Would Your Price Pass a Fair Lending Test?

Making a Mortgage Loan Should Be About the Member, Not the Credit Union

By Tim Mislansky

It seems that not a week goes by without some lender being accused of discrimination in their lending practices. It's a common theme in emails from the mortgage lending periodicals. And these violations or settlements make big news! ■ NCUA is doing more and more fair lending exams. And the whole world of HMDA is being redeveloped in order to assess lenders' lending patterns. ■ So now be a good time to think about how you price your mortgage loans. By price, I mean, how you determine how to set your rates. And with mortgage loan rates moving on up, credit unions are trying to be more competitive with rate. ■ There are lots of ways to price. What are some and which one will potentially get you in trouble?

- Option #1: You could simply look at what the competition charges and then decide how to price. You might want to be the same. You might want to be a little lower. You might want to be a little higher.
- Option #2: You could also price off the bond market. This means converting everything to basis points. Take what you can get for the loan in the secondary market, back out the operating expenses, hedge cost, add back servicing income and warehouse income (again, all as basis points) and work toward a specific profit margin.

"There are lots of ways to price. What are some and which one will potentially get you in trouble?"

Now both option #1 and #2 can be "memberlicious" (deliciously member-friendly). But there's a third option that some credit unions use.

- Option #3: You set a fixed dollar amount that you want to make for each loan.

And if you use Option #3, I will now make the point that this is a *problem.*

A MATTER OF SIMPLE MATH

So let's say we have a fictional Credit Union called ALAB Credit Union (that stands for Act Like a Bank). ALAB wants to earn revenue of $2,000 on every mortgage loan it makes and sells in the secondary market. This all becomes a matter a simple math. The higher the rate on a mortgage, the higher the payout from the secondary market.

And let's also say ALAB makes three homes loans. One is for $400,000. One is for $200,000 and another is for $100,000. These are made to three different members, but all with similar credit profiles, credit scores, debt-to-income ratios, loan-to-values, etc.

And then let's say the base rate on the $400,000 loan is 4.00%. The price of the loan changes as the rate goes up and 50 points (probably a little more, but I want to make my math easy) usually equates to 1/8 of a percent in additional rate.

- On the $400,000 mortgage, ALAB needs to charge a rate to earn 50 basis points to get its $2,000 in income ($400,000 times 0.50%). This borrower gets 4.00%.
- On the $200,000 mortgage, ALAB needs to charge a rate to earn 100 basis points to get its $2,000 in income ($200,000 times 1.00%). This borrower gets 4.125%.
- On the $100,000 mortgage, ALAB needs to charge a rate to earn 200 basis points to get its $2,000 in income ($100,000 times 2.00%). This borrower gets 4.375%.

WHAT'S FAIR TO MEMBERS?

This seems like a potential fair lending issue. People who can buy big homes get a better deal. People who buy smaller homes get a worse deal. Could someone say that you are discriminating? Maybe. Maybe not.

But what if the neighborhoods in your market where there are $100,000 homes (or less) are predominantly populated by minorities. And the neighborhoods where there are $400,000 homes are largely populated by whites? It doesn't take much for someone to assert a fair lending violation.

By setting your mortgage rates on a flat dollar amount per loan, you are saying to your members – "if you can afford a big mortgage, you'll get a great rate. But if you need a smaller mortgage loan, usually because you don't make as much money as people who get big mortgages, then you've got to pay a higher rate because we need to make more money on you."

> "So if you're pricing your loans to make a fixed profit per loan, perhaps you should think again."

That sounds a lot like a for-profit banker talking and not how the leadership of a financial cooperative should be pricing their loans. And it's certainly not memberlicious.

So if you're pricing your loans to make a fixed profit per loan, perhaps you should think again. Best case, you're charging more to some members who buy a modest home. Worst case, you're in the headlines. Neither is memberlicious.

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