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GIVING DUE CREDIT WHERE CREDIT IS DUE

Remarks by

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to the

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It is a pleasure to be here at this very important meeting for financial institutions. It is important, not because of who is sponsoring it, where it is taking place, or how many attendees there are, but because of the topic we have come together to address -- "Credit and the Economically Disadvantaged."

At first blush, this topic may seem a bit narrow to justify my claims of importance for it. But, I believe that it represents one of the most critical long-term issues facing our society, our economy, lenders, and members of our communities. Let me explain what I mean.

It is axiomatic that access to capital is a critical element in the successful creation and expansion of businesses. Similarly, consumers without capital cannot consume. But most businesses cannot grow without credit, and consumers for the most part cannot purchase homes, automobiles, or other goods and services without using credit in one form or another. So for smaller businesses and many consumers, access to capital is primarily through access to credit.

I am sure there is not much disagreement about how important small business and consumer credit is to our economy at the macro level and to the economic health of our communities and neighborhoods at the micro level. It means more jobs, more income, a broader tax base, etc.

For many Americans, access to credit is a taken for granted. Small businesses borrow to expand facilities or to buy inventory and carry receivables. Consumers pull out their credit cards, write checks on their home equity lines of credit, and obtain term loans for the purchase of autos and homes. That is to say, many small businesses and consumers do. But it is quite apparent that not all segments of our society have ready access to credit.

There have been deep-seated concerns for some time that certain segments of our society, particularly minority consumers and minority small business owners, have difficulty obtaining credit, difficulty that may not be justified by economic factors alone. This has had a major impact on the ability of minorities to build businesses, own homes, accumulate wealth, and, generally, participate in our economy on an equal footing.

It has been well publicized, for example, that Home Mortgage Disclosure Act (HMDA) data have documented patterns of comparatively low levels of mortgage lending in minority areas and higher loan denial rates for minorities than for whites. Just three weeks ago, the Justice Department announced settlement of a case involving Decatur Federal Savings and Loan Association in which it presented evidence to show a "pattern or practice" of discriminatory treatment of prospective black home buyers in the Atlanta area.

And just today, the Federal Reserve Bank of Boston has released a study of loan and application files of most institutions in the Boston metropolitan area that are required to submit HMDA reports. This study will be discussed in detail later at this conference, but let me share its primary finding with you: When controlling for other significant economic factors affecting the approval of mortgage loans, there remain unexplained differences in loan approval rates for minorities and whites in the Boston market. Although economic differences do account for a good part of the disparities in loan approval rates in the HMDA data, they do not explain all the differences.

The combination of these studies, the HMDA data, and other research undertaken by private parties has led to further allegations that discrimination in lending is occurring. And, we are witnessing an increasingly loud debate about who is responsible.

What can we conclude from all of this? As I see it, there are three basic conclusions and I would like to share them with you.

The first is that the debate concerning whether disparate treatment of minorities is occurring in credit markets should be over. This may be a bitter pill, especially for those who believe that their institutions treat all applicants for credit equally, regardless of race. But frankly, it would be too much

to assume that attitudes about race held by some in our society do not seep into the lending process. Indeed, they may be present in all aspects of business and daily life, despite our sincerest efforts to avoid them.

The problem for most people in regulatory agencies and financial institutions who are concerned about these issues was that in the past there had been only spotty and largely anecdotal evidence. But I believe that the weight of the information we are now collecting is simply too great to ignore. Recently, as press reports indicate, both the American Bankers Association and the Mortgage Bankers Association have come to similar conclusions. So let's put an end to that part of the debate.

Moreover, the HMDA data, the Boston study, and the Decatur Federal Savings case, have together greatly enhanced our understanding of the why's and wherefore's of disparate treatment. Consequently, these studies will be very helpful in guiding us in our pursuit of solutions.

Second, however, I think we need to be realistic about the difficulties that regulators will continue to face in identifying instances of discrimination. It is extremely difficult to find conclusive evidence of discrimination through inspection of individual loan files during examinations. Even when complaints have been lodged by applicants claiming discriminatory treatment, lenders usually can demonstrate that the applicant was denied

because certain credit standards, considered legitimate measures of risk, were not met. And comparison by examiners of loan applications and denials for any but the largest institutions generally do not yield statistically acceptable conclusions; the number of minority and white applicants with similar economic characteristics who can be compared is often too small to produce valid results. Although we have learned quite a lot from the Boston study and the Justice Department's recent case involving Decatur Federal Savings and Loan, the tools used in these instances are extremely expensive and time consuming. Consequently, reviews of lending practices such as these are not easily replicated.

Make no mistake, however. The agencies continue to take seriously their responsibilities for detection and deterrence of discrimination in lending. There are things we have been doing, and additional initiatives are under way. These include development of new techniques to review loan and application files, new computer software to assist examiners in analyzing HMDA data, and greater cooperation with the Justice Department to work more closely in finding cases where discrimination is present.

Clearly, there is a cloud hanging over financial institutions regarding the discrimination issue. And that cloud will not be lifted simply by demonstrating that the agencies or

the Justice Department can catch some institutions in discriminatory behavior.

Considering what we now know, a punitive approach can only take us so far. Perhaps it can deter some types of behavior, but it certainly cannot be effective in every institution throughout the country. Neither the supervisory agencies nor the Justice Department nor even civil rights groups have the kind of resources that would make that possible.

What then is the appropriate alternative? This brings me to my third conclusion. I conclude that there is a better way -- an approach that must be pursued vigorously in addition to our enhanced enforcement efforts. Unfortunately, much of the good work being done is obscured by the current debate over loan denial rates or arguments about how much discrimination exists in our financial system. In fact, continuing down that path exclusively is not very constructive.

Instead, we should be focusing our attention on those positive actions that institutions can take to help improve access to credit for minorities and low- and moderate-income areas.

In outlining this approach, I want to emphasize that there is nothing mysterious or even new about many of these activities. Indeed, there has been explosive growth in the quality and

quantity of bank programs and initiatives designed to help ensure equal access to credit for minorities and low- and moderate-income areas. And, frankly, I believe that these efforts are not getting the attention they deserve in the midst of the ongoing debate.

These constructive programs and activities fall into two basic categories: (1) those that I believe are simply extensions of ordinary business practices that institutions pursue as a matter of course, and (2) those that entail special initiatives, often in the form of public/private partnerships, which have been developed and refined over the last ten years. What's important here is that none of these activities involve reinventing the wheel; most are now part of everyday banking activities.

There are many things banks do in the course of business which, with slight adjustments and very little extra expense, can be enormously helpful in improving access to credit for minorities and other disadvantaged groups.

One is advertising. Advertising in publications, radio stations and other media which are targeted to minority audiences has proven to be an effective way to promote loan products and generate applications. For example, if a bank offers mortgage products, advertising them in minority publications may bring home the point that minority applications are being sought even



if the institution doesn't have an office in the minority neighborhood.

Another device is extended outreach and marketing, something banks normally do for many products and services. For example, lender call programs designed to reach realtors who operate in minority and low- and moderate-income areas could be quite effective in generating loan applications from qualified applicants. Outreach meetings and calling programs focused on community and church groups can help solidify relationships that turn into loans. One bank runs "Community Loan Day" programs in conjunction with community groups. At one such event held recently in the District of Columbia, the bank brought 30 loan officers to a local community facility in the heart of the minority community to meet with residents, provide credit information and counseling, and take applications for consumer, mortgage, and small business loans. Over 300 people attended and \$100,000 in new loan applications, representing new business for the bank, were taken on the spot. The bank plans to hold additional Community Loan Days in other neighborhoods.

Another part of the answer lies in each institution's service delivery system. Locating branches or loan offices in minority areas is a natural and extremely effective way of increasing applications and loans. Although branches may be expensive, in certain situations, they can be very cost effective

in minority communities which are currently underbanked by any standard.

For example, in Dallas, Texas, a new branch of a major financial institution was opened in the South Dallas/Fair Park area, a community of about 80,000 residents that is predominantly minority and lower income. What is significant here is that no other bank had operated in that area for almost two decades. After one year's operation, the branch had exceeded its target for consumer loans by 40 percent and was a top performer among the institution's branches in Texas. Soon after, another institution opened a branch of its own in the area. Good ideas catch on.

Of course, branches are not the only way to deliver services. Neighborhood loan offices and use of what we call "street bankers" have been very effective and inexpensive means of delivering loan-related services where they are needed.

Some banks have found it productive to provide loan officers with additional monetary incentives for making small business and consumer loans in minority areas. This may involve the use of commissions, a bonus structure or a combination of non-monetary incentives such as additional vacation days.

Another technique used by some institutions is simply providing a second, internal review of small business and

consumer loan applications that would otherwise be turned down, with special attention to applications from minorities. Usually this is done by separate officers or committees that can take a fresh look at each application and ensure that policies and exceptions are applied in the same manner for all applicants. It also provides a second opportunity to see if some blemishes on an applicant's credit record or other problems preventing approval can be resolved. As reported in the press recently, one of the largest mortgage lenders in the country instituted such a program and found that almost 35 percent of the applications initially turned down by application-intake officers, were, on second review, eventually approved.

A slightly different approach to second reviews of denied applications is the mortgage review board. Under this approach, lenders with offices in a community agree to join together, often with community representatives, to review denied applications from all participating institutions. Any lender can agree to fund a loan, or applicants may be referred to public and other partnership programs for financing or credit counseling. This type of approach is part of a broader multi-bank program in the Philadelphia area, called the Delaware Valley Mortgage Plan, which conducts a variety of activities designed to increase mortgage credit availability in lower income and minority areas.

A common retail business technique being used more frequently of late by financial institutions is the use of hired

"shoppers" to visit branches and loan officers to help management determine whether services are being provided effectively and according to policies. We recommend this practice as a way to assess whether employees are treating minority customers in an equitable manner. Where problems are found, they can be promptly corrected. Certainly, this approach is preferable to a legislative mandate by the government for testing that is being called for by some.

Another way banks are addressing credit issues facing the economically disadvantaged is one of the most fundamental and important. That is employee training. All institutions train and instruct new employees, and most provide continuing training of some sort. Many institutions are incorporating enhanced training for employees on fair lending, and not just on rules and regulations. Lenders need to know more about the minority community, the potential business opportunities there and about how more flexible underwriting standards might be used to facilitate more lending on a safe and sound basis. Most importantly, lenders need greater sensitivity to the existence of racial attitudes in our society and how they can effect their own lending and other business decisions. Increasingly, effective training programs are helping accomplish these ends.

But financial institutions have been doing much more, and that brings me to the second set of activities -- special initiatives undertaken through a variety of community

partnerships involving community groups, businesses, and government agencies. These programs usually focus on home mortgage and home improvement loans, and financing for small business development and related activities in low- and moderate-income areas. Often they benefit minority areas and borrowers.

As I noted, it is especially in these community partnerships where financial institutions have made tremendous progress in recent years. The list is far too long to cover here, but let me touch on a few key types of activities which have become almost commonplace in the industry.

Many institutions have established special lending programs in conjunction with local governments targeted for low- and moderate-income areas. These usually use interest-rate subsidies, blended rate loans and loan guarantees that help make the financing affordable to lower income borrowers, and acceptable to participating institutions.

Another tool available to banks which facilitates credit extensions is the use of community development equity and debt investments. Currently, there are about 60 bank holding companies and over 475 national banks that have been authorized to invest in bank-related community development corporations or low-income housing limited partnerships and equity pools. These CDCs and investments have helped finance low- and moderate-income

housing, small and minority businesses and other community projects throughout the country.

Increasingly, banks also are participating in multi-bank loan consortia and housing partnerships that pool resources and help share risks and costs in financing projects in low- and moderate-income areas. Some are statewide organizations like the California Community Reinvestment Corporation; others focus on cities or counties, such as the Boston Housing Partnership or the York (Pennsylvania) Housing Initiatives Program. A growing number of lending consortia are focusing on small businesses. An example is the Development Credit Fund in Baltimore which is a joint effort of five financial institutions in Maryland that provides credit and special services to small minority businesses in the Baltimore area.

Institutions also are participating more heavily in government guaranteed loan programs, such as those of SBA, FHA, the Farmers Home Administration, as well as a wide variety of state housing and business assistance programs. This is just part of their efforts to support community partnerships and help meet special community credit needs.

In addition to financing initiatives, banks throughout the country are supporting a number of groups and services that strive to improve the availability of credit in low- and moderate-income and minority communities. For example, banks

have joined with nonprofit, community-based organizations to help package community development projects and work together to round up affordable financing from many sources. In many communities, banks have found that providing financial support and training to nonprofit groups helps create and sustain valuable partners in the community development process.

One of the more exciting types of community partnership initiatives focuses on credit counseling. A growing number of institutions have teamed with community organizations to establish credit education and counseling programs that help prospective low- and moderate-income borrowers understand credit standards and actions that would help them qualify for credit.

For example, in Kansas City, Missouri, eight banks have teamed up with the Kansas City Neighborhood Alliance to conduct a borrower education and counseling program called "HomeWorks." The program teaches lower income residents how to establish credit, maintain a budget, and handle personal finances. The course also explains the home-buying process. Participating lenders help the program's students by reviewing their credit reports and by providing them help and advice on obtaining bank and other loans for home purchases.

This litany of bank practices and special initiatives could be much longer. I haven't even touched on the growing number of

multi-bank lending commitments totalling in the billions of dollars, bank support for Neighborhood Housing Services groups, or many credit education and counseling programs in the schools and neighborhoods.

The important point is that financial institutions have at their disposal the tools and models to ensure that all segments of our society have access to credit on an equitable basis. These tools and models exist, many are being used extensively, and most can be replicated by both large and small institutions.

Yet, there are still many issues to address. For example, we need more research on credit standards, and how they effect default and loss rates. A number of special bank programs using more flexible standards than required by the secondary market have demonstrated success in serving low- and moderate-income borrowers on a safe and sound basis. We also need a better understanding about how the actions of others in the mortgage market, including realtors, appraisers, mortgage insurers, credit bureaus, etc. can affect loan application decisions. And perhaps we should be taking a closer look at a long-term, comprehensive, industry-wide education program concerning race relations and lending.

But our course is set. Financial institutions and their supervisory agencies have no choice legally or morally. To exclude segments of our society from fundamental economic



opportunities, such as business or home ownership, is to rob our institutions and our economy of growth potential.

In the final analysis there is a large untapped market among minorities and low- and moderate-income groups for both business and consumer credit products. Developing those markets and providing the services they need is just plain good business for financial institutions.

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