Remarks by

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Good afternoon. It is always and forever true that there is a huge difference between Washington, D.C. and New England. It is always a little cooler, a little greener, a little cleaner and a lot more friendly here in New England. And New England remains unpolluted by the hot airs that envelop Washington. It is a mysterious phenomenon, but several years of study by the National Institutes of Health have finally located the primary source -- it is the area immediately surrounding the Capitol building at the eastern end of Pennsylvania Avenue. While the source of these noxious airs has been located, no way has yet been devised to either shut it off or put it to some useful purpose. The Energy Department has calculated that there is enough heat in those vapors to warm the entire city through a bitter winter, but, alas, the fumes are so corrosive that they would eat away the pipes necessary to capture and re-route them.

One of the diseases transmitted by these hot airs, a disease which is endemic in Washington, is called LTR. No, it's not a form of Legionnaires Disease. LTR stands for "legislate to regulate." After two years in Washington, any Member of Congress, be he Representative or Senator, is afflicted with the disease and remains under its influence until cured by having the electorate vote him or her out of office and returned to a healthier climate outside the Beltway.

The behavioral eccentricities which are symptomatic of LTR and which particularly affect the financial industry result in things like "Truth in Lending," "Truth in Savings," "Equal Credit Opportunity," "Fair Housing," "HMDA and "CRA."

In the purest sense, this kind of legislation is intended to discourage or outlaw conscious or unintentional practices by lenders which tend to exclude some members of society from access to credit and the basics of life style which in many cases can only be acquired by the use of credit.

In another sense, the motivation may be to assure that consumers are well enough informed about the conditions and consequences of a financial transaction that they can make an intelligent decision consistent with their own self-interest.

A third motivation for social legislation is the pursuit of re-election. Consumer-oriented and socially evangelistic organizations are well able to persuade legislators that the polls will be stormed, come Election Day, by voters eager to endorse proponents of consumer protection legislation.

And finally, there is the seductive possibility of using private capital to implement the social objectives of government.

The recent suggested reform of CRA, which was out for comment earlier in the year, is a prime example. The Community Reinvestment Act itself is innocent enough. It simply says that a bank which draws resources from a community has an obligation to use its best efforts, within the bounds of safe and sound banking practice, to meet the credit needs of that community. But, the recent attempt at "reform," mandated by a President with ambitious social goals and a skimpy bankroll, clearly went far beyond the language of the CRA or the legislative intent of Congress in 1977. It attempted by regulatory fiat to allocate credit and resources and to introduce cease and desist orders and civil money penalties as the potential price of non-compliance. That appeared to me to be a clear over-stepping of the intent of Congress and a bare-faced effort to use the shareholder capital of privately owned banks to fund the social objectives of the president.

Fortunately, the thousands of comments received provide a rational basis for recasting the reform effort to emphasize safe and sound lending and reduce meaningless paperwork and record-keeping. That effort is under way and I expect the result to be a much more workable framework for implementing the CRA within the original intent of Congress.

But, whatever the motivation for a specific piece of legislation, there are often unintended consequences which may essentially negate the purposes of the legislation or create a whole new set of problems. Truth-in-Lending legislation has increased disclosure requirements and is obviously helpful to consumers in knowing what costs are involved in a loan

transaction as well as what consequences pertain to failure to meet all of the obligations in the transaction. But in the process of meeting disclosure requirements and obtaining acknowledgment -- you might call it informed consent -- the paperwork in connection with otherwise uncomplicated transactions becomes formidable. Clearly costs of making loans are increased and these costs are inevitably passed to the consumer. Whether the additional information is worth the increased costs and laborious paperwork is at least arguable.

When it comes to HMDA, we have a whole new set of unintended consequences emanating from the publication of raw statistical data subject to any interpretation which serves the interests of the interpreter. When the expanded HMDA data reporting applications and their disposition by race and income categories were first released, they were interpreted as confirming widespread discriminatory lending practices since denial rates for minorities, for example, were as much as twice as high as for whites.

But the raw data didn't include information about the credit profiles of the borrowers or their cash flow tolerance for additional debt. In an attempt to clarify the picture as it pertained to some New England banks, the Boston Fed did some analytical work which changes the numbers somewhat, but actually sharpened the criticism since it generally supported the view that minorities, particularly blacks, were far less likely to obtain a mortgage loan than a white person with an income in the same range.

The ensuing uproar in Congress and more focused protests of consumer-interest groups created lots of problems for banks, but also had the effect of alerting banks to the fact that, even though they did not have discriminatory policies in place, their mortgage lending operations were producing suspiciously discriminatory-looking results. It also alerted bank examiners to look more closely at mortgage operations of banks to try to determine whether ostensibly standard procedures were having disparate results because of unconsciously discriminating treatment of applicants during processing.

In my opinion, we have come a long way since 1991. Banks have re-examined their mortgage loan processing and approval operations. They have revamped lender training programs and instituted loan disposition review programs designed to correct denials which are not supported by the facts in the case. Many banks have put in place mandatory coaching for mortgage applicants to enable them to maximize their chances of qualifying for approval.

In my opinion, no responsible banker would tolerate a policy of deliberate discrimination. But, quite unintentionally, certain procedures, standards or policies might create a bias in favor of one category of borrower over another. And that could result in bad numbers and a presumption of discrimination.

What to do? Well, one thing is certain, compliance with consumer protection regulations and legislation is not going to get any easier, and Congress is not likely to reverse direction. CRA compliance will continue to be a key element in application approval criteria and policies or patterns of practice in banks

which result in statistical indications of discrimination are very likely to result in Justice Department referrals by the regulatory authorities.

The consequences of noncompliance are becoming more serious because of pressures from interest groups, the Congress and the Administration. In order to avoid costly litigation, disappointing and perhaps costly disposition of applications and possible disciplinary actions, banks are going to have to perfect their own compliance procedures and make compliance a top policy priority.

I know that the perception is held by some that compliance with federal fair lending laws is somehow inconsistent with ensuring safe and sound operation of a bank. Still others probably perceive fair lending laws as an unproductive aspect of lending that interferes with the work they were hired to do.

It is these concerns among your employees, together with the complexity of certain aspects of the fair lending laws themselves that makes it essential for senior management to "drive" the compliance process from the top down and to make it an integral component of operations.

In particular, only senior management's involvement on an ongoing basis will ensure that loan officers and other staff understand fair lending compliance to be not only a high priority for the institution, but a positive opportunity to strengthen its lending performance, as well.

I urge you to share my view that the pursuit of a fair lending program is not only consistent with safety and soundness,

but can contribute to a successful lending program in at least two respects:

First, the very process of ensuring that lending decisions are not predicated on race or gender or on criteria that disproportionately affect protected groups will produce a better focus on credit criteria that more accurately predict loan performance and may very well lead to the identification of new markets in previously ignored populations or neighborhoods. That seems to me like good business.

Second, I say again, a consistent policy and practice of adherence to fair lending standards will reduce the risk of financial cost or liability that might flow from agency enforcement or, worse still, fair lending litigation, either by the Justice Department or private parties. I don't need to tell you how expensive, disruptive and potentially damaging to an institution's good name and reputation that can be.

The Federal Reserve Board is committed to achieving a fair lending enforcement program that is, above all else, effective, balanced and fair. You should each make a similar commitment of yourselves and your organization's resources to the accomplishment of that goal in your own self interest.

Clearly, we find ourselves in a time of unprecedented interest in this subject. We have Justice Department investigations, litigation, and settlements unlike at any time i can recall. We have talk of "overages," "the thicker file syndrome," regression analyses, HMDA data and the Boston Fed study. I am sure that, to many of you, this may seem overwhelming. But, in all reality, it <u>is</u> manageable.

In order to deal effectively with this new challenge, you personally need to stay on top of it. We have seen circumstances where, despite the best policies management could devise, and despite management's best intentions, things have gone awry. So I urge you to check your organizations from a management standpoint as dispassionately as you can. Review the HMDA numbers and any other data you have for what they tell you and make sure everyone in your organization is rigorously following your policies. It could be the best thing you could do for your organization, even though some of what you find you may not like.

Senior management commitment is an absolute necessity in any successful program of fair lending compliance. You must make absolutely clear to all concerned from board room to teller's window that you are personally involved, that your policies are intended to provide equal credit opportunity, that you will not tolerate noncompliance with your policies and that you will reward those who make bias-free lending a reality.

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Now I want to take just a minute or two to comment on another matter of interest to many of you -- that is mutual-to-stock conversions. In my opinion, this is a natural evolutionary development and should be encouraged by supervisors as a way to strengthen thrift institutions and give them the access to capital markets which will be essential to future growth and ability to compete with other kinds of financial institutions.

It is not good public policy, in my opinion, to set rigid rules for such conversions which are so unreasonable as to discourage conversions. It seems to me that it is counter-

intuitive to punish a whole industry for the excessive greed of one participant. Furthermore, at least two of the proposed rules seem to be totally illogical. Why in the world should a depositor who lives 100 miles from the main office be excluded from the conversion? If I lived in Pittsfield, under this rule, I could not participate in a conversion by a Salem bank even though I might have had an account there for years. And, why should living in Pittsfield disqualify me in such a situation while living in Worcester would not. That rule is just plain dumb.

Even dumber is the thought to disqualify management from participation. I have always been a strong believer in the axiom that a financial stake in the enterprise you manage is a strong incentive to do the best possible job of managing. At the very time when management excellence is most needed, denial of incentives is totally counterproductive. I hope a strong well-thought-out reaction to these proposals will result in their modification along more logical lines.

Thank you for your attention and I will be pleased to try to answer your questions.

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