

**FEDERAL RESERVE BANK
OF NEW YORK**

AT-10712
June 9, 1994

FAIR LENDING: "OVERAGES"

*To the Chief Executive Officers of all Depository Institutions
and Bank Holding Companies in the Second Federal Reserve District:*

Recently, we have evaluated whether the policy of permitting "overages" in loans (imposing a higher interest rate, origination fee or number of points on a loan for some borrowers than is imposed for the same product offered to other borrowers at the same period of time) is permissible under the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHAct). As we understand it, an overage policy can provide a broker or loan originator who shares in the overage an incentive to bring in more business and greater parity in compensation for originating small balance loans as compared to large balance loans; it also can compensate when the value of the servicing rights of loans differs from others.

The practice of charging overages is not inherently discriminatory under the ECOA or the FHAct. As illustrated in the following examples, however, permitting overages could -- under certain circumstances -- result in illegal lending discrimination under the ECOA and the FHAct:

- Whenever a loan officer is given discretion in setting the price of a loan, there is a chance that disparate treatment on a prohibited basis might occur. Therefore, a lender who permits overages in its mortgage loans should review its lending performance to ensure that the overage policy is applied fairly and without regard to a prohibited factor under the ECOA or the FHAct, such as race or gender. A lender may find, for example, that minorities more often than nonminorities were charged an overage regardless of the loan type or loan size. This lender will need a legitimate nondiscriminatory reason for this apparent disparate treatment of borrowers on the basis of race in violation of ECOA and the FHAct.
- A lender whose policy permits overages in mortgage loans of a certain amount, for example, should evaluate whether the policy has a disparate impact on applicants on a prohibited basis. For example, a lender who permits overages only in loans of under \$100,000 may review its lending performance and find that, despite treating all applicants for such loans evenhandedly, a disproportionate number of borrowers who receive loans under the threshold and who pay overages are minorities. This lender will have to provide a defense, based on business necessity, against the claim that the neutral application of its policy has adversely affected a group on the prohibited basis of race in violation of the ECOA and FHAct. Also, even if the lender offers a valid business necessity defense, its practice still would be impermissible if the business objective could be achieved by other means with a less discriminatory impact.

(Over)

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Staff of the Federal Reserve Board has discussed the issues described in this letter with the other financial regulatory agencies, and the Departments of Justice and Housing and Urban Development. More formal guidance on overages likely will be developed in the future through the interagency "Fair Lending Task Force" and following public comment. In the interim, if your institution permits overages, we recommend that you carefully review your policy to ensure that it is applied in a nondiscriminatory manner and without a discriminatory effect.

Any questions you may have on this matter may be directed to Elizabeth Irwin-McCaughey, Manager, Compliance Examinations Department (Tel. No. 212-720-6820).

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Executive Vice President.