Remarks by
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Thank you, Beth, for that very kind introduction. It is my pleasure to be a part of Fannie Mae's Annual Fair Lending Conference. During the past decade, a wave of innovation has transformed consumer lending. New products abound in every area, from mortgages to credit cards to short-term extensions of credit. While innovation has brought more choice for consumers, it has also brought more complexity. This, in turn, has heightened the challenges that we face to ensure that consumers are protected from unfair and deceptive practices. Navigating today's consumer credit landscape can be daunting for even the most sophisticated borrower, and is particularly challenging for lower income borrowers, many of whom lack the financial education and resources to make good credit choices.

Today I would like to talk about what the FDIC is doing to ensure that the banks we supervise comply with consumer protection requirements, particularly with respect to two timely issues: the recently released 2005 Home Mortgage Disclosure Act – or HMDA – data, and the widespread use of non-traditional mortgage products. I will also touch on the importance of financial education in leveling the playing field for consumers, and how banks can act as the gateway to the financial mainstream for the underserved.

HMDA Data

The FDIC is committed to ensuring that the institutions we supervise provide credit in a fair and unbiased manner. A key challenge for us is assessing the degree to which race or ethnicity affects the credit terms received by borrowers. Because of revisions to HMDA that affected reporting on loan originations beginning in 2004, we now have much more data about this important fair lending question. HMDA data now include information on loans that are designated as "high-priced" – first mortgages with an APR-Treasury yield spread of greater than three percentage points or second or lower mortgages with an APR-Treasury yield spread greater than five percentage points.

Last September, the Federal Reserve published a study that accompanied the release of the enhanced 2004 HMDA data1. This study concluded that certain minorities are more likely to receive higher-priced loans than non-minorities. This study and others that followed could explain only part of the differences between racial and ethnic groups by taking account of borrower income, loan amounts and other borrower-related information contained in the HMDA data.2

The 2005 data and an accompanying Federal Reserve study that was released to the public two weeks ago found more of the same.3 The current study reported that the incidence of higher-priced mortgages for African Americans was 54.7 percent compared to 17.2 percent for non-Hispanic whites. In other words, over one-half of African American borrowers receive high-cost mortgages, while only about one-in-six non-Hispanic whites do. The study finds that borrower-related factors explain only one-fifth of the disparity. A more important factor appears to be the type of lender, which explains approximately half of the disparity. Thus, the evidence of even greater disparities in the incidence of higher-priced loans across racial groups contained in the 2005 data further heightens concerns about possible discriminatory practices in the pricing of credit.

While HMDA data do not provide all of the information necessary to evaluate the extent to which discrimination exists, they do complement our on-site examination process. The FDIC now requires compliance examiners to document evaluations of racial, ethnic and gender patterns in HMDA pricing data when conducting compliance exams of all institutions subject to these reporting requirements. The FDIC is also using the new HMDA data to identify "outlier" institutions that warrant special scrutiny because of large pricing disparities for minorities and women. Fortunately, that number is small: only 47. We obtain detailed information about the mortgage credit operations of these outlier institutions including information about the channels through which their customers obtain mortgage loans and the factors loan officers have been instructed to consider in making the loan-pricing decision. We perform comparative analysis where needed to determine whether those factors are applied in a fair and equitable manner.

In an even smaller number of these outlier institutions, we have found evidence that suggests discriminatory pricing based on customer race. In many of these cases, it appears that loan officers had been granted broad and unmonitored pricing discretion. Our work will continue in this area and appropriate enforcement action will be taken, including referrals to the Department of Justice, if warranted.

Non-traditional Mortgage Products

The other day a banker asked me why products such as option ARMs are considered "non-traditional" since banks and thrifts, particularly in California, have been making these types of mortgages for more than a decade. It is true that option ARMs have been around for a long time and some lenders and borrowers have used them successfully. However, their proliferation over the past couple of years is troubling for several reasons. First, while payment-option ARMS were previously used by financially sophisticated borrowers as a financial management tool, they are now being used by a wider array of borrowers.

The expanded use of these products raises concern from a supervisory perspective because they have, at times, been offered pursuant to relaxed underwriting standards. From a consumer protection perspective, there are indications that less sophisticated borrowers simply do not understand the complex terms involved As a result, the banking agencies have proposed guidance that addresses both risk management

issues and how lenders explain nontraditional mortgages to their customers. To foster consumer understanding, lenders should provide information at the points in time when consumers are making critical decisions – when consumers are choosing a product and later, when they are deciding which payment to make each month. Of course, all information must be sufficiently clear to enable customers to decide if this is an appropriate product or payment for them – not just for today, but in the future as interest rates increase and as payment requirements escalate. We are also focusing attention on the relationship between the institutions we supervise and third-party brokers to ensure that these parties adhere to the same fair lending standards we require of the bank. The agencies will have this guidance finalized in the very near future.

Importance of Financial Literacy, and What the FDIC is Doing

As essential as our regulatory enforcement efforts are, regulation alone cannot ensure that customers understand and evaluate their financial choices.

Over the past decade, credit has been offered to consumers who would have been unable to obtain it in the past. Some of the credit extended to lower-income consumers is in the form of traditional loans from traditional lenders such as banks and mortgage companies. Some of the credit to these new borrowers comes from new kinds of loans – such as interest-only ARMs – and from new kinds of lenders. In many ways, having more credit choices is a good thing. More consumers are able to purchase homes, start small businesses, and manage their personal finances in a fashion that provides a cushion against adversity and facilitates wealth accumulation.

But choice is only a good thing when you can make an informed decision. Some loans often just make no financial sense – take payday loans or subprime credit cards as examples, where annual interest rates are usually several hundred percent. While some consumers may understand exactly what they are paying, they may not believe they have any other choice. Most borrowers who use payday loans already have a checking account and a regular paycheck. I would like to see the banking industry develop small denomination loan products at reasonable interest rates for these borrowers – common sense tells me that it is low risk for the bank and can be a profitable product, especially if the bank ties the regular loan payment to a savings account so financially strapped borrowers have an automatic mechanism to build some financial cushion. This seems like a win-win proposition to me. The FDIC is currently looking into various mechanisms to promote such a product.

In addition, financial literacy has become essential for the economic well-being of households. Even experienced financial customers can be overwhelmed by the complexity of choices. Unfortunately, there is a growing population of less-experienced individuals who are exposed to possible fraud or financial abuse, or who are simply making ill-advised, uninformed choices.

I have been a believer in financial education for many years – long before I came to the FDIC. In my previous life, I learned that what works is not rocket science, but the basics.

One of the financial education programs that provides the basics is the FDIC's Money Smart program.

The FDIC started Money Smart in 2001. It is a free program that primarily focuses on helping low- and moderate-income adults develop money management skills. It is designed to introduce consumers to mainstream banking and includes education on banking services, checking and savings accounts, credit cards and other consumer loans, and home mortgage loans. We offer these materials in six different languages through an extensive alliance of organizations, including financial institutions, non-profit organizations, and government agencies. Since its inception, almost a half million people have taken Money Smart classes and about 95,000 have established new banking relationships.

Economic Inclusion

As I mentioned earlier, I also plan to support and build on the work the FDIC has undertaken to provide for more inclusiveness in the banking system. In recent years, the FDIC has reached out to bring immigrant and other traditionally "unbanked" populations into the financial mainstream through our New Alliance Task Force which builds partnerships with public, private and non-profit organizations. Through such efforts the FDIC can facilitate connections between consumers who lack access to financial products and services on the one hand and financial institutions seeking new market opportunities on the other. We are committed to building on these efforts to reach all those who are underserved.

I will stress again, I am a firm believer that banks can provide a gateway into the financial mainstream for the unbanked. Bankers know how to build relationships and relationship building is key to bringing those who have a fear or an aversion to financial institutions into the equation. Banks have the infrastructure and a track record as innovators to provide an array of affordable-lending services to meet the needs of all their customers. As insured depository institutions, they are uniquely positioned to help lower income consumers accumulate wealth through savings. I am particularly interested in innovative new ideas to promote savings. One idea that has piqued my interest is tying a regular savings component into mortgage repayments. I would welcome working with Fannie Mae on this and other ideas to promote financial stability for lower income families. I want to be sure that the FDIC is doing all it can to encourage both banks and consumers to see the value in full participation in the financial mainstream.

Conclusion

I began my remarks today by pointing to the wave of innovation that has transformed consumer lending over the past decade. Most of us would agree that this innovation has had benefits. However, it has not solved many of the long-standing fair lending and consumer protection problems, and, in some ways, has extended these problems into new areas. I believe we must bring the same spirit of innovation to our own efforts to

solve these problems. By seeking new and effective solutions – by being willing to look for new answers – we can help remove those obstacles that stand in the way of fair lending and a more inclusive financial system.

1. Robert B. Avery, Glenn B. Canner, and Robert E. Cook, "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," Federal Reserve Bulletin, Summer 2005.

2. See, for example, Robert B. Avery, Ken P. Brevoort, and Glenn B. Canner, "Patterns of Higher-Priced Lending by Race and Ethnicity," unpublished manuscript presented at the Conference on Bank Structure and Competition, Federal Reserve Bank of Chicago, May 2006; "The 2005 Fair Lending Disparities: Stubborn and Persistent II," National Community Reinvestment Coalition, May 2006; Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, "Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages," Center for Responsible Lending, May 31, 2006; "Fair Lending Indications of the 2005 Home Mortgage Disclosure Act Data," Traiger & Hinckley LLP, June 1, 2006; ACORN Fair Housing, "The Impending Rate Shock: A Study of Home Mortgages in 130 American Cities," August 15, 2005; and "Building Sustainable Homeownership Responsible Lending and Informed Consumer Choice, National Consumer Research Coalition, June 9, 2006.

3. Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, "Higher-Priced Home Lending and the 2005 HMDA Data," Federal Reserve Bulletin, September 2006.

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