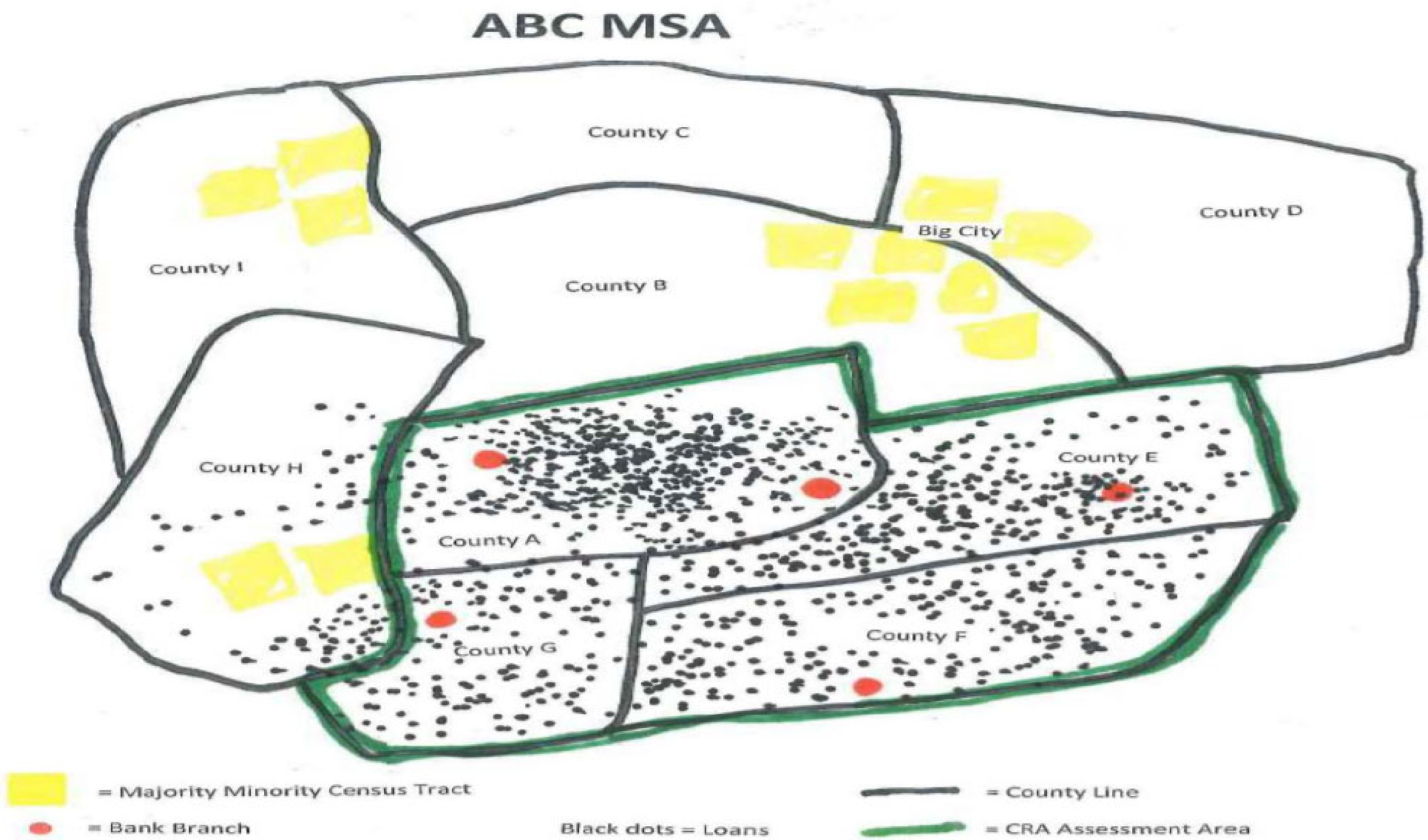
This is from the FDIC Atlanta's 10/16 Call. The AA is in green; the REMA would add County H



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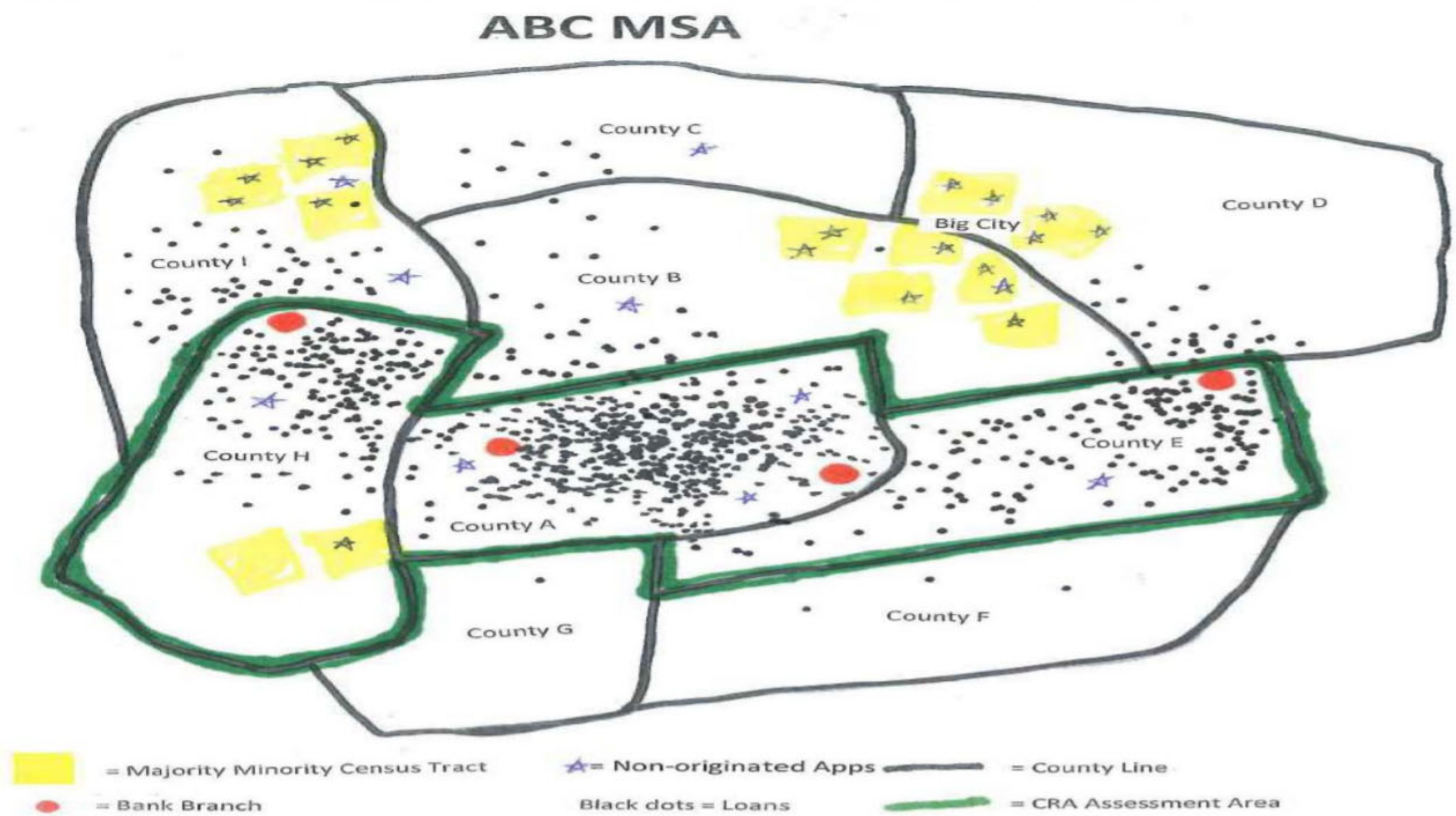
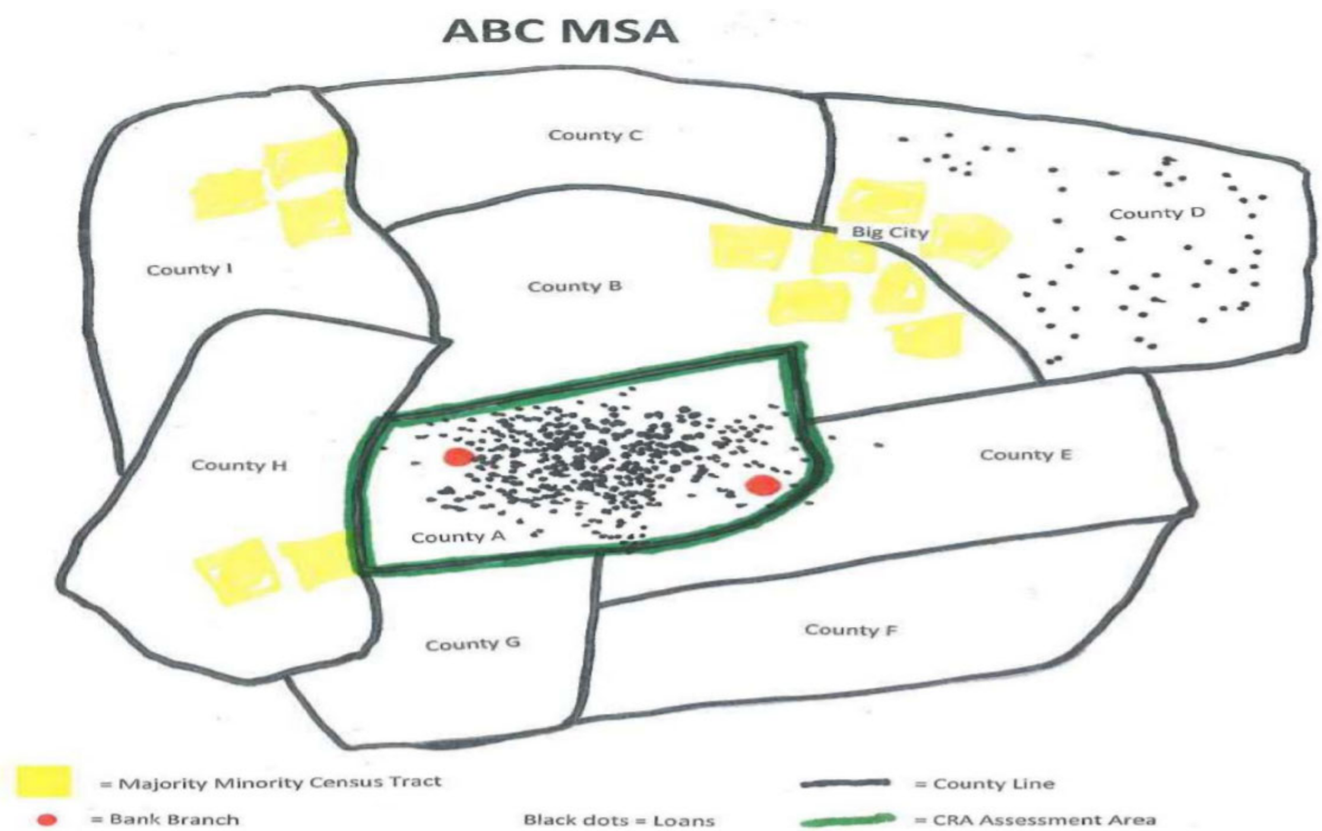
This is from the FDIC Atlanta's 10/16 Call. The AA is in green; the REMA would add Counties B, C, D and I. Notice this looks at applications.



This is from the FDIC's 10/16 Call. The AA is in green; the REMA would add Counties B and D. Lending "Jumps" over County B, which has MMCTs. Could include Counties E and H, Based on Proximity to Branches Considering the Distance to County D, which has Moderate Level of Lending



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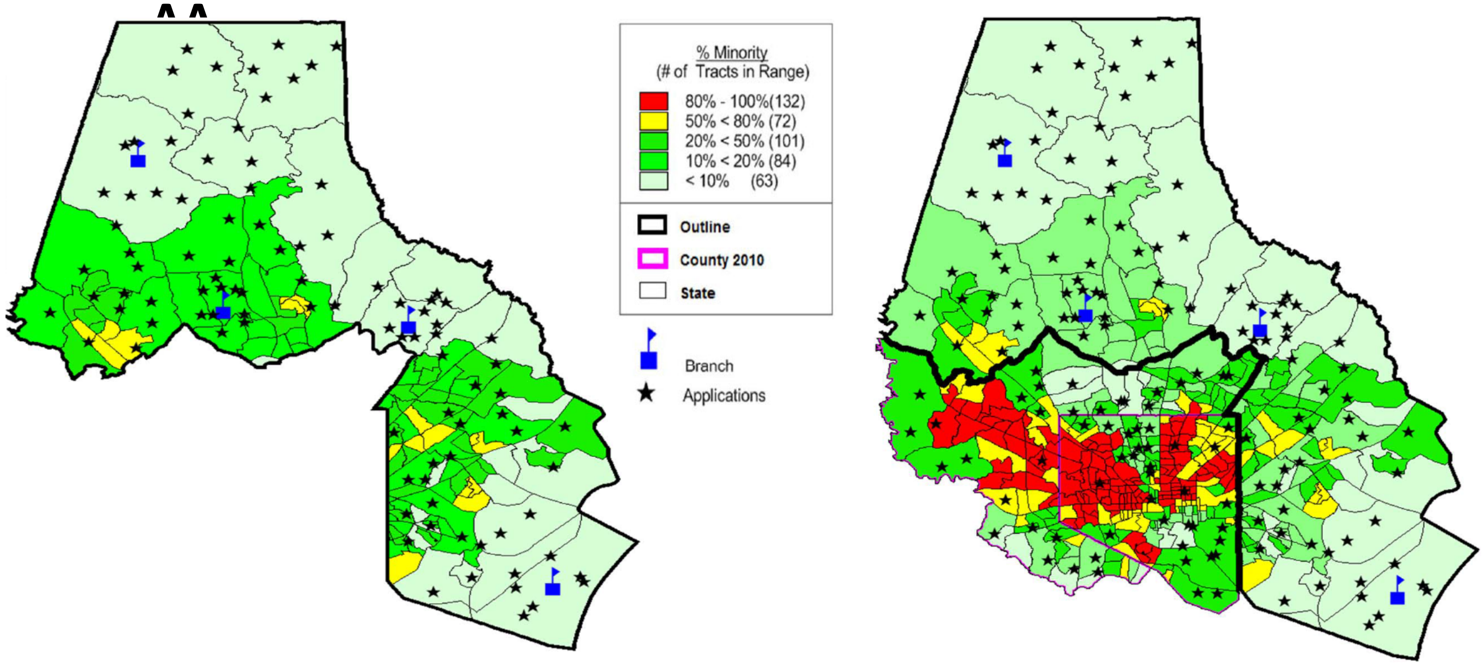
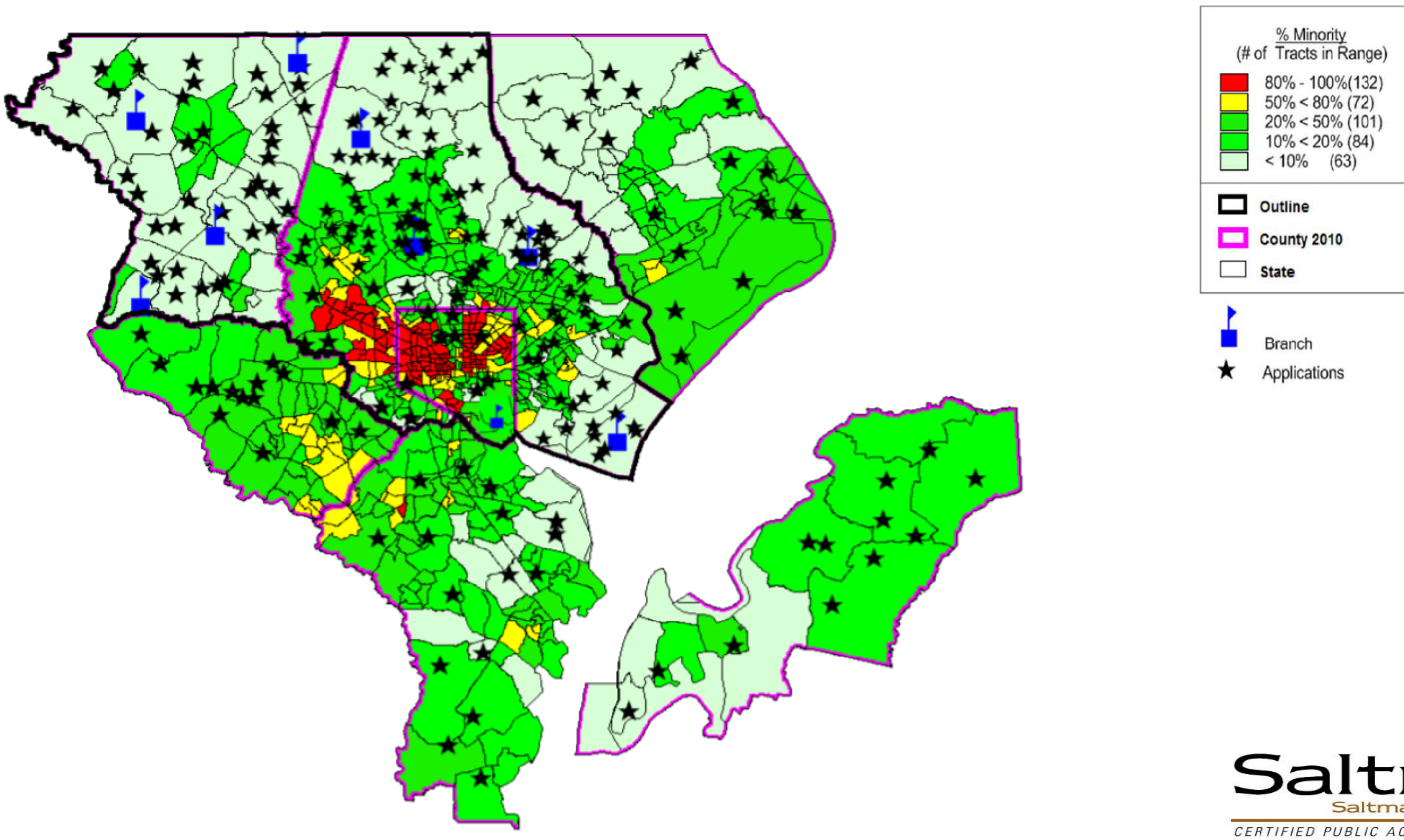
This is from the FDIC's 3/18 Call. AA would likely be criticized because (1) it does not include the whole county and (2) it is unusually shaped and had MMCTs just outside it

CRA AA **REMA**



This is from the FDIC's 3/18 Call. In example, institution selected the top most 3 counties in its AA. But, added the lower counties to its trade area, marketed its loan products in this area, and received applications in the area; so, it would be appropriate for examiners to add this area for the REMA.



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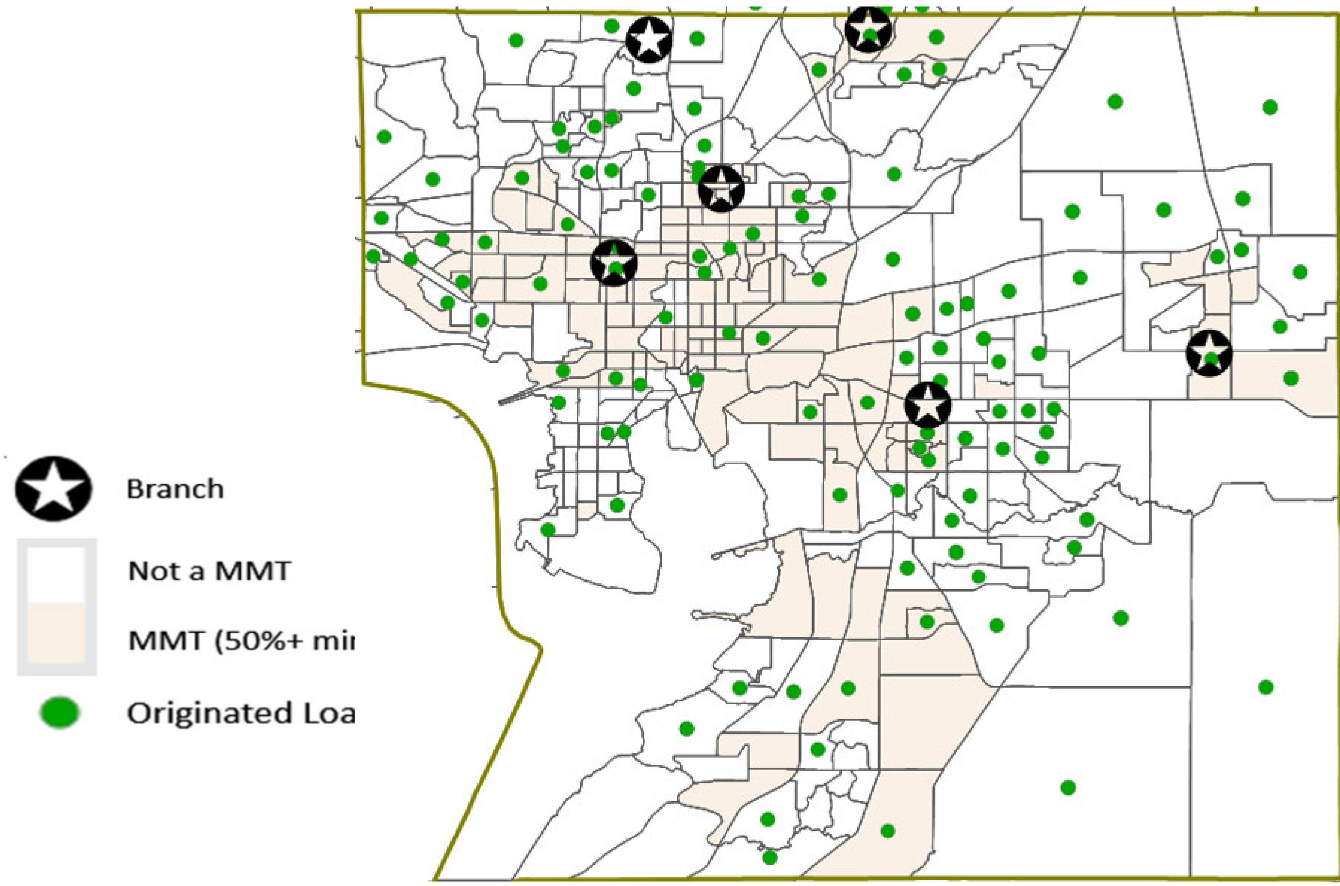
INSTITUTION A – Hillsborough County, Florida AA - Originations

Originations in MMTs



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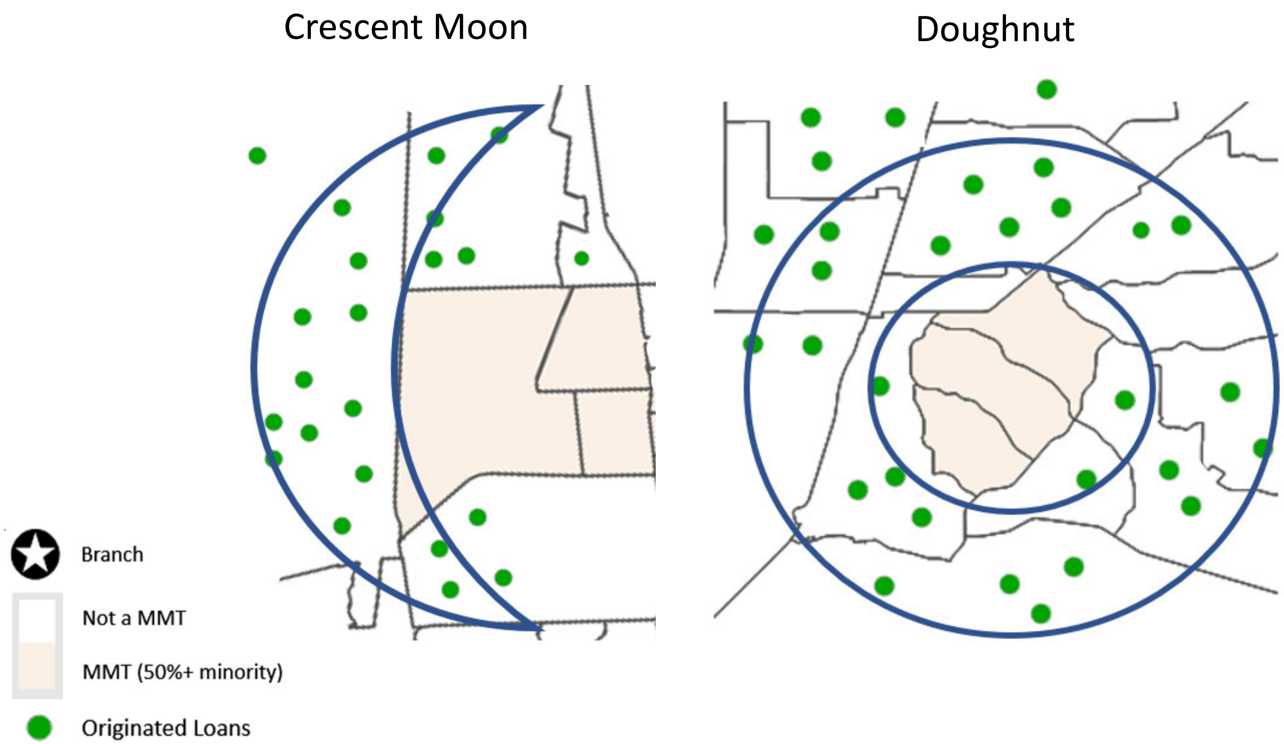
Redlining Mapping - Red Flags



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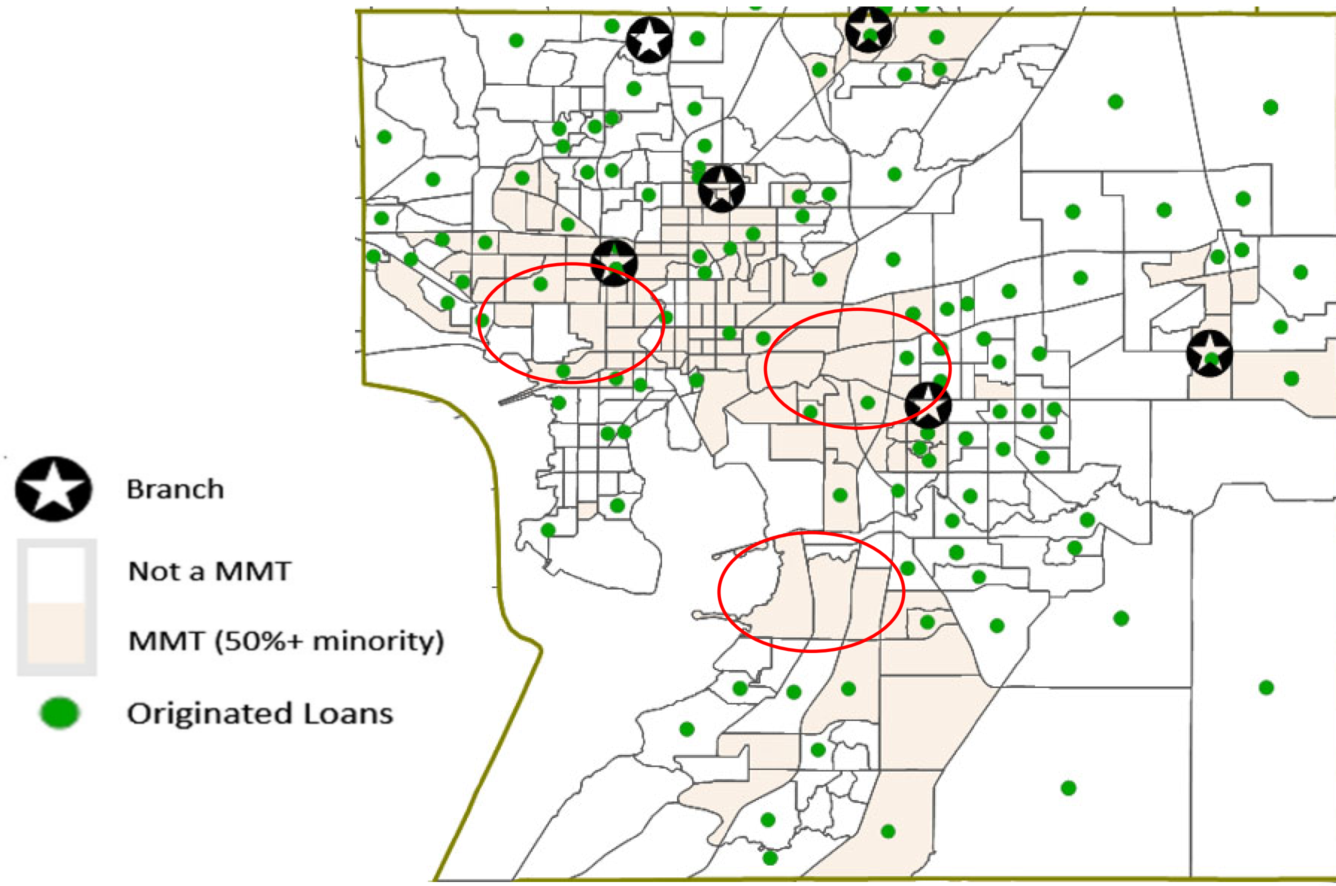
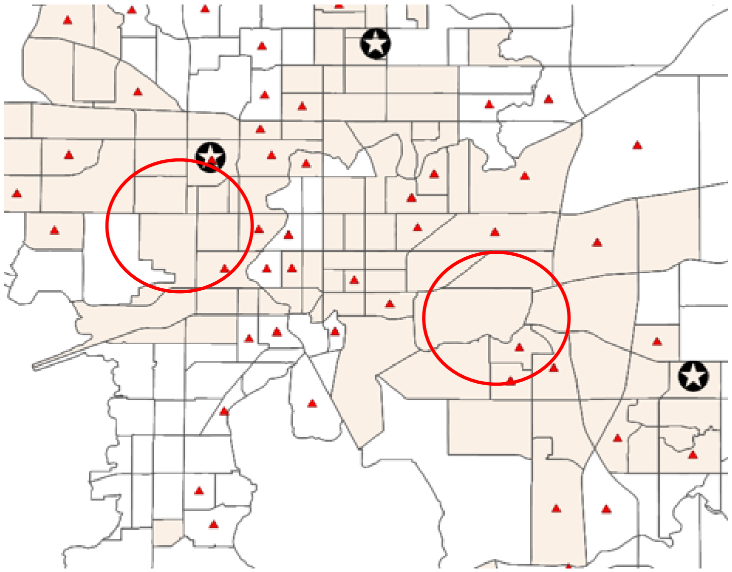
INSTITUTION A – Hillsborough County, Florida AA - Originations

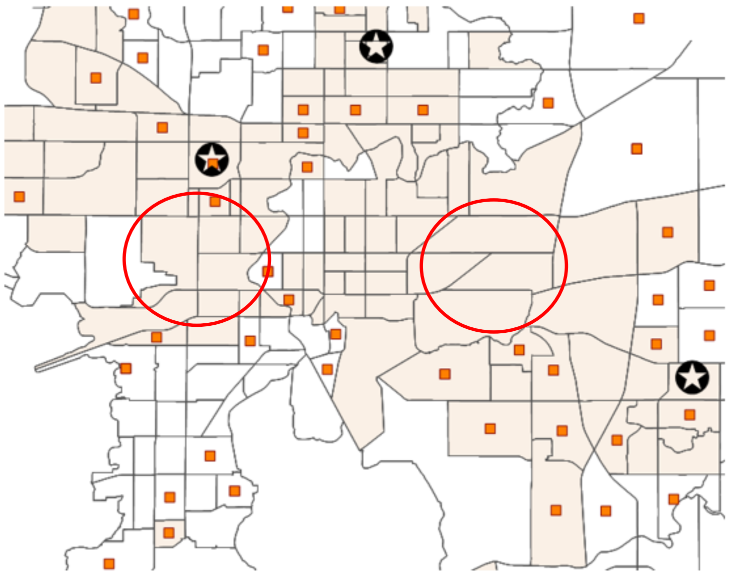


Lending Opportunities

Tampa Area - Denials



Other non-originations



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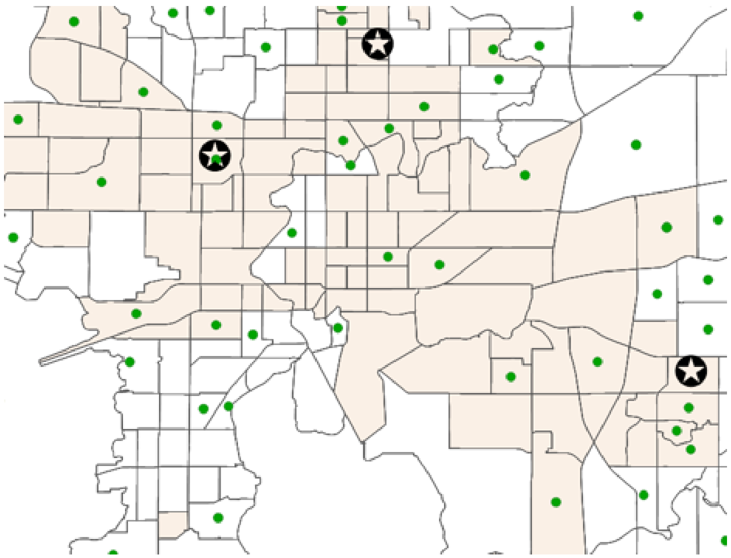
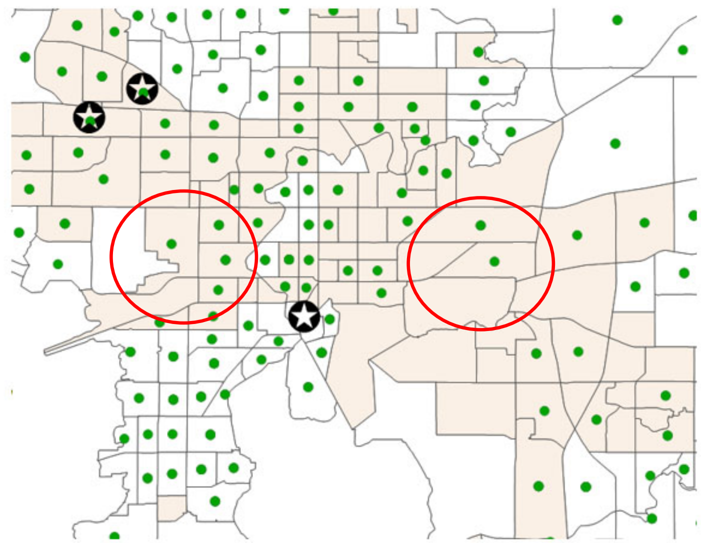
Peer comparison

INSTITUTION A - Originations



INSTITUTION B - Originations



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