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Testimony by

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of the Federal Reserve System

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Committee on Banks

of the

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I am pleased to have been asked to appear before the New York State Assembly's Committee on Banks to provide the Federal Reserve's perspective on issues related to mortgage lending discrimination. My remarks today will focus primarily on data recently released under the Home Mortgage Disclosure Act (HMDA).

The Federal Reserve is one of several federal agencies that monitor the compliance of financial institutions with the nation's fair lending laws, including the federal Fair Housing Act and the Equal Credit Opportunity Act (ECOA). In this context, we directly supervise and evaluate the performance of roughly 1,000 state member banks (34 of them in the State of New York). The Board also has the responsibility for issuing the regulations that implement the Equal Credit and Home Mortgage statutes.

As you know, HMDA is a disclosure law that provides the public with information about the home lending activities of institutions with offices in metropolitan areas. HMDA does not, however, require lenders to make any particular type of home loan or to make loans in any specific geographic area.

Each year, information about the persons who apply for and receive home loans is provided by the institutions covered by HMDA to the Federal Financial Institutions Examination Council (FFIEC) in Washington, D.C., through their respective supervisory agencies. The Federal Reserve compiles the data, on behalf of the FFIEC, and prepares HMDA disclosure statements for each

covered institution. In addition, aggregate reports are prepared to show the overall home lending picture for each of the nation's 341 metropolitan areas.

The collection and processing of the HMDA data is a massive task. For 1990, the data processed consisted of some 6.6 million loan and application records. The FFIEC prepared disclosure statements for nearly 9,300 reporting institutions for each metropolitan area in which they had offices, totalling more than 24,000 individual reports. This disclosure effort resulted in the preparation of more than 1.2 million pages of data.

Historically, the HMDA reports have focused on the geographic distribution of home loans, both home purchase and home improvement. The 1990 HMDA data continue to provide information of this type, and also disclose -- for the first time -- information about the disposition of applications that do not result in an origination; about the race, sex, and income of loan applicants; and about the secondary market purchasers of loans sold by covered institutions.

The 1990 HMDA information became available to the public three months ago. The data caught immediate nationwide attention because of substantial differences in the outcomes for applicants when they were categorized by their race and income and by neighborhood characteristics. In particular, the data revealed that a much larger percentage of applications for home loans filed by blacks and Hispanics were turned down than was true for

white and Asian applicants. The data revealed that this pattern for applicant groups held true even after income was taken into account.

I, like many others, find these statistics worrisome. The data raise concerns about access to home mortgage credit among minority applicants, as well as a perception of unlawful discrimination in the lending process. They also raise questions about the performance of lenders in meeting their obligations under the Community Reinvestment Act (CRA).

I can assure you of the Federal Reserve's longstanding concern about these issues and strong commitment to enforcing compliance with fair lending laws. Our efforts extend both to searching for answers to the questions raised by the HMDA data, and also to seeking ways to promote community development and affordable housing lending.

In regard to HMDA, however, I do want to note some important limitations in the data. In particular, the HMDA data do not include the wide range of financial factors -- about the applicants and the properties they seek to purchase -- that lenders consider in evaluating loan applications. For example, the HMDA data do not contain information about applicant debt and asset levels, employment experience, or credit history. Thus, it simply is not possible to determine, from the HMDA data alone, whether individual institutions or groups of lenders are discriminating unlawfully against minority applicants.

At the Federal Reserve, we rely primarily on our on-site examination process to assess lenders' compliance with the fair lending laws and CRA. During this process, our examiners look at actual loan files and review the factors that a particular lender took into account in its credit evaluations, and then try to determine whether the lender's loan standards were applied in an evenhanded and nondiscriminatory manner.

In particular, examiners look for instances in which loan applicants met established standards but were denied credit and, conversely, for instances in which applicants failed to meet the guidelines but were nonetheless granted credit. When they find exceptions, examiners seek to determine whether similarly situated applicants were accorded like treatment by the lender, focusing particularly on members of protected groups. To date, our bank examinations have not revealed evidence that individual state member banks discriminate on the basis of race when making credit decisions.

We also have a consumer complaint program, with special guidance for dealing with complaints that may involve illegal lending discrimination and for determining whether the allegations appear well-founded. But I must tell you that we receive few complaints alleging illegal credit discrimination against state member banks. Investigation of these complaints has not revealed any illegal activity on the part of the state

member banks involved. The other federal agencies report similar experiences.

A discrepancy clearly exists between the few complaints we receive and the prevalence of allegations of widespread discrimination made by community organizations and others. In May 1990, our concern over this discrepancy prompted us to write to 675 civil rights groups, fair housing organizations, offices of state attorneys general, and others -- people that come in contact with consumers who might have complaints about how they were treated in applying for a mortgage loan. We advised these organizations about our complaint program and that of the other federal agencies, asking them to refer complaints they may have received about credit discrimination to the appropriate banking authority. In October 1990, we sent a follow-up letter. This effort has, to date, had no identifiable impact on the number or types of complaints we have received.

We recognize, of course, that discrimination can take subtle forms and may be difficult to detect. With the new HMDA information about applicant race or national origin, sex, and annual income, we believe our examiners will be better able to look behind the statistical differences in denial rates that may exist among subsets of applicants at particular institutions. To facilitate these statistical analyses, the supervisory agencies are working to develop computer-based systems that will help examiners identify specific groups of applicants for whom the

application-disposition rates are significantly different from those of other groups. Such systems will provide agency examiners with lists of individual application files that can be targeted for in-depth review during on-site examinations.

We will also be using the data to help us measure lenders' compliance with the Community Reinvestment Act. In this regard, the new data provide a better basis for assessing the demands for credit from a defined community experienced by individual lenders. The data also provide an opportunity to gauge the success of lenders' community outreach and loan marketing efforts.

To further support our compliance efforts in the fair lending area, the banking agencies once again have undertaken, among other things, to review examination procedures -- to see if there are ways we may better carry out our enforcement responsibilities. We are also participating with the Department of Justice and the Department of Housing and Urban Development on a federal agency task force reviewing the mortgage lending discrimination issue.

As I've noted, one of our key concerns about the interpretation of the HMDA data rests on the absence of full information about financial factors that lenders consider in their credit evaluations. We are seeking to address this lack of information. For example, the Federal Reserve, in cooperation with other supervisory agencies, is developing a research effort

that would supplement the HMDA data with information from application and credit files for a sample of loan applicants. Evaluation of these data should help us better gauge the extent to which these other factors may account for differences in the denial rates observed across racial lines. Such information also can be used to help examiners identify a specific sample of loan applications to review during future examinations.

The banking and other federal agencies have a legal obligation to ensure fair lending compliance. At the same time, the responsibility for fair lending rests with the financial institutions themselves. We continue to encourage creditors to review their lending practices for aspects that may have a discriminatory effect. In this context, we believe that lenders should look both at the types of products they offer and at the underwriting standards that they have in place -- to see if they are flexible enough to accommodate the varied circumstances of potential borrowers, without compromising safety and soundness concerns.

I will conclude by complimenting this Committee for the attention you are giving the issue of possible discrimination in mortgage lending, and I will be glad to try to answer any questions you may have.