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FEDERAL DEPOSIT INSURANCE CORPORATION

Statement on

FAIR MORTGAGE LENDING LAWS AND REGULATIONS

Presented to

Senate Committee on Banking, Housing, and Urban Affairs, to ①
United States Senate

by

Irvine H. Sprague, Chairman
Federal Deposit Insurance Corporation

5302 Dirksen Senate Office Building

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Good morning Mr. Chairman, Members of the Committee.

I appreciate the opportunity to appear here today to participate in the Committee's oversight hearings on fair mortgage lending laws.

The Federal Deposit Insurance Corporation is responsible for enforcement of fair mortgage lending as part of our supervision of the Nation's 8,887 State nonmember commercial banks and 322 mutual savings banks. Basically, our supervisory authority derives from four laws: the Fair Housing Act, the Equal Credit Opportunity Act, the Home Mortgage Disclosure Act and the Community Reinvestment Act.

The FDIC has done a creditable job so far, but we know that more can be done, and we are working on ways to improve our enforcement.

In response to your staff inquiries, we have included in this statement detailed information about the housing laws we enforce, the examination process, the training and promotion and motivation of specialized examiners, and the results of our enforcement activity. In addition, your staff memorandum of December 7 posed specific questions for my comment:

(1) Adoption of Substantive Fair Mortgage Lending Regulations and Guidelines. We have not yet achieved our full potential for enforcement under existing laws and guidelines, and I am reluctant to add additional regulations or guidelines unless we determine we cannot do the job with the tools at hand.

(2) Data Analysis. We are now in the final stages of field testing a mortgage loan application analysis system that may or may not prove superior to the system used by other agencies. The system will not be computerized for banks making only a few real estate loans; it will analyze for possible discrimination where part of the household income is earned by a woman, and it will single out individual cases where certain threshold ratios indicate possible discrimination. To get more accurate data without burdening the banks, we have used Corporation personnel during the field test to collect loan application data and we will decide later whether or not to ask banks to do the collection. Once we are convinced that an effective system has been developed -- whether it is ours or that of the OCC or the FHLBB or a combination -- we will put a system into effect. Our purpose is to use the best enforcement tool we can find.

(3) Prescreening. HUD, in conjunction with the Ford Foundation, is about to make a study of using testers to detect prescreening and we expect to learn from their findings. Meanwhile, we are seeking to determine if data analyses will help us spot prescreening.

(4) Absence of Findings of Substantive Discrimination Violations. We are not satisfied that we have found the answer of how best to uncover substantive discriminatory practices in fair mortgage lending, but we expect this function to improve and evolve as our new training for examiners begins to show benefit in the field.

(5) Discrimination Based on Whether or not Applicant is a Customer of the Bank. In these times of tight money, an institution's policy of lending to its customers first would seem legitimate, provided that the arrangement, in combination with individual circumstances, is not a sham that has the effect of discriminatory lending.

(6) Definition of Redlining in Reporting Form. We see no need to revise the definition on the report form. The question is merely a convenient summary of the examiners' findings. Examiners have been trained to detect redlining in whatever form it may take, and they are required to give specifics of any such findings.

(7) Enforcement Actions. Violations are followed up by the Regional Office in much the same way as for safety and soundness violations. We use moral suasion first, and in the few instances in which the Regional Office cannot get satisfactory corrections, we may employ our cease-and-desist authority.

The uniform enforcement guidelines are still under consideration by a Task Force of the Federal Financial Institutions Examination Council. It is my understanding that the Task Force is having difficulty with a cost benefit analysis but expects to have a recommendation to the Council in the next few months.

(8) Program for Field Examiners Specialization in Compliance Examination. We believe that a well qualified compliance examiner should have a strong background in safety and soundness activities; we have therefore restricted entry to our compliance examiner ranks to commissioned bank examiners (Grades 12 and 13). All assistant examiners receive training in compliance and are required to spend three months working in the compliance area before undergoing their performance evaluations to become commissioned examiners.

(9) Complaint Processing. Our compliance examiners who investigate fair housing complaints have received instructions concerning the effects test and do evaluate the complaints for violations of the effects test.

These and other issues will be discussed in more detail in my following comments.

COMPLIANCE ENFORCEMENT

We rely on our bank examiners, our FDIC representatives in the field, as our first line of enforcement for fair mortgage lending laws, as for other banking laws.

We have created a special compliance examination to check for fair mortgage lending and other civil rights and consumer laws, and we have made this kind of examining into a career specialty for bank examiners.

Compliance is also assessed through complaints received by the agency. Consumers may focus attention on possible violations of the law not picked up in the course of examination. Our

Office of Consumer Affairs and Civil Rights, which receives and takes appropriate action on consumer complaints, last month set up a consumer hotline to make FDIC even more accessible to the public. We have received about 1600 hotline calls in the first seven weeks of operation, including about 10 on fair mortgage lending matters.

We also publish and distribute to banks and the public a series of pamphlets setting forth consumer rights under various statutes. We are in the process of redrafting and improving our fair housing pamphlet, and we will be translating this and other consumer pamphlets into Spanish.

Additionally, regulators and staff meet from time to time with consumer groups and the banking industry to discuss fair housing laws and regulations and to maintain a constructive dialogue.

One current example of this is our compliance seminars at which FDIC representatives show bankers how to comply with fair mortgage lending laws and other consumer laws. We conducted two pilot seminars this month -- one in Rockford, Illinois, where more than 80 banks were represented, and a second in Richmond, Virginia, which was held this week. If these seminars prove as useful as we hope, we intend to expand them to the entire nation.

I plan to elaborate on each of these areas later in my testimony.

FAIR MORTGAGE LENDING LAWS

First, I believe it would be helpful to set down the four laws from which the FDIC derives its supervisory authority in the fair mortgage lending area.

(1) The Fair Housing Act (Title VIII of the Civil Rights Act of 1968) prohibits any conduct by a lender which has the purpose or effect of discriminating in the financing of housing or home improvement loans on the basis of race, color, religion, sex or national origin. Section 808(d) of this law requires all agencies with housing-related programs to act in furtherance of the fair housing goals set by Congress. In addition, Section 8 of the Federal Deposit Insurance Act provides enforcement machinery to correct violations by our regulated banks of this Act and other laws.

(2) The Equal Credit Opportunity Act of 1975 (ECOA) prohibits discrimination by banks and other creditors against any applicant on the basis of race, color, religion, national origin, age, sex or marital status, or because an applicant derives income from a public assistance program or has exercised a right under the Consumer Credit Protection Act. Like the Fair Housing Act, ECOA prohibits conduct having a discriminatory effect, as well as purposeful discrimination. Section 704 of the Act gives enforcement authority to the FDIC for its regulated banks.

(3) The Home Mortgage Disclosure Act of 1975 (HMDA) financial institutions with deposits over \$10 million and with an office

located in a standard metropolitan statistical area (SMSA) to disclose to the public the amount of their housing related lending by census tract. The disclosure is intended to give the public sufficient information to determine whether particular financial institutions are fulfilling their obligations to serve the housing needs of the communities and neighborhoods in which they are located and to assist public officials in deciding where to deposit public funds. Section 305 provides enforcement authority to the FDIC and other financial regulatory agencies.

I am already on record in support of an extension of HMDA, which provides a data base for enforcement of the other three fair mortgage lending laws. A study on this law, sponsored jointly by the FDIC and the Federal Home Loan Bank Board, is near a final report for submission to Congress. The study will make certain recommendations which deserve careful consideration before we decide on any package of HMDA amendments to be recommended to this Committee.

(4) The Community Reinvestment Act of 1977 requires that during an examination a Federal regulator shall assess a financial institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the institution, and that during evaluation of an institution's application for a deposit facility, the regulator shall take such record into account. We have found this authority effective in focusing attention of bank managements on their responsibilities in this area.

COMPLIANCE EXAMINATIONS AND PROCEDURES

To enforce these and other consumer laws, as distinct from bank safety and soundness laws, we have evolved a separate examination and a report form. We began the process in 1974 by introducing a separate Compliance Report. In 1977, we split off the so-called compliance examination from the regular safety and soundness review and made the compliance examination a separate, specialized entity in its own right.

Today we conduct compliance examinations of all our banks on a regular cycle, scheduled for every 18 months. In the first nine months of 1979, we conducted about 4,500 such compliance examinations.

This year we upgraded our compliance enforcement program another notch by creating a career specialty within the FDIC examiner corps. Our initial staffing is targeted at 114 compliance specialists. We have had a recruiting problem and we are working on it. To date, 44 examiners have chosen this field. We believe it is important that compliance examiners have a strong background in bank operations and safety and soundness aspects of regulation and we continue to believe that the compliance career path should begin at the Grade 12 level so that incumbents will have had the benefit of experience in the lower grades and will have gained valuable insight into the complete examination process and the operational concepts of banking. At this time our efforts are aimed at finding ways to make the compliance examiner career path as attractive as the one for our safety and soundness examiners. This I intend to do.

The job of a compliance examiner is one that demands case-by-case determinations, good judgment, flexibility, and good investigative techniques. Since these types of consumer examinations do not lend themselves to mechanical rules and mathematical calculations, we rely heavily on our examiners' dedication, experience, training and judgment.

About 23 percent of compliance examiner time in the first three quarters of 1979 was devoted to fair mortgage lending activity.

COMPLIANCE REPORT

We have continued to refine our compliance examination in light of our examiners' experience with this new tool. Today our Compliance Report serves our examiners as a framework for the review of bank compliance with 15 laws and one Executive Order. Separate pages of the examination report cover:

(1) "Security and Controls Against External Crimes" as required by Part 326 of the FDIC Rules and Regulations and the Bank Protection Act of 1968 (Pub. L. 90-389);

(2) "Financial Recordkeeping and Report of Currency and Foreign Transactions" as required by Treasury regulations and the Financial Recordkeeping and Currency and Foreign Transactions Reporting Act of 1970 (Pub. L. 91-508);

(3, 4, 5) "Truth-In-Lending - Fair Credit Billing - Consumer Leasing" as required by Federal Reserve Regulation Z and the Truth-In-Lending Act (Pub. L. 90-321), the Fair Credit Billing Act (Pub. L. 93-495) and the Consumer Leasing Act (Pub. L. 94-240);

(6) "The Fair Credit Reporting Act" as required by that law (Pub. L. 91-508);

(7) "Emergency Preparedness Measures" as required by Executive Order 11490 of October 28, 1969, as amended;

(8) "Advertising of Interest or Dividends on Deposits" as required by Section 329.8 of FDIC Rules and Regulations and by the Federal Deposit Insurance Act;

(9) "Equal Credit Opportunity" as required by Federal Reserve Regulation B and the Equal Credit Opportunity Act (Pub. L. 93-495);

(10) "Real Estate Settlement Procedures" as required by HUD Regulation X and the Real Estate Settlement Procedures Act of 1974 (Pub. L. 93-533);

(11) "Fair Housing" as required by Part 338 of FDIC Rules and Regulations and the Fair Housing Act (Title VIII of the Civil Rights Act of 1968) (Pub. L. 90-284);

(12) "Home Mortgage Disclosure" as required by Federal Reserve Regulation C and the Home Mortgage Disclosure Act of 1975 (Pub. L. 94-200);

(13) "Community Reinvestment" as required by Part 345 of FDIC Rules and Regulations and by the Community Reinvestment Act of 1977 (Pub. L. 95-128); and

(14, 15, 16) "Fair Debt Collection" as required by the Fair Debt Collection Practices Act (Pub. L. 95-109); "Electronic Fund Transfer" as required by Federal Reserve Regulation E and the Electronic Fund Transfer Act (Pub. L. 95-630); and "Preservation

of Consumer Claims and Defenses" as prescribed by Federal Trade Commission Trade Regulation Rule (16 CR CFR, Part 433).

Violations of these laws and regulations are reported on an exception basis as they are noted without reference to a structured report page.

For the record, I would note that seven laws covered by our Compliance Report -- the Truth-In-Lending Act, the Fair Credit Billing Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act, the Consumer Leasing Act, the Fair Debt Collection Practices Act and the Electronic Fund Transfer Act -- are now incorporated into a single statute, the Consumer Credit Protection Act enacted in 1968 (Pub. L. 90-321) and amended in subsequent years.

We have included at the end of this statement a table to show the portion of examiner time spent on the four fair mortgage lending laws and on the other laws monitored through the compliance examination.

Table I shows that about 44 percent of examiner time is given to Truth-In-Lending compliance, about 23 percent to CRA, ECOA and Fair Housing Act and the remaining 33 percent to the other 11 laws and regulations and one Executive Order covered by the compliance report.

The Committee already has been given a set of examination and training materials used by the FDIC.

EXAMINING FOR FAIR MORTGAGE LENDING

Our examiners review the bank's mortgage and home improvement loan policies and practices for evidence of discriminatory treatment against applicants and borrowers, particularly treatment which has the effect of discriminating on a prohibited basis. The examiners review each stage of the lending process, focusing on the bank's policies and practices in prescreening applicants, developing credit information, making property appraisals, applying credit standards, and servicing and collecting loans. In addition, a sample of accepted and rejected loan applications is reviewed for consistency of treatment.

In examining for potential discriminatory effects, our examiners are instructed to review a bank's mortgage loan policy for loan and credit-granting provisions such as a limitation on loans for properties above a certain age or below a certain dollar value. Such provisions may, under some circumstances, have a disproportionately adverse impact on the ability of minority buyers to purchase homes. Potential discriminatory effects are also considered when an examiner investigates a consumer complaint.

FDIC examiners also review the bank's application, appraisal and other forms and procedures for technical compliance with applicable regulations, in particular the technical requirements of the Equal Credit Opportunity Act and Regulation B, the data collection and retention requirements and the advertising requirements of the FDIC's Part 338 Fair Housing regulations.

Examiner findings are included in the Compliance Report which is reviewed in the Regional Offices for internal consistency, correctness of statements and conclusions and conformity with FDIC procedures and practices.

The reports are then transmitted to the banks concerned, with a cover letter discussing the examiner's findings and conclusions and the need for corrective action. The cover letters, reports and subsequent correspondence between the bank and the Regional Office are reviewed in the Washington Office to monitor the problems, developments, and the progress of corrective action in the individual banks and for conformity among Regions.

It might be helpful to run down some of the questions an examiner must focus on when checking for bank compliance with the various fair mortgage lending laws.

PREScreenING

Item 1 of the fair housing sheet, for example, asks whether there is any evidence that the bank has engaged in any discriminatory practice in prescreening applicants for mortgage or home improvement loans.

Prescreening is the process of denying or avoiding receiving a loan application before it comes into being. It is one of the most difficult discriminatory practices to detect.

We are attempting to address this problem in several ways.

First, during the compliance examination, examiners look for procedures which would lend themselves to intentional or unintentional prescreening.

An examiner can get a feeling of the situation by talking with bank loan officers and looking at the fair housing log. If he sees, for example, that the log shows virtually no loan inquiries, and that virtually all loan applications are approved, this could signal that the bank is prescreening and turning away customers before they even get to the formal applications process.

Second, we encourage banks to adopt internal controls which will prevent individual employees from engaging in prescreening.

Additionally, we are looking for ways in which any data analysis system we ultimately develop may be used to identify banks where the possibility of discriminatory prescreening needs to be investigated in depth. Such a system should identify banks with low overall rejection rates and will compare the proportion of inquiries made and applications filed by members of significant racial minorities with the proportion of such minorities in the population of the bank's service area. We have not been able, however, to make confident estimates of "expected applicant flow" by racial or other category. Most data now available on a regular basis are not appropriate for accurate detection of prescreening. We are trying to determine if it is feasible to adapt HMDA for use in detecting prescreening, particularly by neighborhood.

As you indicate, it has been a standing practice that our examiners obtain the approval of the Regional Director before interviewing customers or others outside the bank. This is true whether the purpose is to detect prescreening or for some other reason.

We are currently monitoring a proposal by the Department of Housing and Urban Development to conduct, with the assistance of the Ford Foundation, a pilot program of testing financial institutions to determine the presence and the extent of prescreening and certain other discriminatory practices. We will be looking at the results of this project.

Item 7 in the fair housing part of the Compliance Report asks whether the bank has taken the necessary internal steps to ensure compliance with fair housing lending requirements, for example, by issuing appropriate instructions, training personnel and establishing procedures to facilitate compliance. In this case, the examiner is looking for a bank loan policy and specific fair housing lending procedures and training. Evidence that institutional procedures do not exist may well prompt the examiner to look further into the bank's fair housing lending practices.

Under the CRA part of the compliance examination, examiners are asked to look at the bank's description of the community it serves and determine whether the delineation is reasonable. The examiner then goes on to describe and assess the bank's record of performance in meeting the credit needs of its entire delineated community, including low and moderate income neighborhoods, consistent with safety and soundness factors.

In assessing CRA compliance, examiner attention is focused on factors such as: activities the bank uses to ascertain community credit needs, including efforts to communicate with

community members on the kind of financial services provided by the institution; practices intended to discourage applications for the types of credit set down in the bank's CRA statement; the geographic distribution of bank loans, credit applications, and credit denials; and the bank's ability to meet various community needs based on its financial condition, size, and other factors.

Lastly, the examiner describes apparent violations, together with a statement of the corrective action taken or promised by the bank.

Community groups have been helpful in this effort and we encourage public hearings to assist us in developing all the facts.

Six items are checked for compliance with HMDA, including whether the bank is noting complete and correct data and whether that information is being made available to the public at prescribed locations as required by law.

The ECOA part of the Compliance Report contains 17 questions which focus on the various requirements under the Act. When a violation is discovered, details are provided on a separate violations page.

Examiners review overall bank loan policy and check for a number of specifics -- whether there are any discriminatory terms on loan applications or in evaluations of creditworthiness (e.g., requests for information from the applicant about birth control practices or intentions concerning the bearing or rearing of children), whether the bank has changed the terms of

an existing account or refused to extend credit because of the applicant's age, whether the bank has furnished adverse action notices in accord with the steps required by regulations, and similar inquiries.

EXAMINER TRAINING

It might be helpful now to review the kind of training an examiner receives on how to examine for compliance with consumer laws, including fair mortgage lending.

During a week-long fair lending training session at our Rosslyn Training Center, examiners learn about the issues that led to passage of particular laws so that examiners can have a better understanding of the spirit of the law as well as the most effective ways to enforce it. Examiners develop a good working knowledge of the Fair Housing Act, ECOA, CRA and HMDA.

Trainees learn investigatory tools and techniques. Trainees are taught to measure compliance by using racial and sex data, adverse action notices, loan files, internal forms, loan policies and HMDA data. In addition, trainees are taught how to interview bank personnel to derive basic information necessary to complete an examination or investigate a consumer complaint.

The fair lending session is divided between lectures and case studies. Instructors are staff specialists from the Washington and Regional Offices and experienced compliance examiners.

Since inauguration of the current training format in February 1979, 245 FDIC examiners have attended, including the 14 Regional Consumer Affairs Specialists, various members of the Washington staff, representatives from the State banking departments of Oklahoma, North Carolina and New York, and two representatives from the General Accounting Office. For the calendar year 1980, an additional 250 students are scheduled to be trained in eight sessions.

The FDIC, in conjunction with the Federal Financial Institutions Examination Council, is also preparing for interagency fair lending training. The pilot session, scheduled for the first quarter of 1980, includes development of a refresher course for experienced compliance examiners and Regional Consumer Affairs Specialists and an introductory session for those supervisory personnel not regularly working with fair lending, but whose jobs require an understanding of this area.

VIOLATIONS

During the first three quarters of 1979, 62 percent or 2,818 of 4,544 compliance reports processed cited at least one fair housing deficiency or violation, most technical in nature.

More than half of those violations reflected a bank's failure to request and maintain the information required under the FDIC's Fair Housing regulations.

About 17 percent stemmed from bank failure to indicate prominently in all its advertisements that it makes loans without regard to race, color, religion, sex or national origin.

About six percent of the violations stemmed from bank failure to display the Fair Housing Lending Poster in all public areas where deposits are received or home loans are made.

Table II shows a breakdown of banks reported in violation of each of the four fair mortgage lending laws based on compliance reports reviewed in the Washington office since 1976. (Reports are reviewed in Washington, usually six to eight weeks after the examination has occurred.)

It is clear that bank compliance must be improved. The FDIC, both through its supervisory powers and through educational seminars, is attempting to improve bank familiarity and compliance with fair mortgage lending laws.

For banks that do not respond to moral suasion, we resort to formal proceedings under Section 8 (b), leading to issuance of a cease-and-desist order to correct fair mortgage lending violations. We have taken 17 such actions, each citing violations of one or more laws, in the past three years, and we have begun formal proceedings in another three instances which are now pending. Table III summarizes this activity.

Your staff memo notes that Federal Home Loan Bank Board examiners have reported more fair housing violations than our FDIC examiners. Earlier training of FDIC examiners had emphasized technical requirements of the regulations.

The preponderance of violations our examiners uncovered therefore tended to be of a technical nature while both the examiners and the industry acquired experience and a body of knowledge. What we have learned during this period led us to develop and implement a revised fair housing training program. It went into effect early this year, and we expect a corresponding improvement in coming months in our monitoring and citation of substantive fair housing violations.

COMMUNITY REINVESTMENT ACT

The FDIC has 19 pending applications which have been protested on Community Reinvestment Act grounds. We use HMDA data as reported by individual banks in reviewing the bank's performance under CRA.

Six other protested applications have either been settled, approved or disapproved, including one case in New York where we rejected an application on CRA grounds last spring. This first rejection by any agency signaled to the industry and to our examiners that we are serious about CRA enforcement.

Some banks are taking the initiative, using CRA statements as marketing tools to show how they are serving their communities and to seek more business, which I think is a good idea.

While bankers in general are never overjoyed about new statutes or regulations that impose reporting requirements

or mandate actions not directly related to their institutions' profitability, they sometimes find that there are at least some salutary side effects.

A recent issue of the American Banker quotes John Popovich, a Vice President of United California Bank in Los Angeles, in a speech before the Bank Marketing Association. Mr. Popovich said that the law has had some positive aspects.

Expressing his belief that there is much untapped business in low-income communities, Mr. Popovich said, "CRA gives us a strong incentive to develop that business. There is no doubt in my mind that a lot of potential loan customers have not sought loans from us because they believed they'd be turned down. But the business is there . . . and at UCB, we're finding it where we never before dreamed it existed."

Mr. Popovich told his colleagues that "CRA is forcing us to explore areas of new business and new profits" and that "if banks respond to the demands of CRA in a really positive fashion, we will enjoy the lasting goodwill of our customers and communities we serve."

DATA ANALYSIS

We are in the final stages of implementing a system for performing computerized data analysis of mortgage lending activities of certain banks -- those with a sufficient volume of activity to warrant such action.

FDIC has developed a computer system for analyzing files of mortgage loan applications and has applied evolutionary versions of this system to several banks. Data have been collected from ten banks within the last six weeks to test a "final" version of this analysis system. These banks averaged about 200 mortgage loans a year. The data have been keypunched and are being entered into a computer. We expect to have our first data analysis printout by mid-January.

EXPLANATION OF APPLICATIONS ANALYSIS

The purposes of the mortgage loan applications analysis are threefold: (1) to detect statistical evidence of illegal discrimination in making a decision whether to accept or reject a loan; (2) to detect statistical evidence of illegal discrimination in granting loan terms (e.g., higher interest rates or larger down payments to blacks or unmarried females than to white married couples); and (3) to raise a red flag of possible discrimination in individual cases and give the examiner statistical evidence which the examiner may use to elicit further evidence or explanation from the bank.

The FDIC for the past two and one-half years has been working closely with neighborhood and civil rights organizations concerned about better enforcement of the Fair Housing Act of 1968, the Equal Credit Opportunity Act, and similar statutes. Since joining the Corporation, I have escalated this effort and I want to make it clear that we will continue

to cooperate and consult with these organizations -- that we will continue our efforts to improve fair mortgage lending enforcement long after the terms of our lawsuit settlement expire next May.

The computerized data analysis system is a special project focusing on a narrow aspect of bank operations -- mortgage lending -- and, therefore, by its nature has confronted us with special problems, i.e., how to provide us with the information we need without an inordinate use of examiner time or imposition of an undue burden on banks.

FDIC's Fair Housing Regulation, Part 338, issued effective July 1, 1978, requires each "HMDA" bank (over \$10 million in assets, at least one branch in an SMSA) to keep a Fair Housing Log and to keep certain specified data in an applications file. Examiners have been monitoring compliance. Many of these required records have been found in technical violation and a major effort is underway to improve record-keeping.

FDIC has developed a computer analysis system for Logs, and has applied it to about 60 banks. We are now evaluating this analysis system and the Log itself as tools for enforcing compliance.

FDIC's plan is to carefully evaluate the methods now being tested, including both examination procedures and statistical analyses, to determine what methods provide the most effective and efficient means of enforcing compliance

with fair housing statutes. In addition to our own experience, we will examine the experience of OCC in using its monitoring system which comes into operation on January 1, 1980, and the experience at the FHLBB.

Now let me respond to your specific Question 2 in you staff memo of December 7.

(a) The Corporation does plan to establish a general guideline threshold of the number of applications per year below which computerized data analysis will be considered impractical. OCC's threshold of 75 applications seems reasonable, but may need to be modified by experience.

(b) The Corporation has as yet fixed no specific timetable for making the computer data analysis for qualifying banks a routine feature of the examination process. We are looking to the results of our current experiment first.

(c) The Corporation's experimental applications analysis system has made use of data collected in the banks by Corporation personnel during special data-collection visits which are not part of a regular compliance examination. We will observe OCC's experience in having the banks collect and submit this data. By comparing their experience with ours, we expect to be able to make a judgment as to the preferable approach.

(d) We intend to incorporate into the applications analysis a system to spot possible discrimination against households where at least a part of the income is earned by a woman. The applications analysis now being tested would show the percentage of

household income earned by a co-borrower. This information will appear in a "probit" form and also as a ratio-analysis output as discussed in (e) below. The "probit" approach will employ a statistical method for estimating the probability that a given factor, such as race, influenced a loan decision.

(e) You ask about a listing of loans and rejected loans showing statistical disparities that might indicate violations. The applications analysis now under test provides a listing of each case considered, with the demographic description of each applicant and the individual case values of the ratios computed. It will also be possible to set threshold values for each ratio and single out cases in which the thresholds are exceeded. This would indicate the possible existence of discrimination based on one of the prohibited factors. These lists will be supplied to the examiner in those cases where it appears useful.

ENFORCEMENT ACTIONS

Your staff memo poses a series of questions on enforcement actions. Reported violations or exceptions are routinely followed up by the Regional offices to assure that necessary corrective measures are taken. The Review Examiner (Consumer Affairs/Civil Rights) in each Regional Office coordinates this function and serves as the contact between the Regional Office and the Washington Office on matters of compliance. In following up on reported violations, the Regional Offices make every

effort to obtain compliance on a voluntary basis before recommending formal administrative proceedings to compel compliance. Voluntary efforts may include additional follow-up examinations or visitations, meetings with the boards of directors of the banks involved and negotiated memoranda of understanding designed to correct the compliance problems noted.

As a last resort, we would use our Section 8 cease-and-desist authority.

The uniform enforcement guidelines are under active study by the regulators under the aegis of the Federal Financial Institutions Examination Council. The matter has been referred to the Fair Housing and Equal Credit Opportunity Act Subcommittee of the FFIEC Task Force on Consumer Compliance. Some field testing has been finished, but the compilation and evaluation of results are still in process. We hope to have a report on this matter in the early part of 1980.

REGULATIONS AND GUIDELINES

Your staff memo asked about the possibility of fair mortgage lending regulations and guidelines.

FDIC has no present plans to issue regulations and guidelines which specify the kinds of practices that constitute prohibitive mortgage lending discrimination. We believe that the prohibitive conduct is adequately stated in the language of the Fair Housing Act, the Equal Credit Opportunity Act, and Regulation B which was issued by the Federal Reserve

Board to implement the Equal Credit Opportunity Act. In particular, Regulation B refers to the judicial authority for the effects test, and the banks have been on notice since March, 1977, that the effects test is applicable to mortgage lending practices. In our opinion, banks can apply this test as well as other criteria set forth in the existing regulations and laws to determine what specific marketing practices and other mortgage lending activity are illegal.

During the September, 1978, hearings before the Subcommittee on Commerce, Consumer and Monetary Affairs of the House Government Operations Committee, FDIC's representative testified that FDIC had the authority to issue regulations prohibiting mortgage lending discrimination based solely on the age and location of a dwelling. This testimony somewhat overstates the case for FDIC's authority in the area of mortgage lending. We believe that there may be a legal basis for FDIC to issue such a regulation; however, such authority would be inferred rather than expressed.

Your memo also asks whether the definition of redlining, as used in our Compliance Report, should be revised. We do not feel that this is necessary because the capsule language in the report is intended merely as a convenient summary. What is more important is the understanding of the law and regulation and the examiner function in this area, and we rely for this on training materials, official memoranda and examiner experience.

We have no regulation which specifically describes age and location of dwelling, specific marketing practices, or types of "redlining" which may, intentionally or in effect, violate the law. We are not convinced that it is wise or possible to try to "cover the ball park" with such a regulation. Instead, we have focused on training our examiners to identify, in a particular bank's policies and practices, those areas which do, or may, raise questions of noncompliance.

COMPLAINT PROCESSING

One item in your memo suggested we instruct examiners that, in the course of reviewing complaints, they should evaluate lending and underwriting criteria for possible violations of the effects test. In fact, we already do this. Our week-long training course in fair lending examination includes detailed instruction to examiners on how to evaluate a bank's lending and underwriting criteria to determine if discriminatory factors are included. Examiners also get extensive instruction in the operation of an effects test and in examination procedures for detecting violations.

CUSTOMERS FIRST

Your memo asks FDIC's view of "customers first" policies by banks. We believe it is legitimate for an institution to meet its customers' credit needs first, particularly in times of tight money, unless that policy is used as sham for discriminating on a prohibited basis. Good business relationships would require that

a bank take care of its standing customers first or risk losing them. However, we are mindful that in some situations a "customers first" policy may violate an effects test and constitute a discriminatory practice. Such a situation, for example, could occur when a lender which has a white deposit base is suddenly confronted with loan applications from minorities and then invokes a "customers first" policy even though money may be relatively plentiful.

HMDA STUDY

A two-year study of the Home Mortgage Disclosure Act, sponsored jointly by FDIC and the Federal Home Loan Bank Board, is nearing completion. We expect to be able to submit a final report within the next few weeks. The study's purpose is to assess the validity and worth of HMDA data required to be collected by covered depository institutions in Standard Metropolitan Statistical Areas.

While I am already on record in support of an extension of HMDA, agency staff and I plan to examine the study's conclusions and recommendations carefully before coming up with our own recommendations for possible amendment of the Act.

COMMUNITY GROUPS

One area that I have not touched on is the importance of financial regulatory agency dialogue with various community groups. I believe open lines of communication have served to improve our supervisory efforts as well as improve bank performance.

I refer not only to individual community group actions with regard to CRA, but to meetings such as one the regulators had recently with a national housing group. As a result of those discussions, the FDIC is considering such changes as making HMDA data more accessible to interested neighborhood groups by placing HMDA reports in a local library or other central location, requiring a uniform HMDA report form for all types of covered institutions and requiring that reports be available on a common reporting date.

CONCLUSION

Mr. Chairman and Members of the Committee, I have sought to give you a comprehensive view of our compliance enforcement activities, with special emphasis on fair mortgage lending enforcement.

In summary, we are now working toward optimum enforcement of existing laws and regulations and any further policy dictates through law or regulation would hinder rather than help our efforts.

Working under an absolute employment ceiling, we are testing means of better utilization of our examiner force to meet our basic safety and soundness responsibilities, as well as our requirements in the consumer area.

In this regard, I am pushing the divided examination concept, which has promise of substantial manpower savings.

We now have such agreements with three States, Georgia, Missouri and New Jersey, and in 1980 we expect to enter into agreements with at least two and possibly four additional States.

In the final analysis, the only way to meet this challenge is with a philosophical commitment to the goals, a continuity of effort, imagination and sweat.

We have that commitment.

I will be happy to answer any questions.

TABLE I

TOTAL COMPLIANCE HOURS ALLOCATED BY ENFORCEMENT FUNCTION
(through third-quarter 1979)

1. Compliance Examination Hours:

	<u>Hours</u>	<u>Percent</u>
Truth-In-Lending Act	80,135	44
Equal Credit Opportunity Act	14,596	8
Fair Housing Act	8,819	5
Community Reinvestment Act	17,180	10
Remaining laws and executive order	<u>58,770</u>	<u>33</u>
Sub-total	179,500	100

2. Support Activity Hours:

Re-examinations	7,734
Visitations with bank officials	9,758
Report review in Regional Office	<u>19,222</u>
Sub-total	<u>36,714</u>
TOTAL	216,214

Source: Third-quarter 1979 Quarterly Progress Reports

DBS: December 19, 1979

TABLE II

Number of Banks with Fair Mortgage Lending Violations
Based on Compliance Reports Reviewed¹ in the Washington Office
During the Periods Indicated

Law or Regulation	1976		1977		1978		First Three Quarters of 1979		
	Reports Reviewed	Number Citing Violation	Reports Reviewed	Number Citing Violation	Reports Reviewed	Number Citing Violation	Reports Reviewed	Number Citing Violation	Percentage of Reports Citing Violation
Fair Housing	540	52	388	78	6,036	2,191	4,544	2,818	62.0
Equal Credit Opportunity	2,297	557	6,949	1,995	6,313	3,402	4,571	2,250	49.2
Home Mortgage Disclosure	-	-	650	86	6,212	783	4,562 ²	497	34.8
Community Reinvestment	-	-	-	-	-	-	2,840	286	10.1

¹Reports are reviewed in the Washington Office about six to eight weeks after the examination is conducted.

²3,133 of these Reports were on banks exempt from the requirements of Federal Reserve Regulation C. The percentage given, 34.8 percent, is based upon Reports on the remaining 1,429 banks subject to Regulation C.

TABLE III

SECTION 8 ENFORCEMENT CASES BY TYPES OF FAIR MORTGAGE LENDING VIOLATION

<u>CEASE-AND-DESIST ORDERS ISSUED</u>		<u>VIOLATIONS CITED</u>	
		<u>ECOA</u>	<u>Fair Housing (Part 338)</u>
1977	9	9	0
1978	3	3	0
1979	<u>5</u>	<u>5</u>	<u>4</u>
SUBTOTAL	17	17	4

<u>NOTICE OF CHARGES ISSUED</u>		(First step of formal enforcement action)	
1979	<u>3</u>	<u>2</u>	<u>2</u>
TOTAL	20	19	6