

TESTIMONY OF

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ON

MORTGAGE DISCRIMINATION

BEFORE THE

SUBCOMMITTEE ON CONSUMER AND REGULATORY AFFAIRS  
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS  
UNITED STATES SENATE

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Good morning, Mr. Chairman and Members of the Subcommittee. The Federal Deposit Insurance Corporation is pleased to testify today on our activities in dealing with mortgage discrimination.

Over the past year, and the last six months in particular, the FDIC has given significant consideration to additional ways in which we can further enhance the monitoring and enforcement of anti-discrimination laws. To that end, we have made a number of changes in our consumer compliance programs.

#### Community Affairs Officers

First, we have established a new Community Affairs program that we believe will strengthen our efforts in the area of community outreach. The new program provides for a Community Affairs Officer (CAO) in each of our eight Regional Offices. These CAO's will report to a Deputy Director in the Office of Consumer Affairs in Washington, which will have oversight responsibilities for the program. The Deputy Director and CAO positions have been posted and the selection process is underway. The CAO's will be responsible primarily for making contact and meeting with consumer and community groups, government and industry organizations, and others regarding community needs and the lending practices of institutions within their communities. The CAO's also will be involved in formulating community lending and income profiles and performing related data analyses. These individuals will work independently of our compliance examiners and thus will be supplementing analyses done during the examination process. They will provide information and data to the examination staff to assist them in evaluating FDIC-supervised institutions as to their fair lending performance. The FDIC will share the results of these efforts to gather and analyze pertinent information regarding community credit needs and loan discrimination with other federal financial institution regulators.

#### Specialized Compliance Examiners

Second, the FDIC has decided to establish a new consumer compliance examination program with specialized consumer compliance examiners who have career paths distinct from safety and soundness examiners. The program will include an expanded corps of field compliance examiners and an increased emphasis on the consumer compliance area in both our Washington and Regional offices. The program will be under the jurisdiction of our Division of Supervision (DOS), but will be separate and apart from its safety and soundness examination activities. In the Washington Office, we have designated a DOS Assistant Director with specific responsibility for the new consumer compliance examination program. Further, we will soon designate an Assistant Regional Director with specific consumer compliance responsibilities in each of our Regional Offices.

This new consumer compliance examination program is a significant undertaking. We expect to start phasing it in by June 30 of this year. During the phase-in, we will continue our practice of using existing examiners, who have both consumer compliance and safety and soundness expertise, to assist in carrying out our compliance examination program.

### Compliance Training and Education

Third, the FDIC also has taken steps to strengthen its consumer compliance training program. In April, 1990, we held two one-week sessions of our newly developed Advanced Consumer Protection School. Approximately one and a half days were devoted to fair lending issues. As part of our efforts to present a balanced view of these issues, one segment included a presentation by Mr. Allen J. Fishbein, General Counsel of the Center for Community Change. The Advanced Consumer Protection School will be an on-going training program. We have two additional sessions already scheduled for 1990. We are also in the process of revamping our Basic Consumer Protection School to improve its effectiveness. In connection with the development of the separate compliance examination program, we expect to further expand our training efforts. We plan to hold more frequent training sessions and to add training programs at both the Washington and Regional Office levels to supplement the Basic and Advanced training programs.

The FDIC also intends to continue conducting consumer compliance seminars for bankers in various part of the country, at which the Community Reinvestment Act (CRA) and other consumer laws and regulations are addressed. These seminars have been well attended in the past, and we expect to hold at least three such seminars this year.

### CRA and HMDA Implementation

During the past few months, the FDIC staff has been actively involved with the other banking agencies in implementing the amendments to the CRA and the Home Mortgage Disclosure Act (HMDA) contained in the Financial Institutions Reform, Recover and Enforcement Act of 1989 (FIRREA). We have coordinated the development of guidelines, revised regulations and examination procedures, reporting requirements, and a training program.

### Community Reinvestment Act

On December 22, 1989, the Federal Financial Institutions Examination Council (FFIEC) published in the Federal Register a Notice of Request for Comments on its proposal to implement changes to the CRA rating system mandated by FIRREA. The notice also set out proposed uniform procedures for disclosure of the

CRA rating and the preparation of standard, written evaluations using the twelve assessment factors for judging CRA performance. On April 20, 1990, the FFIEC approved for publication in the Federal Register the "Uniform Interagency CRA Final Guidelines for Disclosure of Written Evaluations and Revised Assessment Rating System." On April 30, the FDIC's Board of Directors approved changes to our CRA regulations (Part 345) in order to implement the FFIEC guidelines for the institutions we supervise.

From May 1 through June 1, 1990, the FFIEC is conducting interagency CRA training of examiners. The training focuses on the new CRA Assessment Rating System and Public Disclosure Guidelines. Uniformity and consistency among the agencies in evaluating institutions and assigning CRA ratings is one goal of this interagency training effort. A total of eight sessions will be held in four locations throughout the country (Atlanta, San Francisco, Pittsburgh, and Dallas). We anticipate that FDIC examiners attending the training sessions will be involved in further training in their respective Regions. The FFIEC Consumer Compliance Task Force is also developing a pamphlet for financial institutions that will address the new rating system and disclosure guidelines.

#### Home Mortgage Disclosure Act

Beginning this year, HMDA requires disclosure by financial institutions of both (1) data on loan applications and their disposition and (2) the race, sex and income of borrowers and applicants. The Federal Reserve Board's Regulation C, which implements HMDA, has been revised to incorporate these new requirements. These revisions require a "register" form of reporting called the Loan Application Register or "LAR" under which lenders record the required data on a loan-by-loan and application-by-application basis. Lenders began using these forms as of January 1, 1990. As provided in FIRREA, these registers will be submitted to the federal supervisory agencies in early 1991, and reports reflecting individual institution and aggregate data will then be generated.

The LAR information now required to be maintained by institutions subject to HMDA will reveal very specific data about their lending patterns. We envision that this information will help the institution determine its own mortgage profile and decide what corrective actions need to be taken to remedy any possible existing discrimination even before a regulatory agency performs its fair housing lending analysis during compliance examinations. In the past, institutions were only required to organize the volume and dollar amount of their mortgage and home improvement loans by census tract. Now the LAR data will show actual loan demand and racial, gender, and income characteristics of all applicants for such loans. The FFIEC ultimately will provide tables to institutions cross-tabulating the LAR data and enabling them to compare their individual data to the aggregate data of other institutions in their

Metropolitan Statistical Area. Even before that time, however, the institutions themselves will be in a position to recognize lending problems and perform the necessary outreach to applicants from segments of their lending areas either represented on the LAR as unsuccessful or not represented at all.

Institutions with assets under \$30 million currently are exempt under HMDA from recording information about the race, sex, and income of loan applicants. To expand the opportunity for self-analysis to those institutions, the FDIC is currently working on a proposal to amend its own fair housing regulations to require these institutions to maintain that information on the LAR.

Due to the fact that these new reporting requirements became effective so recently, it is too early to draw any valid conclusions until we start receiving the new data next year. However, our examiners will consider information reflected on the register form as we conduct examinations this year.

#### Consumer Compliance Task Force Issues

As mentioned in our October testimony, the FFIEC Consumer Compliance Task Force is considering further possible actions for strengthening compliance with the fair lending laws. We addressed the establishment of mortgage review boards and the use of testers in our December response to the follow-up questions to our October testimony. Since then, the Task Force has attempted to identify mortgage review boards throughout the country. Very few active programs have been found. Representatives for the banking agencies conducted interviews in connection with the review boards in Boston and Detroit, as well as a mortgage partnership in Philadelphia. The Task Force is currently evaluating this information, and no further recommendation to the FFIEC has yet been made. The Task Force also is gathering more information about the inactive programs it found to understand why they are not active and to identify potential problems. We will continue to pursue this matter.

With regard to testing, the FFIEC on November 17, 1989 discussed a proposal from its Consumer Compliance Task Force to consider conducting a Fair Lending Audit, which would include testing at the pre-application stage. The consensus was to not pursue such an effort. The FDIC continues to support that position. We believe that it would be counterproductive for the financial institution regulatory agencies to engage in testing of depository institutions because of the adversarial relationship that testing would engender. The examination and supervision process depends not only on the training and ability of the examiner, but on the willingness of the institution being examined to be open and honest about problems at the institution. If the agencies were to engage in testing, we believe it would create a climate of mistrust that may

jeopardize the examination process. Further, it is our view that testing at the loan application processing stage is unnecessary since the FDIC's fair housing examination procedures, as well as our complaint investigation procedures, already require examiners to review a sample of approved and denied home loans. FDIC examiners determine whether the information available in the records supports the reasons for denial stated in the adverse action notices and is consistent with the institution's mortgage lending policies.

The Task Force is also reviewing a proposed questionnaire format that could be used for the broad-based sharing of community contact information among the agencies. The questionnaire is being designed for use by Regional and field personnel. Final FFIEC action on this endeavor is expected in the next few months.

### Compliance

The FDIC continues to share the concerns of Congress and the public regarding reports which indicate possible discrimination in mortgage lending. We remain committed to doing whatever is necessary to address these concerns. Institutions under our jurisdiction that do not comply with consumer protection and civil rights laws and regulations find that violations can result in increased regulatory oversight, administrative actions, and civil money penalties. An institution also is likely to be subject to CRA protests and complaints, which can result not only in denials of applications, but in costly time delays. However, the FDIC's overall experience, with few exceptions, has been that once a problem is brought to an institution's attention, steps are taken to correct it. No FDIC-supervised institution with a CRA rating of less than satisfactory has had an application approved without first agreeing to take appropriate corrective actions.

The following table indicates the CRA ratings for FDIC-supervised institutions examined during the past three years:

#### CRA RATINGS

<u>Year:</u>	<u>1</u>	<u>2</u>	<u>3</u>	<u>4 and 5</u>
1987	221	1,965	40	8
1988	307	2,683	58	12
1989	306	2,295	54	4

Our composite consumer compliance ratings are an additional measure of possible discriminatory patterns and practices. The following table indicates the composite compliance ratings for FDIC-supervised institutions examined during the past three years:

COMPOSITE COMPLIANCE RATINGS

Year	1	2	3	4 and 5
1987	319	1,617	290	16
1988	472	2,166	394	34
1989	449	1,885	298	28

Based on CRA and composite compliance ratings, it can be seen that the great majority of FDIC-supervised institutions continue to be in satisfactory or better compliance with the fair lending laws.

CRA protests by the public against applications provide the FDIC with an additional vehicle through which we can monitor possible illegal mortgage lending discrimination. The FDIC received ten CRA-related application protests in 1987 (against eight institutions); six in 1988 (against five institutions); and seven in 1989 (against six institutions). Of those submitted in 1989, six protests were withdrawn after the institutions made commitments to address the protestants' concerns, and one of the applications was withdrawn so the applicant could address CRA concerns raised during our investigation. Two protests (against two institutions) have been submitted during 1990. These are currently under investigation.

The FDIC's toll-free "hotline" is another useful indicator of possible lending discrimination practices. During 1989, the FDIC's Office of Consumer Affairs and our Regional Offices reported approximately 48,100 telephone calls for information and assistance. Of this number, 549 calls involved community reinvestment matters and 1,707 involved fair housing. For the first three months of 1990, nearly 17,030 telephone calls were reported, with 379 relating to community reinvestment and 372 concerning fair housing matters. Many of these calls were from bankers in connection with regulation revisions. In 1989, OCA and the Regional Offices also received about 4,400 written complaints and inquiries, 3 of which involved CRA issues and 4 of which involved fair housing. During the first three months of 1990, over 1,200 written complaints and inquiries were received. One of these involved community reinvestment and none involved fair housing. After investigating the inquiries, we found no actual evidence of mortgage lending discrimination in any of these instances.

Conclusion

In conclusion, we share the Subcommittee's concerns about mortgage discrimination, and we are committed to doing our part to ensure that financial institutions do not engage in this illegal practice. Over the past six months, we have made a number of significant changes in our consumer compliance program with the goal of improving its effectiveness. These changes

include new efforts at community outreach, a new consumer compliance examination program separate from our safety and soundness program, and increased consumer protection training efforts. We believe that these changes will improve the FDIC's consumer compliance program.

ADDITIONAL QUESTIONS FOR FEDERAL REGULATORY AGENCIES

1. In how many instances over the past three years has your agency found substantive violations of the Fair Housing Act or Equal Credit Opportunity Act (ECOA) while conducting examinations? Provide some examples of how these substantive violations were resolved.

Thirty-eight substantive violations were cited for institutions examined from January 1, 1987 through December 31, 1989. Most were considered isolated violations and not a pattern of discrimination. In every case, we required management to make corrections, including amending their loan policies where necessary. When we forwarded examination reports to the institutions, they had to advise the FDIC of the corrective actions taken. Examiners are also required to follow-up on cited violations at subsequent examinations. Corrective actions were taken in almost all the cited cases and repeated violations generally were not found. (In those few instances where corrections were not made, we have increased supervisory actions to ensure that the institutions take corrective action as soon as possible.) By way of example, in one instance an institution had an illegal policy of automatically assigning young and elderly applicants a greater risk factor. This was one of many apparent violations in the institution. We required the institution to sign a Memorandum of Understanding specifying needed corrections. Also, the institution's policy was changed and other corrections made. Examiners verified the corrections at the next examination.

2. In how many instances over the past three years has your agency referred cases of possible discrimination to the Department of Justice for prosecution? What were the results?

No cases have been referred to the Department of Justice over the past three years. The FDIC has adequate authority to enforce compliance with the fair lending laws and regulations through increased regulatory oversight, administrative actions, and civil money penalties.

3. Has your agency found violations of the Fair Housing Act or ECOA (Regulation B) based on an "effects test" analysis? Can you provide any specific examples of how you have used this approach to prohibit lenders from maintaining loan policies which have a discriminatory effect on minorities?

Violations of the Fair Housing Act or ECOA are identified in the examination process through prescribed examination procedures. In following these procedures, our examiners review and analyze an institution's lending policies and procedures to determine if discriminatory practices are evident. Analysis includes an evaluation of whether any of the policies or procedures fail the "effects test." However, the FDIC does not separately track the individual methods, including the "effects test," that may be used by examiners to detect violations of the Fair Housing Act or ECOA.

4. How many fair lending written complaints did your agency receive over the past three years? How many of these complaints led to a finding of a substantive violation? Provide some examples of how these substantive violations were resolved.

From January 1, 1987 through May 1, 1990, we received 3,615 complaints related to the fair lending laws (ECOA, FHA, CRA, and HMDA.) None of them led to a finding of a substantive violation. The largest volume involved nationwide credit card operations, i.e., denial of credit applications. In one particular instance, the volume and nature of the complaints led to an examination of the institution based on our concerns about the allegations. While the examination did not reveal actual violations of the laws or regulations, the institution had failed to follow its own policies and procedures with regard to communicating its denials of credit to applicants, resulting in confusion on the part of applicants. We advised the institution to adhere strictly to its policies in the future and make any necessary corrections. The following is a breakdown of the written complaints by year:

<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>5/1/90</u>
1,381	835	378	72

5. How many fair lending telephone calls did your agency receive over the past three years? Can you characterize these inquiries? Are there any patterns among these inquiries? What are complainants told in response?

Our Office of Consumer Affairs and eight Regional offices reported over 2,100 telephone calls related to the fair lending laws (ECOA, FHA, CRA, and HMDA) in 1987; nearly 3,100 in 1988; and about 5,600 in 1989. Many of the calls were from bankers concerning regulatory changes. Many of the other calls were from consumers with questions about credit denials or home ownership counselling requirements. We also received a number of calls from individuals involved in fair lending studies in their communities, and seeking general information. No

patterns were noted nor was any particular institution the focus of the inquiries. Those wishing to register a specific complaint are generally requested to do so in writing. In every case, we investigate the complaints received and try to resolve the problem or provide necessary information.

6. Do appraisers, private mortgage insurers, or the secondary market play a role in discrimination? What should Congress do about the problem of under-appraisals of properties in minority areas? Would your agency detect this problem in its normal examination or complaint-response procedures?

Any group or individual involved in mortgage lending activities could play a role in mortgage lending discrimination, including financial institutions, appraisers, private mortgage insurers or the secondary market. We have no information, however, on which to express an opinion about whether appraisers, private mortgage insurers, or the secondary market actually play a role in such discrimination.

The FIRREA contains real estate appraisal reform amendments, the purpose of which is to require that real estate appraisals utilized in connection with federally-related transactions be performed according to uniform standards by individuals whose competency has been demonstrated and whose professional conduct is effectively supervised. Accordingly, the FFIEC established an appraisal subcommittee which early this year released guidelines for state certification and licensing of real estate appraisers. These new standards should help ensure uniformity and consistency throughout the appraisal industry.

With respect to under-appraisals, we have found no evidence of this practice through our normal examination process or complaint procedures. However, if we received any complaints or found any evidence of under-appraisals, we would investigate.