Evaluation of Credit Decisions for Evidence of Unfair Lending

In this paper, we will discuss the impetus behind fair lending testing in banks operating in the United States and give examples of the process banks use to self-evaluate for potential issues. Then we will discuss the potential for application of these techniques in other markets.

Due to historical patterns of unfair lending in the United States, federal laws require that lenders treat customers equally, regardless of race, gender, age, religion, disability among other criteria. In addition, banks must demonstrate, via analysis, that their lending practices conform to these laws. In the past ten years, two different banks were each fined over $100 million USD for violating some or all of these laws.

In the United States, there are three types of discrimination: overt discrimination, disparate treatment and disparate impact. The first two do not require evidence for a person or entity to file a claim of discrimination, but disparate impact does. The majority of banks' analytical work focuses on disparate impact, as it is the form that does require overt action (or inaction) by the bank or its employees.

This paper will discuss the process of evaluating a bank's risk for each type of discrimination, and focus on the process of evaluating a score or process for disparate impact. Included will be a discussion of the challenges of identifying potential members of a protected group when there is no identification in the dataset.

Finally, the paper will discuss how these learnings can be applied in countries outside the United States.