STATE OF ALABAMA
STATE BANKING DEPARTMENT

Bob Riley
Governor

John D. Harrison
Superintendent of Banks

MEMORANDUM

TO: Chief Executive Officers of all Alabama, State-chartered Banks

FROM: John D. Harrison, Superintendent of Banks

SUBJECT: Caution Regarding Fair Lending Practices, Monitoring, and Documentation

DATE: July 10, 2006

While we normally don't get involved in federal consumer compliance examination issues, it has come to our attention over the past few months that fair lending questions have arisen with some of our banks. As you know, noncompliance with federal fair lending laws and regulations may be cited when there is evidence of illegal discrimination. In this State, we are particularly concerned whenever there is even the appearance that one of our banks may have illegally discriminated in any aspect of a credit transaction. Our concern is not only due to our intolerance for illegal, discriminatory lending practices, but also because the penalties for such practices are so severe as to have the potential for impacting our assessment of the safety and soundness of the institution.

In recent months, serious questions have arisen which stemmed from Home Mortgage Disclosure Act (HMDA) data. Information on pricing of loans was included with the 2004 and 2005 HMDA data. In some cases, the data indicate that loans to some minorities were priced at a higher annual percentage rate than loans to non-minority borrowers. Although there may be legitimate reasons for these pricing disparities, banks should have appropriate processes and monitoring in place to ensure that any pricing disparities are fully attributable to legitimate factors. In such cases, there may be legitimate, business reasons for the pricing disparities, but it is incumbent upon the bank to produce more in-depth and detailed analyses of the data and clear documentation of the business reasons for such pricing differences. While there is significant expense in producing such analyses and maintaining appropriate documentation, we believe that the expense is considerably less than the cost of being unable to produce such analyses and documentation when challenged.

As a caution to our banks, we offer the following suggestions to ensure compliance with fair lending laws and regulations and to ensure that our banks can adequately analyze and explain any indications of disparate treatment of or impact on their borrowers:

CENTER FOR COMMERCE • 401 ADAMS AVENUE • SUITE 680 • MONTGOMERY, AL 36130-1201
TELEPHONE (334) 242-3452 • FAX (334) 242-3500 OR BUREAU OF LOANS (334) 353-5961

- Examine the incentives given and the degree of autonomy which loan officers or brokers are allowed in setting the terms of different types of credit products. Decide whether these incentives and this degree of autonomy expose the bank to an unacceptable risk of noncompliance with federal fair lending laws and regulations.

- Determine whether the bank has adequate information/monitoring systems, reports, and review procedures to investigate and, if needed, self-correct differences in credit terms.

- Determine whether the bank's information systems capture and retain sufficient information to yield detailed analyses of data which may indicate disparate treatment or impact on borrowers including any pricing disparities.

- Determine whether legitimate explanations for differences in credit terms or deviations from established pricing and other policies relating to the terms and granting of credit are thoroughly documented in the bank's files in a timely manner. Documentation of proper approval of such policy deviations should also be retained.

- Most importantly, after reviewing your fair lending practices, policies, monitoring and documentation systems and procedures, you should contact your bank's primary federal regulator to discuss any questions and concerns. State member banks may contact:

  Ms. Joan H. Buchanan
  Assistant Vice President
  Federal Reserve Bank of Atlanta
  404-498-7345
  joan.h.buchanan@atl.frb.org

  State, nonmember banks may contact:

  Mr. Michael J. Dean
  Deputy Regional Director - Compliance
  Atlanta Region
  Federal Deposit Insurance Corporation
  (678) 916-2244.

Finally, if one of our banks finds itself under elevated scrutiny from our federal regulatory counterparts because HMDA or other data indicates potential noncompliance with federal fair lending laws, we strongly recommend that the bank retain expert consultants having considerable experience working with fair lending matters.