



FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

November 6, 1992

DALLAS, TEXAS 75222

Notice 92-108

TO: The Chief Executive Officer of each
member bank and others concerned in
the Eleventh Federal Reserve District

SUBJECT

**Fair Treatment of Applicants
for Mortgage Loans**

DETAILS

The Federal Financial Institutions Examination Council has issued a statement on behalf of the regulatory agencies to emphasize concerns about fair treatment of applicants for mortgage loans and their continuing efforts to assure such treatment.

ATTACHMENT

Attached is a copy of the regulatory agencies' statement.

MORE INFORMATION

For more information, please contact Marion White at (214) 922-6155. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.



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Press Release

For immediate release

October 9, 1992

The federal financial institutions regulatory agencies are issuing this statement to emphasize their concerns about fair treatment of applicants for mortgage loans and their continuing efforts to assure such treatment. Increasing evidence indicates that differences in loan approval rates between white and minority home mortgage applicants, apparently unwarranted by economic factors, characterize some lending.

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BACKGROUND

On October 8, 1992, the Federal Reserve Bank of Boston, with the cooperation of the federal financial institutions regulatory agencies and the U.S. Department of Housing and Urban Development (HUD), released a detailed study on mortgage loan denial rates in the Boston area. The study examined whether racial and ethnic disparities in mortgage loan denial rates reflect even handed use of legitimate credit standards.

That question arose because the Home Mortgage Disclosure Act (HMDA) data released in October 1991 revealed disparities in denial rates. Those data showed patterns of relatively low mortgage lending in minority areas and indicated that black and Hispanic

applicants were denied loans two to three times as often as whites. The disparity in denial rates in the Boston metropolitan area was among the highest in the country.

STUDY RESULTS

The study by the Federal Reserve Bank of Boston incorporated data submitted voluntarily by about 130 Boston lenders. The data came from application and loan files for 1,013 minority and 3,123 nonminority applicants and included information from loan applications, credit reports, and lenders' worksheets. The statistical analysis performed for the study took into account an applicant's debt ratios, wealth, credit history, and income stability. The analysis also included loan-to-value ratios, information about private mortgage insurance sought or approved, the neighborhood characteristics of the property being financed, and other factors.

The study found that economic differences account for a substantial part of the disparities in the HMDA data, but that they do not explain those differences entirely. Minority applicants in the study had, on average, lower income, fewer liquid assets, more late and delinquent credit accounts, and higher debt to income ratios than white applicants. However, even after controlling for differences in relevant economic and financial variables, black and Hispanic mortgage applicants were more likely to be turned down than similarly situated whites. Specifically, on a statistical basis, minority applicants with credit-related characteristics identical to those of an average white applicant would experience a 17 percent denial rate, as compared to the white denial rate of

11 percent.

The study also found that the vast majority of minority applicants obtained loans, and that loan approval rates for well-qualified and clearly unqualified applicants of all races were essentially what would be expected in a nondiscriminatory system. Disparities appeared to be most common among applicants who have some imperfections or flaws in credit qualifications. Many such applicants can -- and do -- qualify for a loan if a lender acts diligently, creatively, and flexibly on their behalf. However, the study's results suggest that applicants of different races do not all benefit equally from such discretionary efforts in the lending process. This tentative explanation of the study's findings is also consistent with investigation-based allegations recently reported by the U. S. Department of Justice.

SUPERVISORY INITIATIVES

This recent evidence suggests that lenders and regulators should continue their efforts to ensure that minorities have equal access to credit. Several actions by the agencies to improve enforcement of fair lending laws and prevent discrimination already have been taken or are underway.

Enforcement-oriented analysis. The agencies are analyzing the Boston data at the level of individual lenders. If statistical analysis -- or follow-up review of applications and loan files -- yields reliable evidence indicating loan decisions by particular lenders were based on race or ethnicity, that information will be forwarded to the Department of Justice or HUD, as appropriate.

HMDA-based targeting. The agencies are continuing to

emphasize the need for examiners to use HMDA data, as well as other information, to identify institutions that should be subjected to follow-up procedures to ensure fair lending practices. Where appropriate, examiners are conducting detailed reviews and comparisons of loan and application files as part of fair lending examinations.

New computer programs and analytical tools are being developed to make HMDA data more useful to examiners. This software, when fully developed and available to examiners, will help them identify geographic and other discrepancies in mortgage lending that may suggest further inquiry. The agencies are also continuing their efforts to develop additional software capabilities to assist examiners and institutions to analyze HMDA data.

Revision of examination strategies. The computerized statistical analysis used in the Boston study (and by the Department of Justice in its investigation) is of very limited use in most bank examinations. Very few institutions have a sufficient volume of denials for minority applicants to reliably document whether there is a "double standard" in loan qualification criteria. Nevertheless, these findings make it imperative that the agencies explore every alternative to make bank examinations as reliable as possible in identifying possible discrimination.

Under the auspices of the Federal Financial Institutions Examination Council (FFIEC), the agencies have initiated a comprehensive, coordinated review of their examination policies, procedures, and examiner training to determine whether they can be strengthened to help deter and detect racially-based disparate

treatment of applicants by financial institutions. A key part of this process will be the use of a third-party consultant who can provide an objective review of existing agency efforts and make recommendations for changes to policies and procedures.

Industry education. Lending personnel of financial institutions may need additional information and training about fair lending laws, and greater sensitivity to cultural and racial differences among applicants for credit. Consumers need information about the credit granting process -- how it works and what is expected in order to be a successful applicant for mortgage credit. In this regard, the agencies believe that additional efforts to expand and intensify educational programs for both lenders and consumers will be required.

The agencies themselves will continue to develop informational materials and participate in conferences and seminars for financial institution representatives concerning their responsibilities. The agencies have distributed a guide for financial institutions, Home Mortgage Lending and Equal Treatment. The guide highlights lending standards and practices that may adversely impact the capacity of institutions to serve minorities and other protected classes of borrowers, and alerts them to subtle forms of discriminatory behavior that should be avoided. Copies are available from each of the agencies. For mortgage applicants, a brochure, Home Mortgages: Understanding the Process and Your Rights, is available from the agencies to assist borrowers in knowing what to expect in applying for a loan and what their rights are if they suspect mistreatment.

LENDING PRACTICES

The agencies call on financial institutions and their trade associations to intensify their equal credit opportunity education programs for management, lending personnel and consumers. This should include efforts to identify and promote examples of successful techniques used by institutions to ensure equal treatment of loan applicants.

These techniques might include use of internal systems to conduct independent second reviews of applications from minorities initially recommended for denial to assure equal treatment with nonminorities. One lender recently reported making loans to 35 percent of initially rejected applicants after instituting such a review procedure. A similar kind of review underwriter is also an element of the Department of Justice settlement.

Other initiatives might include development of training programs to ensure fair treatment of prospective borrowers, credit counseling education for groups of prospective loan applicants, participation on mortgage review boards, and the use of "shoppers" hired by the institution itself to test its personnel's adherence to its own lending procedures.

Despite the many commendable efforts of lenders, the data from the Boston Study demonstrate that unequal treatment of applicants still occurs in some instances. The message from Boston is that the initiatives many lenders instituted in response to the release of the HMDA data cannot now be abandoned. For lenders who have not initiated such efforts, the message is that they must do so to assure that all prospective borrowers are considered fairly.