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ENFORCING THE FAIR HOUSING LENDING LAW

Address by

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before the

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Since becoming Chairman of the FDIC several weeks ago, I have received many invitations to speak. I have turned down most of those invitations because I have felt that it is important to spend as much time as possible at my desk during this early period. However, I was happy to accept this invitation to speak at the NAMSB convention. The FDIC is the only Federal supervisory agency for the savings bank industry, and savings banks comprise about one-third of the deposits of all banks examined by the FDIC. Happily, from both our points of view, savings banks give us much less than their proportionate amount of supervisory problems.

Today I would like to say a few words about our view of the condition of the savings bank industry and also our analysis of the current year's outlook. I then will turn to my major topic today, fair housing lending.

Attention has been given in recent weeks to a decline in the surplus position of mutual savings banks. In our view, this decline, which we see as a relatively insignificant one, has been a result more of the problems associated with inflation than anything else. Inflation has three direct undesirable effects on mutual savings bank capital. First, inflation, accompanied by an increase in the money supply, results in an increase in the dollar amount of deposits. Second, inflation results in an increase in operating expenses. Third, inflation is accompanied by high interest rates, which increase the interest expense of savings banks more rapidly than the interest income from long-term assets. The net result is an inability of savings banks to retain earnings in a sufficient volume to margin the rapid deposit growth. We are concerned, of course, about continued decline of mutual savings bank surplus ratios. We recognize, however, that the decline in recent years has not resulted from losses or substantial deterioration of asset quality, or from a deliberate movement of the industry toward a riskier capital position, but instead is simply a reflection of the economic forces that the industry has faced.

The last few years have been troublesome ones for the commercial banking industry. One of the most serious problems faced by commercial banks has been in real estate lending. This, of course, is the area in which mutual savings banks devote most of their resources. Yet the mutual savings banks have weathered this very trying period of real estate financing virtually unscathed. Commercial bank real estate loan losses are at record levels. Mutual savings bank real estate loan losses, while up slightly, are still low and no cause for concern.

Similarly, a great deal of attention has been paid in recent months to our problem list. The number of commercial banks on the problem list is at the highest level since the aftermath of the depression. I hope the worst is past with respect to the commercial bank problem list. But the mutual savings bank problem list has caused us almost no concern at all. There are very few mutual savings banks on the problem list, only two or three, and this represents no real change from the situation of several years ago.

Of course, mutual savings banks have gone through a difficult few years. We expect, however, that 1976 is going to be a near record year for mutual savings bank earnings. Our analysis of first quarter reports finds the industry moving about on the track we expected. Deposits have been flowing into mutual savings banks at a record pace all year, and show no signs of slackening off. Obviously these inflows are sensitive to market interest rates, and at the present time, the rates offered by mutual savings banks compare very favorable with rates available on the open market. We recognize that that might change. Many forecasts anticipate some increase in short-term interest rates over the last half of 1976. But while that may well be the case, we see little likelihood that interest rates will rise fast enough or high enough to result in disintermediation. The deposit inflows, so far this year, have allowed savings banks to greatly improve their liquidity position. This includes both the repayment of borrowings, and an expansion in holdings of short-term securities. Mutual savings banks will turn more heavily to the mortgage market in the remainder of the year, and we expect mortgage holdings to increase by over $3.5 billion in 1976. Obviously, investment in short-term securities tends to penalize earnings in the short run, but there is no question that it has left the industry in a very strong position to meet whatever the future may bring. Not only is there adequate liquidity to handle the threat of possible outflows, but an increase in interest rates this time around will find the savings banks with substantial resources which can be moved into attractive high-yielding investment opportunities.

The improved earnings that the savings banks are experiencing this year are accounted for by the sizable growth in deposits. Profit margins, while expected to be somewhat higher than the last couple of years, are still low and are poor in comparison with the more robust profit margins of the early 1970s. We project net income at .42 percent of assets for 1976 compared with about .35 percent in 1974 and 1975. In 1972 and 1973, the ratio was above .5 percent. Inflation, with its impact on noninterest costs, and the steady rise in the percentage of savings bank deposits accounted for by high-yielding term accounts, may make it impossible to return to those days of higher-profit margins. But a narrower margin on ever-increasing deposit volume may not be an unsatisfactory industry position.

I'd like to move now to the question of fair housing lending.

At my confirmation hearing, Senator Proxmire and I discussed several matters. He led off with one issue, however, which he returned to at the conclusion of the hearing. That matter concerned FDIC enforcement of fair housing lending laws. I think it fair to infer from the stress he put on that topic that it is his view, and that of the Senate Banking Committee, that the FDIC should give serious attention to this matter over the coming months. I was not unhappy with that emphasis because it has been my personal view also that the FDIC should devote substantial effort to assuring that mortgage lending by commercial and mutual savings banks is carried out in a nondiscriminatory manner. I would like to review the background of this matter with you briefly, and then discuss what we might do about it.

In 1968, Congress passed a Civil Rights Act that included a title on fair housing. A section of this Act made it unlawful for any financial institution to discriminate in real estate lending on the basis of race, color, religion or national origin. A further provision of the Act requires "all executive departments and agencies to administer their programs and activities relating to housing and urban development in a manner affirmatively to further the purposes of this title." In 1974, this Act was amended so as to prohibit discrimination on account of sex in mortgage financing. The Equal Credit Opportunity Act added marital status and age as illegal bases for discrimination.

The Civil Rights Act provides a clear proscription against these enumerated discriminatory practices, but does not specifically call for regulations to be issued by the financial regulatory agencies or spell out other duties or obligations of such agencies with respect to enforcement. In December 1971, the FDIC issued a press release giving notice of intention to formulate regulations related to the Act, and issued a policy statement on fair housing directing banks supervised by the FDIC to give public notice that their real estate loans are available without regard to race, color, religion or national origin. We also required that a fair housing notice appear in real estate financing advertisements. This policy statement became effective on May 1, 1972. Our routine examination process since then has included checks on bank compliance with the requirements for advertising and the required lobby poster on fair housing. We have found relatively few violations, and those have been promptly corrected.

In the fall of 1972, we proposed some regulations on fair housing that involved record-keeping requirements, and in December we held two days of hearings on these proposed regulations. These regulations were never issued because we were not convinced that the record-keeping requirements would provide meaningful data for monitoring fair housing lending practices. In the spring of 1974, we began a pilot survey along with the Comptroller of the Currency, the Federal Reserve and the Federal Home Loan Bank Board to test various types of reporting forms to determine what a feasible and effective record-keeping system would involve. I will comment in a few minutes on some of the problems we encountered in that pilot survey. In any case, after review of all the data, we concluded that use of any of the three different types of reporting forms would not enable us to detect patterns of discrimination.

It is fair to say then, that even now we have not determined the best route to take to assure ourselves that discrimination in housing finance has been eliminated. All during this period, we have received petitions and proposals submitted by civil rights organizations urging us to do things. Many of them appeared to be costly and burdensome, and not necessarily effective. We have also received comments from bankers telling us that nothing should be done since banks do not discriminate in mortgage financing. The problem is a very difficult one for reasons which I will get into shortly. Regardless of the difficulties of the problem, however, we have become increasingly subject to criticism from the Congress and others that we have not met the responsibilities that they would like us to assume.

Part of our problem in enforcing the law is that the concept of discrimination is a very difficult one and its exercise can take place in subtle ways. Discrimination connotes the exclusion of some individual or group of individuals from some activity on the basis of one or more identifiable attributes possessed by the individual concerned. Some forms of discrimination represent indefensible biases (for example, exclusions from certain jobs on the basis of sex or race), and work to the ultimate disadvantage of both the affected individuals and society as a whole, while other forms of discrimination may be appropriate and, in fact, benefit society (for example, the exclusion of confirmed kleptomaniacs from jobs as bank tellers). Our economic system is based on a type of discrimination. In our market economy, an increase in the price of any goods excludes certain members of society from consuming the goods or restricts their purchases below what they would have desired at the previous price. That is, if a commodity is in short supply, its price rises so that the supply is allocated to those to whom it is worth the most and, hence, discriminates against others. But while markets are inherently discriminatory, they should be discriminatory with respect to economic phenomena only. Two individuals with vastly different incomes would be expected to receive different amounts of credit with, perhaps, different credit terms. On the other hand, two individuals with similar economic characteristics but with different skin colors would be expected to receive essentially the same amount of credit on essentially the same terms. It is primarily noneconomic discrimination with which the Civil Rights Act is concerned.

It is very difficult to detect or to measure this noneconomic discrimination because, in order to do so, it is necessary to control for economic characteristics. If this is not done, a finding of apparent systematic discrimination in, say, credit allocation, to one group of individuals may be due to valid economic considerations rather than noneconomic biases. If blacks, on average, have lower incomes than whites, we should not be surprised to find that blacks receive a share of mortgage loans made that is less than proportional to their number in the population. But for those blacks who have comparable incomes with whites, loan rejections should not be at a higher rate. We must also take account of the size of the loan requested in relation to the appraised value of the property. But are appraisals influnced by the racial composition of the neighborhood? These economic factors, enormously complicated by themselves, must be analyzed thoroughly before we can say anything about noneconomic discrimination.

A further complication in the enforcement of the Civil Rights Act is that its coverage is much broader than simply affirmative or negative decisions on loan applications. The Act forbids discrimination with respect to downpayments, interest rates, maturity and other terms or conditions of the mortgage loan. A borrower may feel that he is discriminated against when his loan application is rejected, and he may have some basis for that judgment. He may not know he is being discriminated against with respect to terms of the loan that is granted, since, at least under present institutional arrangements, he does not necessarily know the prevailing policy of the institution with respect to maturities, downpayments or even interest rates.

In our experiences with surveys and record-keeping proposals, we have found it difficult to specify information which would provide sufficient evidence of discrimination to prove that the law has been violated.

I recognize all these problems as well as some others I have not mentioned. I think they explain why the FDIC and other banking supervisory agencies have not been successful in promulgating regulations aimed at enforcement of the Civil Rights Act. It is possible that racial or religious discrimination may be quantitatively an insignificant problem in the savings bank industry. But our information does not enable me to confirm that view. I am sure all of you feel that racial discrimination does not play any role in your bank's mortgage lending decisions. But can you know for sure that all your loan officers are conducting themselves in accord with bank policy? How do you know?

It may well be, as many bankers have argued, that the costs of more vigorous enforcement of the law will substantially outweigh the benefits. There is a law on the books prohibiting discrimination, and we have felt an obligation at the FDIC to determine the existence and extent of discrimination and devise appropriate enforcement procedures to insure compliance with the law. If it turns out to be very costly to enforce this law, it will be up to Congress to deal with the situation. We will certainly bring information on enforcement cost to their attention. In any case, I personally am in agreement with the Congressional view that the FDIC should continue to take action to make sure that illegal discrimination does not exist.

In the past, some bankers have had the view that since they feel that there is no real problem in this area, it was not worthwhile to devote much energy to thinking about realistic and effective solutions. If I do nothing else with my comments today, I would like to change that view. I would like to encourage each of you to think about this problem, and let me know what steps you feel can be taken that will represent acceptable burdens for the vast majority of savings banks that are not discriminating in mortgage lending, yet will be effective in ferreting out those few situations where discrimination may be taking place. Write me. Give me your suggestions. At least tell us how you convince yourselves and your trustees or directors that you're not violating the law.

It may be helpful to your thinking on this matter if I describe some of the steps that have been taken, or have been proposed, in the past. Our first step in implementing the law against discrimination was easy and noncontroversial. We told the banks that there was a law that made discrimination illegal. Some bankers may have been discriminating in real estate lending and felt that it was their prerogative to do so. Informing them that the law now prohibited such discrimination probably had some effect. After all, bankers are basically law abiding. I believe it is quite possible, for example, that prior to 1974, some bankers did discriminate in real estate lending to women. We heard several stories of unjustifiable discrimination against women at our 1972 hearing. Sex discrimination was not illegal at that time, and I am sure that simply passing a law making such discrimination illegal and bringing this action to the attention of the bankers had a significant impact in reducing such discrimination.

The next step was somewhat harder. We required banks to include a statement in real estate advertising saying that they were a fair housing lender and to post a notice in their lobby alerting bank customers that discrimination in mortgage lending was illegal. The lobby poster informs the customer with a complaint that he can tell either the FDIC or HUD of the complaint. While this kind of requirement seems rather innocuous, some of our staff questioned whether this was an appropriate step. After all, most bankers are law abiding, and many are offended by being required to post a notice suggesting they may be violating the law.

None of these requirements have generated many complaints from potential borrowers. Since 1968, the FDIC has received very few complaints regarding discrimination in mortgage lending. This may mean that there is no such discrimination, but it may also reflect an unwillingness of loan applicants to get involved in the complaint procedure, a skepticism on their part about our sincerity in following up on complaints, an ignorance about the process of complaining, or any of a number of other reasons.

The civil rights groups have told us that reliance on the complaint procedure is necessarily ineffective, and that we could not expect a large volume of complaints. They argue that those discriminated against have no faith that action will be taken unless they have indisputable proof that they were victims of illegal discrimination and that examples of such proof are very rare; discrimination is generally much more subtle or sophisticated. They also argue that minority applicants go to lenders who make loans to minority applicants, and that word "gets around" as to who will and who won't give a real estate loan to a qualified minority or a woman. I recognize there is some validity to these arguments, but it is difficult to conclude that discrimination is widespread when we receive so few complaints.

There are steps that could be taken to generate more complaints. We might solicit complaints more actively by, for example, running a newspaper advertising campaign on the law, and urging borrowers to write us if they have any suspicions that they have been discriminated against, or even if they suspect that a given institution is not a fair housing lender. Obviously, such a program would be expensive, might simply generate unjustified complaints, and might appear to suggest that we believe that discrimination is widespread. I am certainly not endorsing such a program at this time, but it might be one way of convincing the public that we take the complaint process seriously.

The problem becomes even more difficult when we talk about record-keeping requirements. The first piece of information that becomes necessary in any record-keeping program designed to monitor compliance with fair lending requirements is information on the race, religion, sex, and national origin of the borrower. Many bankers dislike asking a loan applicant about his race or religion, and many borrowers would be offended by being asked such questions. Such information really is none of the lending officer's business (if he is doing his job correctly). Moreover, there may be concern on the part of the borrower that such information will be used to discriminate against him. In any case, it is hard to require the furnishing of such information, and many borrowers would decline to furnish it voluntarily. On our pilot surveys, for example, we found that about 18 percent of mortgage applicants refused to fill out the voluntary racial questionnaire.

Another problem with the record-keeping requirements is that many applications are disposed of informally, even before they get to the stage of the written application. In some cases, telephone or other casual inquiries are rejected with the simple statement that the bank is not making mortgage loans at the present time. The banker who wants to discriminate may find it fairly easy to discourage the filing of an actual application. This might then lead into the need for some sort of log of informal inquiries or even phone calls. We recognize that this could be burdensome and difficult to enforce. In some cases, discrimination may occur even before a potential loan applicant approaches the bank. He may be discouraged by a real estate agent or broker, either with or without the bank's knowledge or approval.

Since the laws are aimed at racial, ethnic, religious and sex discrimination, and not discrimination on an economic basis, any sort of reporting or record-keeping designed to prove a case of discrimination must include detailed information on the financial situation of the borrower and the property being financed. We have not yet determined what sort of reporting or record-keeping is essential to monitor compliance with the law. The civil rights groups have told us that, in their view, we have to be alert to <u>patterns</u> of discrimination and, hence, some sort of record-keeping is necessary. To the extent that red-lining fits this category, the Home Mortgage Disclosure Act recently passed should help resolve this problem since it mandates that certain records shall be kept. Obviously, however, red-lining doesn't cover all possible patterns of discrimination.

It has been suggested that our examiners are not skilled enough nor trained enough in the kind of investigative work necessary to detect discrimination, and that we might do better if we had FBI agents participating in examinations aimed at compliance with civil rights legislation. We have not been convinced of this, however, and would prefer to train our own staff to the extent necessary. We have been devoting a part of our examiner training program to the fair housing area, and we are developing an expanded training program that will include investigatory techniques.

I think this description of some of the possible techniques indicates the source of my concern and frustration. We recognize the shortcomings of various enforcement techniques, but we must enforce the law and meet our responsibilities.

I would like to return briefly to the specific problem of sex discrimination. As I noted, in the course of the hearings we held on fair mortgage lending, it was clear that the most convincing evidence of discrimination related to discrimination on the basis of sex. Numerous documented instances of such discrimination were presented. The problem of sex discrimination is a particularly knotty one. As I have mentioned, there appears to be strong evidence that discrimination on the basis of sex has taken place in banks and other financial institutions, and I am in sympathy with the Congressional decision to do something about it. I also recognize, however, that women do bear children and frequently leave the work force to rear those children, although it can also be argued (1) that women now have more control over the question of pregnancy or not, and (2) that those women who need an income do not leave the work force for a sustained period when they have a child. Alimony and child support payments are probably not as steady and reliable a source of income as salaries and wages. Thus, one might argue that discrimination against women in the past had more of an economic foundation than the racial and religious discrimination covered by the Civil Rights Act of 1968.

Even after recognizing this, however, it appears that for some time, many bankers did not follow very enlightened policies with respect to lending to women. The role of women in our economy has changed, with the majority now part of the labor force, but bankers did not adjust swiftly to this profound social change. I concede that the ground rules on lending to women are not very clear cut, but we do intend to meet our obligations to enforce fair lending requirements in this case, as in the case of all other areas. Many bankers have already developed credit standards for dealing with lending to women in an equitable and nondiscriminatory manner, and we encourage the remaining bankers to follow suit.

Bankers, just like other citizens, do not participate enough in a positive way when legislation and regulations are being drafted. They have a tendency to argue that certain laws or regulations are unnecessary, and then depart from the scene. Perhaps the supervisory agencies are somewhat at fault in not more actively soliciting comments and suggestions from the banking community and giving them the weight they deserve. At the same time, I hope you all realize that it is not the practice of the FDIC to put out regulations for comment when a decision has already been made. Here, where we are not at this time putting out additional regulations for comment, but where we are wrestling with the problems of enforcement in a specific area, we clearly have an open mind as to the best way to proceed. I am earnestly soliciting your suggestions and hope you will be able to come up with ideas that will be helpful for all of us.