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PROBLEMS IN COMMUNITY DEVELOPMENT BANKING, MORTGAGE LENDING DISCRIMINATION, REVERSE REDLINING, AND HOME EQUITY LENDING

HEARINGS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

FEBRUARY 3, 1993—COMMUNITY DEVELOPMENT BANKING

FEBRUARY 17, 1993—REVERSE REDLINING; PROBLEMS IN HOME EQUITY LENDING

FEBRUARY 24, 1993—MORTGAGE AND OTHER LENDING DISCRIMINATION

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COMMUNITY DEVELOPMENT BANKING

WEDNESDAY, FEBRUARY 3, 1993

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:40 a.m., in room 562 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

OPENING STATEMENT OF CHAIRMAN DONALD W. RIEGLE, JR.

The CHAIRMAN. The committee will come to order. Let me welcome this overflow gathering this morning. We are in a different committee room because the normal committee room is undergoing a regular refurbishing and it is done every few years, and we will be back in that room shortly. I want to also indicate the reason we are starting later than our announced time, which is that after scheduling this hearing for 10 o'clock, some votes were scheduled on the Senate floor which we have just completed. And so that necessitated members being there and delayed the opening of this hearing. I say to our witnesses particularly, I appreciate their patience today.

Before we begin this morning's hearing directly, I want to announce for the record that, as members arrive, they will be recording their votes on favorably reporting the nomination of Laura Tyson to be Chairperson of the Council of Economic Advisers. We will begin the period for voting now and it will extend until this hearing concludes.

If a quorum is established in that time, which I anticipate, the final vote will be announced as we adjourn and the nomination will be reported to the full Senate later today.

Let me now move to the subject that brings us here this morning. This is a very important hearing, I think one of the most important that is likely to happen this year with respect to the new direction that the country needs to take and is preparing to take with respect to revitalizing our urban communities particularly.

We are here today to talk about community development banking. President Clinton, to his credit, has advocated the creation of a national network of community oriented financial institutions dedicated to the revitalization of distressed urban neighborhoods, and as well, depressed rural economies.

Our distressed communities are in need, and really urgent need, of new strategies to address neighborhood disintegration and clearly inadequate access to capital.

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That need was clearly demonstrated by the riots in Los Angeles and it is obvious from the general condition of many of our communities where homelessness, unemployment, and crime are really at crisis levels.

Recent studies, official, national studies show that redlining and discrimination are significant problems, and that many people are denied credit based on the color of their skin rather than on any measure of their true creditworthiness.

We are going to be examining this issue of mortgage discrimination at a hearing on February 24. But the point today is that more than ever, we need new initiatives for revitalization, particularly in our communities that are in the greatest difficulty today.

I believe that any new Federal community lending initiative should be built upon the roles played by all existing lending institutions.

Enforcement of the Community Reinvestment Act, I think must be improved and strengthened so that traditional lenders increase the flow of credit to low-income and minority communities.

However, the Federal Government should also, as recommended by President Clinton, experiment with new and additional models that can further increase availability of capital and build the capacity of residents to revitalize their own neighborhoods.

Any new initiative must recognize that both efforts are necessary, both through the established channels and through new channels, and at the same time ensure that the safety and soundness of federally insured depository institutions are not put in jeopardy.

Our witnesses today will focus on some of the new models for promoting revitalization, including community development banks, and other types of community lending institutions.

Community development banks are organizations the primary mission of which is to revitalize their communities by investing in them. They combine the structure and expertise of an insured depository institution with the commitment typical of a community based, nonprofit organization.

Currently, there are four such institutions in the Nation. Two of these institutions, South Shore Bank and Community Capital Bank are here with us today and incidentally are located in the home States of members of this committee, Ranking Member D'Amato, who will be here in due course, and Illinois Senator Carol Moseley-Braun.

We will also hear from two prospective community development banks who will discuss some of the pitfalls encountered in starting new institutions of this kind. We will also hear from representatives of several nonprofit lenders, including a group from Senator Domenici's home State of New Mexico. These community-based lenders include a wide range of organizations that promote revitalization and will help us get a fuller understanding of the field of community banking as it is happening across the country.

I want to welcome all of our witnesses this morning, and I want to extend a special thanks to Steven Lopez, here from my home State of Michigan, and also the County Executive of Wayne, Edward McNamara.

I want to say a word more about that in a minute.

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Finally, let me say that I also look forward to hearing from the administration as soon as they are ready to testify on this important issue, and put their package and recommendation before the Congress.

During the campaign, President Clinton said that he would like to create,

> A national network of community development banks to provide small loans to low-income entrepreneurs and homeowners in the inner cities. These banks will also provide advice and assistance to entrepreneurs, invest in affordable housing, and help mobilize private lenders.

So I know from that statement and things said since, that this is a very high priority for the new administration, and the committee will move forward very promptly as soon as they have put their proposal on the table for us.

Let me now just finally say a word before calling on our other members, and then going to our first panel of witnesses.

It is a particular pleasure for me to welcome my two Michigan representatives who are here at the table today. But I want to say a special word about Ed McNamara, because it is very difficult to make local government work sometimes and there are a lot of problems, especially because of changes in funding patterns and the starvation, I think, of financial help from the National Government to help local communities deal with some of their problems.

I think Ed McNamara is probably without question the most effective county executive anywhere in the country. I am very proud of that personally, and my State is very proud of that as a matter of his work and his accomplishments. I have found, over the years, that if you want somebody that can turn a problem into a solution, a good person to call is Ed McNamara.

So I am very pleased that he is here today and I am very much interested in what he will be saying in his comments and the concept that he has in mind in our State, as does Mr. Steven Lopez as well, representing from the perspective of folks in the Grand Rapids area.

So before going to our witnesses, I know Senator D'Amato will be arriving shortly, let me now yield for any brief opening comments that members might have.

Senator Mack.

OPENING COMMENTS OF SENATOR CONNIE MACK

Senator MACK. Thank you, Mr. Chairman. My comments will be brief. Unfortunately, I am going to have to leave in about 20 or 25 minutes, and I really wanted to have the opportunity this morning to have the input from the two panels.

Let me say, at the outset, that the issue that we are going to be talking about this morning I think is a significant one. It is difficult for me to believe that capitalism can work without capital. There are areas of our country in which we know that capital is now flowing.

Credit is to the economy what oxygen is to the body. And without capital, without credit, it is very hard to see how you can bring to fruition all the other efforts of empowerment that is a popular word that is been used for a number of years now.

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I must say to you, however, having spent 16 years in the banking business myself, having had to go through the process of making decisions about who to lend to and who not to lend to, the difficulties in putting together new organizations with new missions is a very very challenging one.

While I come here with a very open mind, and want to be supportive, at the same time, I have got some skepticism to deal with. I look forward to your testimony to kind of help me through that, if you will. So I welcome you along with the other members of the committee, and look forward to your testimony.

And thank you, Mr. Chairman, for the opportunity.

The CHAIRMAN. Thank you, Senator Mack.

Senator Boxer.

Senator BOXER. Mr. Chairman, I do not have an opening statement. I just want to commend you for holding this hearing and I look forward to hearing from the witnesses.

The CHAIRMAN. Very good.

Senator Faircloth, did you have an opening comment that you wanted to make?

Senator FAIRCLOTH. No thank you.

The CHAIRMAN. Senator Campbell.

Senator CAMPBELL. No opening statement, Mr. Chairman.

The CHAIRMAN. Senator D'Amato I know has a strong interest in this area, and has talked and very active with respect to the issues of the community and urban redevelopment particularly.

Senator D'Amato.

OPENING STATEMENT OF SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. Thank you very much, Mr. Chairman.

Mr. Chairman, I join you in welcoming today's distinguished witnesses as the committee considers ways to promote community development in inner cities, rural areas, and other economically distressed neighborhoods of the country.

I want to extend a special welcome to Lyndon Comstock, who is the chairman of Community Capital Bank in Brooklyn, and to thank him for his willingness to provide us with his insights and suggestions concerning this important issue.

Our Nation's inner cities, rural areas, and other economically distressed neighborhoods are in dire need of credit for community development. We need to find a way to encourage banks and other lenders to return to these areas and to provide the credit needed for economic redevelopment.

There are all sorts of community development bank proposals floating around in Washington. Some proposals require huge amounts of taxpayers' money. Other proposals call for creating a new kind of specialized community development banks. Still other proposals seek to coerce banks to make community development loans by stronger enforcement of the Community Reinvestment Act.

While I know that these proposals are well intended, I do not believe that we need new kinds of banks or new Government spending programs. Instead, we should take the money and time wasted on creating paperwork to satisfy Community Reinvestment Act regulations and channel those resources into making real loans to

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home buyers and small businesses in poorer communities all over America.

Community development banks are basically ordinary banks with an extraordinary purpose. By pooling resources and talent under one roof, community development banks can focus their efforts on designing products and services that meet the special credit needs of the inner cities and rural areas.

We should encourage banks, especially smaller banks, to pool their resources and carry out their community reinvestment responsibilities through investments in community development banks.

If every bank invested up to 5 percent of their capital, and that happens to be the current legal limit, in a community development bank, it would dedicate almost $12.9 billion to revitalize our inner cities and poorer neighborhoods. This translates into $193 billion in new credit for community redevelopment. Now that is real money, even by Washington standards.

Mr. Chairman, there are those who say this idea would enable banks to buy their way out of CRA. But I say, this is the best way for banks to buy into CRA. Instead of building mountains of paperwork in the name of CRA, banks can be building affordable housing and stores for small businesses. Under CRA, banks should get credit for giving credit.

I hope to examine my proposals with today's witnesses and to work with them and other financial institutions and community groups to find the most efficient and least costly way to promote community development activities.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Shelby.

OPENING STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman.

Mr. Chairman, I ask unanimous consent that my full prepared statement be made part of the record.

The CHAIRMAN. Without objection, it is so ordered.

Senator SHELBY. Mr. Chairman, I am very happy to have the opportunity today to learn more about the community development banks.

Since President Clinton has mentioned his interest in creating a network of community development banks, I have followed with interest the media coverage of existing community development financial institutions. There currently exist, according to my information, somewhere between 2,000 and 3,000 community development organizations.

These organizations take several different structures and have a number of different missions, but seem to concentrate their efforts on developing affordable housing, creating and retaining jobs, providing credit to small businesses and micro enterprises, and providing banking services to under served members of the community.

If these numbers are to be believed, these community development organizations have been extremely successful. They have created thousands of jobs, developed thousands of units of housing, and moved a significant number of Americans off public assistance through employment and self-employment opportunities.

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I believe that community development financial institutions clearly have an important role in our financial system. They satisfy a need not met by other sectors of the financial services industry, constrained as they are by the demands of the shareholders.

I look forward, Mr. Chairman, to hearing from this mornings witnesses and to see what else we can learn about the community development banks.

The CHAIRMAN. Thank you, Senator Shelby.

Senator Bryan.

OPENING STATEMENT OF SENATOR RICHARD H. BRYAN

Senator BRYAN. Mr. Chairman, thank you very much.

I too would like to ask unanimous consent to have my statement made a part of the record.

The CHAIRMAN. Without objection, so ordered.

Senator BRYAN. I would also like to indicate to the distinguished panel that I look forward to learning more about your experience. I hope it will enlighten us to some opportunities to provide additional capital to the urban centers of our communities, that are so desperately in need of additional resources to develop themselves.

Thank you very much.

The CHAIRMAN. Thank you, Senator Bryan.

I am going to introduce each of our witnesses now, and then we will go right down the table to hear from them.

First we will hear from Mr. Milton Davis who represents the South Shore Bank in Chicago, IL, often pointed to as the leading example of a community development bank. Mr. Lyndon Comstock, with Community Capital Bank of Brooklyn, NY, another very important illustration of the efforts now underway. Then Mr. Steven Lopez, representing the Southside Bank in Grand Rapids, MI and Mr. Ed McNamara who is the county executive for Wayne County, coming from Detroit, as it were. I will introduce the second panel when we call them forward.

Mr. Davis, we are very pleased to have you and interested to hear about your experiences and the advice you have for us. Let me say to all the witnesses, we will make your full statements a part of the record, so I want you to feel free to summarize and go right to the points you really want to stress for us.

STATEMENT OF MILTON O. DAVIS, CHAIRMAN, SOUTH SHORE BANK OF CHICAGO

Mr. DAVIS. Honorable Chairman and members of the committee, thank you for inviting me to appear today. It is a great honor, particularly because this committee has been at the forefront in recognizing the potential of community development banks at the same time the committee has already been able to shed considerable light on the complex issues facing distressed communities, and the range of distinct institutions and products appropriate the different market challenges in these communities.

As requested, I would like to briefly provide background on Shore Bank and Southern Development Corp., before touching on some of the distinguishing characteristics of development banks, their relationship to other banking and nonbanking activities, and the opportunities for replication.

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Three colleagues and I formed Shore Bank in 1973. We believe that the multifaceted problems of distressed communities required large scale permanent institutions. Such institutions would have to take a business like comprehensive approach to community development. They would need high levels of credibility, expertise and market knowledge to profitably invest in the area, and to restore the confidence of private investors revitalizing healthy market forces.

A bank holding company with nonbanking community development subsidiaries can have all of these characteristics. We thus conceived of a development bank as a specialized structure with the capacity to transform the market dynamics of a geographic target area.

Shore Bank owns a bank, the South Shore Bank of Chicago, but it also owns a real estate development company, a minority small business investment company, and has a nonprofit community affiliate engaged in small business assistance, labor force development, and various community services all active in this targeted community in Chicago.

These companies, through their coordinated activities in carefully targeted areas, aspired to comprehensive community development. While provision of credit is an important tool toward this end, it is not enough. Community development requires more than credit, and delivering credit successfully in disinvested communities requires more than a bank.

In 1973, the South Shore community had rapidly changed from all white to overwhelmingly black, and no credit was being extended there. Since that time, Shore Bank has made development investments totalling $351 million in South Shore, and a few other recently targeted neighborhoods. And has financed or leveraged the renovation of nearly 8,000 housing units in South Shore alone, nearly a third of all such units in that community. While doing so, our financial performance has been comparable to peer institutions. For the last 10 years, Shore Bank's compounded annual growth rate has been 16.6 percent.

Southern Development Bank Corp., our sibling in Arkansas, was formed with Shore Bank assistance in 1988. It applies the same principles of comprehensive, coordinated interventions tailored to particular communities, to a rural area whose primary market needs are business development.

Southern also owns a bank and a real estate development company, but it is nonprofit affiliate includes, in addition to a venture capital fund, a microenterprise fund and a sophisticated manufacturing, finance and consulting company. To date, Southern has invested $19 million and has been very profitable.

In essence, these institutions work because they bring a singular focus and specialized expertise to a carefully targeted area combined with mutually reinforcing interventions. This allows the development bank to successfully manage what would otherwise be high risk investments, to more aggressively initiate, identify and evaluate development opportunities, and to address multiple dimensions of community renewal.

From the point of view of banking, a development bank occupies a special niche, primarily growing the market by fostering and sup-

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porting deals which would not be present or bankable without the comprehensive target characteristics of a development bank. For these reasons, development banks do not primarily compete with conventional banks. Instead, they are natural partners addressing complementary equally important credit needs.

Unleashing the enormous credit potential of conventional banks, with appropriate incentives, is vital to strengthening the Nation's economy and to under invested communities. But if the goal is development of distressed communities, this credit is not enough. It will not reach the deals in these communities which cannot be identified or prudently banked with credit mechanisms alone. Perhaps the broader point is that different markets require different types of development products which are most effectively delivered by different types of institutions.

Bank community lending departments in large banks, community loan funds, credit unions, community development corporations and others, all provide much needed but distinct products. Appropriate support should be crafted for each with the recognition that they have different needs and serve differing goals. This considerable range of activity, interest and expertise in community development relates to one final point, replication.

Many talented people and capable institutions, ranging from conventional banks to loan funds to community development corporations are exploring becoming development banks. We believe that with appropriate start-up support, our experience can be widely replicated.

Development banks represent an unusual model of private institution serving public purposes, offering a new partnership between the private sector and government, and effectively delivering resources to revitalize disinvested communities. As in so many areas of public need, after many years of experimentation, we know something that works. The difficult challenge is to carefully design a program which translates this knowledge into public policy.

Thank you for your interest and commitment. I would of course be glad to answer questions.

The CHAIRMAN. Thank you very much, Mr. Davis.

Mr. Comstock, we would like to hear from you now, please.

STATEMENT OF LYNDON COMSTOCK, CHAIRMAN, COMMUNITY CAPITAL BANK

Mr. COMSTOCK. Thank you for inviting me to address the committee on the topic of community development banking. It is a privilege to speak after Milton Davis from Shore Bank, which has been a principal inspiration for our bank.

My name is Lyndon Comstock. I am the chairman and founder of Community Capital Bank of New York City. Community Capital Bank is, as far as I know, the only commercial bank ever organized specifically as a community development bank in the United States. Our bank is now 2 years old, and has $20 million in assets.

I am also the chairman of LEAP, Inc. LEAP is a nonprofit venture development organization with its office at Community Capital Bank. LEAP provides intensive management assistance, including help in sourcing risk capital, to small businesses in low-income areas of New York City.

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At the outset, I would like to note that community development banks are only one of the categories of community development financial institutions or CDFI's, for short. I include, as CDFI's, along with community development banks, community development credit unions, community development loan funds, microenterprise funds, and venture development organizations.

Each of these various categories, including rural reservation based and urban CDFI's, is performing an important service to community economic development, and could benefit from Federal support. Assisting in the expansion of existing institutions, and not just the creation of new CDFI's, is particularly important.

Our bank is a member of a recently formed ad hoc coalition of community development financial institutions which advocates Federal support for building the capacity of the CDFI industry.

I understand that you have been provided with a copy of the coalition's position paper, "Principles of Community Development Lending and Proposals for Key Federal Support." I hope that is correct.

The CHAIRMAN. Yes, we have that, and we are making that a part of the record.

Mr. COMSTOCK. Thank you. I hope that your investigation of community development financial institutions will lead you to the same conclusion I reached some years ago. CDFI's are a highly effective, private sector means for channeling capital into community development. An investment in low- and moderate-income communities is essential to the establishment of functioning economies in those areas.

To expand the capacity and therefore the impact of the CDFI industry I suggest three principal factors are needed.

The first is equity capital. Equity capital for CDFI's is very difficult to raise, and appropriate Government participation, perhaps on a one to two match, could help induce private sector investment.

Second, grant funding is needed to fund technical assistance for new or expanding community development related businesses or projects. Technical assistance is also needed for new CDFI's.

Third, professional training programs will need to be created to help provide the staffing for a major expansion of the CDFI industry.

Within the context of this discussion of CDFI's, I have two comments I would like to make about the Community Reinvestment Act.

First, I believe that all of my colleagues in the CDFI industry agree that any Federal support for CDFI's should not cause a weakening of the CRA. We support full CRA enforcement.

Also, it is entirely unrealistic, in my opinion, to think that the CRA will cause widespread bank support for CDFI's which could therefore substitute for Federal support. Banks already generally receive CRA credit for investing in CDFI's, but have only chosen to do so in relatively small amounts. Most of that investment has been deposits or their equivalent, rather than the equity investment and technical assistance grants which are needed for the expansion of the CDFI industry.

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I hope there will be more investment in CDFI's by banks, but Federal support is needed if there is to be any significant step up in the rate of CDFI formation and expansion.

Turning to the CDFI's that I have founded, Community Capital Bank is a New York State chartered, FDIC insured commercial bank.

Our bank has committed more than $7 million in loans and letters of credit so far, all of which are community development related. Approximately $3 million of this total is directed to multi unit affordable housing, while the other $4 million supports small businesses and nonprofits in low- and moderate-income areas of New York City.

I am happy to tell you that the bank does not have a single nonperforming or delinquent loan so far. Our bank has received no Government subsidies of any type to date, nor, may I add are we asking for any operating subsidies. Our bank makes small commercial loans from $25,000 up to $450,000 or to $750,000 with an SBA guarantee.

Let me sum up for you the competition in that market in lower income areas of New York City. We have had only two deals where we were truly in competition with another bank—I am talking not about just the loans that we have made but the loans that we have seriously considered. We have not lost any of our existing loans to another bank, and we have not taken a loan from another bank that was anxious to keep that loan.

I would also like to briefly describe LEAP, Inc., to you. LEAP started out of a recognition that a commercial bank cannot provide risk capital, meaning equity or seed capital. A bank may also have significant problems in providing intensive technical assistance, partly for legal reasons.

LEAP is a nonprofit which fulfills these needs for small businesses that have a high community development potential, especially as to job creation. I refer to LEAP and similar organizations as venture development organizations.

Finally, it is important that any legislation supporting CDFI's that may come about be flexibly structured. This is a young and growing industry whose needs are evolving. A responsive administrator of Federal support is equally important so that the process does not become so time consuming as to be effectively useless, especially for newly forming CDFI's.

I urge that strong input from CDFI practitioners be incorporated into the administration of any Federal support to CDFI's. The best vehicle for accomplishing these administrative purposes may well be a quasi-independent corporation.

I appreciate the opportunity you have given me to express my views on community development banking. A considerably more detailed version of my testimony has been submitted to you in writing.

Thank you very much.

The CHAIRMAN. Thank you very much.

Let me just indicate, for the record, that a quorum has now been established, and has expressed itself unanimously in favor of Laura Tyson's nomination. We will leave that voting roll open for others

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to be able to be recorded and she will be reported out favorably on that basis.

Mr. Lopez, we are pleased to have you, and we would like to hear your summary now.

STATEMENT OF STEVEN LOPEZ, PRESIDENT AND CEO, SOUTHSIDE BANK, GRAND RAPIDS, MI

Mr. LOPEZ. Mr. Chairman, honorable members of the committee, I am really delighted to be here today as president of Southside Bank, to share with you why the members of that community got together to form the bank.

They got together to form this bank because, for example, in 1989, the established banks held $508 million in deposits in various commercial banks and savings institutions, and only about 1 percent of that was being loaned to members of the community for mortgage purposes. I find it very difficult to participate in a capitalistic system when you have no capital.

In today's economy, when States are struggling with tax revenues—when you are dealing with a shrinkage for tax purposes because most of your employees are idle, employers are making sacrifices to save money, I think it would behoove the system to make sure that small businesses have access to capital.

Because, without access to capital, small businesses are going to find it very very difficult to generate jobs. Like, for example, in the community that I represent, you are going to find minority contractors who have received contracts from the city, the State or the Federal Government, and they go to the banks and try to finance them. They have a difficult time getting it financed. Most of these people have to resort to family loans, if they are lucky enough to come up with family loans.

So I recommend and suggest to this body that at a time when the United States needs to grow its economic base, it cannot afford to continue to ignore a major segment of its market.

The African-American market, which is 32 million strong, in 1991 earned $300 billion. Unfortunately, we seem to be on the consumer side of the economy, as opposed to the supply side. And based on that, I would strongly suggest that we start looking at community banks as a way of shoring up the established banking system.

I know a lot has been said about the Community Reinvestment Act. It has been my experience, and I am not here to bash the established banks, what has happened is that the Community Reinvestment Act has been looked upon as a safety valve for the major corporations, together with black organizations in the African-American community, where it has provided the corporations with a safety valve.

For example, the corporations have a way of making or underwriting events for black organizations, and the bottom line is that no perpetual mechanisms are being built. Also, financial institutions factories that will eventually make a difference in terms of helping the African-American community not only find jobs, but also give them a sense that they, too, can participate in the capitalistic system. And the only way we are going to change this is by changing the perception that African-Americans are only entitled to

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entitlements, as opposed to fully participating in the capitalistic system.

Right now, we are sponsoring organizations in Russia to teach them the capitalistic system. At the same time, we seem to be ignoring the potential of the 32 million African-Americans that we have in this country. And I think that we would all be better off if we would start teaching the African-American how to become fully partners in the capitalistic system.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Lopez. And I appreciate the observations you have just given us.

Mr. McNamara, pleased to have you and we would like to hear you now.

STATEMENT OF EDWARD H. McNAMARA, WAYNE COUNTY EXECUTIVE, DETROIT, MI

Mr. MCNAMARA. Thank you.

Honorable Chairman and members of the committee, thank you for inviting me to testify this morning.

In other testimony given today, and at previous hearings, you have heard representatives of Shore Bank Corporation discuss their work with organizations throughout the country who are exploring the establishment of development banks. Wayne County, MI, is one of those organizations.

Why is Wayne County the Nation's eighth largest county with a population of over two million people interested in forming a development bank?

The greater Detroit area, including Wayne County, has witnesses a tremendous shift of wealth over the past 30 years. A lethal combination of blight, disinvestment, and suburban sprawl has contributed to the decay of many neighborhoods across our county.

Our older urban areas have been virtually abandoned as investment has moved further and further away from the central city. Urban blight has now touched some of our inter ring suburbs, yet we continue to push development further and further out into farm land.

Essentially, what we are doing is throwing away billions and billions of dollars in infrastructure investments that we made earlier this century in our urban neighborhoods. At the same time, we are spending billions more to build new schools, roads, and sewer lines in greenfield sites. I am sure you will agree, Mr. Chairman, that this is a shameful waste of resources.

As Americans are becoming more cognizant about the benefits of recycling, it seems we need to develop a strategy to rebuild our aging communities, house by house, block by block, and neighborhood by neighborhood.

Our older communities in Wayne County face three basic problems. Nonfunctioning real estate markets, minimal job creation through business development, and a deteriorating social fabric.

We have identified three communities in Wayne County as potential markets for our development bank: Hamtramck, Highland Park, and the East Side of Detroit. In each of these markets, real estate activities have essentially been nonexistent.

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In 1989, only two mortgage loans were made for 1,000 housing units in Highland Park, compared to 55 mortgages per thousand housing units in healthy markets. The perceptions of crime, violence, and depreciating values has discouraged new investment in homes and businesses.

Despite these perceptions, there are many signs of potential in these markets. The housing stock is very affordable, each area boasts a strong African-American population, and there are many active block clubs and community based organizations. Furthermore, there are numerous opportunities for economic development, both commercial and industrial.

Our proposed institution would have three operating units: A commercial development offering conventional bank services; A real estate development arm to focus on housing, commercial and industrial development; And a not-for-profit affiliate which would provide non- bank business credit, business support services, and housing assistance.

The investment and credit activities of the bank will be complemented by these other two units which can initiate development projects and mount a coordinated revitalization effort.

The bank will inspire prospective homeowners to purchase homes in established neighborhoods. It will nurture the entrepreneurial spirit by encouraging ma and pa rehabers. And it will encourage other investors to pump money into newly stabilized neighborhoods, therefore generating jobs and opportunities for local residents. The economic challenge facing our older communities will require some heavy lifting.

A development bank will need to work together with conventional lenders and private and public sector leadership. All of the bankers with whom we have met to discuss the development bank concur that development banking is a niche business that complements conventional banking.

Since we began discussing the business plan with individuals from the private sector, we have received many calls from individual bankers expressing their support for our efforts. As government, we at Wayne County have had to recognize our limits in the creation and operation of a development bank. We can be the convener but cannot operate, control, or influence an entrepreneurial private sector development bank without constraining its ability to respond to changing marketplace.

In the document we submitted for the Congressional Record, we recommended the committee keep in mind certain guiding principles as it drafts legislation. And to summarize these principles:

We believe the fundamental premise of a development bank as an entrepreneurial adaptive organization must be preserved. We do not believe a separate regulatory structure is necessary.

Because of the significant organizational and legal costs, we believe grant funding should be allowable for start-up costs, and matching Government funds for private capital commitments will allow a development bank to build a sound capital base.

We have been talking about, what we have done, in effect, is to plagiarize, from President Clinton's campaign theme, a theme that we believe applies in this case, and we truly believe that it is the neighborhood's stupidity.

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In conclusion, this county has established public purpose, permanently capitalized professionally managed institutions to carry out activities important to society. Museums, hospitals and universities are all examples. And now it is time to create similar institutions for urban neighborhoods. After 2 years of extensive planning and research, Wayne County is prepared to launch the first community bank of the Clinton administration.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

As we start down through the questions here, I am going to, for those Senators that were not given the chance or were not here to make an opening statement, we will provide a little more time in their period so they can do that. Because I know particularly Senator Moseley-Braun has a comment I am sure she will want to make with respect to Chicago's experiment. I know Senator Domenici has expressed a special interest in this area as well.

Let me just ask you several questions at the outset. It seems to me that—I am very strongly in support of the Community Development Bank idea. I think they are by their nature hard to make happen, because you have got to have a committed pool of talent that can sort of come together and assemble resources, and with the support and blessing of governmental institutions get off the ground.

I am struck by the fact, as to the study that I have done on the South Shore Bank that you have been very favored over a period of time by having an extraordinary team of leadership represented importantly by yourself and your colleagues there. I have asked myself this question: If you subtract that extraordinary team of people that over the years now have made this the success that it is, and have nurtured it and have brought it along, could it otherwise have happened? In other words, would the concept succeed by itself if you did not really have an extraordinary team sort of making it happen?

I am going to ask you in a minute to comment on that, but I have drawn from it at least in my own mind, subject to what you tell me, that you really do need quite an extraordinary team, and they have got to be tough, and they have got to hang in there over a period of time because these are not simple issues to resolve and to get the momentum and to sustain the momentum. I am also interested in the degree to which we run any risk here of the traditional banking institutions who have not done very much yet anyway in many cases—not in all, but in some—of doing a sufficient amount of community based lending. There is a lot of mortgage discrimination and other lending discrimination we know from Federal Reserve studies.

I am very much concerned that I do not want to see a burst in community development activity allow the traditional banking system to back away or to maintain an anemic commitment to urban and community revitalization. I think we need them involved far more than they have been involved. At the same time, we foster the development of Community Development Banks to come along and do some of the niche-type work that has been described here. So I think we need both.

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Now, Mr. Davis, let me start with you to ask you to react to both of those points, if you would.

Mr. DAVIS. Well, if I could take your second question first, because it is really the easier. As I said in my statement, the work of Community Development Banks and of the larger regional banks should be complementary. In our case, for example, we are a small institution. The bank now has assets of just in excess of $200 million.

The CHAIRMAN. Over now what time period? It has taken you how long?

Mr. DAVIS. We bought the bank in 1973. This is a 52-year-old bank, incidentally.

The CHAIRMAN. Right.

Mr. DAVIS. It had tried to move from the neighborhood, was denied that request by the Comptroller of the Currency which regulates national banks as you know.

The CHAIRMAN. Right.

Mr. DAVIS. We then went in to talk to them about purchasing it with the idea of keeping it there.

The CHAIRMAN. Right.

Mr. DAVIS. It was then a $40 million institution.

The CHAIRMAN. If I could just stop you, so it has been literally a 20-year climb?

Mr. DAVIS. In August of this year we will be 20 years old as a development institution; correct. So we do not view ourselves as competitors for the $30–$40 billion institutions in this country.

The CHAIRMAN. Right.

Mr. DAVIS. There is no way that we can compete with the First National bank of Chicago. However, we are in need of support from the larger banks.

Our real estate subsidiary, for example, borrows very heavily from the large banks in Chicago to do its projects, which we could not do unless they were there to provide that pool of credit. So there is a lot that the larger banks can do in support of these niche-players, and you have to bo a niche-player to make this work.

You have got to be in the neighborhood, know the market, and there is a market in every single community in this country. It is just dysfunctional in a lot of cases at the moment.

The CHAIRMAN. That is right.

Mr. DAVIS. So we need to help restore that. You have got to be in the neighborhood every day doing your business to learn that market and make it work. Our hope is that we can then say to the larger institutions: We are here. We know this market. Help us provide the kind of credit that is needed.

On your first question about individuals, it is true that our interest grew out of the fact that the four of us who now form the management team for South Shore had all worked in community development organizations in prior years and had seen the extreme difficulty that those organizations had in trying to do their work.

Most were concerned with how were they going to keep the lights on next week——

The CHAIRMAN. Right.

Mr. DAVIS [continuing]. Or how were they going to pay the utility bills? And they did not have time to look at the real problems that

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they were trying to address. We concluded that a permanent institution organized specifically for development was the way to go.

I think if you may recall, in the 1970 amendments to the Bank Holding Company Act the Federal Reserve Board itself stated that in their opinion bank holding companies possessed a unique combination of managerial and financial resources with which to deal with the Nation's social ills. We concur in that.

Specifically, just one quick example which I think illustrates how this works. In the area of housing we have a not-for-profit and a for-profit real estate company that does housing rehabilitation. They go in and do large-scale projects: 100, 200 units. That enables the bank to come behind them and loan to private individuals at market rates who are interested in investing in housing rehabilitation and improving the neighborhood.

As of the end of last year, we had caused 30 to 35 percent of the housing stock in this one neighborhood, the rental housing stock, to undergo some form of rehabilitation.

Our development companies use Government subsidies for their programs. But for every unit of subsidized housing that gets produced in that neighborhood, we produce 4½ units of unsubsidized. That is the kind of leverage that I think development institutions can bring to bear.

The CHAIRMAN. Let me just say before yielding, it seems to me, again with this 20-year march that you have made as an institution starting after you took over the bank with $40 million I think you said in assets and you are up to $200 million now, it has taken 20 years of sweat, and vision, and hard work to do that.

I think I draw from that the lesson that: As powerful and as valuable as this concept is, we cannot just speak it and expect that 1,000 flowers will bloom, that it is going to take a comparable effort and support from the rest of the system.

We cannot have the rest of the banking system saying: "Boy am I glad this community development bank is coming down the track as this will relieve us of our CRA responsibility, and we will let them tackle the hard problems and we will go out and sort of cherry-pick the credit market."

I think what I am hearing you say is that these things really have to work in tandem if we are going to really start to break the strangulation of credit that is not getting into our inner cities, to minority people, and to others who have the—I mean, to be peddling capitalism in the Soviet Union and not doing capitalism in the United States to me seems to be absolutely upside down.

Mr. DAVIS. I think so. Two responses.

One is, we are much smarter today than we were 20 years ago about all of this business. I think we have now in fact moved to a second Chicago neighborhood. The pace at which redevelopment is occurring is much faster than it was when we were sort of the first people out there by ourselves in Chicago.

I would like to re-emphasize, I think one thing you said—and this is not a quick-fix to this problem—if there is one thing that this has taught me, it is that when I started I had no gray hair. I now have prey hair.

[Laughter.]

Senator D'AMATO. At least you have hair.

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[Laughter.]

The CHAIRMAN. Well, and we have asked you to be our lead witness because you bring great wisdom and experience, and we need to draw upon that, and we are doing so.

Mr. DAVIS. Thank you.

The CHAIRMAN. Senator D'Amato.

Senator D'AMATO. Mr. Chairman, I would like to piggyback on something said earlier and try to understand from the people who are out there on the battleline, why would it not be a good idea to give credit to institutions who indeed give you the credit and the capital that you need to continue your work? You are the specialists.

So why should we not say, for example, if *xyz* bank has $150 million in capital itself and is in a suburban area where there may not be the kinds of needs and demands, where they do not have the kinds of specialties that you have developed by being in the community as every one of you have indicated, and why should they not be able to take 3 percent of our capital, or 4 percent of their capital and invest it in your bank?

Mr. DAVIS. I support that 110 percent, Senator. In fact, we have suggested that and are now in a process in Chicago of trying to get the larger—because we need more capital to grow—we are trying to get the larger banks to buy stock in Shore Bank, and for that they would get CRA credits.

Senator D'AMATO. Yes?

Mr. COMSTOCK. Yes, Senator, if I could respond to that.

First of all I think it is important to understand that it is generally regulatory policy already to give CRA credit for these type of investments. So I do not think you need to take new action in order for that regulatory policy to be in place. I mean, there are a lot of bank regulators, but in general that is policy already. The question is——

Senator D'AMATO. Let me suggest how we can open that up and get you more.

They get no relief from the regulatory requirements in reporting. So consequently, if a bank gives you 3, 4, or 5 percent—and they can only go up to 5 percent and we might look at that—of their capital, what you do is encourage them, because they save *x* dollars per annum in not having to meet volumes of paperwork because they are actually investing, and they can say that $5 million in capital or so is invested with you.

Mr. COMSTOCK. Could I make a little further response to that?

Senator D'AMATO. Yes.

Mr. COMSTOCK. I am a banker, not a public policy person, but it seems to me that there is a very fundamental issue about CRA that maybe the Congress has to think about—which is the fact that there has never been standards set for CRA. Part of the bottom line here is that the regulators do not know, and the banks do not know what is an acceptable performance on CRA.

It may be that Congress has to look at that question of what is an acceptable performance on CRA in order to be able to come to a solution to this question.

Senator D'AMATO. All I am suggesting to you is that if these banks meet certain capital requirements that they invest with com-

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munity development banks such as yourselves, and others who have the expertise and get a double bang. You are getting capital that you never would have gotten before. They are getting expertise at bargain rates. They are getting the best in the business, people who are there, and they are also relieving themselves of that reporting requirement.

Yes, Mr. Lopez.

Mr. LOPEZ. Senator, I would like to share with you also that some of these banks know that they can invest 4 percent of their equity into these community banks, but some of them blatantly refuse to do so because they see these small banks as competitors. You also have to take in——

Senator D'AMATO. Let me set it up this way so that you understand fully. What we would say is that unless you put *x* dollars in, you have got to meet CRA. You have to then go through that, because then there is a presumption.

We want to see what you are doing as it relates to your loans. If you put that 3, 4, 5 percent—I don't know what the number should be—then there is a presumption that you have met your responsibility by virtue, prima facie, of giving that kind of contribution to a community development bank. What do you think of that?

Mr. LOPEZ. Yes, but the point is, as I said earlier, that they are aware of this but in some cases they just refuse to do it.

Senator D'AMATO. Right.

Mr. LOPEZ. OK? They refuse to do it.

You also have to understand that bankers bring their cultural biases to their jobs. You have bankers who pretend that they have never seen Black people, or Hispanic people. There is no way that I can hide the fact that I am an African-American. From the time I step through that door, you know who I am.

What bankers are doing these days is they are not recording applications that they are taking in from minorities. You walk in with your application, and they give you a verbal turndown. So when the regulators come in, they see that *xyz* bank took in eight applications and turned down two, and this is why you have some of the inflated rating that you have.

Senator D'AMATO. Mr. Davis, what do you think about us setting it up as an alternative? Do you think that would promote a great deal more investment?

Mr. DAVIS. I have a couple of responses.

I truly believe that most bankers in this country are not racists. I really believe that. I do know and believe that this is a market with which they are not familiar. Like all of us, if it is something we do not know well, we tend not to understand it, and we avoid it. So what we need to do is to try to move to an arena which gets a fuller understanding of these markets to those bankers. I think there is no better way than investing in a small community institution whose business is this.

With Mr. Lopez I think I disagree, that we are not competitors. There is no way that a small bank can compete with a mega institution. It is a different world.

What we need to do is to work toward what is the arena in which we can do our job best, and where they can be most supportive.

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And on the issue of CRA, I think the fault with it now: when CRA was passed, South Shore Bank was the only bank in the country who came here to this city to testify in favor of it—the only one.

What is wrong with it I think is that it is a punitive thing. It says to a bank, if you do not do this, then we will not let you buy this bank over here, the branch. What one should be doing instead is to provide incentives, which is what I think this is, for them to do so.

Senator D'AMATO. Exactly. You got my point exactly.

I hope we can get out clearly that what we are trying to do is to provide encouragement for people to meet this responsibility and go beyond it bring that critical capital.

We are talking about hundreds of billions of dollars capital that can be flowing into those poor neighborhoods. I think we can really make it the kind of thing where banks will be happy, the larger institutions, to be able to meet this opportunity and their social obligations and their financial obligations, and not have something that is now very punitive and detrimental.

Mr. DAVIS. And just another point, the leverage is enormous. For every dollar of capital that a large bank would invest in Shore Bank, it allows us to put $15 on the street.

Mr. COMSTOCK. Could I make one further point here? I think I do not have any problem with the general line of thinking that you are going on, Senator. We certainly would like to have more bank investment in our entire industry.

Senator D'AMATO. That is right.

Mr. COMSTOCK. We encourage that. And we have some already. Morgan Guaranty, for example, is a shareholder in our bank. I think one of the questions we are going to have, though, is if you are talking about this as being an alternative to CRA, whether this is an appropriate standard. Five percent of capital is going to translate to roughly one-half of one percent of assets for a bank. Is that an appropriate level?

That question I do not think has ever been addressed by Congress that I know of: What is an appropriate level of total bank loans, or total bank assets that ought to be going into CRA? I think most people are going to end up feeling that half of one percent of assets is not adequate.

Senator D'AMATO. Let's look at this.

My time is over, but you are getting right to the core of the issue. Banks are still going to be making lots of other loans. The fact that you now have a relationship with Morgan, and you might then have one with Chase, and who knows who else, then they are going to be doing other kinds of business with you. Morgan probably has already been doing more business with you as a result of that and taking on some of the bigger loans, or participating, and that is the thing that Mr. Lopez is discussing.

It brings people together who heretofore have not been together. So think about it.

The CHAIRMAN. Let me, if I may, given the pressure of time, the late start, and we have got another panel, if you will indulge the Chair for a moment, Senator Moseley-Braun of course is directly relevant to the story that we are talking about in Chicago, and I know you must leave to attend to another assignment in a moment,

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so I will interrupt the order to just allow you to make comments that you wish to make right now, and then resume the original order. Go ahead.

OPENING STATEMENT OF SENATOR CAROL MOSELEY-BRAUN

Senator MOSELEY-BRAUN. Thank you very much, Mr. Chairman and I will be brief. I would like my prepared statement to be placed of record.

The CHAIRMAN. Without objection.

Senator MOSELEY-BRAUN. I would like to thank you, Mr. Chairman not only for allowing me to break in the order this way, but also for calling this hearing so early in the process. This is a tremendously significant area.

It I think lies at the very heart of our efforts to redevelop our country and to put our people back to work, to reclaim our neighborhoods, and it is probably the single most important area in my opinion that we can move in terms of the urban agenda. So I want to thank you for putting this first in terms of our hearings.

I am particularly proud of Mr. Davis. Not only are we personal friends, but we go back 20 years. I felt old, Milton, when you said it was that long.

[Laughter.]

Senator MOSELEY-BRAUN. I go back to his efforts in the South Shore community, and that is of course where I live in Chicago.

I remember when we were all very young, bright-eyed and bushy tailed, young people starting out. I was in Government and Milton was in banking, and we had such great hopes for the future. Well, the future is now, and I am just very proud to see you here testifying on behalf of what is a successful, laudable experiment that has been taken up nationwide. I just wanted to express that to you before I leave. I am going to try to get back in time.

I understand the Chairman is going to plow through with the hearing and continue, because the areas that you touched on, particularly as regard to the CRA, and Senator D'Amato's questions, is just so critical to our understanding of the approach and the direction that we take.

So again to all of you gentlemen, Mr. McNamara, Mr. Lopez, Mr. Comstock, and of course Milton Davis, I want to thank you all for coming this afternoon and for starting this ball rolling, and starting this level of conversation, because we need your help in this regard.

Thank you again.

The CHAIRMAN. Thank you, Senator.

Senator Boxer.

OPENING STATEMENT OF SENATOR BARBARA BOXER

Senator BOXER. Thank you, Mr. Chairman.

I would like to get the panel's reaction to a very important event that occurred a little over a week ago in California when the Sumitomo Bank of California agreed to provide more than $500 million, a full 10 percent of its assets, for home and community development loans to neglected areas in California. The bank, as have others in California, has been criticized for its failure to make enough loans to minorities in the inner-city.

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For example, in 1991 Sumitomo made only two loans to African-Americans and 6 to Latinos out of 180 total home mortgage loans. Unfortunately in California this is the story over and over again in every area.

Now my understanding is that Sumitomo's commitment is the largest from a Japanese controlled bank; it begs the question I believe Senator D'Amato is pursuing, the question of how best to ensure that capital-starved areas are Federal.

Here, with Sumitomo, we have a bank that is under a lot of pressure from the community and agreed to this very big contribution. As I listen to you—and you have all been eloquent—it's clear that one of the strong points of a community development bank is its location in the neighborhood; you keep your eye on the problems, you are out there with the people, and you know what is going to work.

My question is: Should there be a spinoff from traditional banks that only handles community development? Or can we trust that a bank that has never done this before is suddenly going to understand the needs of the community?

Mr. McNamara. Just from a practical standpoint, if I might comment, the South Shore Bank has proven that the concept works. They have for 20 years not lost money. So obviously it is not a giveaway program; it is not a grant program; it is a business. But it is a business with a social agenda that is specific from that group. It is niche-operation, niche-banking, and I think that is what is extremely important.

If we are going to bring back the inner cities, the communities that have been so blighted, it is as I mentioned a house-by-house, block-by-block, neighborhood-by-neighborhood action, and I am not sure large banks that you are referring to have that kind of social conscience about them.

Senator Boxer. So you would prefer to see community redevelopment spearheaded by a very special institution that oversees its needs, as opposed to having a large bank do it by themselves?

Mr. McNamara. I would prefer to see the organization that could be most effective to accomplish that end. I think it is niche-banking that has the best—the most stability to make it happen, rather than a large bank that would lose this process someplace in its total operation.

Senator Boxer. Mr. Lopez.

Mr. Lopez. It has been my experience that when the larger banks have a community development arm, that you continue to get more of the same.

I would just like to say, to follow up on Senator D'Amato's question, like for example again I am confining myself to Grand Rapids where in the community I see qualified African-American borrowers in front of me, like for example Ms. Lambert here, who is a member of a board.

She is a member of a board to the point where she has committed $60,000 of her measly savings because she sees the need for this bank—not only, herself having been denied loans, even though she is a qualified person who owns her own business, but she has associates who have been denied loans.

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Like for example right now I see a gentleman in front of me who is a graduate of Northwestern University, who started a soda business. All the banks in the area turned him down. OK? When they turned him down, he went to them and said, OK, give me a second mortgage on my home. They refused to do that, too.

Senator BOXER. Well, I do not mean to interrupt, except that I am on yellow here and I want the answer to the question: Do you agree that a large bank with a community development arm would not meet the needs of the community, as well as——

Mr. LOPEZ. It would be more of the same.

Senator BOXER [continuing]. A niche bank?

Mr. LOPEZ. Correct. It would be more of the same. And I think the best way to relay this is to share with you an example——

Senator BOXER. I agree already. I am just trying to pin it down because in California we have got this big announcement, and it is very exciting, but I want to know if the organization should be changed to meet this need.

Mr. COMSTOCK. If I could just make a quick response, I think the basic word is that our communities need all the help they can get. If Sumitomo Bank is willing to jump in and do it, let us encourage them in whatever way we can. I think they will find out very quickly that it does take a lot of expertise to do this work. Apparently they have not been doing it, and they are about to find out.

One of the things the community development financial institutions are trying to do is actually provide the know-how that is going to help leverage this lending. I think it is absolutely the case that we are functioning just as Mr. Davis has just described to try to help leverage more conventional bank lending into these neighborhoods.

I think the role is going to actually be complementary, but they will soon find out that they are going to need a lot of expertise and will have to turn somewhere to get it. I do not know that we have to tell them legislatively that, you should not do this; I think we should just try to encourage them.

Senator BOXER. Mr. Chairman, could Mr. Davis just answer that?

The CHAIRMAN. Sure. Go ahead, Mr. Davis.

Mr. DAVIS. I think it is a good question because—and it seems it me the bottom line is whether the money that has been committed gets out into the neighborhood.

Senator BOXER. Right.

Mr. DAVIS. And I do not care whether it comes from them at their big office downtown or someplace else. I think I would argue, however, that if they committed and then expect to do it from downtown, it will not happen.

If you look at all the mortgage disclosure information that revolved around the issue of discrimination, it was because people were trying to do these programs from their downtown headquarters, and they were being serviced by people who had been trained to look at credit in a different way from the way I think you have to look at it in the neighborhoods.

I have always thought of States like California being the optimum place for this because you could simply take a branch that was located in a low-income neighborhood and turn it into a devel-

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opment institution and staff it with people from the neighborhood who know their neighbors, and know the market, the local market of that community.

You would not have to form anything new. It is just that this branch becomes this specialized niche-player in this market where you have people who understand the economy of that community and the people in it. So it has to be done in some way where there is a local presence by this bank to make sure that the credit gets out.

Senator BOXER. Thank you so much. That was very helpful.

The CHAIRMAN. Thank you very much. Very useful.

Senator Bennett.

OPENING REMARKS OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you, Mr. Chairman.

Mr. Davis, I will talk primarily to you, but I would be delighted to hear the others comment, as well. You made the comment about replication, and you said talented people with start-up support can do it. That is my big concern.

You are kind of a hero. South Shore Bank has caught everybody's attention, and it has been written up, and gotten lot of press. As I sit here, I find myself thinking: If I were not under the kind of strictures that the Ethics Committee puts on us, I might be interested in investing in your bank.

Mr. DAVIS. We would welcome you.

[Laughter.]

Senator BENNETT. I know you would.

[Laughter.]

Senator BENNETT. But my interest comes, quite frankly, not from your social conscience that I have heard people talk about, saying the banks will not have the social conscience to do this; my interest comes from the fact that you have made money.

The entire economy is filled with companies that find a niche that bigger companies have overlooked and have filled the niche and have made money in the process. I wrote myself a note: "It is not social conscience; it is good management that makes this work."

And as I hear you explain things in answers to the questions, you always come back to that theme: We know how to do it. We have the expertise. This is a 52-year-old bank, you said. You did not start up something with a social conscience dream.

You saw as a manager an opportunity that the existing managers were not smart enough to see, and you bought the bank, and you made money on it. I salute you, and I wish we could replicate you everywhere.

My one concern in these hearings is: How are we going to do that? At the Federal level, what can we do that can produce the kind of management ability and expertise that you have? Standing up in here and saying "we salute the concept" is not going to produce the kind of managers on the street that will make this happen. So I would like some comments from all of you about that particular problem.

Mr. DAVIS. Well, a couple of comments.

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One is: Today we are now operating, or are at least under contract, with different owners of the development institution in Arkansas, which is where the now President first became familiar with this.

We have, as the gentleman here said, we have been—we are now talking to people in Wayne County, but we actually have an institution in the Upper Peninsula of Michigan headquartered in Marquette that is beginning to do this kind of activity in conjunction with people who came to us from that section of the country because they wanted to do this same kind of thing. In this case, it is not a full-blown bank.

Senator BENNETT. So far you are proving my point. "You" are doing it——

Mr. DAVIS. No, we are not——

Senator BENNETT [continuing]. Because of the expertise you accumulated.

Mr. DAVIS. We are helping them. They came to us, and we helped them think through the business plan. We have an advisory service which again we set up partly to help spread the word as to how this is done.

But back to your point, it also is another source of profits for us. What we do is consult. We are now talking with 12 cities: Cleveland, Milwaukee, Portland, Louisville—about development banks. So they hire us to help them develop the plan as to how this ought to be organized and run.

Now in Arkansas we were able to send one person from our staff who had been trained there to go and be the president of that institution. But it cannot work that way. I mean, we just cannot—we are too small to provide training for all the people that are needed. But part of what I think Mr. Comstock was saying is that part of this could be money for training.

People can be trained. There are smart people around this country interested in this issue who can be trained. There is nothing holy or sacred about banking. It can be taught, and there are smart people who want to learn it.

If we had the resources with which to teach them, we could do it. That is where I think you will get the people that you will need to staff these banks.

Senator BENNETT. Let me ask Mr. Comstock a question about the success of things you say.

You are also the chairman of LEAP, Inc., a nonprofit venture development organization with its office at the bank.

Mr. COMSTOCK. Correct.

Senator BENNETT. Is that an essential part of the economic viability of these efforts?

Mr. COMSTOCK. Yes.

Senator BENNETT. Would the bank not work if you did not have that? Is that another piece of the expertise that you bring to the table?

Mr. COMSTOCK. I am not saying that the bank would not function. I mean, there are a lot of loans that could be made in the community. But in terms of an overall community development strategy, we very much agree with South Shore's concept that

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there are a number of different pieces that are needed to make any economic development work.

I would point out in particular that the need for equity capital is at least as great as the need for debt capital in our communities, and banks are not the vehicles to provide equity capital.

Senator BENNETT. I have started enough businesses that I know exactly what you are talking about.

Mr. COMSTOCK. The idea of LEAP is that it is kind of the leading edge of the bank. The bank cannot work with people until they are bank-able.

How do we help get the community development related businesses, the businesses that are doing job creation in low-income communities, formed and stabilized to the point where they become bank-able, which means intensive management technical assistance, plus finding equity capital for them. So that is very much a part of the overall issue here.

Mr. DAVIS. Could I just endorse that a little stronger than Mr. Comstock did?

There are three nonbank subsidiaries of our holding company. It owns the bank, but it also owns a for-profit real estate development company. It owns a venture capital company, and it owns—or there is affiliated it that is not-for-profit.

I think we could never point to the success in South Shore if it had not been for those nonbank entities. The bank alone simply cannot do it. The complete development entity has to include those nonbank subs.

Senator BENNETT. And that is, again, the part of the good management you bring to the table.

Thank you, Mr. Chairman.

The CHAIRMAN. And the question of whether you can compress this 20-year growth now with their know-how and experience down to a time frame so that we get an answer to the problems within the lifetimes of the people—I mean, we are going to need the expertise that you bring, as well, in terms of this view.

I think both the other witnesses wanted to respond, and then we will move on. Go ahead.

Mr. LOPEZ. Mr. Bennett, that is a pretty good point. I think talent and skill is really an essential ingredient, once we capitalize.

One of the things I am critically looking at is to make sure that we have a comptroller that is versed in banking, because he has been a comptroller in one of the banks——

Senator BENNETT. You mean a Comptroller of the Currency?

Mr. LOPEZ. No, a comptroller of the bank.

Senator BENNETT. OK.

Mr. LOPEZ. Also, the point I am trying to make is you are going to have to go with seasoned people. Regardless of their color, you cannot confine yourself to ethnicity. You are going to hire people because you are satisfied that they are capable of doing the job.

The CHAIRMAN. Mr. McNamara, you wanted to make a comment?

Mr. MCNAMARA. Yes. I would just like to comment relative to that. You know, we are a governmental unit, and we are talking about establishing a bank, and probably the worst group in the world you could have going into the banking business is a governmental unit.

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But the approach to this is to form a founder's group. The founder's group are people like Heinz Prechter, who is chairman of the American Sun Roof; Wayne Dorne, president of Ford Land Co.; Don Barden, Dave Bing who is a businessman and at one time was a great basketball player at S. Martin Taylor. These people would become the board of directors. They would run this as a business. The county would stay in until these people took over. Then, like the Communist Party, we would wither away and turn the operation——

[Laughter.]

Senator BENNETT. I hope not like the Communist Party.

[Laughter.]

Mr. MCNAMARA. Well, the theory of the Communist Party.

Senator BENNETT. All right.

Mr. MCNAMARA. But it is not a case of—it is a case of bringing the business community to run this thing with that social conscience as their objective.

Mr. DAVIS. And I think, Mr. Bennett, also just a final point, some people have asked us why we did this as a for-profit rather than a not-for-profit. There is not enough philanthropic money in this country to rebuild cities. We could give up now.

We have got to begin turning the thinking around that they are good places to make investments, and investments on which you will get a return. I think once we have demonstrated that you can make a profit doing this, we describe it as a lot of the really hard money of this country will begin to then flow into this process.

Senator BENNETT. And you begin to attract investors like me.

Mr. DAVIS. Good.

Senator BENNETT. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Senator SARBANES. Mr. Chairman, would the Senator yield?

Senator SHELBY. I would yield to the Senator.

Senator SARBANES. Could I be recorded in favor of the nomination of Laura Tyson? I gather we are reporting that out this morning?

The CHAIRMAN. Yes. You will be so recorded.

Senator SARBANES. Thank you, very much.

The CHAIRMAN. Thank you.

Senator SHELBY. Mr. Chairman, thank you.

How can the Federal Government best expand the role community development organizations? For example, is it the provision of the patient capital that is needed to support community development reforms? Is it capital and management? Or management and capital?

I believe you have got to have capital, and you have got to have management. If you have capital and you have inadequate management, we know you are planting the seeds of a disaster. What are your comments?

Mr. Comstock, you look eager.

Mr. COMSTOCK. Thank you.

I think there is quite a substantial existing talent pool already to build on. We have actually more than 300 community develop-

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ment financial institutions in the country. It is not just the four development banks.

So one of the first starting points is to realize that we could expand upon the capacity of that group. I think anyone who looks at it closely would say that that group is doing a good job at what they do, and their impact could be increased if their capacity could be expanded. What would it take to expand their capacity? More equity is number one.

Senator SHELBY. By equity, you are talking about money? Capital, right?

Mr. COMSTOCK. Capital. Equity capital.

For the for-profits, some form of shareholder type of capital. For the nonprofits, equity grants. But that equity base is the first starting point in terms of expansion of capacity.

The second point is that in terms of economically devastated communities, communities that are heavily disinvested where there is a very low level of business development and economic development taking place now, there is a lot of technical assistance and hand holding needed to get that process going. That is inherently something that is not self-supporting and needs grant funding.

The third thing is: As Mr. Davis had suggested, we could increase the talent pool if we had some support for professional training programs.

Senator SHELBY. Should we give CRA credit, or consider giving CRA credit to other banks to have them train people? Because management is so important to any organization.

Mr. Davis.

Mr. DAVIS. I would vote for that overwhelmingly. I think there are a range of——

Senator SHELBY. That makes sense, does it not?

Mr. DAVIS. Pardon?

Senator SHELBY. It makes sense, does it not?

Mr. DAVIS. It makes great sense. I think there are just a range of things that could be done. The need at the moment I think is for somebody to do the appropriate level of work on the kinds of things that it would make sense to do so that, based on the experience we have had, that we can move closer to believing that these are things that would truly work.

In the more extensive version of my comments today, there are some of those things being suggested that we have to look at. I think, like all things, some of them will turn out to be good ideas, others will not work. But we need to do the work that is required to see whether or not those would work.

But I think training—I mean, it would have to be differently from the way the large banks do it now, because you really want to train people in this development arena. But they certainly have the resources with which to work to pull that kind of thing off.

Senator SHELBY. And they could train them in a special niche which you are serving in the community. Is that correct?

Mr. DAVIS. Right. Precisely.

Senator SHELBY. Mr. Lopez, if I wanted to start, or help some people start a Community Development Bank in my State of Alabama, what would you suggest? Capital and people, I am sure.

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Mr. LOPEZ. Well, capital and people, and I must remind you that we have a lot of unemployed bankers out there.

[Laughter.]

Senator SHELBY. They would probably be diligent workers if they were re-employed; right?

Mr. LOPEZ. Correct. Absolutely. But I couldn't emphasize that more, that it is an arduous process when you have very limited capital. So whatever assistance can be given in tandem with getting a good talent pool, identifying a talent pool.

My only comment is: I would be a little reluctant to give banks credit for training people unless I can get some commitment from them within a certain parameter. I just would not——

Senator SHELBY. Why not? Who could train them better than actual banking experience? The Federal Government should not be training them.

Mr. LOPEZ. Well what I would do is, No. 1, I would identify a president of a bank who is capable of doing what he is supposed to do, and then let him go out and find the support talent that is needed.

Senator SHELBY. OK.

Mr. McNamara, you mentioned in your statement: The organizational and the legal costs for a Development Bank are quite significant, you know, for start-up, preparing management, and preparing fund raising. You have got to get the capital. That is a formidable task, is it not, sir?

Mr. MCNAMARA. Absolutely.

Senator SHELBY. Any suggestions there? Get your core group together, management first? Is that what you do?

Mr. MCNAMARA. No, we have not——

Senator SHELBY. OK.

Mr. MCNAMARA. I think you do things like determine the neighborhoods where this process will work.

We have brought together people who we consider very competent who would become in a sense the Board of Directors of the founders. We are attempting now to identify sources of private dollars from Foundations. We have had discussions with major banks in the State of Michigan who are extremely enthusiastic and positive about this. It may be a form of conscience money, but we do not care what motivates them. we would like to see it flow.

The management will come, but I am not sure that that is the initial concern on our part.

Senator SHELBY. Oh, the initial concern I suppose is the concept of how to put it together, and without the capital management you will not need the money?

Mr. MCNAMARA. That is correct.

Senator SHELBY. OK. Any other comments?

Mr. COMSTOCK. That seed capital is very hard money to raise. You have got a good point, that organizing a new bank, typically, it is up to 15 percent of the amount of capital raised that we spend on the total organizing costs of the bank. I am talking about any kind of bank, community development or otherwise.

In this case, since you do not have a small group of millionaires forming the bank, which would be the typical case in the typical small bank, you are going to have a hard time raising that seed

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capital. So grants for that purpose are going to accelerate the process of formation of these banks.

The CHAIRMAN. You know, my—if you would yield?

Senator SHELBY. I would yield, Mr. Chairman.

The CHAIRMAN. Might we not also think about maybe—I mean, I like the incentive approach. We are talking about change in some capital gains treatment, and capital gains treatment based on holding period. There might well be a way to incentivize through the Tax Code a greater flow of equity capital into this kind of thing to achieve a strategic objective for the country. I mean, it is not a novel concept to try to target and do something that you need, as long as it is done competently, and because we are going to get the money back.

We are going to get the money back in economic growth and revitalization by some multiple of what it is we spend. I mean, this is precisely the path intelligent nations have to take. Anyway, I do not want to trespass further.

Senator SHELBY. Mr. Chairman, that is a very good comment. One follow-up on it. Mr. Davis, is there any competition or any overlap between the commercial bank in an area trying to fulfill the mandated CRA and what you do in a niche? Is there any overlap there, or some competition? In other words, say a commercial bank in Chicago serving the same neighborhood that you would be, they compete within a niche?

Mr. DAVIS. Unfortunately, this is an area of when we went to South Shore it had 80,000 people in the community.

Senator SHELBY. OK.

Mr. DAVIS. We were the only bank there at that time, and we still are the only one.

Senator SHELBY. OK.

Mr. DAVIS. But, I would hasten to add that we really are not talking about creating anything new here. The holding company is examined by the Federal Reserve Board.

Senator SHELBY. Sure.

Mr. DAVIS. The bank is examined by the State Banking Commission because we are a State-chartered bank, and the FDIC because we have insured deposits. And we think in doing this work in a glass bowl, so to speak, is what partly makes it very successful and we would not change that.

So this is not a new institution. It is going to be subject to all the regulations that banks are at the moment. But I guess to answer your question specifically, we would welcome another Development Bank in this neighborhood, because I think this competition is the strength of what makes this country run. And that needs to be brought to this arena.

As I said earlier, we are not looking for charity or for grants. We have got to get these markets functioning in these neighborhoods so that none of the special sort of stuff is needed again; that it then moves just as the rest of this country operates, under regular, normal market forces operating in those places.

Senator SHELBY. Are you giving people in the inner cities, or wherever you are operating, an incentive to save money, to invest, to put money in your account where it is available there that they did not have before? You were the only bank.

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Mr. DAVIS. Well, we are—I am not sure we are doing that much to increase savings. Part of the purpose of what we do is we have the purpose of trying to increase wealth in these neighborhoods, because that is a big problem. I mean, there is no money there. A lot of what we are doing, we have a cadre of five or six dozen we call them ma and pa rehabilitaters to whom we loan to buy these large buildings to rehabilitate them.

We are making an 80 percent loan-to-value for acquisition. We will do 100 percent of the financing for rehab. We will not do a loan unless there is a rehab component to it. We have, I am not ashamed to say, created through that process several millionaires within South Shore at the moment, and that is a part of what we want to do.

Senator SHELBY. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Domenici.

OPENING STATEMENT OF SENATOR PETE V. DOMENICI

Senator DOMENICI. Thank you very much, Mr. Chairman.

I too want to, right up front, indicate that I think this is one of the truly important areas that Congress ought to be looking at in an effort to see what we can do to help create wealth in some of our poverty areas and, as has been indicated here, to create entrepreneurs in the area, and certainly to create ownership.

As I see it, as has been summarized here, we are not going to rehabilitate and revitalize our inner cities, or even our dilapidated rural areas unless we have something like this working with this kind of investment taking place. The Government is just not going to be able to do it all. It is going to have to be done by applying this concept of community development.

I am here also to welcome a New Mexican, Pauline Nunez-Morales, who is sitting in the front row. Pauline, I am not sure when you testify if I will be here, but I will try. I think what you have to suggest by way of a small community organization in New Mexico that does some work in rural areas and relies on contributions from more or less charitable organizations to get your nucleus started is a concept that at least we ought to look at in terms of this overall picture, and I thank you for being here.

Let me suggest, Mr. Davis, one of the things that is always difficult when we attempt to write laws or change laws to try to stimulate something that is working, that is a model and we want to expand it, and we know that its concept is very vital and really important, that we tend to try to have Government do the next step.

No one in this institution is more concerned about small business and minority small business people as entrepreneurs in this country. In fact, I agree with the statements made here. You know, we do not have a fair society.

If minority business people are not getting their fair share of loans and ability to accumulate equity when they have good deals, it is just not American. We are not going to fix the slums until that momentum moves in that direction. But it is not so easy to do. It is very easy to say we want to change.

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Right now I would say, Mr. Lopez, small businesses that are not African-American are lining up at our doors saying they cannot borrow money. So the issue for the next few years is: How do we get bank money into small businesses? And in the process, what can we do to see to it that we do not miss the boat again when it comes to small minority businesses?

The set-aside programs on contracts and the like is not the whole answer to this. I mean, the answer is to get loans and equity so they can have their own businesses and not be so dependent upon preferential treatment.

Now having said that, Mr. Davis, I would support in a minute a set of laws that moved American business in the direction that you have just gone through, and that you now have in your Community Development Bank.

What I am kind of worried about is: How are we going to write that into law so that we can duplicate your kind of activity all across this land? And what is needed from us to help with that?

Right up front, I truly believe the concept of building profit into it as a motive is very, very important. You clearly cannot ask people to invest if they do not expect to get a return. You cannot expect bankers to be bankers if they cannot expect to make some profit. There may be a nonprofit role, but I truly believe the heart of this activity ought to be accumulating capital and equity from across America that wants to invest.

In this instance, the invest is invest in a viable business organization or entity that they have a chance of owning, or sharing in, or making profits from.

If you had to in just 2 minutes, if you had to define for us what would you change about the banking system or the current laws as you know them that would most probably cause more development companies like yours to come into existence in this country, what would those four, five, six things be?

Mr. DAVIS. I think we touched on that earlier I think before you came in the room.

No. 1, Senator, I am not sure I would change any laws at the moment. In 20 years of looking at this, I would not. Where I think the help is needed is not in changing laws but in trying to think through what is the proper role of Government in something like this. I do not think it as doer, but I think it is as being supportive for those in the private sector who are attempting to pull this off.

So I think, as Mr. Comstock said earlier, it is a matter of making capital available for the development of these institutions through sort of a third-party, not the Government investing directly. I can give you an example of that in which we are intimately involved.

The U.S. Congress gave something called the Polish-American Enterprise Fund $250 million as a grant to spur economic business development in Poland. That was a grant made by this Government to that fund. When they received the money, they came to us and said: "We don't know much about small business development in Poland, for understandable reasons."

We have now entered into a contract with the Polish-American Enterprise Fund to manage a small business loan program in Poland. We are in our second year of that. It has gone extraordinarily

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well. There is almost $40 million that has been put out for small business development in Poland throughout the country.

We have had two losses on that program, and am happy to say that in both cases we have recovered the full amount of those loans. So it is that kind of thing that I think is applicable to development banks, that some pool of capital is made available for a third party to administer that then gets put in the form of equity. Also there is money, as was said earlier, for training people who are going to run these institutions.

Specifically I guess I would not change any laws because I think they are sufficient and appropriate for this kind of development. I would try to find the role that the Government could play vis-a-vis capital, grants, training funds to make these things happen.

Senator DOMENICI. Mr. Chairman, I have just one suggestion that maybe our staff could do.

It seems to me that we do have an awful lot of development programs in the Federal Government, and I am not so sure that they are all directed at the same target in the same itinerary of objectives such as Community Development Block Grants, Minority Business Development, Urban Development Action Grants, sometimes called UDAG, EDA—we don't have many more UDAG's, I understand.

Through appropriations we have done away with them, not by law; so we just do not fund them anymore. But it seems to me we might take a look at how are they directed criteria wise. Maybe there ought to be more of a uniformity of criteria that directs them at community development, at least proportionately, if we want community development banks to be tied to community development programs.

It might be an interesting source of resources. I gather that is sort of what you are saying?

Mr. DAVIS. Precisely.

The CHAIRMAN. And I might say that Mr. McNamara, being a county executive, has to deal with certain of those other programs coming through those other categorical avenues.

Let me say, we are finishing a vote that started about 12 minutes ago on the Senate floor, so we must all go and vote, but I want to announce what our program is for the remainder here.

Senator Sarbanes left early to vote. He will be coming back. He wants to ask some questions of this panel. When he has done so, we will then excuse this panel and call our next panel.

I want to move right on forward, and while we are all here finish the work today and go through a part of the lunch period. I will appreciate everybody's indulgence in doing that because we are being interrupted by votes which we could not forecast when we established this.

So we will stand in recess for a very short period of time until Senator Sarbanes returns, and he will reactivate the committee and he then will follow through.

Senator DOMENICI. Mr. Chairman, might I say that I did not have enough time for each member, but I appreciate your testimony and I thank you very much.

[Recess.]

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Senator SARBANES [presiding]. Mr. Davis, if you and Mr. McNamara could take your seats, I think we could get started again. Hopefully we will be able to finish with this panel shortly and then move on to the next panel. I know it has been a long morning.

I am interested in this question: I guess ideally one would not want to have to set up special institutions or arrangements in order for credit to be available in these communities. Would you agree with that?

Mr. DAVIS. I would, wholeheartedly.

Mr. COMSTOCK. Yes, and I do not think that we are advocating a new class of charter or anything of that type. What we do need is institutions that have the desire and focus to work in these kinds of communities.

Senator SARBANES. Well, do you think that we should go in the direction of setting up, or trying to set up these institutions who have the desire and focus to work in those communities and say to the existing institutions, well, you don't seem to have the desire or the focus to work so you go off and do what it is you want to do and we are going to figure out some other way to get the institutions to the focus we need. What is your reaction to that?

Mr. LOPEZ. Senator, I cannot speak for Mr. Comstock and Mr. Davis, but I know the banking community where I come from in Grand Rapids is that I think we do need an institution in that area that is going to be sensitive to the needs of the minority business people and individuals as a whole.

Senator SARBANES. Why should not the existing institutions be sensitive to that?

Mr. COMSTOCK. I think they should. The issue has simply been that, in 16 years of CRA, we have only had limited success with that legislation in trying to force institutions that do not want to lend to do so. Now there are——

Senator SARBANES. Now would you say that your perception is that a real effort has been made to apply CRA?

Mr. COMSTOCK. No. And I think that is one of the issues. If a real effort was made, which I think would have to start with setting some realistic standards for what CRA ought to mean, if such an effort was made, I think that would be good. I support full enforcement of CRA.

I would not want to see the banks that are doing something now go back to doing nothing. That would be a step in the wrong direction. If anything, maybe they could do more. But I do think that it is always going to be difficult to try to get institutions—especially large institutions who do not want to do this work—to do it just to satisfy a Government regulation.

I doubt if that will be the ultimate long-term answer for this problem, although I do not think that we should have them backing away from what they are doing now.

Senator SARBANES. How much of a problem do you think that is, that the development of alternative institutions will become an in lieu of instead of a complementary or an in addition thereto?

Mr. DAVIS. On your first question, I think that what 20 years has taught us is that in order to do this you must have an institution whose primary objective and goal is development. That simply is not the case with the large institutions, or at least the large finan-

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cial institutions at the moment. Their primary objective is profits. With that going in, you are sort of off on the wrong track.

I do not think anything I have said today I hope has not been looked at as inferring that the large banks should not be in this. This has not been their business for all the years that they have been operating. They do not know the markets in these neighborhoods. The last thing I would to happen is to have them forced to make investments in the neighborhoods, have them all go down the tubes, and then for the banks to say we tried this but it did not work.

What I have been trying to focus attention on is to find the avenues through which the work of these community development institutions and the larger banks can be complementary so that we then—and I know in the case of South Shore, because we are in the neighborhood, on the ground, are willing to help them think through where they can play a role most effectively and where we will have success.

Senator SARBANES. How long did it take you to get South Shore from ground zero to sort of where it was a viable, functioning organization?

Mr. DAVIS. We did it in increments, Senator. As I said earlier, this is a 50-year-old bank. We bought it——

Senator SARBANES. It is 50 years old?

Mr. DAVIS. Fifty years old, right. It was chartered in 1939.

Senator SARBANES. All right.

Mr. DAVIS. When the neighborhood changed racially, the bank wanted to move. The comptroller denied them permission to move it. So in 1973, a group of us who were interested in this issue of development banking were able to put together a group that bought the bank. We have only had ownership for now 20 years.

But it was an ongoing institution, which is what we basically recommend for this kind of activity because there are a lot of problems you have normally with start ups, and so if you are going to try to start a bank with all the natural problems you are going to have, plus lay the development agenda on it, it is not impossible to do, it just takes you longer.

We bought an institution that was relatively clean, without problems, that had a stream of earnings behind it. And so on the day that we walked in there, we were able to begin our development agenda.

That bank located in the neighborhood was one of the many institutions—with most of them in Chicago—who would not make a mortgage in that neighborhood, and they had not done so. The day after we were there, we announced that the bank was back in the mortgage business. So that is just an example that we started with that. Then as the years went on, we began to add more and more development products to that arsenal.

Senator SARBANES. Now how long was it before people started coming around and saying you're doing such a fine job here that we want you to go elsewhere and tell about what you are doing, or hold you up as an example?

Mr. DAVIS. Well, our original hope had been that we would demonstrate that bank holding companies could do this kind of activity and be profitable.

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Then, naively we assumed that a lot of other bankers would come running to emulate it. That did not happen. Specifically in answer to your question, it was 10 years after we were there.

I think a lot of people were watching just to sort of see if what we were doing was some sort of fluke, or whether it was real. So after 10 years of profitably doing this work, the neighborhood actually getting better, that some people began to say, well, maybe it is for real.

That interest has increased. As I said earlier in my testimony, we are now consulting through our consulting company with at least representatives from a dozen other cities about establishing this kind of institution.

Senator SARBANES. Now would you say that it would probably take others a comparable period, maybe somewhat less, to get into the same position?

Mr. DAVIS. I think it would take somewhat less.

Senator SARBANES. How much less? By a factor of what?

Mr. DAVIS. I said earlier we are 20 years smarter about all of this than we were. We have a consulting company which we set up specifically for this purpose, for others who wanted to talk about how to do it.

We are smarter about how one would structure an entity like this in another place so that, rather than going through the trial and error that we did, people can put in place more or less—I think Lyndon generously acknowledged the help that he had gotten from South Shore, or had seen at South Shore when he established his bank, and I think he would agree on the basis of having that experience of what we had done and our willingness to help him in any way we could—that he was able to move much faster. His bank is now three——

Mr. COMSTOCK. Two years old.

Mr. DAVIS [continuing]. Two years old, and he talks about the—I don't remember the numbers exactly, but in 2 years they have been able to do significant financing out of that bank for the areas in New York in which they operate.

Senator SARBANES. I guess what I am concerned about, I have enormous respect and admiration for what you have done, and I would be happy to see it replicated anywhere we can do it, but I have some concern that the normal channels of activity in this area continue to be pushed to sort of meet their responsibilities.

Otherwise, it seems to me the exceptions will not be the rule. You will just have the exceptions, so to speak; they will be trying to make the exceptions the rule, and that is a difficult process. It takes a lot of time, and there are a lot of existing resources out there.

You know, the Federal Reserve Bank of Boston in a recent study found that after controlling for genuine credit concerns—this is after the control for the genuine credit concerns—minority applicants were 60 percent more likely than white applicants to be rejected for home mortgage loans.

You have, you know, the Community Reinvestment Act came out of in part the sense that financial institutions were drawing monies out of the community but not putting moneys back into the community, and this was an effort to try to get them to do that. Now——

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Mr. DAVIS. I understand, Senator. I am sorry. I thought you were finished.

The CHAIRMAN. Go ahead.

Mr. DAVIS. I just wanted to respond that you are right. The large credit institutions are risk averse. But the one example I can give is South Shore. When we first got to that bank, or bought it in 1973, there was not a financial institution in Chicago who would make you a mortgage in that neighborhood.

Now, because we saw our role as getting out front and demonstrating that it was a safety place to make investments and actually making the market work, any financial institution in Chicago will now make you a mortgage in South Shore. That is the role that——

Senator SARBANES. You mean in the South Shore area?

Mr. DAVIS. Yes.

Senator SARBANES. And they are now doing it?

Mr. DAVIS. Yes.

Senator SARBANES. To what extent? Is South Shore still doing it?

Mr. DAVIS. To what extent is South Shore Bank?

Senator SARBANES. No. To what extent are regular commercial financial institutions now lending in the South Shore area?

Mr. DAVIS. Well, they are. That is the point I was making, that 10 years ago you could not get a loan of any sort in that neighborhood. Now you can walk into the First National Bank of Chicago, Harrah's Bank, those banks will make you credits in that neighborhood because of the work of Short Bank as a development institution we think has now made those institutions perceive that neighborhood as a safe place to invest, and they are doing it.

Senator SARBANES. My question is: What percent of the credit in that area is being provided by South Shore as opposed to these other banks?

Mr. DAVIS. I will give you—In the area of single-family mortgages, they are all being made by financial institutions because what we did, when we first got there, was to announce the next day, as I said earlier, that we were making single-family mortgages. OK? But we are a small bank.

And because you can now get a mortgage at any institution practically in Chicago for a single-family mortgage, we have withdrawn from that market and now have put our attention on the larger, multifamily buildings where we are hoping that we can have the same results, that we will build that market to the point where we can withdraw from it, go off and do something else, and——

The CHAIRMAN. Would you yield just——

Mr. DAVIS [continuing]. And then get those markets working in their normal way in that neighborhood.

The CHAIRMAN. If you will yield just for a moment, here is a concern that I have.

In other words, now that pattern has changed from the normal commercial lenders that Senator Sarbanes is isolating on here, and importantly so. It seems to me in part they are now doing that because, by your efforts, you help take the neighborhood, the area within which you have been operating over the 20-year timer span, you took it up over the redevelopment threshold.

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You turned the whole area around step by painful step until you finally became, I suspect, an attractive enough area because of the improving dynamics, that suddenly the outside institutions took a different view. They took a look, and they saw that the profile was changing sufficiently that his now—and there may have been some social conscience issues at work, too. I don't profess to know them all.

But to the extent it is because you did the hard work to change the dynamics and come up above this redevelopment threshold, are they now coming in because, you know, you have put 20 years into making it attractive to them.

My concern is that I would be concerned that if a development bank has to come in and do all the heavy lifting, for some number of years before you finally turn the community dynamics around enough that the commercial bank says "Hmmmmm! Looks sort of interesting."

I mean, we have been redlining this area for a long time regardless of the creditworthiness of an individual borrower, but now these folks have plowed the ground. They have turned this thing around. It is now interesting. We will do a little lending in there, too.

I am concerned that you may have that element in here that would be part of the story of the 20-year haul that we have to kind of separate out when we think about what is going to happen with the brand new one that is going to start out, and does that new community development bank have to do essentially all of the heavy lifting to get over that redevelopment hump?

Mr. DAVIS. I think that is why I think the question that was being discussed earlier today about allowing those banks to invest in community, they ought to be owners of community development institutions. That way, they are locked in from the very beginning.

This is an institution where we do not wait 20 years for them to get involved. They are in there from day one as owners, and I would suspect and hope that through that ownership that they would also be investors in the neighborhoods in terms of making loans there.

So the time that it took us to get to the point where they felt the market was safe is greatly reduced, because you get them in from the very beginning.

Senator SARBANES. Well, the problem that I am worried about is that these community institutions, which I am very much impressed by and in favor of, first of all have—there is a time lag in getting started, but more importantly that they become an in-lieu way of the normal institution responding.

In other words, the normal institutions to some extent are engaged in practices that they ought not to be engaged in, that do not have an economic rationale for the practice even on the basis of some of these studies.

The question then is: Should they in effect be able to move away, or walk away from that because you put these community banks in their place? I mean, somehow you have to figure out a way to get both, it seems to me, if you are going to try to address this problem.

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Mr. COMSTOCK. If I could respond to that, I think your point is well taken, in that until there is a large enough amount of investment going on in low-income neighborhoods, then we need everybody that we can get there, by whatever means, to be operating there.

We are a long way away from having the community development financial institutions be able to take over the entire role of providing investment in low-income communities. We are just not even close to being there.

Senator SARBANES. And we may not even want that. What we really may want is for the normal institutions to recognize the kinds of possibilities that Mr. Davis' institution recognized and go ahead an take advantage of them.

Mr. COMSTOCK. Although in his case——

Senator SARBANES. You do not have a separate outfit that manufactures soap to be sold to low-income people. You know, Procter & Gamble makes it and everybody buys it.

Mr. COMSTOCK. Although this problem is not common to just banking. I mean, we could talk about grocery stores. I realize you are the Banking committee, so you are not going to focus on grocery stores——

Senator SARBANES. No.

Mr. COMSTOCK [continuing]. But it is not a problem just exclusive to banking in terms of the lack of an economy in a low-income neighborhood. I think——

Senator SARBANES. Let me ask you this question and then I will desist, Mr. Chairman.

To what extent do you think the problem in these neighborhoods has an essential economic rationale to it? And to what extent is it other factors that are at work? That if you really analyze the economics, a good deal could be done—a lot of activity could be done on sound economic grounds, but they either do not perceive that, or are unwilling to engage in that kind of activity which is tougher in some ways and therefore they do not go in, and to what extent is it in fact that the economic basis is not there and if you are going to do some of these things you have just got to find unique, underwritten, subsidized ways in which to do them?

Mr. LOPEZ. Sir, could I just share this with you?

In Grand Rapids, again it depends on the perception of these banks. They look at these communities as a source of raw materials which you can go in and get cheap deposits, and you already redline it. You have a policy of redlining it by not investing in it. You invest that money elsewhere. So it is a good markup.

The reaction of some of the banks when we first announced that we had been chartered and that we were capitalizing was to try to snuff us out. They also started pairing off their lending officers, one white, one black, going into the community to ask the people what they wanted. They started out with the ministers.

So getting back to the Community Reinvestment Act which seems to be an important aspect of this whole problem of minorities accessing credit is that to be it appears that the banks are satisfied with the concept that they can do public relations and nothing else and get away with it. I think that is what is at the heart of the issue, the way I see it.

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Mr. DAVIS. Could I try it? I think it would be——

Senator D'AMATO. Mr. Chairman, if I might, Paul, because you raise the issue that goes really to the heart of it, and to which we have to give careful consideration.

If I can make an observation—my proposal is to give banks credit for their investment in the local development banks, or in the banks that are doing the kinds of work that Mr. Comstock's bank is doing, and that Mr. Davis' bank is doing, that is exactly what I am suggesting. I am not suggesting that we give them a gold star. I am not suggesting to you that they will then be allowed to discriminate.

Discrimination is against the law, and we should enforce that law vigorously. If banks are not making mortgages to credit-worthy people, as some of the studies have indicated, we ought to crack down on them.

I am suggesting that we have an ability to leverage and bring capital into capital-starved neighborhoods in an intelligent manner and in a way that will in the fullness of time build these community development banks. So what if there are going to be some unprincipled people—and there are always going to be some—who say, well, this is the way to meet our obligation, and that is how we will do it.

What do we care? If Mr. Davis gets the capital, if Mr. Comstock gets the capital, if Mr. Lopez gets the capital, we have accomplished our purpose. We are not suggesting, however, that banks that capitalize there community development bank can now go out, break the law and discriminate.

But it seems to me that in another aspect, and we talked about training and how to get help, that when somebody invests in Mr. Davis' bank, in the Southside Bank, they are helping the community he serves. If they put $500,000 worth of capital in there, they are also going to help. They are going to have people in there who are going to provide some expertise, et cetera.

It is a natural extension. They have an investment and they are going to see what takes place there, and we are going to begin building bridges. We are going to begin building bridges and getting capital into arteries that do not even exist now.

We will first put an artery in there, and we will get that flow of that capital going. Will there be some problems? Sure. But I suggest there will be far fewer than if we do it by using the existing system.

Mr. Davis pointed out that for every dollar of capital, that is a $15 infusion into the community. So we have a bank that is doing that kind of thing. And there are a lot of smaller banks—not just big banks. There are some small banks, for example—in relative terms they may not be small, they may have $1 billion worth of assets—that went to get involved in trying to make loans in depressed neighborhoods and they may not even have any in their community.

What a wonderful thing to get them to meet CRA requirements and actually take money from affluent communities and have a stake in investing it in the less affluent communities that are not within their service or market area. I think that potential exists but we have to study it. I do not think it is just a matter of saying

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that now you can go out and break the law—or not meet basic requirements, that you can go discriminate. I just share that with you.

Senator SARBANES. No. I was not suggesting that, obviously. I would assume no one would want to do that. I am trying, though, to get at how these responsibilities are met and how we address the problems that are in these communities, and how we can maximize the effort.

A lot of it may depend on what is the price you pay. I mean, if you are going to let them meet their community reinvestment requirements by just sort of buying in, then it is a big question of how much is the buy-in, if you are going to do it that way.

Now that still leaves you with the question of whether you want to completely give up on the idea that the normal institutions ought to be—that is why I asked this question about the economic differentiation, because if they are cutting it off at a point where the economics still make sense, and my suspicion is that that is the case on the basis of South Shore's experience, that is one thing.

If they are cutting it off at the point where they say, look, our bottom line is we have to show a profit and we just cannot handle this particular problem because we are down to a point where the economics of thing just will not work, then that is a different kind of problem.

But the question is whether the range in which the economics will work, how you try to address getting the existing normal institutions to assume activity in that range, as opposed to creating institutions which in effect will substitute for them.

Mr. DAVIS. Just two responses. I would like to say, I think I have heard nothing here today, and I certainly have not intended in any way to infer, because some questions were asked at the break, nor am I saying that an investment in a development bank lets the banks off the hook.

Absolutely not. I think all that I am saying is it is another way to help them meet that CRA requirement.

Second, Senator, I think if we had only gone into South Shore with a bank making credit, I would not be sitting here before you today, because we would have lost everything we put in.

As I said in my testimony, a development bank is much more than a credit granting facility. I mean, unfortunately in this country—and we all share the blame that we have allowed these areas to deteriorate to a point where perhaps in another day earlier credit would have turned them around. It cannot do it by itself.

Senator SARBANES. That is a good point, I think.

Mr. DAVIS. So therefore we have got to have a lot of other things going on to make it work. My general rule of thumb is that I would rather lead by example in this area and pull people along rather than try to legislate what they should be doing.

Because I think if we can begin to move the banks along to show them that there are profit opportunities in these communities, OK, and work with them, I think that at least the banks we have had experience with in Chicago have indicated an interest in doing that and have in fact begun to participate with us, that we will then get them to the point—which is what I think you are saying—where they will not need us or anybody else.

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They will view those as good markets and will go off on their own because they have come to feel that they represent good investment opportunities, and that the markets then begin to work in those places.

The CHAIRMAN. If I may, and I do not want to be arbitrary in terms of time, and everybody has been very understanding given the interruption for votes, but we have another panel that I want to move to.

I do want to make one comment before we leave this panel in thanking all of you for your participation. That is, I do not think we have a lot of time here to work with. We are seeing examples of cities that catch fire and burn down, and we can see a lot more of that happen. Lives and opportunities are being squandered and I think destroyed in effect every day that we under-respond and under-acknowledge a pile-up of problems that has been in our society for a long period of time. So we have got to have a concept that will work, but it cannot take forever and it cannot string out over a long, long period of time because we are playing catch-up as it is.

I want to make sure that the extraordinary teams that have come into being that have succeeded, like the two that we are seeing here, and the two that aspire to do it that we have also heard from, I am sure if we could go back and sort of look at the landscape behind us we would find other groups that tried and did not make it. They are not here today because of how relentlessly difficult it is to make this kind of thing happen. So I think we have got to harness everybody.

We are having discrimination hearings in here within a matter of days because I think I am determined, as Chairman of this committee, that we are not going to tolerate a continuation of discriminatory lending practices by federally chartered and insured institutions. It is not going to happen.

The new Comptroller of the Currency has said to my face that he intends to rip it out root and branch, and I intend to rip it out, and I think our new President feels the same way, and I think this committee feels that way.

So we are going to unlock that part of the strangled capital that has not been making its way through simply because, as you point out, loans have not been going even where they are economically justified, quite apart from the issue of how you get a community up to the point where it is attractive to new capital investment.

We do not have long to do this with, in my view. So we have got to take and compress this timeframe. If it is going to take every community development bank 20 years to get to where you are now, America is not going to beat the train to the crossroad. We have got to do this. We have got to compress this down into a much tighter time frame and thank God we have some relevant experience from which we can draw if we use our brains.

We need to do the training and make sure that the credit is coming through, but we are going to need the commercial banking system to step up to the plate and not just cherry-pick the loans that look attractive, or the easy ones. And the regulators are going to have to do their job on community investment criteria.

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It does not mean a thing to generate a lot of paperwork that does not convert itself to an adequate flow of credit going into the areas that have been starved for credit. I do not want file drawers full of papers so that bureaucrats can, you know, justify the fact that they have been monitoring the problem, when we have got people in communities dying on the vine out there because the credit is not getting through. Maybe we have to set criteria.

I do not want some paltry fraction of 1 percent of the capital and the credit making its way into the areas that are dying for lack of credit, and where there is an economic justification for that credit to go. So we have got to do better in that area in the traditional system. We need both.

There is no way in the world we are going to get the job done in sufficient volume and in sufficient time unless we get full mileage out of community development banks, which I am for, and I want to grow as many as we can that meet the test of being competent, capable, rooted in the communities and able to succeed, but I want the private banking system and the other financial intermediaries to step up to the plate. I mean, we have got—they have got to respond to the needs of the whole country, and not just a part of it.

Thank you, very much.

Let me thank this panel. You have been very helpful to us. I will excuse this panel and call our next panel.

[Pause.]

The CHAIRMAN. Let me welcome this panel.

Again, you have been here all morning, so you know the circumstances of our having been interrupted by the votes on the floor. I know some of you have planes to catch, and we are under very tight time constraints here, in any case. So I am going to make your full presentations a part of the record and ask you to summarize.

Ms. Nunez-Morales, I know you must leave soon to catch a plane.

Ms. NUNEZ-MORALES. Yes.

The CHAIRMAN. I am going to call on you first——

Ms. NUNEZ-MORALES. Thank you.

The CHAIRMAN [continuing]. And if you would each give your summary comments, we will go in that order.

STATEMENT OF PAULINE NUNEZ-MORALES, EXECUTIVE DIRECTOR, NEW MEXICO COMMUNITY DEVELOPMENT LOAN FUND, ALBUQUERQUE, NM

Ms. NUNEZ-MORALES. Thank you, Mr. Chairman, and members of the Senate Banking Committee. My name is Pauline Nunez-Morales and I am the executive director of the New Mexico Community Development Loan Fund, a statewide organization.

Today I am representing my own organization and the National Association of Community Development Loan Funds [NACDLF], an association representing 41 community development loan funds. NACDLF is active in an ad hoc coalition of community development financial institutions which are microloan funds, community development loan funds, community development credit unions, and development banks. This coalition has pioneered the business of community development lending over the past several decades.

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We have prepared a position paper comprising our best thinking at this time on the issues involved in setting up a federally supported network of CDFI's. A copy of the paper is attached to my testimony.

The CHAIRMAN. We thank you for that.

Ms. NUNEZ-MORALES. Thanks.

The New Mexico Community Development Loan Fund is a private, nonprofit financial intermediary created in 1989 and dedicated to the economic and social empowerment of the people of our State. The fund borrows capital from 29 socially responsible investors and lends it in support of affordable housing, community based businesses, basic human services, and community development in general.

NMCDLF is the only community development lending vehicle in a State that has one of the highest percentages of people living below the poverty level in the United States.

As a primarily rural State, New Mexico faces a unique set economic challenges. For many people, major markets are distant. The limited job opportunities, and access to all types of services, particularly financial and public services is inadequate. Over a third of the State's population is Hispanic. Native Americans comprise 10 percent of the population. Both populations make up the majority of rural residents. Within these traditional communities, language and racial barriers can contribute to their inability to access traditional capital sources.

The NMCDLF mission is to help create long-term solutions to poverty by placing resources back into communities, to create jobs, retain community services, and improve housing opportunities. To this end, our fund has helped to expand rural health facilities, support organic agriculture, reduce program costs for transitional housing groups, and expand rural enterprises.

Let me give you an example of how we work. One of our loans recently was made in Mora County, which is one of the poorest counties in the State of New Mexico.

We just recently are going to close on a loan for $25,000 to a logger in that county. It is a small contractor that otherwise would not have been able to have access to capital. We also participate with other institutions in making loans. Last week we closed on an $80,000 loan to a shelter, St. Elizabeth's Shelter, in Santa Fe. That was to help them purchase a nine-unit apartment building to house facilities in transition in Santa Fe. A locally owned bank provided a $170,000 loan for permanent financing, and a local donor contributed $50,000 for the downpayment.

What our loan helped do was actually make the project happen. So as you can see, the NMCDLF lends for both housing and business projects, recognizing that distressed communities need to develop both aspects of their infrastructures.

NMCDLF is a relatively young and small organization in the loan fund industry. The 41 NMCDLF member loan funds have loaned more than $100 million which have leveraged $760 million in public and private capital to finance 15,000 housing units, and to create 3,500 jobs for poor Americans.

NMCDLF strongest member funds, such as the Delaware Valley Community Reinvestment Fund [DVCRF], in Philadelphia; the

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Low-Income Housing Fund in San Francisco; the Boston Community Loan Fund; and the Cascadia Revolving Loan Fund in Seattle provide leadership for the NMCDLF and other growing loan funds. They are the pioneers in our field, and their experiences and success are models for growth in our industry.

They and other loan funds have demonstrated the nonprofit, nondepository revolving loan funds can aggregate significant amounts of private capital from individuals and institutional social investors, successfully fill gaps in credit markets in urban, rural, and tribal communities, work hand in hand with conventional lenders to their mutual benefit, and finance new forms of ownership such as mobile home park cooperatives and land trusts.

These institutions are now planning to significantly increase the scope of their efforts. For example, DVCRF is studying the possibility of adding a depository arm. My colleague from DVCRF, Jeremy Nowack, is here today and would be glad to answer any questions about these plans. And I am afraid he is going to have to handle the Q and A today for me, since I have to leave.

At the other end of this growth ladder, new development funds such as NMCDLF are models for emerging loan funds and start-up efforts in places like Maine, Western New York, Delaware, South Carolina, and Chicago.

NMCDLF believes that a performance based lending and grants program should be the model used to create a national network of community development financial institutions. It fosters discipline in business activities while allowing institutions the flexibility to provide loan products and related services that are appropriate to the communities they serve.

Collectively, the existing CDFI industry provides a baseline against which the progress of a Federal program could be measured. Capitalizing more than $700 million, much of which was raised from within communities or constituencies they serve—development banks, credit unions, and loan funds—have extended more than $2 billion in loans. Loss rates are comparable to those of the best conventional lending institutions. We offer a solid foundation for a bold community development lending initiative that might include new institutions, community organizations, conventional lenders, and others.

We believe that Congress and the Clinton administration must make a clear financial commitment to the CDFI system to signal their support for the long-term viability of the industry. But this should be just one part of the funding mechanism. The $850 million figure reportedly under consideration by the administration for dispersement over 5 years seems to be an appropriate scale.

We respectfully suggest that this money should be committed primarily as equity support in increasing amounts over the 5 years in accordance with a performance-based lending investment program that provides support to all rungs of the CDFI industry growth ladder. Those CDFI's that perform up to industry standards would gain access to increasingly large amounts of the $850 million. This ensures that the money is not distributed without due accountability measures.

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That concludes my prepared testimony. Thank you for this opportunity to discuss the work of the New Mexico Community Development Loan Fund and our peers in NACDLF.

The CHAIRMAN. Thank you, very much.

Ms. NUNEZ-MORALES. As I said before, Jeremy will answer the questions.

The CHAIRMAN. Let me excuse you. I know you have got a plane to catch.

I want to introduce our final three witnesses, and then I will call on them in this order: Mr. Ron Phillips representing Coastal Enterprises here from Maine; Mr. Robert Jackson representing the Quitman County Federal Credit Union here from Mississippi; and Mr. Michael Swack who is here representing the Institute of Cooperative Community Development from New Hampshire.

Let me just say, Mr. Phillips, that George Mitchell, the Majority Leader, had intended to be here and we were not able to be able to tell him when this moment would come, and so he has been on his way at different times and then had to turn back because we were running long. So in any event, he wished to take account of your presence today and to introduce you personally.

Having said that, let me invite you now to proceed with your summary, and we will go to the others. I would like to keep these summaries within 5 minutes in each case, if we can do so.

Thank you.

STATEMENT OF RON PHILLIPS, COASTAL ENTERPRISES, WISCASSET, ME

Mr. PHILLIPS. Thank you, Senator Riegle.

I was hoping Senator Mitchell would come, because he does such a good job talking about CEI that I could have made my remarks really brief.

Senator Riegle and members of the Senate Banking Committee: Thank you for inviting me to testify on the proposed community revitalization system. I am using that term because that is the term developed in a paper written by your staff.

My name is Ron Phillips and I am president and principal founder of Coastal Enterprises, a nonprofit community development corporation located in Wiscasset, ME.

The community revitalization system is a strategic step to accelerate job-creating community development initiatives. It is an investment in America that will grow businesses, create jobs, building housing, and generate assets for low-income and working families. The return on taxpayer investment will multiply and recycle year in and year out.

I encourage your support for and crafting of legislation that is both flexible and inclusive, and that will provide a menu of opportunities for community development banking, credit unions, community development corporations, micro and community loan funds, and small-scale venture capital groups, a network which enthusiastically awaits a resurgence of Federal support for their efforts.

As a practitioner of community development for over 15 years, and board member of the National Congress for Community Economic Development, a 325-member trade association for commu-

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nity development corporations—and I have attached to the written testimony a list of all the members by State of this association.

I want to share briefly with you the legacy of CDC's, CEI accomplishments, and then conclude with some recommendations.

What are CDC's? CDC's originated in the 1960's with the title 7 amendment to the Economic Opportunity Act of 1964 to develop businesses, housing, commercial real estate, and create opportunities for disenfranchised residents of America's distressed urban neighborhoods and rural communities. This amendment was introduced in the U.S. Senate by the late Senators Robert Kennedy and Jacob Javits.

What we contemplate today for a National Community Revitalization System is owed in great part I believe to the accomplishments of CDC's. CDC's are in virtually all States. Their activities are diverse.

They develop and finance day care facilities, community health centers, affordable and supported housing, industrial and business parks, small business incubators and shopping centers. They finance franchises and joint ventures, and provide small-, micro-, and medium-sized loans and venture capital to businesses that cannot secure conventional capital. They are comprehensive and knowledgeable about their communities, create new income and assets for residents, are professionally managed, and leverage funds with the economic mainstream.

CDC's are nontraditional financial intermediaries. They work in partnership with the public sector—Federal, State, and local government—and the private sector—foundations, banks, private business—to attract investment and lending capital to low-income communities.

According to our recent research studies, between 1985 and 1990 alone over 1,100 CDC's across the United States built or rehabilitated 320,000 units of low-income housing, developed over 17.4 million square feet of commercial and industrial space, made over 3,500 business loans, and created or sustained over 90,000 jobs.

Now let me briefly describe CEI as a model rural community development corporation. Maine's is a small business economy with 90 percent of the businesses employing fewer than 20. Yet, Maine has traditionally been at the end of the capital pipeline, ranking among the lowest nationally in bank deposits per capita. It is also among the highest in dependency on transfer payments.

CEI was organized in 1977 to address the capital gaps of small businesses to create income, employment, and ownership opportunities for low-income people. CEI is privately and publicly funded.

We provide financing and technical assistance in development of job-creating value-added natural resource industries, start-up and expanding small manufacturers, microenterprises, women in business, family and center-based child care, and affordable housing.

We link our investments to the hiring of low-income people in our enterprises. We have loaned or invested $20 million, leveraged $60 million in partnership with banks, and created or sustained some 3,500 jobs.

We are an SBA-504 certified lender and operate the SBA's Micro Loan Demonstration in Maine, and the Farmer's Home Intermediary Lending Program. We participate in private founda-

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tion program related investments such as with the Ford Foundation.

What are some examples of CEI projects? We have a growing portfolio financed on the continuum of capital need from less than $5,000 to over $300,000.

Our smallest loan is less than $700 to Sweet Deceptions in Lewiston, a self-employed starting AFDC microentrepreneur producer of sugar-free sweets and baked goods with only a very small amount of sales.

Our largest is over $400,000 to DeLorme Mapping Co., in Freeport, ME, the home of L.L. Bean, in a subordinated debt loan and an equity investment to a producer of advanced technology geographic and recreational maps, with over 100 employees.

The CHAIRMAN. Let me just stop you for a minute, because we are going to run out of time.

Mr. PHILLIPS. Yes.

The CHAIRMAN. It is very important that we get the recommendations, and I know you are coming to that, but if I may I am going to ask you to jump ahead to that and tell us what you think ought to be done here in light of the earlier conversation that would foster and speed up the kind of work that you are doing.

Mr. PHILLIPS. OK. Well, let me do that.

CEI's function is to fill the credit gap, basically. We work closely with banks. We work in partnership with them. We have agreements with them both for guarantees, as well as for making subordinated debt loans. Equity and subordinated debt capital is a key feature of our activities.

We believe that the concept of a community development bank based on the discussion I have heard this morning is very interesting, and is something we are looking at in Maine.

I cannot go into too many details about it, but we think in the life of our institution in Maine this could be a very interesting possibility, and it could be perfected in a way that continues our partnership with banks, which is the second level of approach I take. In other words, if you are going to do a piece of legislation here and establish some funds, I would target them in four areas.

I have listed them in my testimony. One is of course to set up at least a pilot program for doing some community development banking, and to support further development of credit unions, or at least something to get that niche-bank marketing effort going.

The second thing I would do is capitalize existing efforts among CDC's like our organization where we work in partnership with banks. We operate revolving loan funds and equity funds, and we need that kind of infusion of capital from the Federal Government which we can then leverage with the private sector to continue to do our work with banks.

The third thing I would do is set up a program to ensure we can get capital that can be used for equity investments.

Now the SBA has been the traditional Federal agency in the United States that has been working with an equity type program. It has had some difficulty in the past.

There are new initiatives going on there, and it is something that I think we should take a good hard look at as a source of equity capital for venture capital investment.

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The next thing I would do is make sure that there is adequate grant based funding for microloans and community loan funds because this kind of capital is very difficult to raise in the private sector. Small lending is also very labor intensive. It is costly and capital needs to be very flexible.

Let me just try to conclude with this: I would also consider special assistance to nonprofits to form a community development bank or acquire a troubled bank. There may be some opportunities in that area if you can get the FDIC working in tandem with the effort you are making in community development banking.

The last thing I recommend is: It is critical to provide technical assistance and planning grants to enable community organizations to analyze their market and develop a business plan.

The CHAIRMAN. Thank you, very much.

Mr. PHILLIPS. Thank you very much, Mr. Chairman.

The CHAIRMAN. I apologize for the time squeeze. We are all in the same time squeeze together here.

Mr. Jackson, we would like to hear from you now, please.

STATEMENT OF ROBERT JACKSON, TREASURER, QUITMAN COUNTY FEDERAL CREDIT UNION, MARKS, MS

Mr. JACKSON. Thank you, Mr. Chairman.

I am Robert Jackson, treasurer for the Quitman County Federal Credit Union. We are located in Marks, MS, a low-income rural community in the Mississippi Delta, about 80 miles south of Memphis, TN.

I also serve on the board of directors of the National Federation for Community Development Credit Unions, a coalition of credit unions that serve low- and moderate-income communities throughout the United States. The Federation is affiliated with the Credit Union National Association, the national trade organization for credit unions.

Speaking for my small credit union and for the larger credit union movement, I would like to express strong support for the new administration's initiative for expanded community development of financial institution activity. The story I have to tell about the situation in the Mississippi Delta will show very clearly just how urgent our needs are.

Before talking about the particular experiences of my credit union, I would like to say a few words about the national community development credit union movement. Of the 14,000 or so credit unions in the United States, more than 300 serve low-income communities and rural communities, inner-city neighborhoods, and Indian Reservations.

The primary mission of the institution is to provide credit and other financial services to people who are considered unbankable by mainstream financial institutions. The need for credit in these areas is desperate.

One CDCU in central Florida makes loans to migrant farm workers who need second hand trucks in order to commute to work in surrounding counties. Another CDCU in San Francisco has made small loans that allow newly arriving Vietnamese immigrants to continue earning a living as fisherman.

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The Harlem CDCU once lent funds to an entrepreneur who wanted to expand his auto repair business that had been turned down by 10 different banks. In this case, the borrower repaid the credit union loan 3 years early.

In Central Appalachia, a CDCU works with public assistance recipients who want to start their own businesses and get off welfare. The groups efforts were recently described in a front page Wall Street Journal article.

Hispanic and Haitian immigrant farm workers, Vietnamese immigrants, small business owners in Harlem, and welfare mothers in Appalachia are not the kind of lucrative clients that other institutions are looking to serve. Frankly, in my opinion many institutions do not even want those folks coming in the front door because they cannot make a profit serving that kind of clientele.

In Quitman County, our credit union was formed 11 years ago in order to cope with a lack of access to credit. Like many other places in the Mississippi Delta, Quitman County is a place where African-American residents are mired in poverty and trying to cope with the legacy of centuries of economic and political discrimination.

My town, Marks, was one of the key cities of civil rights activity that was visited by Dr. Martin Luther King, Jr., which was highlighted in newspaper publications in the magazine section across the country on Sunday, January 17, 1993. To this day, however, there is persistent rural poverty. Unemployment in the area is 18 to 20 percent in the African-American community, and 9.8 percent overall. The per capita income in the county is $6,450 annually. The per-capital income for African-Americans is lower, $4,133.

Many African-Americans are living in substandard housing without running water. They would like to buy new homes, or repair their old ones, and they would like to start a new business or borrow money to send a child to school.

Until 1977, there was only one bank in the Marks area, and it was owned by a local family that also controlled much of the land and political machinery in the county. Since loans are routinely denied to many poor people, including my parents who were sharecroppers, they did not even bother to go to the local banks.

Out of pure desperation, we organized a grass roots movement for equality that led to the creation of the Quitman County Development Credit Union, that is also a CDC and a member of the National Congress for Community Economic Development, and the Quitman County Federal Credit Union. The credit union has $1,017,000 in assets and serves 850 members and growing. Since the day we were organized, we have lent more than $2,126,000 to local people, most of whom would not have had other access to credit.

To tell you a story about a typical loan that we make to a family that had stayed on the farm, or plantation, all their lives up until 1989, the farmer got sick and could not work on the farm anymore and was asked to move out of the plantation owned house. The family had nowhere to move, no credit history to assume a mortgage, and no breadwinner for the family. The family approached the credit union for a housing loan to purchase a $10,000 house. The credit union made the loan because we knew the family. I am

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happy to say that they have made their monthly payments like clock work.

What would have happened to the family? I am afraid to think what may have happened or transpired if the credit union had not been there. This is not an exception; this is the rule. Families are being displaced from large plantations with nowhere to go, no money to move anywhere else, no sympathy from the landowners, no severance pay, nothing.

I believe that the CDCU's are financial institutions with a conscience and we need more of them. While we have been successful in providing credit to people who would otherwise be shut out of the capital market, there is a great deal more that we would like to do. We are particularly interested in duplicating the successes of the Nation's largest CDCU, the Self-Help Credit Union of North Carolina.

Self-Help has more than $40 million in assets and has extended loans throughout the State of North Carolina. Their success is due in large part to an innovative structure that combines the credit union and a nonprofit development organization. Working together, the two institutions can provide a full spectrum of services needed to further economic development.

We have the same structure in Quitman County. Our credit union provides credit and savings services, while the nonprofit Quitman County Development Organization is able to conduct fund raising and take a larger part in high-risk development projects. All this is done in coordination with each other and other nonprofits in the community.

I am confident that we can grow to Self–Help's size and scope in a safe and sound manner, but that will require relief from current regulations imposed on us by our regulatory agency, the National Credit Union Administration.

We also need more technical assistance from them and a strategic investment of Federal resources. In talking about public investments in CDCU's, an important ratio to keep in mind is 10 to 1.

For every dollar that a CDCU receives in reserve funds, the institution is able to extend $10 in loans for home acquisitions and repairs, small business development, and other purposes.

If credit unions had a $100,000 infusion of equity, I can guarantee you that we would make $1 million worth of loans in Quitman County, MS, the poorest section of the United States.

As you go about the process of creating a community development banking program—and I am confident that you will—there are a few positive steps that you can take to help credit unions like mine and others throughout the United States.

I support the recommendations of the National Federation of Community Development Credit Unions for steps which Congress can take to improve access to credit for consumers and small businesses which are in my written testimony.

In closing, let me again emphasize the importance to easing the current regulations under which we labor. To effectively do our job, we must never be held back by limits of nonmember deposits, and we must have traditional flexibility in making small business loans to our members. Attached is a CUNA position paper on these issues with amendments, which I support.

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This concludes my testimony, and I will be glad to answer any questions.

The CHAIRMAN. Thank you, very much.

That is very helpful, and I appreciate getting that sort of insight with respect to how it is being done through the credit union structure.

Mr. Swack, you have been very patient and I appreciate it, and I am going to ask you if you would summarize as much as you can. We would like to hear from you now.

STATEMENT OF MICHAEL SWACK, CO-DIRECTOR, INSTITUTE FOR COOPERATIVE COMMUNITY DEVELOPMENT, MANCHESTER, NH

Mr. SWACK. OK. Thank you, Mr. Chairman, and committee member.

My name is Michael Swack and I am co-director of the Institute for Cooperative Community Development, which runs the working capital program, microenterprise program, that has extended over 450 business loans in the last couple of years.

But I also come as someone who has a wide range of experiences with community development financial institutions, having worked in them for 14 years, helped start up two community development loan funds, and I am currently chairman of a community development financial institution that is chartered by the State of New Hampshire.

I am here today to speak primarily about microenterprise programs. Microenterprise programs work with entrepreneurial individuals seeking to start or expand small businesses. Microenterprises range from self-employment businesses to businesses employing five people, and typically lend between $250 and $10,000 to help a business operate or expand.

Microenterprise programs represent a community based economic development strategy for business development and job creation among those traditionally left out of the economic mainstream. They provide individuals with the capital and skills they need to turn their businesses or business ideas into reality. The individuals served by microenterprise programs are predominantly women, often people of color, and almost all are welfare recipients, unemployed, or working poor.

The creation of small businesses is just one goal of microenterprise programs. They are also designed to increase income, stabilize families, raise self-esteem and self-confidence, develop skills, create role models and spark a process of community renewal.

Over 150 microenterprise development programs are represented nationally by the Association for Enterprise Opportunity in Chicago, which also houses one of the more successful microenterprise programs, the Women's Self-Employment Project.

Senator Moseley-Braun, I was told to make sure I mentioned that, if you were here.

[Laughter.]

Senator MOSELEY-BRAUN. Good.

Mr. SWACK. Many microenterprise programs include loan funds, or offer financial services in partnerships with local banks or credit unions, but microenterprises face many barriers. The loan sizes re-

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quired by microenterprises are typically too small to be considered by traditional financial intermediaries. The cost of transacting such loans is unprofitable for these intermediaries. Additionally, the borrowers are considered to be too risky. They do not have equity to put into the business. They have very little collateral, and they do not have histories of running profitable businesses.

Although these loans are considered too risky by traditional intermediaries, many community based organizations have successfully loaned to microenterprises.

My own organization, the Institute for Cooperative Community Development, has run a program called Working Capital, for the past 2 years. We have made close to 450 loans utilizing a model of lending called peer lending, a model utilized extensively overseas in places like Bangladesh and throughout Latin America. In this model, people join borrowing groups. Members start out by borrowing small amounts of money for their businesses, and incrementally are able to borrow more.

We have enjoyed close to a 97 percent repayment rate over the life of the program. In addition to providing capital, many microenterprise programs provide training, technical assistance, and in some cases support services such as child care and transportation to borrowers.

The provision of these nonfee-generating services combined with the small loan sizes means that microenterprise programs are typically not able to support themselves on fee and interest income alone.

Although it is not within the purview of this committee, it is important to note that microenterprise programs face barriers other than the barrier of access to capital.

For microenterprise programs to succeed, the Government must eliminate barriers and penalties for transfer payments and public assistance recipients who pursue self-employment. They are currently penalized.

We need to allow AFDC recipients to accumulate business assets and deduct business related expenses in calculating that income. We need to change unemployment insurance laws to exempt recipients from looking for work while they are starting a business, and we need to change public housing rent provisions to minimize increases for residents generating wage or self-employment income.

Any legislative initiative to create community development financial institutions we believe needs to explicitly recognize and encourage microenterprise lending, whether through microenterprise loan funds or other community based intermediaries.

An investment of Federal funds into microenterprise funds could be done in a variety of ways. Our Working Capital Program has worked out a unique arrangement with three different banks in New England whereby we have access to bank lines of credit for microenterprise lending. In exchange for access to this credit, we establish small loan loss reserves at the bank. A small investment into loan loss reserves currently made by foundations has enabled us to leverage substantial amounts of credit from banks for microenterprises.

A legislative initiative that supports investment in microenterprise funds in training and technical assistance to borrowers we be-

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lieve could greatly enhance the viability and success of these programs.

Finally, as someone who has been an active participant in community investment for 14 years with a variety of institutions, I have four specific recommendations that do not apply only to microenterprise, and many of them were touched on this morning:

First, a wide range of community development financial institutions, including community development banks, credit unions, loan funds, and microenterprise funds should be eligible to receive investment from a Federal initiative for community development financial institutions. However, any institution receiving investment from a Federal initiative should specify how they will help achieve goals of community development and investment.

Community investment means more than simply investing money in a particular geographic place. A successful program of community investment has succeeded in many places in creating those community organizations which then go out and build housing and create jobs.

We have found with the New Hampshire Community Loan Fund, of which I am a founder, that our simple existence has created many community organizations that never would have existed because they now know they can access credit. They have gone out and built housing and developed jobs.

A key in community development finance, and you have heard this quite a bit, but this is a slight variation on it, is the need for equity investment. A Federal initiative should provide equity or permanent capital to community development institutions, but also allow them to invest equity in community housing and economic development ventures.

Traditional loan products are simply not sufficient to meet community capital needs. My experience as chairman of the New Hampshire Community Development Finance Authority, a quasi-public agency, has demonstrated how critical equity is to the success of projects.

Through equity investments—and we do not actually own these businesses; we do it through preferred shares, or getting a share of net operating income—we are able to invest the kind of money that then leverages private money.

There is not a single deal that we have been involved in—and in the past year we have made about $3.5 million worth of equity investments, that would have gone ahead if we were not able to put equity into the project.

Allowing community development financial institutions to invest equity is a way of getting greater participation of private financial institutions. Equity investment improves the capital structure of the venture. It leverages private debt. And most importantly, it enhances the probability of financial success of the venture itself.

The CDFA also encourages—and in fact is completely funded through private investment. I think it is something worth looking into in response to a question Senator D'Amato asked.

The State of New Hampshire provides a tax credit against a business's business-profit tax to commit funds to this General Venture Fund. The CDFA then uses these funds to make equity and debt investments into community based housing and economic de-

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velopment projects. That is, the legislation specifically directs that it must go into community based housing and economic development projects.

Federal legislation should include mechanisms that encourage private sector investment into community development financial institutions. Finally, the Federal initiative, we believe, must promote the development of secondary market mechanisms to support the growth and liquidity of community development financial institutions.

One of the things that we have really had problems with is, we have made these loans, but since they are non-standard underwriting criteria, we are often unable to place these loans. So we have demands on our money. I know we could make a lot more loans.

We often come to the table where we say, well, we are having requests for about $1 million of loans. We have only $200,000 we can make right now.

If we are able to package these nonstandard ones that we seasoned, that we can provide credit enhancements for, to either institutions like existing banks or through Government Sponsored Entities like Ginnie Mae and Freddie Mac, I believe that would greatly enhance our ability to increase the flow of capital to these communities.

Finally, I believe that we do have the expertise here that has been mentioned several times. It is not just the South Shore Bank. There is a lot of expertise. There are probably 500 institutions represented by the various groups here that are involved in this. That experience has been gained over the 15 years.

We have a track record that we invite you to look at in terms of loan losses and money placed that we think compares favorably to any traditional financial intermediary. So in the focus this morning and concern on South Shore Bank, it is important to expand that to say that, although it is still a fairly narrow level of expertise, it goes far beyond one institution.

Thank you for allowing me to speak.

The CHAIRMAN. Well, I appreciate that. I appreciate your point, and that is why we have asked you to be here, to both make that point and to draw on that level of knowledge and differentiation.

I am going to submit to you some questions that I will have on behalf of the committee and on behalf of other committee members to respond to for the record.

I am going to give the gavel here to Senator Moseley-Braun for her questions, and she will take you on through the remainder of our hearing today.

I want to thank you for your participation, and again thank you for your patience. It is frustrating for all of us when we set our time schedule and events over which we have no control intervene, but that is the nature of your life much of the time, and it is the nature of our life here all the time. So, Senator Moseley-Braun.

Senator MOSELEY-BRAUN [presiding]. Thank you, very much.

Mr. Swack, I have a question with regard specifically to the microloan funds and the enterprise development that you were testifying about. One of the distinguishing characteristics about the South Shore experience was that it integrated the banking and financial services with technical development and, if you will, human

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resources development, and helped people get around to navigate other kinds of issues that were not purely financial or credit related.

To what extent—you mentioned in your testimony the need for welfare reform, to recognize this as an area, and public housing authorities, to recognize this—to what extent do you provide technical assistance, human resource development assistance to people as a part of the loan strategy, or the community development strategy?

Mr. SWACK. There is a wide variation among microenterprise programs. In some of the programs it is very, very extensive. That is, the human development element is in fact one of the most, if not the most important element, and the way success is measured in these programs often is not simply has a person gone on and created a job.

That is, if you have gone through a training program in business development, some people may start a business, but if you go back and you say has the program been successful a couple of years later, you may say, well, what if the person does not have a business that employs him full time? But what if instead they found permanent employment in the work force? Is that not also a successful outcome? So there are different ways that microenterprise programs measure them.

Certainly for many microenterprise programs the training component in business development, developing cash-flow statements, identifying a potential market, writing a business plan, getting access to capital, are key in terms of the success of the business owners themselves.

Senator MOSELEY-BRAUN. Again I guess the question—and that is part of what I wanted to hear you say to me this afternoon, but I guess the second part of the question is: To what extent do you help people after the loans are made to continue to do what it is they have to do? I mean, a lot of time it is a lack of accounting experience or expertise. A lot of time people just do not know what the rules are and what the expectations are.

Mr. SWACK. Let me talk about our Working Capital Program in particular.

Working Capital requires people to stay in peer groups after they get the loan. That is, we do not forget about them afterwards. And in fact, one of the elements of the model is technical assistance, rather than being loaded all up front, what we will typically do is go through a very short training period with the borrower, get them a small amount of credit—everybody starts with $500 quickly—and begin to identify the different technical assistance needs that can be provided to those groups on an ongoing basis.

There is learning on the job while they are starting their businesses. The peer groups are the agent through which we are able to provide a lot of technical assistance, and we work through community groups, community enterprise agents throughout the region.

That is, we have a central program that only employs a couple of people. Then we contract with community groups to organize these peer groups. The enterprise agents are also responsible for coordination of technical assistance that we can provide.

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It is very important that it is on an ongoing basis both through the peer group assistance they give each other, as well as assistance we offer in how to do marketing, how to set up books, how to get to the next level. So it is an ongoing process of technical assistance provision.

Senator MOSELEY-BRAUN. Mr. Phillips.

Mr. PHILLIPS. Yes. May I respond to that? We help a lot in that area. About a third of our effort at Coastal Enterprises is in technical assistance both before a loan and after a loan, and in fact, also in other than lending relationships. We operate a counseling program and have three full-time business counselors that have counselled some 4,000 businesses over the past 5 or 6 years.

So it is a very, very active program, and they have also facilitated those small businesses—which average about 2.5 people in employment—to get bank loans not just loans from our flexible revolving loan fund. They have managed to facilitate some $10 million of financing just through the technical relationship of working with clients on all those issues you are talking about, from clinics and workshops, taxes, accounting, to one-on-one counseling, marketing, and so forth.

A second area, which is a very exciting area and is what the group in Chicago does, too—and I hope you will visit them sometime—is a very specialized, customized program to help AFDC recipients gain access to self-employment.

They participate in a much more intensive and even peer support type of training program. We are working with about 170 in a 3-year program in rural communities and some small urban communities in Maine to deal with the opportunities of transitioning AFDC recipients from welfare to work through the self-employment process.

Participants go through a very rigid business planning type of development, understanding how to put a plan together, very small step loans, and working alongside our loan staff as well as counselors to then break into a more independent business of activity.

So it is a very, very busy area for us, and for a lot of our peers throughout the country.

Senator MOSELEY-BRAUN. What has been your experience with that effort? Do you receive State and local support for that?

Mr. PHILLIPS. We have a special Federal grant. It is money given to us to create a pool of capital to support both the technical assistance side, as well as the softer loan side of the equation.

Senator MOSELEY-BRAUN. A Federal grant from where?

Mr. PHILLIPS. From the Department of Health and Human Services, Office of Community Services.

Senator MOSELEY-BRAUN. And State and local?

Mr. PHILLIPS. The State Department of Human Services—we have a $1 billion budget deficit, by the way, in Maine.

Senator MOSELEY-BRAUN. One billion dollars?

Mr. PHILLIPS. A $1 billion. It is a very difficult time there. So they are struggling, but they are putting some money into the program. They also complement the program with various supports to the participants in child care, transportation, and that sort of thing.

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We have a nonfinancial agreement with them, basically. We have to have an agreement with them to work in tandem with this program. It is a very interesting relationship and it is one that we need to keep encouraging both at the Federal level, which actually requires it, but as well at the local level.

Yes?

Senator MOSELEY-BRAUN. I am sorry, Mr. Phillips? Your State has a $1 billion deficit, not Coastal Enterprises?

[Laughter.]

Mr. PHILLIPS. We are actually quite solvent.

Senator MOSELEY-BRAUN. OK. I was just trying to help out there.

Mr. PHILLIPS. No, we have a healthy fund balance.

Senator MOSELEY-BRAUN. So the State Department of——

Mr. PHILLIPS. Human Services.

Senator MOSELEY-BRAUN [continuing]. Human Services is also involved——

Mr. PHILLIPS. Yes, as a partner.

Senator MOSELEY-BRAUN. Is there other local participation?

Mr. PHILLIPS. There is an employment training program in the area that handles the Department of Labor funds.

Senator MOSELEY-BRAUN. I hope I am not asking redundant questions now. I think everybody knows I had to go——

Mr. PHILLIPS. I mean, all these programs work in coalitions and partnerships. The name of the game is partnership. Everybody does a piece, and maybe we will get something done.

Senator MOSELEY-BRAUN. Now what is your public-private funding mix?

Mr. PHILLIPS. We have about a third of our funds from private foundations. Largely the balance, maybe shy of 10 percent, from the Federal Government. The State government has put some money in.

Senator MOSELEY-BRAUN. OK, so the bulk is Federal, some State, a tenth of the Federal—of the two-thirds public money and a third private.

Mr. PHILLIPS. Basically, yes.

Senator MOSELEY-BRAUN. And in terms of your loan experience, what has been your experience?

Mr. PHILLIPS. That is the anchor of our program. We do financing, technical assistance, and development work. We have done 300 business projects over the past 8 or so years. We have put out $20 million of our money.

The key thing here is we have leveraged another $60 million of primarily bank financing. That is our partnership with the banks.

So in effect we are bringing them into the kinds of projects and sectors that are vital to Maine economic development, from the very small microenterprises, to some very important other sectors.

We have done a lot of child care development in Maine, both small family day care loans as well as larger facilities, such as Head Start/Child Care wrap-around facilities. We just participated in a Head Start Project in Rockland, ME which was about $380,000. We also had the bank as part of that, and the Farmer's Home. We also raised private money locally. So it is a real party.

Senator MOSELEY-BRAUN. To what extent—and this will be my last question—to what extent have you been able to establish con-

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tinuing relationships or communication with the major, large financial institutions in the community? And if you have established that, in what form does it take? Do you have regular meetings with them? How did you get their attention?

Mr. PHILLIPS. I am glad you asked that, because I think that is vital to our work. We cannot work without the banks. No. 1, we are co-lenders. We work in a subordinated debt relationship. No. 2, we have three bankers on our board, Fleet Bank, Key Bank, and Casco Bank, which is owned by the Bank of Boston.

We have a network with banks, and have deposits with banks, and link our projects and relationships with them. We also get money from them. They donate money to us particularly for our technical assistance programs because we are basically helping to make projects bankable, and there are new prospects, new borrowers for them. Also some of the banks have been working on very direct TA programs and mentoring type programs, and we have given them some advice on how to internally develop better ways to interact with their markets. So they are a vital part of our operation. Does that answer your question?

Senator MOSELEY-BRAUN. But how do you interface with them?

Mr. PHILLIPS. Well, I had an example of a company we financed in Westbrook, ME, which is Moulded Fibre. It takes recycled paper and processes it into a fiber product that can be molded to any particular shape. It replaces styrofoam as a packaging material.

Senator Gore visited that company before the election, and he was using that as an example of a job creating environmental company.

That was a $1 million start-up project. They hired AFDC people, and people with disabilities. They employ about 44 now. We got the bank involved—it happened to be Fleet Bank, with a percentage of the financing.

We had to provide the equity and subordinated debt financing to make that happen. So in financing a project, we bring the bank in and we provide the more flexible subordinated capital. Am I answering your question?

Senator MOSELEY-BRAUN. Maybe I am not asking the question right. Your relationships with the majority banks, is it just a matter of informal relationships? Or is there something more structured, something more formal, something that is institutionalized that allows you to have regular interactions with the majority banks?

Mr. PHILLIPS. Well, a lot of things happen in rural communities more informally than formally as a network, and one way of expressing oneself institutionally is the informal network.

We do have standing agreements, written, signed agreements, however, with seven banks that reflect the fact that we are going to deposit money in the bank, say up to $100,000, and in turn the bank will both interact with us by way of referring projects, or work with us on financing a project that it may not be able to do on its own.

We still have to review the business, but the relationship triggers that process. Those funds can also serve to guarantee a portion of the bank loan. So that is a more formal part of that.

Senator MOSELEY-BRAUN. Thank you.

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Mr. Nowack.

STATEMENT OF JEREMY NOWACK

Mr. NOWACK. Just to build on that, many of our relationships with banks, or relationships where the banks invest in us directly, but in the last few years we have structured a formal participation pool with banks where banks buy into participation pools in areas that we manage where they commit a certain amount of money based on some agreed upon underwriting criteria that we work out together.

We process the loans and put the loans on, and then we monitor and service the loans. So we become a wholesaler for those banks. That has happened particularly—and it has happened with the largest banks in the Philadelphia region. It has happened particularly in parts of north Philadelphia and Camden where they have been most resistant to credit provision.

So banks have seen us as kind of a wholesaling arm for them, and we have seen in the banks a form of credit, obviously. But we have bought also with our own loan fund, our own $10 million loan fund, we have bought 10 percent of each one of those credits for the banks.

Senator MOSELEY-BRAUN. Would you send to us something in writing on that situation?

Mr. NOWACK. Absolutely. And if I could just say one very brief word, so much of the conversation earlier today was around this almost either/or issue of CRA and banks. I think that most of our experience is that you cannot look at it as an either/or question.

The way that you build community development financial institutions in part is by getting banks to meet CRA regulatory requirements. And a significant way to meet CRA regulatory requirements, but not the only way to meet CRA regulatory requirements, is to work with institutions like ours, and I think that is an important point.

Senator MOSELEY-BRAUN. I think one of the things we are looking at is to the extent that we can make CRA more of a carrot and stick than it is currently.

Mr. NOWACK. Right.

Senator MOSELEY-BRAUN. And so everybody is really groping for directions and answers in that regard, and I think it will be on a bipartisan basis. So we really appreciate your contribution to helping us find some answers in that area.

I want to thank all of you: Mr. Jackson, Mr. Phillips, Mr. Swack, and Mr. Nowack, for your testimony.

The vote bell has already rung, so the members have to go off and vote. As you know, I am now standing in for Mr. Riegle, but I want to thank you for your contributions to this hearing to this important area.

I am confident that the chairman will follow up and will continue in this area, and we are certainly open to any further submissions that you might have, or information, or assistance that you can give the committee.

So, ladies and gentlemen, thank you very much. This meeting is recessed to the Call of the Chair.

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[Whereupon, at 2:05 p.m., the committee was recessed, subject to the Call of the Chair.]

[Prepared statements and additional material supplied for the record follow:]

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PREPARED STATEMENT OF SENATOR RICHARD H. BRYAN

Mr. Chairman, I commend you for holding this hearing today to provide an overview of community development banks and to familiarize the Committee with the operations of the four existing community development banks. As we know, President Clinton has proposed a network of community development banks as part of his urban policy, this hearing will give us all an opportunity to become acquainted with this private sector initiative.

Many of our urban and rural areas are severely distressed with a multitude of problems: homelessness, crime, unemployment, and hopelessness. These are the many faces of decline. We must not allow our cities and towns to languish, we must address these needs and find ways to revitalize our communities. However, we are hampered in our efforts by our growing deficit and the decreased ability of the Federal Government to finance new programs.

The success of these community development banks shows that solutions do exist using private sector capital with some incentives from the Federal Government. The availability of capital in these communities means the residents will have the possibility of establishing new businesses, building affordable housing, and putting resources back in the neighborhoods—in other words creating jobs.

I am anxious to hear from our witnesses today about how they have achieved their great success and their suggestions about how the Federal Government can help make this network of community development banks a reality.

PREPARED STATEMENT OF SENATOR CAROL MOSELEY-BRAUN

Mr. Chairman, the subject before us this morning is extremely important to low- and moderate-income communities around my State and across the Nation. Community development banking must be a real priority for this committee. I therefore want to congratulate you, Mr. Chairman, for calling this hearing so promptly.

At the outset, I want to take special note of one of our witnesses. Milton Davis of the South Shore Bank is a constituent of mine. He is a banker who has really made a difference to his community. You don't have to do anything more than walk up and down the streets in the neighborhoods where South Shore lends to see the dramatic difference he and his institution have made.

We in Illinois are very proud of South Shore Bank. It is a bank with a national reputation, and it is a reputation that is fully deserved.

There are a lot of questions regarding community development banking that must be addressed. Today's witnesses, however, by their very presence, point out an important policy objective for any community development banking proposal this committee considers. That is, it must be flexible; it must permit multiple approaches to community development that takes local community needs carefully into account.

We need institutions that can make loans, use loans to leverage additional financing from more traditional financial institutions, make equity investments when that is called for, make micro-loans that can make such a difference to individuals and their neighborhoods, and undertake the full range of community development financial needs. Not every institution can or should necessarily do all of these things, but any Federal approach must allow the kind of institutional flexibility that permits communities to move forward with approaches that meet their own special needs.

I look forward to hearing from all of the witnesses here today. They bring a variety of experiences to bear on community development issues. They can tell us about a variety of approaches that have worked in communities across this Nation. I know their testimony will be of great help to us as we work with the administration to meet community development needs.

PREPARED STATEMENT OF SENATOR GEORGE J. MITCHELL

Mr. Chairman, I'm pleased to be here today to introduce Ron Phillips, the founder and President of Coastal Enterprises Inc. (CEI), a non-profit community development corporation based in Wiscasset, Maine.

Coastal Enterprises has been a leader in small business lending in my State and has mobilized over $60 million to support a variety of manufacturing, child care, natural resource, and microenterprise development projects in Maine. CEI specifically targets assistance to low-income people, women, and people with disabilities.

As an original cosponsor of the Micro Lending Demonstration Act, I have worked closely with CEI on issues related to small business credit. I can affirm that under Ron's leadership, CEI has established a strong record of achievement in bringing financial and technical resources to Maine businesses through partnerships with banks, public and private agencies and community organizations.

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I commend Ron for his dedication to this program, and I applaud him for all he has accomplished for the people of my State. He is a recognized leader in the field of community development corporation lending, and I'm sure that based on his extensive experience he will bring valuable insights to the hearing you are holding today.

I congratulate you, Mr. Chairman, for holding this hearing. So many communities, both urban and rural, are desperately in need of credit and investment policies that will stimulate growth and create new jobs.

President Clinton drew attention to the need to create a network of community development banks to encourage investment and opportunity in distressed areas. I hope the hearing you are holding today on development initiatives will focus attention on the diverse network of community-based lenders that already exist.

Development banks have made a tremendous contribution to their communities, but I am sure they would be the first to admit that they are not alone in their mission. Many other community-based organizations, like CDC's, perform the same functions and pursue the same goals as development banks. They may work cooperatively with development banks, as well as conventional banks, to achieve their purpose: To provide financing that is vital to stimulating economic growth in disinvested communities.

I believe a wide array of community based lenders, and CDC's in particular, should be integral part of any strategies or programs implemented to rebuild our troubled communities. As you examine the issues related to invigorating community development lending in our country, please look at and learn from what already successfully exists, as well as what we can build for the future.

Thank you for the opportunity to introduce Ron Phillips, and I assure you I look forward to working with you, Mr. Chairman, and the rest of the committee on developing these initiatives.

TESTIMONY OF MILTON O. DAVIS, CHAIRMAN, SOUTH SHORE BANK OF CHICAGO

FEBRUARY 3, 1993

Honorable Chairman and Members of the Committee: Thank you for inviting me to make recommendations about the creation of community development banking institutions. I assume that it symbolizes a marked national increase in interest in institutions that can react effectively to investment opportunities in the Nation's troubled urban neighborhoods and small towns.

The invitation requested information about the history, structure, experience, impact and lessons of the bank holding company that my colleagues and I founded on the south side of Chicago in 1973. I have been asked by a sister institution, Southern Development Bancorporation in Arkansas, to convey its experience as a development bank holding company which serves small towns in rural southern Arkansas. Finally, Shorebank and Southern would like to offer some principles that could guide Federal assistance to the creation of such institutions in other places.

Shorebank is a comprehensive community development institution: the "need" it aspires to address is development of disinvested communities, but not exclusively credit needs. Indeed, a salient lesson of our experience is that community development requires more than credit, and delivering credit successfully requires more than a bank.

For this reason, it may be most helpful to understand Shorebank by focusing first on the concept of community development banking and the resulting institutional prerequisites. Within this context, I will describe the experience and lessons of Shorebank and Southern to date.

I. RENEWING COMMUNITY ECONOMIES: THE CONCEPT OF DEVELOPMENT BANKING

The failure of the local economy—particularly of its markets and market driven investments—ranks high among the many causes of decline in urban communities. In deteriorating communities, capital flows out of the area; people cease upgrading their homes and landlords fail to maintain their buildings; property values fall; store owners quit investing in their businesses and close or move; community residents lose hope, stop investing effort in education and work skills, and fall into unemployment. In declining small towns, patterns are similar and, in addition, residents rely more on absentee-owned large corporations than locally owned small firms for employment and entrepreneurial opportunities due to weaker links between residents and business markets and financing. Revitalizing such communities requires recognition that disinvestment is itself a market phenomenon and, consequently, will only be reversed by fundamentally reinvigorating local markets. Per-

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manent, self-sustaining community renewal results from creating an environment where private investors inside and outside the community are confident their investments will be rewarded as healthy community dynamics are restored.

A few key observations concerning this process of community renewal and investment underlie the concept of development banking:

- Many persons in economically distressed communities desire to improve their own life conditions and, although they may lack conventional credit histories, **many ordinary residents are fundamentally credit-worthy.** Local residents will invest time and money to improve their community when they are confident about its future.
- Local development capacity, be it in the form of "ma-pa" entrepreneurial rehabbers, fledgling business entrepreneurs, or community development corporations, needs to be supported in a disciplined, business-like fashion. **Positive community development is a long term partnership between residents who care about their communities and financial institutions with similar motivations.**
- **Market forces can be restored in under-invested communities if the level of institutional capability is sufficient for the task at hand,** and if redevelopment is targeted to clearly identified geographical areas with the potential for renewal.
- **Targeting allows an institution to develop the necessary specialized market expertise,** and assures that investment will be concentrated in order to create the critical mass of activity which shifts resident and investor perceptions and reestablishes healthy functioning markets.
- **By using an array of banking, real estate, venture capital, technical assistance, human resource and other tools tailored to particular community needs, a community development banking institution enhances its market knowledge and impact, controls risk, and undertakes complementary activities which create a positive, safer environment for private investment.**

Sustained economic development occurs when local residents invest their savings and talent. The clearest indicator of a permanent community renewal process is active investment by private and institutional investors who believe that an identity exists between their self-interest and that of the current residents. Deliberately accelerating local economic activity requires releasing this local energy by providing access to capital, credit, technical assistance and market information; and by supporting an entrepreneurial culture that values risk-taking, business discipline and self-reliance. In particularly distressed, disinvested communities, external resources must be attracted to leverage the limited local capacity and allow provision of the necessary credit and capital. Ultimately, development banking seeks to restore healthy market forces by attracting and combining the resources necessary to building a critical mass of permanent development activities sufficient to restore investor confidence in the community.

Institutional Implications: Characteristics of a Community Development Bank. The term "community development banking" means different things to different people in the community development finance field. My colleagues and I believe that a community development bank is a bank holding company with a specialized structure which is organized to transform the market dynamics of a geographical target area. This structure, including a bank and community development subsidiaries, has a number of attributes which make it particularly well suited to promote the revitalization of distressed communities.

- **As a fully regulated, large scale institution, a bank is known, trusted, legitimate, well-capitalized and self-sustaining.**
- **A bank possesses unusual capacity to be continuously knowledgeable about the neighborhood economy.**
- **A bank can convert ordinary bank deposits into development loans. This availability of credit committed to the community can precipitate the release of local energies, inducing residents to risk their own savings and become personal stakeholders in the future of their community.**

A bank alone, however, cannot accomplish these objectives in the context of distressed communities with dysfunctional markets. A community development bank is designed to be a comprehensive community development institution which, in addition to a bank, includes other development subsidiaries and affiliates that complement the investment activities of the bank. These subsidiaries and affiliates enable a development bank to successfully manage what would otherwise be higher risk investments; to more aggressively identify and better evaluate opportunities and initiate development activities; and to address multiple dimensions of community renewal, ranging from developing retail shopping centers to upgrading labor

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force skills. Through its non-bank development affiliates, the institution can invest equity capital in businesses owned by others, rehabilitate and construct residential and commercial real estate, operate social development and business technical assistance programs, attract other private and public investors, and generally link residents, financial resources and government programs into a coherent renewal effort.

A community development bank is further distinguished from conventional banks by its specialized commitment to the revitalization of a targeted area for the benefit of current residents. Through its leadership, ownership and governance structure, the development bank makes its mission the long-term development of a community. It measures its success in terms of the development impacts it has on that community. It becomes a permanent institution whose success is joined with the improvement of the community. In order to accomplish its mission, the development bank's leadership and staff must bring together highly localized knowledge of the community, technical banking skills, and a broad understanding of the strategies and process of economic development.

Thus, a development bank combines the structure and expertise of a for-profit financial institution with the commitment to place one normally sees in community-based non-profit organizations. By developing specialized expertise in carefully targeted areas, and achieving synergies through comprehensive coordinated interventions, a development bank is able to manage the tensions between the goals of profitability and community development impact, making development profitable. Profitability is an essential feature of a development bank. Profits enable the bank to be self-sustaining and to grow and assure that continuing business discipline will be brought to the task. However, while profitability is essential, the purpose of a development bank is not to maximize profits, but to help effect lasting community renewal.

A development bank also combines the qualities of a community based, market driven, private institution with unusual scale, expertise and ability to leverage resources. A development bank is a uniquely capable delivery agent for external public and private resources. Many private and government programs are not fully available in the communities for which they are intended because of the lack of sophisticated, market based delivery systems. A development bank uses foundation investments and grants, Federal loan guarantees, secondary markets, low-income housing tax credits, JTPA and numerous other programs to accomplish common objectives. A development bank can be considered a "handyman" of sorts, intimately familiar with particular local problems, equipped with a "toolbox" of varied government and private "tools" to address them, and possessing the expertise to select and productively use the appropriate tool.

Finally, a development bank can be flexible and innovative. Location dictates strategy and design: the organizational structure and the strategies or tools it employs can be adapted to a wide range of circumstances. Thus, whether a bank or other kind of large scale, regulated depository institution is most appropriate, and what affiliated activities are needed, will vary from community to community. For example, Southern Development Bancorporation uses a different array of affiliates than Shorebank as it has been designed to specialize in business and rural development rather than urban community reinvestment. (See organizational chart.)

II. Shorebank Corporation: History, Structure, and Impact

The South Shore community where I reside was 100 percent white in 1960 and 70 percent black in 1970. By 1972, little credit was being extended in the community despite excellent housing and amenities; the neighborhood is on Lake Michigan and a 15 minute drive from downtown. South Shore Bank, its largest bank, assumed that the inevitable economic decline that accompanies racial change would occur in its market and sought regulatory permission to move downtown.

During the late 1960's, an interracial group of bankers—Jim Retcher, Ron Grzywinski, Mary Houghton, and myself—had begun a successful minority small business loan program at the nearby Hyde Park Bank and Trust Company in the University of Chicago neighborhood. The program out-performed similar large bank programs, according to a Yale Law Review article at the time. We began exploring the potential of additional private sector approaches to urban problems, including a carefully structured bank holding company as a vehicle for reversing the downward spiral of deterioration that accompanied racial change. In 1972, The Federal Reserve Board stated that bank holding companies: *"possess a unique combination of financial and managerial resources making them particularly suited for a meaningful and substantial role in remedying our social ills."*

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Fed regulations under the Bank Holding Company Act explicitly permit bank holding companies to make equity and debt investments in corporations or projects designed primarily to promote community welfare.

Backed by patient, primarily institutional, investors who shared our community development goals, we formed the Illinois Neighborhood Development Corporation (now called Shorebank Corporation) to be a one-bank holding company and in 1973 purchased the South Shore Bank. In 1978, we raised additional capital to create two additional for-profit subsidiaries and one nonprofit affiliate. This was the first attempt to use a banking enterprise as the core of a comprehensive development institution for revitalizing an economically distressed, inner-city neighborhood. The Corporation's principal subsidiary, The South Shore Bank of Chicago, is a commercial bank chartered by the State of Illinois and regulated by the Federal Deposit Insurance Corporation. The other subsidiaries and affiliate active in its targeted communities in Chicago include:

- City Lands Corporation (CLC): a for-profit real estate development company engaged in multi-family housing and commercial real estate development.
- The Neighborhood Fund (TNF): a for-profit venture capital company licensed by the U.S. Small Business Administration as a MESBIC.
- The Neighborhood Institute (TNI): a 501(c)(3) non-profit community development corporation engaged in labor force development (job training, job placement, educational remediation, self-employment support), cooperative, rental and ownership low-income housing development, cultural and civic activities.

The Bank and these three affiliates operate in concert in targeted communities in Chicago. (In 1986, Shorebank targeted a second community—Austin, on the west side of Chicago—opening a branch of the bank and focusing CLC, TNI and TNF activities there. Austin also has good housing stock and locational advantages, but has suffered from 20 years of disinvestment.)

The non-bank affiliates can take greater initiatives than the bank. They take the first steps to change the market. Thus, for example, the real estate subsidiary will initiate large scale, visible and attractive housing-rehabilitation projects requiring more complex development and financing, generally including several layers of public subsidy. The dozens of local, entrepreneurial real estate borrowers which the bank has cultivated can then follow wide multiple smaller scale private rehabilitations in the same area, knowing that these investments reinforce each other's viability. Similarly, Shorebank's real estate subsidiary developed a major shopping center, attracted a major grocery anchor tenant and leases space to minority owned businesses supported by the venture fund and/or bank; our non-profit affiliate placed several hundred residents in jobs created by the anchor tenant.

After twenty years, including a difficult start-up period and the challenging learning curve of a new type of institution, Shorebank has achieved considerable success. Through December 31, 1992,[1] Shorebank has made development investments totaling $351 million in its targeted Chicago neighborhoods. In 1992 alone, over $41 million was invested in Chicago development loans and other projects. As a result of its efforts, through the end of 1991, Shorebank had financed or leveraged the renovation of some 7,716 residential rental units in South Shore alone, almost 30 percent of all such units in the community. In both South Shore and Austin, local black rehabbers are transforming the neighborhood, building by building. About 100 rental buildings, with 6–36 units, are improved each year. Charts reflecting annual and cumulative development achievement are attached. Not shown in the attachments are the non-financial community development achievements: for example, TNI manages three small business incubators; and, in 1991, TNI placed 380 residents in private sector jobs.

Equally important, Shorebank has been financially successful. The bank performs at levels comparable to its peer group banks, and the holding company has been profitable in every year since 1983. As of December 31, 1992, Shorebank assets had reached $244 million and stockholders' equity stood at $17 million; South Shore Bank assets were $229.1 million, with equity of $14.2 million. 1992 bank net income was $2.2 million, constituting a 15.3 percent return on equity and a 1 percent return on assets. For the last ten years, the compounded annual growth rate in the book value of common shares of the holding company has been 16.6 percent. Substantial additional detail is provided in the attached charts.

In the last five years, Shorebank added three additional subsidiaries and affiliates to manage expansion activities. They are Shorebank Advisory Services, a for-profit consulting firm providing comprehensive advisory services on community economic development; North Coast BIDCO, a for-profit small business investment company regulated by the State of Michigan; and NEICorp., a 501(c)(3) non-profit organiza-

[1] 1992 numbers are estimated; final numbers are not yet available.

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tion which supports small business development in the Upper Peninsula of Michigan. A current organizational chart for Shorebank is attached.

Southern Development Bancorporation in Arkansas was formed with Shorebank assistance in 1988. It targets small towns in southern Arkansas from offices in Arkadelphia and Pine Bluff. Its mission is to channel appropriate financial and information services to local entrepreneurs so that small town residents can build thriving, diversified economies and be independent of the decision-making processes of large, distant corporate headquarters (who previously moved low value-added branch plants in and out of their towns). In 1992, Southern invested $9 million, bringing cumulative investment to $19 million (for 74 firms, 27 farms, 79 self-employed residents, and seven real estate projects).

In addition, Shorebank assisted in structuring the recapitalization of the Douglass Bank, a minority-owned bank in Kansas City, Kansas, and continues to assist it through a five year advisory contract. Finally, through the Polish American Enterprise Fund, Shorebank helped create and run a small business loan program in Poland.

Shorebank Advisory Services is currently working with about a dozen credible organizations from throughout the country which are in varying stages of seriously exploring establishment of development banks, and presumably there are many others. In every instance, particular local needs and capacities dictate an adaptation of the institutional design. The general principles—that a flexible, private, market-driven bank holding company committed to community development as a business, intimately familiar with targeted local markets and achieving synergies through reinforcing affiliated non-bank activities, can contribute to restoring community economies—appear to be applicable elsewhere. Shorebank's own experience in Arkansas and Michigan supports this.

Nevertheless, development banks are only one model, are neither necessary nor appropriate in many communities, and are far from a panacea. Other existing models and programs, often complementary or addressing other equally important markets and needs, similarly deserve support. Such programs include community development loan funds, community credit unions, micro-lending programs, and community development corporations.

Policy and Legislative Implications

The expanding—and welcome—discussions concerning community development banking involve institutions engaged in a wide range of activities, from conventional banks to community development corporations. As these discussions turn to legislative activity, it will be crucial to be clear about the distinct goals and markets addressed and the most appropriate mechanisms for addressing them. The goals of community development and of expanding access to credit are complementary but distinct. In the particular market niche of disinvested, local communities, a development bank appears to be a successful model for promoting community development because of its ability to both successfully provide credit and proactively engage in the additional initiatives that are required in order to succeed.

I urge you to devise ways to support the capital needs of various institutional structures with distinctly different programs. This will avoid the risk of a broad, shallow program which will accomplish little. Supporting an array of different types of institutions under one umbrella will result in programs that do not work well for any because the legislative support is not sufficiently tailored to their particular strengths and weaknesses. If one carefully analyzes the differences between the types of institutions, the credit products they offer and the markets they serve, it becomes clear that reducing these issues to a least common denominator of "community lending" is counter-productive. "Community lending" encompasses a lot of different activities and institutions, all of which are important and should be supported, but which need to be supported in different ways.

The distinct categories where government opportunities are presented are:

1. Legislative and regulatory incentives directed at existing commercial banks to achieve an increase in community lending and community development.

2. A program to facilitate start-up and expansion of community development banks.

3. Strengthening the array of programmatic support available to any entities engaged in community development.

Existing Commercial Banks. There are 11,000 commercial banks in the country, government regulated and funded in part by government insured deposits. The response to inner-city deterioration and rural stagnation could be led by the existing commercial banking system. The key Federal policy action is to use the regulatory process to offer major financial incentives in exchange for quantified and significant levels of investment in low- and moderate-income communities. Banks do not invest

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much in these communities today. Distressed economies need smaller loans, a local presence, more sophisticated lenders, and partnerships with comprehensive redevelopment efforts. These realities reduce profits; this is a legitimate disincentive for privately capitalized banks. Yet the country's 11,000 banks employ seasoned loan underwriting talent, have proven credit mechanisms and controls, and know how to operate within a prudent and regulated context. They have not yet been sufficiently motivated to apply this talent to the specials business of economic development banking.

Legislative action defines the permissible activities of these regulated depositories. Permitted activities could be orchestrated to better serve public purposes by allowing those depositories which are most responsive to public needs to also engage in profit making activities that are now prohibited or curtailed. Interstate banking privileges, authorization to sell insurance, permission to underwrite securities, higher levels of deposit insurance, or other incentives could be provided to banks engaged in public purpose lending. Such privileges, however, should only be granted to banks that meet a high hurdle of investment in low- and moderate-income communities. Clarification of the Community Reinvestment Act, particularly its enforcement system, such that it rewarded proportionately higher investment levels in low- and moderate-income communities, rather than tolerating resources spent in documentation and process, could also further these goals.

In the highly regulated banking industry, the tightening of regulations and regulatory enforcement can have a significant effect on the availability of credit. The tension between maintaining the regulatory oversight necessary to ensure the safety and soundness of each institution and the industry as a whole and ensuring banks the latitude to exercise the independent judgment necessary to meet credit needs is a delicate balance. Small business lending, in particular, has recently been negatively effected by a change in this balance. New mechanisms must be found to encourage lenders to prudently but aggressively make more loans to small businesses. Credit enhancements, such as mechanisms to securitize small business loans, need to be developed.

Finally, some large banks might most productively invest in low- and moderate-income communities indirectly through a business partnership with a community development financial institution. Such partnerships might include investments in community development organizations that include community development banks, community loan funds, community development credit unions and micro-credit programs. These types of partnerships should be taken into consideration in the incentive structure.

Community Development Banks. Conventional banks and community development banks do not compete; they are natural partners. Community development banks operate in a market niche which is generally not "bankable" except by such specialized, comprehensive institutions. In effect, they "grow" the market for conventional banking much more than they take a "slice" of the existing "pie." The need for a network of development banks would not be supplanted by expanded community lending by conventional banks, but rather development banks would reduce risk for conventional banks. A few preliminary thoughts on the proposal for Federal support for expanding the number of community development banks follow.

Creation of a network of 100 community development banks over the next four years can have a dramatic impact on the quality of life in disadvantaged communities across the country. In scope, this plan is very ambitious for the allotted time. However, the creation of a large network of development banks can be achieved if legislation is enacted during 1993 that provides Federal funding for equity investments in development banks. Community development banks need to continue as privately-owned, regulated, financial institutions subject to the discipline of the marketplace and the oversight of economically self-interested investors. Equity investments by the Federal Government should, therefore, be matched by equity investments from the private sector on at least a 1 to 1 basis.

Investments by Federal Government should be made and overseen by an independent agency ("Entity") that will carefully select and nurture these nascent organizations. The ultimate success of this program will, however, depend upon the extent to which local market forces rather than regulation set the direction of development banks. Development banks will fulfill their mission by responding to the marketplace, not a command and control bureaucracy.

Development banks need capital. They must also generate profits to support future growth and generate financial returns for their shareholders—including the Federal Government. If the Federal Government is serious about creating a national network of development banks, it must invest equity capital in these banks and expect a long term financial return on its investment. The Entity that manages this investment activity should be independent of existing regulatory authorities and

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apolitical. The mission, structure and management capacities of each development bank will vary with the need of the distinct geographic area it serves. Thus, a careful, competitive, selection process must be implemented which selects institutions with comprehensive business plans, well-qualified professional management, an experienced board or directors, appropriate structures tailored to the needs of local communities, and demonstrated capacity for comprehensive community development An array of institutional structures will be appropriate to particular circumstances, including partnerships with existing community development corporations and financial institutions. Accordingly, the Entity must be afforded great discretion in its investment decisions.

Grants, forgivable loans, and other creative financing should be made available to support start-up, and to support the work of the non-bank, non-profit affiliates of development banks on the cutting edge of development finance. The non-bank affiliates of existing development banks focus on human development issues and on making "non-bankable" deals work. The non-bank affiliates will be the arena in which community development banks interface most with traditional financial institutions in areas such as low income housing development, equity financing for small business, workforce development, and technical assistance for entrepreneurs. Viable affiliate organizations working in partnership with the financial subsidiary, delivering non-bank development resources, are essential to the success of the development bank.

As a federally insured depository institution, a development bank will be highly restricted by existing regulatory authorities. As noted above, this regulation provides a level of discipline and credibility which is crucial to success. Development banks emphatically should not be established under a wholly new, special charter which exempts them from the existing regulatory system. At the same time, additional Federal regulation, specific to these institutions, would unnecessarily stifle them.

The Entity should exercise guidance particular to development banks through the avenues available to it as a principal shareholder. First, the selection process must be rigorous. Only organizations that card leverage Federal investments with private capital and demonstrate capacity to manage a regulated depository as part of implementing a carefully designed, comprehensive community development program should be considered for investment. Secondly, the Entity can guide the course of development banks by being an active shareholder, voicing its concerns and voting its shares. Finally, the Entity can exercise control through investment agreements that identify specific goals for each development bank. Investment agreements would allow the Entity to replace management or to withdraw from a development bank in the event that the bank does not make sufficient progress in fulfilling its development (as opposed to financial) goals. On a regular basis, the Entity itself should be required to report to Congress on the development impact and the financial return on its investments in community development banks.

In under-invested communities, development banks are net importers of the capital needed to stimulate local markets. This happens in two ways: through equity investments by private owners and through deposits generated outside the community. Development banks must attract these funds in the same manner and at essentially the same investment terms as conventional banks. However, development banks are at a competitive disadvantage in competing in the national marketplace because they are smaller and have higher costs associated with their support for development activities.

Equity investment in development banks must be made with the expectation of the ability to recoup one's investment with a modest return. If investors do not have this expectation, the discipline and oversight critical to success is lessened. On the other hand, achieving community development goals is a long term undertaking that requires patient investors that do not seek to maximize profits. Innovative mechanisms to enhance the long term financial viability of equity investments in development banks and to increase the liquidity of such investments would increase the availability of private capital and lessen the need for Federal equity investment.

Similarly, conventional banks, particularly those that do not have retail lending operations, could be significant partners with development banks. These institutions do not have readily available, effective delivery mechanisms for meeting local credit needs in under-invested communities. Equity investments in community development banks could expand their ability to meet their responsibilities under the Community Reinvestment Act without the requirement that they change the nature of their business. Sanctioning and encouraging these types of investments could provide a new source of capital for development banks. Recognition of the public purpose served by banks making equity investments in development banks should not

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replace continued emphasis on CRA enforcement and serious attention to the need to remedy racial disparities in lending markets.

The majority of depositors in development banks seek market rate, FDIC-insured bank deposit products. Because development banks draw from a national market place, non-interest bearing checking accounts are not an attractive product because of the slowness of making deposits by mail. Allowing ATM deposits across state lines in development banks would make regular checking accounts more attractive to a national customer base.

Many potential social investors, like pension fund, nonprofit institutions, and religious endowments, would deposit in development banks if deposit products could be developed that meet their needs as fiduciaries to secure the highest return with the lowest level of risk. An increase in the amount of FDIC insurance available to development bank depositors would leverage more deposits without additional cost to the Federal Government.

The deposit base of a development bank, like that of a conventional bank, needs to be diverse to guard against sudden outflows from a small number of depositors. Individuals interested in a social return on their banking might be more able to deposit in development banks if the deposit products were fully competitive with those of large conventional banks. However, development banks are not large enough to have the economies of scale needed to offer these products at competitive rates to large numbers of individuals. Creation of innovative tax deductions or credits for foregone interest on below market rate deposits would open access to deposits from individuals and corporations without jeopardizing the income stream of the development bank.

Numerous other issues need to be considered for legislation to foster large scale replication of development banks. Appropriate training and capacity building programs will be needed, particularly to build from the strong existing base of community financial institutions.

Development banks can achieve public purposes on a profitable basis, through unusual institutional design and partnerships. The challenges of inventing an appropriate Federal role and of assuring careful implementation are considerable but, I believe, well worth the effort.

Programmatic Support for Community Development. This third category of potential government activity encompasses a universe of existing and new programs. Particular, distinct programs could be broadly examined, enhanced, coordinated and made available as appropriate to all institutions—from conventional banks to microloans funds—which engage in community lending. Guarantee mechanisms (such as those of SBA and FHA), secondary market mechanisms (such as FNMA and FHLB), housing tax credits, JTPA funds, loans to revolving loan funds from the Department of Agriculture, capital grants from HHS, and other programs are all essential "tools" of community development. Performance based programming tailored to the distinct types of institutions, products and markets should be expanded.

A great deal of additional attention might be productively devoted to this category. Others much more qualified that I, including many who are attending this hearing, might be asked for suggestions.

Thank you.

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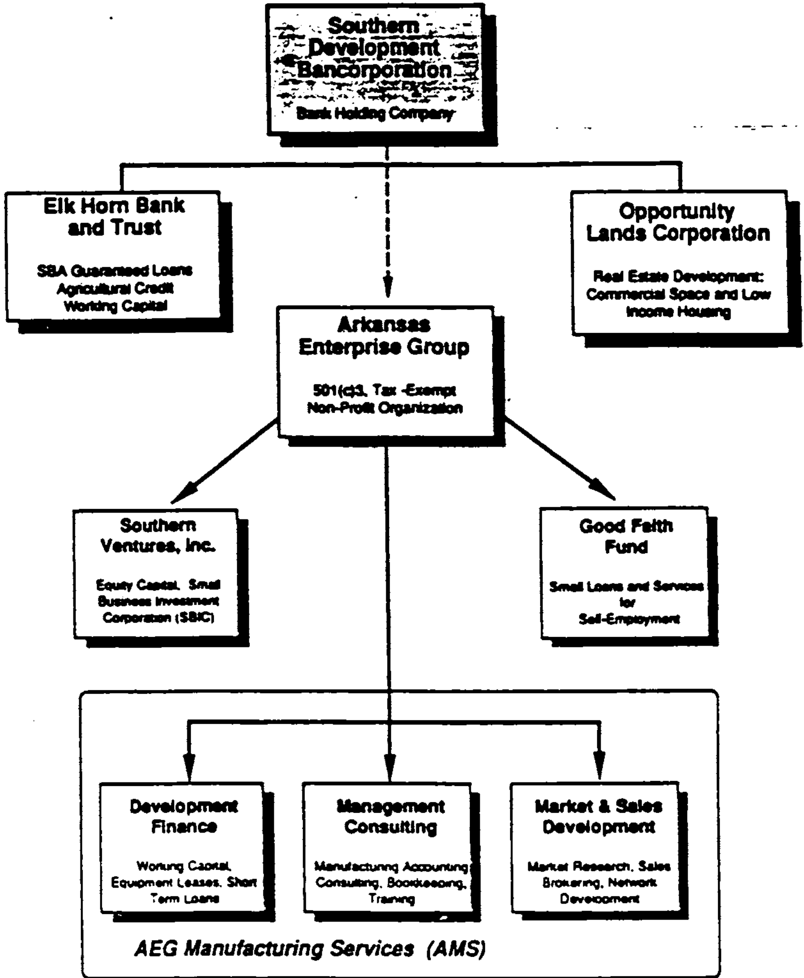

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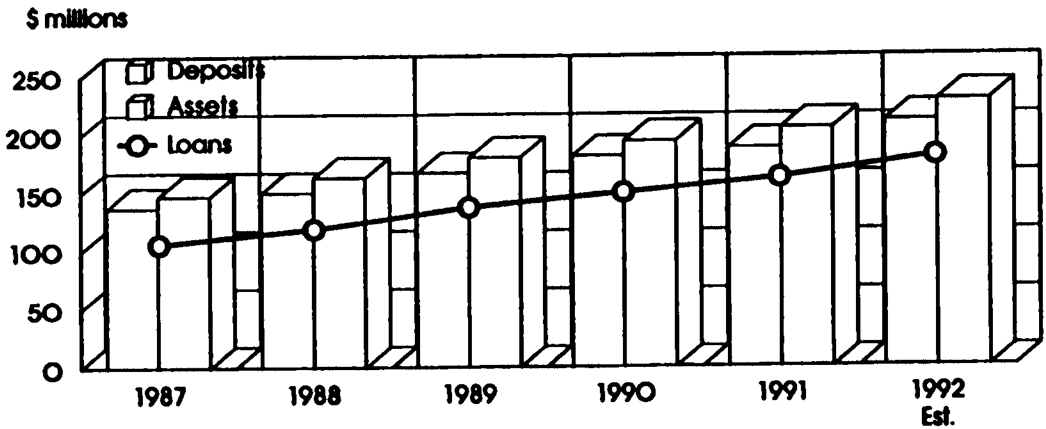
Asset, Deposit and Loan Growth
South Shore Bank



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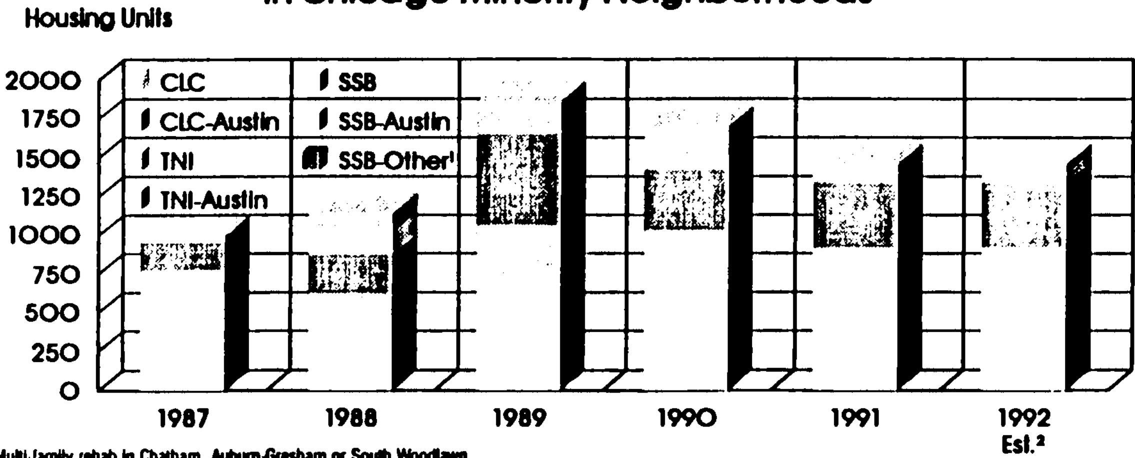
[2]220005 n08 1/6/93:

Housing Units Rehabbed, by Area & Affiliate
Shorebank Corporation



[1] : Multi-family rehab in Chatham, Auburn-Gresham or South Woodlawn

[2] : 1992 Expected to exceed 1991 activity

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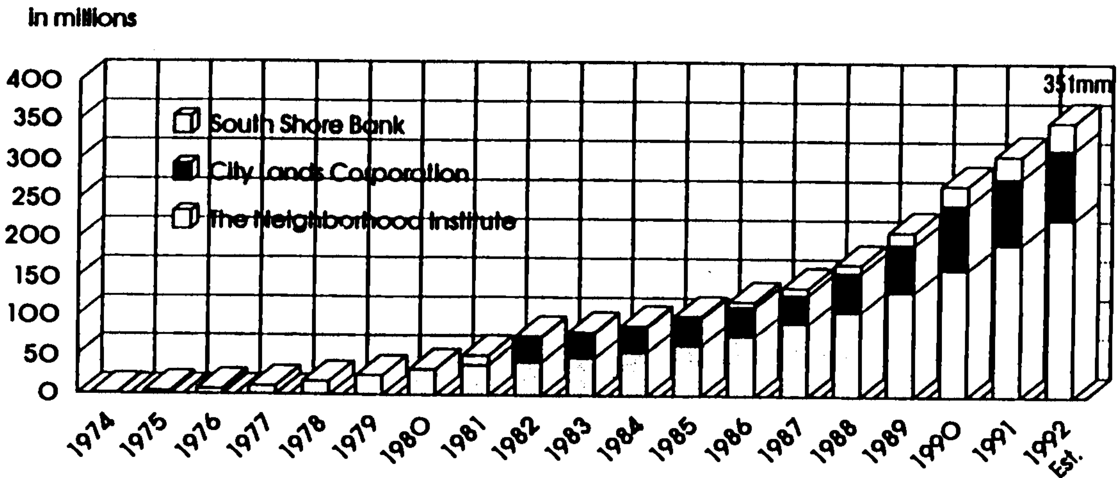
[2]1220007.n08 1/6/93:

Cumulative Annual New Chicago Development Investment

Shorebank Corporation



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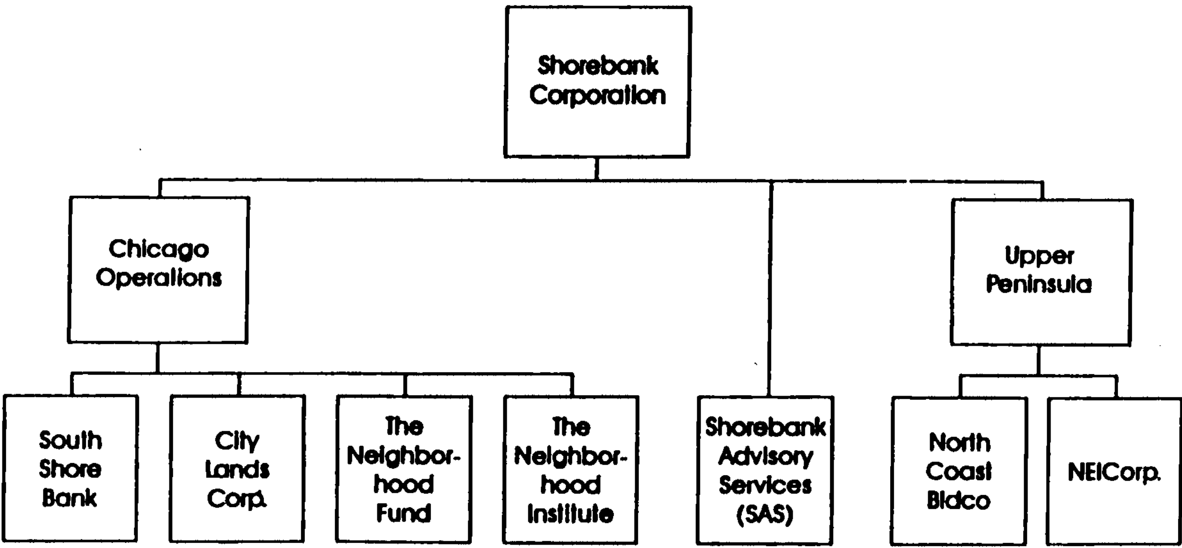
Shorebank Corporation Organization Chart



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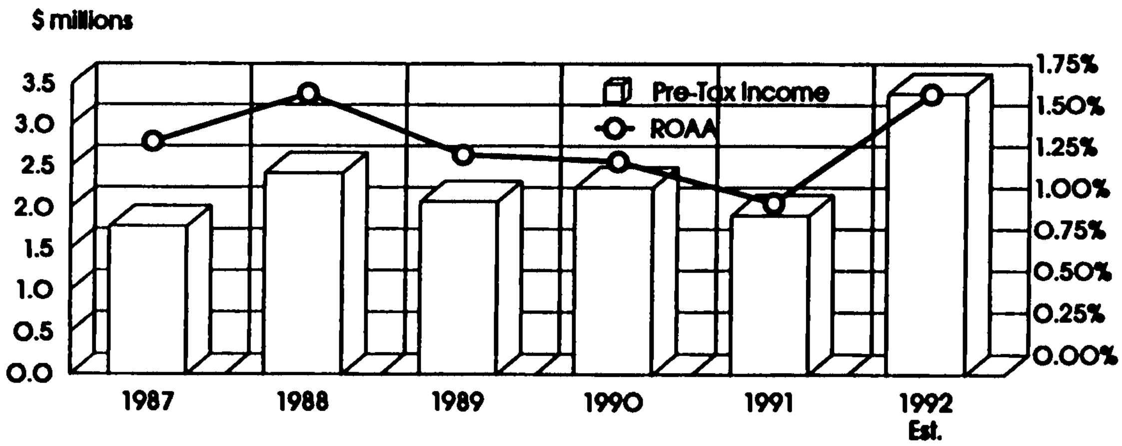
30120001.n08 1/25/93:

Pre-Tax Income and Return on Average Assets

South Shore Bank



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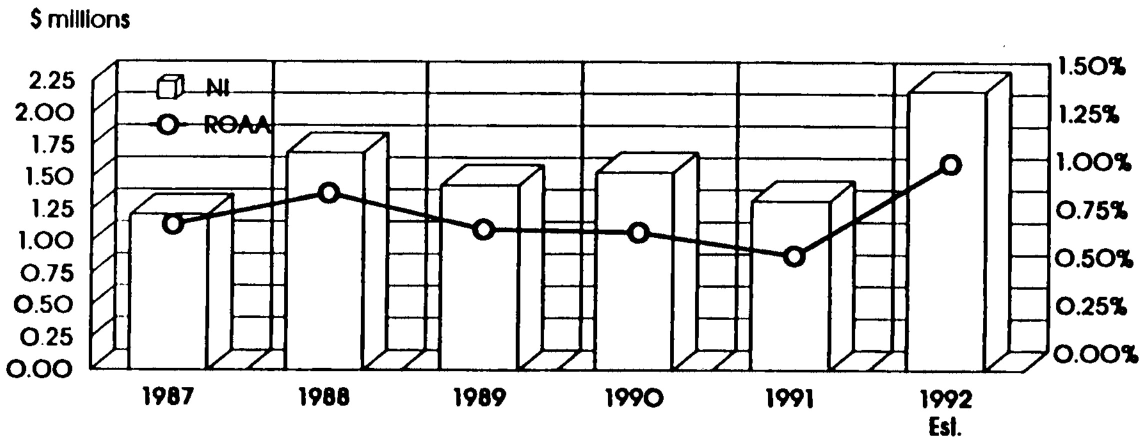
Net Income and Return on Average Assets

South Shore Bank



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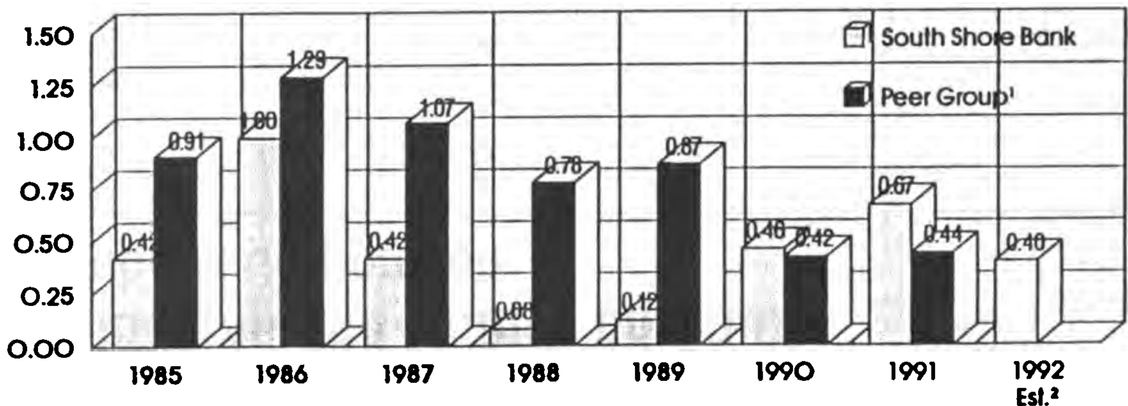
21220004.n08 1/6/93:

Net Loan Losses Compared to Peer Group

South Shore Bank

South Shore Bank Performs Near or Better than its Peer Group in 7 of Last 8 Years



[1] Peer Group figures: FDIC Uniform Bank Performance Reports

[2] 1992 Peer Group figures unavailable

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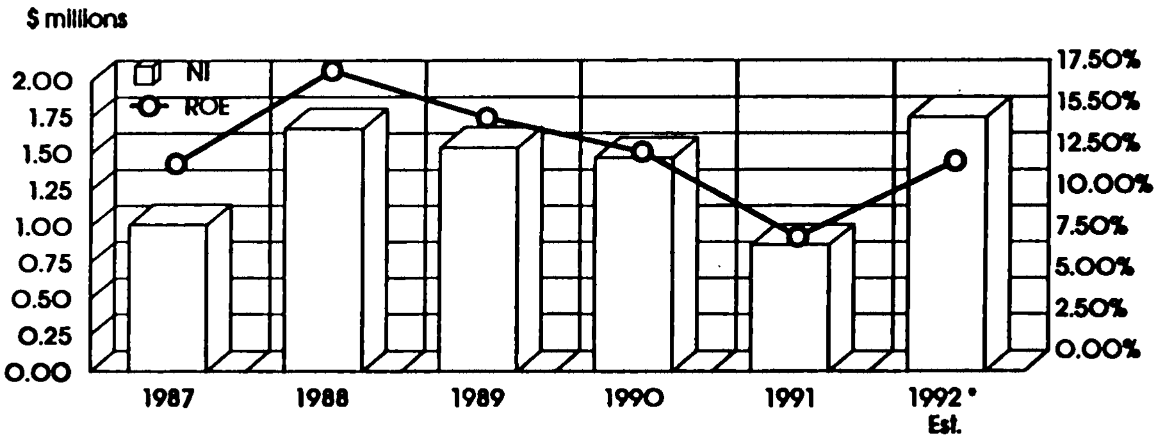
Net Income and Return on Equity
Shorebank Corporation



* : For nine months ending 9/30/92

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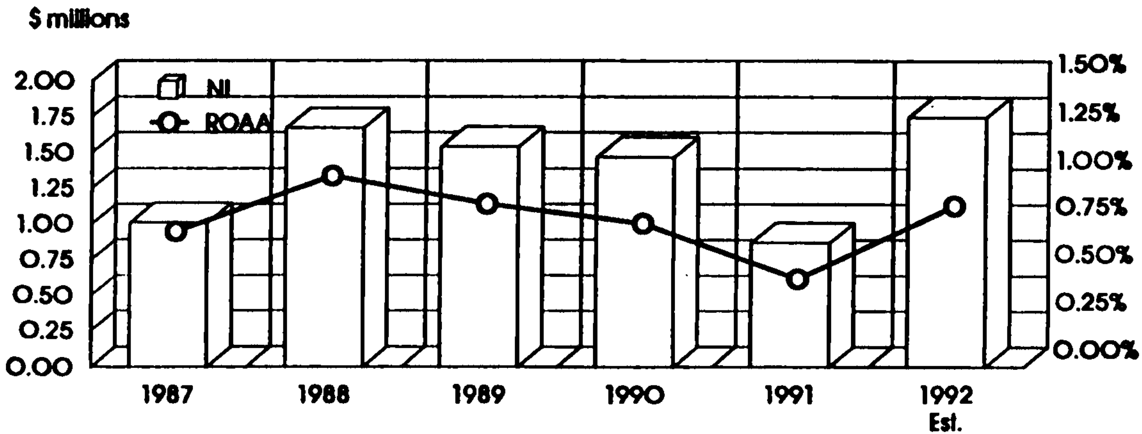
Net Income and Return on Average Assets

Shorebank Corporation

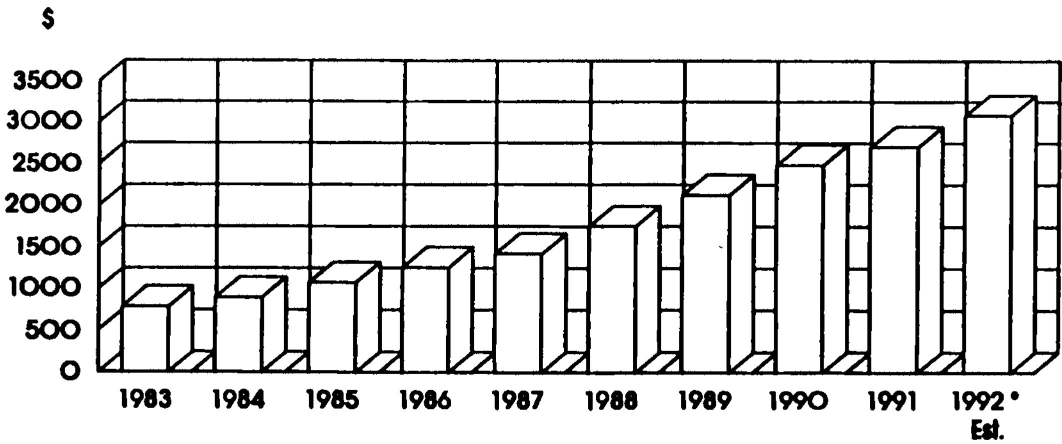


30120004.n08 1/25/93:

Book Value Per Common and Common Equivalent Share

Shorebank Corporation

Shorebank achieved a compound annual growth rate of 16.6% between 1983 and 1992.



* : For eleven months ending 11/92

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STATEMENT OF LYNDON COMSTOCK CHAIRMAN, COMMUNITY CAPITAL BANK

FEBRUARY 3, 1993

1. Personal Statement

Thank you for inviting me to address the Committee on the topic of community development banking.

My name is Lyndon Comstock. I am the Chairman and Founder of Community Capital Bank of New York City. Community Capital Bank is, as far as I know, the only independent commercial bank ever organized in the U.S. specifically as a community development bank. Our bank is now 2 years old and has $20 million in assets.

I am also the Chairman of LEAP, Inc. LEAP is a nonprofit venture development organization with its office at Community Capital Bank. LEAP provides intensive management assistance, including help in sourcing risk capital, to small businesses in low income areas.

2. Community Development Financial Institutions

At the outset, I'd like to note that community development banks are only one of the categories of community development financial institutions, or CDFI's. I include as CDFI's, along with community development banks, community development credit unions, community development loan funds, microenterprise funds, and venture development organizations. While there are only three independent commercial banks that explicitly specialize in community development lending, there are a total of more than 300 CDFI's at present. I recommend that any Federal support encompass all of the various categories of CDFI's, inclusive of the rural and reservation-based CDFI's, as well as the urban. Assisting in the expansion of existing institutions, and not just the creation of new CDFI's, is particularly important.

Our bank is a member of a recently formed ad hoc coalition of community development financial institutions, which advocates Federal support for building the capacity of the CDFI industry. I understand that you have been provided with a copy of the coalition's position paper, "Principles of Community Development Lending and Proposals for Key Federal Support."

Each type of CDFI has done a highly effective job of supporting community development, especially so considering our limited resources. We are professionally managed, private sector organizations that have been created and operate with little or no Government assistance. The capacity of each type of CDFI could be significantly increased, however, with appropriate Federal support.

3. Need for Community Development Lending

The largest pool of investment capital in the U.S., and the most important to the financing of businesses, housing, and consumer credit, is the several trillion dollars within the banking system. What proportion of total bank lending goes to low- and moderate-income individuals, their housing, or the businesses in their communities? I estimate no more than 1 percent. Yet more than half of the people of our country have low- or moderate-income.

Half of the population, yet perhaps as little as 1 percent of the bank loans. This situation could be fairly called "capital starvation" for the low- and moderate-income communities which suffer from it.

CDFI's represent a useful starting point for increasing our Nation's investment in the development of low- and moderate-income communities. CDFI's make virtually all of their loans in low- and moderate-areas, yet, as an industry, have had little problem with loan losses to date. CDFI's have proven their ability to provide the critical first wave of investment and project development in economically devastated neighborhoods, and to do so for the benefit of the existing residents, not their displacement. And CDFI's do this work at their own choosing, without regulatory pressure and elaborate negotiations.

4. Expanding the Capacity of CDFI's

As part of an overall national strategy of dramatically increasing investment in low- and moderate-income communities, I urge the Federal Government to help promote a major expansion in the capacity of the CDFI industry by the end of the century.

There are three principal factors needed to make a major expansion of the CDFI industry possible. First is equity capital. Hundreds of millions of dollars in equity capital will be needed by the CDFI industry over the coming years to make possible the degree of expansion of CDFI's which the Clinton administration has called for. Because the capital markets for social investment capital are only beginning to take

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shape, a high level of Government participation will be needed to help induce adequate private sector investment.

Second, a large amount of technical assistance is needed in order to help create the needed flow of new community development projects. High quality technical assistance is critical to the success of new community development projects, yet it is inherently unlikely to be self-funding. Additionally, technical assistance is needed for new or emerging CDFI's.

Third, professional training programs will need to be created to help provide the staffing for a major expansion of the CDFI industry. Conventional financial experience is an excellent starting point, but I believe CDFI loan officers and technical assistance providers need a specific background in community development-related projects.

Since "community development financial institution" isn't a term defined by statute or regulation, minimum eligibility requirements need to be established for any Federal CDFI support program. I suggest two key criteria. The applicant institution should have an explicit, formally adopted, primary mission of supporting community economic development, which ought to be appropriately evidenced.

Further, the CDFI's loans or investments must be principally directed to the support of community development once the Federal support has been utilized. I suggest that be defined as: at least two-thirds of the loans or investments of the CDFI must support affordable housing, small businesses, or social services in low- or moderate-income areas, or provide credit to individuals of low- or moderate-income. It should be the CDFI's responsibility to make an affirmative showing that its lending or investment practices meet this definition if it wishes to receive Federal support. New CDFI's, whether startups or conversions of existing institutions to CDFI status, will not have had the opportunity to prove their community development orientation, Those new CDFI's should therefore be required to submit a detailed business plan which supports this intended lending or investment posture.

5. Community Reinvestment Act

Within the context of this discussion of CDFI's, I have two comments I'd like to make about the Community Reinvestment Act. First, I believe that all of my colleagues in the CDFI industry agree that any Federal support for CDFI's should not cause any weakening of the CRA. We support full CRA enforcement.

Also, it's entirely unrealistic, in my opinion, to think that the CRA will cause widespread bank support for CDFI's, which could therefore substitute for Federal support. Banks already generally receive CRA credit for investing in CDFI's, but have only chosen to do so in relatively small amounts. Most of that investment has been deposits or their equivalent, rather than the equity investment and technical assistance grants which are needed for the expansion of the CDFI industry. I hope there will be more investment in CDFI's by banks, but Federal support is needed if there is to be any significant step-up in the rate of CDFI formation and expansion.

6. Community Capital Bank

Turning to the CDFI's that I've founded, Community Capital Bank is a New York State chartered, FDIC insured commercial bank. Our Bank has made or committed more than $7 million in loans and letters of credit so far, all of which are community development related. Approximately $3 million of this total is directed to multi-unit affordable housing, while the other $4 million supports small businesses and nonprofits in low- and moderate-income areas of New York City. Examples of these small business loans include minority contractors, nursing homes for AIDS victims, and a Ben and Jerry's franchise in Harlem employing homeless men.

I'm happy to tell you that Community Capital Bank does not have a single nonperforming or delinquent loan so far.

Community Capital Bank was initially capitalized at $6 million, which we raised from socially concerned institutional and individual investors in a limited public offering. Approximately one-third of our capital is from a wide variety of religious organizations, one-third is from other institutions including banks, corporations, foundations and labor unions, and one-third is from 190 individuals.

I know from personal experience that raising this amount and type of capital for a new organization is extremely difficult. In our case, it took about one person-year of professional staff time per million dollars raised, not to mention the help of numerous unpaid supporters. The problem of raising equity capital is the single most important reason that there are so few community development banks today.

Community Capital Bank has received no Government subsidies of any type to date. We've received a $100,000 CD at a market rate from the New York City Comptroller's office, but the rest of our $15 million in deposits comes from some 800 pri-

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vate institutions and individuals. We do make active use of Government credit enhancement programs, especially the SBA loan guarantee program.

Because our bank is unsubsidized and needs to support itself financially, we must operate efficiently. We are running an entire $20 million bank with eight people, about to increase to ten. Our people are talented professionals, and all except our secretary have previous banking experience. Our President and CEO, Stephen Laine, has almost 30 years in banking. Our V.P. Real Estate, Gina Bolden, has an extensive background in affordable housing lending.

Since our loans are entirely commercial loans requiring individual crafting, they are quite labor intensive. We have been able to compensate for this by being extremely efficient on the operations and deposit gathering sides of the bank. Much of our deposit support comes from socially concerned investors, which has allowed us to construct a stable deposit portfolio efficiently and at reasonable cost.

7. Competition

Our bank makes small commercial loans—from $25,000 up to $450,000, or to $750,000 with an SBA guarantee. Let me sum up for you the competition in that market in lower income areas of New York City. We have had only two deals where we were truly in competition with another bank. We haven't lost any of our existing loans to another bank. And we haven't taken a loan from another bank that was anxious to keep that loan.

8. LEAP, Inc.

I would also like to briefly describe LEAP, Inc. to you. LEAP started out of a recognition that a commercial bank can't provide risk capital, meaning equity or seed capital. A bank also has significant problems providing intensive technical assistance, partly for legal reasons. LEAP is a nonprofit which fulfills these needs for small businesses that have a high community development potential, especially as to job creation. I refer to LEAP and similar organizations as venture development organizations.

LEAP does not have its own pool of capital. Instead, we use our knowledge of foundations and other socially concerned investors to help access capital for these small businesses.

LEAP focuses on two particular industries at present—food processing and primary health care. Our current clients include an effort by a group of laid-off bakery workers to start their own employee-owned commercial bakery. Another client is a group of Caribbean-American doctors who hope to start a Medicaid managed care program in central Brooklyn.

Because we receive so many requests for information about community development banking, LEAP has also become involved in providing technical support to some other community development banking efforts.

9. Federal Government Support

I hope that your investigation of community development financial institutions will lead you to the same conclusion I reached some years ago: CDFI's are a highly effective, private sector means for channeling capital into community development.

Federal Government support could greatly boost the capacity of the existing CDFI infrastructure. This support should target both existing CDFI's, to enable them to increase their scope of activity, and the creation of new CDFI's. A relatively small amount of Government support for the expansion of this industry could ultimately have a dramatic effect on community development, especially because of the inherent leverage of equity capital by CDFI's.

To give you a feel for the dollars needed, a new community development bank should aim for $5 million to $8 million in initial equity capital. This will enable the bank to reach approximately $40 million to $60 million in total assets within a few years. If Federal equity investment were provided on a 1:2 match, the Federal investment would therefore be $2 million to $3 million per bank. For other types of CDFI's, the initial investment per institution will usually be significantly less.

The creation of fifteen or twenty de novo (startup) community development banks over the next few years would be a major accomplishment, and could be achieved with appropriate Federal support.

In this context, I'd like to note that seed capital is very difficult to obtain for start-up CDFI's. The cost of organizing a new bank can be estimated as up to 15 percent of the initial capitalization. For a $6 million capital bank, this leads to an estimate of as much as $900,000 in organizing costs. Federal grants for half this amount could greatly accelerate the formation of new community development banks and other CDFI's.

The incentive of Federal equity capital could help lead some existing banks to become community development banks, which would also expand the network of

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CDFI's. And the existing network of CDFI's could significantly expand its asset base with the benefit from Federal equity investment of some tens of millions of dollars, again utilizing a 1:2 match.

Any Federal equity investments must be nonvoting. In the case of community development banks, I recommend twenty-five year preferred stock investments with a noncumulative dividend in the 2 percent–3 percent range. In that case, it will be important that Congress provide a directive to banking regulators that these investments be counted as the equivalent of perpetual preferred stock (Tier 1) core capital until the final five years of their term. For the remaining term, I suggest the investments should be considered the equivalent of intermediate-term preferred stock (Tier 2) supplementary capital.

All community development financial institutions, new or previously existing, which receive Federal equity investment should be required to provide annual compliance information as to their support for community development until that investment has been retired. Immediate repayment of the equity investment should be required for noncompliance.

10. Technical Assistance to New CDFI's

Specialized technical assistance for new and emerging CDFI's is needed. For example, for each new community development bank to attempt to duplicate the learning process needed for a successful equity underwriting effort, including knowledge of the national network of social investors, is impossibly laborious. Yet there are no investment banking firms at present which assist in this type of socially directed underwriting for CDFI's.

The organizing process for a CDFI, especially a community development bank is complex, difficult, and not widely understood. I refer now not just to the regulatory approvals needed, although that is certainly a significant part of the bank organizing process, but to the actual creation of a substantially sized and, in some CDFI categories, highly regulated business. Appropriate business planning, board member recruitment, and management recruitment are the most critical issues, along with regulatory approval and capital raising.

A highly particular type of technical assistance, rooted in both the finance and the community development issues of a CDFI, is needed to help launch new CDFI's. Federal support to assist with the organizing process for new CDFI's could best be provided by grants or contracts to help pay for the cost of appropriate technical assistance from specialized providers.

The availability of the qualified management needed for an expanding number of CDFI's is likely to be problematic for the foreseeable future. For example, with community development banks, it will be a prerequisite to recruit experienced bank officers for the more senior positions, presumably from community sized banks where they will have had exposure to the types of issues and breadth of responsibilities faced by management of a small bank. In my opinion, the pool of senior officers of small banks who will have both the capacity to succeed in managing a bank focused on low-income communities, and the desire to take such a job, will be rather limited.

The only obvious answer to this problem is to train more bank officers who combine the experience and qualifications to manage a bank with the skills and interest to manage a bank that is specifically focused on community development. That, however, could become a very long-term project if the process isn't actively assisted.

11. Legislation

Finally, it's important that any legislation supporting CDFI's be flexibly structured. This is a young and growing industry, whose needs are evolving. A responsive administrator of Federal support is equally important, so that the process doesn't become so time-consuming as to be effectively useless, especially for newly forming CDFI's. I urge that strong input from CDFI practitioners be incorporated into the administration of any Federal support to CDFI's. The best vehicle for accomplishing these administrative purposes may well be a quasi-independent corporation.

I appreciate the opportunity you've given me to express my views on community development banking. I will provide you with one page summary descriptions of Community Capital Bank and LEAP, Inc. are attached for your review.

Thank you.

Community Capital Bank—Summary Description

Status

- New York State chartered, FDIC insured commercial bank.
- Two years old.
- Third commercial bank in the U.S. with an explicit community development focus.

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- First de novo community development commercial bank.
- All loans to date support multi-unit affordable housing, small businesses, or non-profits in low- and moderate-income neighborhoods of New York City.
- Full assortment of deposit products at market rates, plus CIRRUS ATM cards, FEDWIRE, and ACH.

Financials

- $20 million in assets at 12/31/92.
- $7 million in loans and letters of credit committed, all community development-related, to 30 borrowers.
- No delinquent or nonperforming loans so far.
- $15 million in deposits from 800 depositors in 25 states.
- 60 percent of deposits from institutions, 40 percent from individuals.
- $2 million assets/employee exceeds industry average for operating efficiency.

Capitalization

- $6 million initial equity capital from 250 shareholders.
- One-third of capital from 30 religious organizations.
- One-third of capital from 30 corporations, banks, foundations, and labor unions
- One-third of capital from 190 individuals.

Loans

- All commercial loans to date.
- Loans for working capital, construction, permanent mortgage, and equipment, plus standby letters of credit.
- Examples of borrowers including nursing homes for AIDS patients, housing rehab in Brooklyn, minority contractors, minority owned Ben & Jerry's franchise, knit-wear manufacturer, small apartment buildings, and hardware stores.
- Government credit enhancement programs are used, especially SBA loan guarantees.

Staff

- Eight employees, increasing to ten in early 1993.
- All employees but one have previous banking experience.
- President and CEO Stephen Laine has almost 30 years of experience in small banks.
- Chairman Lyndon Comstock (part-time) has both community development and banking background. He is also Chairman of LEAP, Inc., a nonprofit venture development organization with its office at Community Capital Bank.

Mission

The purpose of LEAP, Inc. is to help businesses that benefit low- and moderate-income communities in New York City. LEAP is particularly interested in assisting businesses that provide decent jobs for residents of these communities. LEAP is known as a community development venture sponsorship organization.

Services

To support the creation or expansion of for-profit or nonprofit ventures, LEAP provides a range of services that combine elements of investment banking, venture capital raising, and management consulting. LEAP assists management in:

- Raising capital—e.g. grants, equity, senior and subordinated debt—for a variety of purposes—including seed capital, working capital, and funding of fixed assets.
- Key development tasks—e.g. management recruitment, business planning, test marketing, site selection, and access to professional services.
- Strengthening finance, marketing, and public relations, including use of specialized consultants or peer contacts.

Clients

LEAP's current clients are food production and primary health care companies as well as microenterprise funds. LEAP works intensively with a small group of clients over an extended time frame. Client selection is not based on ability to pay.

Staff

Lyndon Comstock, Chairman. Jonathan Glazer, Project Director. Vivian Hunt, Project Director. Earl DePass, Project Associate. Brenda Lauchart, Secretary.

Board of Directors

Lyndon Comstock, Chairman, Community Capital Bank/LEAP Inc. Beverly Brown, Program staff, Joyce Mertz-Gilmore Foundation. Carl Ferenbach, General Partner, Berkshire Partners. John Guffey, Chairman, Calvert Social Investment

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Foundation. Oliver Wesson, President, Morgan Community Development Corporation.

LEAP's office is located within the office of Community Capital Bank in downtown Brooklyn. LEAP is a tax-exempt nonprofit corporation under IRS section 501(c)(3).

STEVE W. LOPEZ, PRESIDENT/CEO, THE FUND TO ORGANIZE THE SOUTHSIDE BANK

WHY THE NEED EXISTS IN DISTRESSED NEIGHBORHOODS TO IMPROVE ACCESS TO CREDIT

Although African Americans, Hispanics, etc. comprise a substantial segment of inner-city residents in the United States, they continue to live outside the beltway of the capitalistic system: To participate fully in the *capitalistic system*, one must have access to capital, for without capital one cannot participate in the capital structure or equity base of the United States. According to Jack Kemp in a recent testimony to the Senate Finance Committee on Enterprise Zones, he stated that African Americans owned less than 1½ percent of the equity of the United States, even though we are 13 percent of its population.

At a time, when the U.S. needs to grow its economic base, it cannot afford to continue to ignore a major segment of its market. The African American community (32 million strong) that earned $300 billion in 1991. The African American community that accounted for 10 percent of domestic automobiles purchased in the U.S. (Chryslers share of the U.S. Market is 10 percent). If African Americans were to be spun-off as a Nation based on income earned, it'd be the 9th richest country in the world. The $300 billion figure compares to the amount ($300 billion), as per Ross Perot, the U.S. spent for the same period defending NATO. The African American market is substantive, and should not be ignored by American Corporations, when they are seeking an increase in market shares. If the U.S. can use its resources to teach the Russians and Eastern Europe how to be capitalists, it should also teach African American citizens how to be capitalists. It is in the national interest of the U.S. to do so.

Today, U.S. corporations go abroad to find cheap labor to increase their market shares at the expense of urban and rural America. There appears to be this sense in the Nation, that urban areas or powerless segments of the country can be ignored. It is not being realized, that as the urban centers deteriorate, so will the suburbs. It is only a matter of time, when there will not be a hiding place for anyone. Presently cities, counties, townships, etc. are pitying their citizens vs. one another because of a shrinking tax base, reduced revenue sharing from the Federal Government, and due to an idle workforce, that looks to the state for some type of *"non productive entitlement."* What happens then (as is now) when states and cities have no one else to tax? What happens when the tax base cannot support the debt capacity of tide local or state Government? How can one help to stem the tide?

Ethnic balkanization becomes more prevalent, local schools and law enforcement agencies become overloaded and we then start to invest our local resources in non-productive prisons. One way of growing the economy to help expand the tax base is by doing the following:

A. Making it possible for *"qualified entrepreneurial borrowers"* in the inner cities to have access to *"sufficient credit"* to make a *"feasible project"* operate so it can in turn create jobs and hire neighborhood residents. Too often "inadequate loans" are made to selected *"incompetent minorities,"* so the system can have Pygmalion statistics in the negative to justify benign neglect.

B. Duplication of Southshore type banks in the inner cities and rural areas to provide *"viable Ventures"* in distressed area's access to capital, so they can remain as going concerns. Too often, commercial banks, savings and thrifts will accept cheap deposits from inner-city residents, but will invariably refuse to loan it to them due to perceived *"higher risk problems."* For example, in Grand Rapids, where Southside Bank is in formation, the inner-city is populated by 85,000 citizens, 35,000 of which are African Americans; in 1989 the commercial banks' savings and thrifts garnered $508 million in deposits, but made only 1 percent of the amount in loans to the area:

(1) Experienced business persons even with signed City or State contracts could not get loans.

(2) Skilled persons purchased businesses commensurate with their expertise and cannot obtain working capital loans.

(3) Professionals such as dentists, doctors, lawyers, teachers, etc. have a difficult time getting a loan approved and gave up.

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(4) African Americans and Hispanics depositors have a difficult time getting a loan approved even when their savings exceeds the amount requested to be borrowed.

(5) Residents have a tough time getting a conventional mortgage or a home improvement loan.

(6) African American and Hispanic contractors and developers cannot obtain financing for their projects.

On the basis of the above, African American business persons have a difficult time becoming job creators, or employers and be in a position to hire other minorities. Complicating the situation further, are the following circumstances:

The tendency of African Americans to boycott themselves—not doing business with one another—for example; in 1989, African Americans in Grand Rapids earned $208 million but spent most of it outside the community—contributing further to non-job creation—confirming the notion, that African Americans have always been on the consumer side of the equation as opposed to the supply side. Mark Green, Commissioner of Consumer Affairs for New York commissioned a study on the spending habits of African Americans and Hispanics in New York compared to the Asian community. The results were interesting:

1. For each $ the Asian person brought to his community, it turned over *16 times* before it left. Why? The Asians own their own banks, factories, real estate, stores, restaurants, etc. They provide jobs for one another.

2. In the *"African American community"* and the *"Hispanic community,"* it had the "rubber effect." As soon as the $ came in, it bounced back out—African Americans own very little land and tools of production. Going back to the Middle Ages, the power brokers and decision makers were the landowners, the churches, and the class that produced goods and services.

3. Us African Americans still do not understand the meaning of the word *"Freedom."* Our concept of *Freedom* is still confined to Civil Rights. We still don't get it—that the color of freedom is *"green money"*—not which end of the Bus we ride on—not what names people call us—but what we own, what we manufacture—if we own the Bus, it does not matter which end we ride on—if we own the "Hotel" and the *clerks* call us *names* we can *reprimand* or *fire* them.

4. The Corporate Network views the African-Hispanic American people strictly as consumers—a place where they send delivery trucks to sell their products. There is no reciprocity—for example, investing in the people or businesses that are in the area. Unfortunately, the African American is not as sophisticated as the Jewish American to retaliate by doing *"selective buying."* In the Jewish Community anyone that is inimical to the *Jewish people* or the State of Israel is boycotted.

5. The African American community does not benefit from the community reinvestment act for the following reasons:

A. Weak reviews or audits by pertinent Government regulators of Banks and their compliance with C.R.A.

B. The corporate citizens are provided with safety valves through community organizations such as local NAACP, Urban League, some churches, etc. to underwrite annual dinners, little league teams, etc. Investment into meaningful or *substantive projects* that would provide meaningful jobs, so a person can support a family are not undertaken. The corporate citizen fills his C.R.A. Portfolio with these meaningless public relations activities, in addition to writing it off as a tax deduction. The persons in whose name this was done are no better off for it.

C. Most African American community members do not understand the C.R.A.—much less monitor it. The banking community has found ways of circumventing the C.R.A. through mere public relations.

D. The African Americans have abdicated themselves to *"helplessness"* and *"confusion."* We are going to need *competitive assistance* to start turning things around.

Barriers Encountered in the Formation of Community Banks

A. Established law firms and consulting firms cannot be obtained for Chartering and writing of the Offering Circular due to prohibitive fees. Established law firms have *expertise* and *networks* that the *"Entity in Formation"* cannot benefit from, unless it has a Godfather to pay for it.

B. The utilization of affordable lawyers delays the process for the following reasons:

(1) Lack of expertise in the Chartering of new or De Novo Banks.

(2) Lack of sufficient business and banking experience on the prospective banks Board (Southside Bank was initiated by community activists).

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(3) Understanding of the distinction between a social agency and a *"for profit"* venture.

C. Typically the offering is small and not attractive to Brokerage houses for marketing. The stock has to be marketed by the Executive and Board members who are hampered by the following:

(1) Limited advertising resources.

(2) Educating members of the community who would be the beneficiaries of the banking services.

(3) Board members invariably have full-time jobs and do not have much time to devote to stock sale. Consequently, stock sale falls squarely on the shoulder of the Executive.

D. The time period of one year for capitalization is too short—in minority communities, it should be for 2–3 years. I would strongly recommend that the Banking laws be amended.

E. Lack of cooperation and concern on the part of some of the following:

(1) Most members of the local financial community who typically benefits from tax abatements, etc.

(2) Most members of the religious community.

(3) Middle class minorities (African and Hispanics).

(4) Municipalities and agencies.

F. Lack of sufficient financial resources (such as a credit line) to weather the swings in stock sale. Only the fees from stock sale can be used for administrative purposes.

G. Bankers manage *"risk"* to make a maximum return. Unfortunately, the *"perception"* is that, that *"risk"* cannot be in an *African-Hispanic* atmosphere.

TESTIMONY OF EDWARD H. McNAMARA, WAYNE COUNTY EXECUTIVE

FEBRUARY 1, 1993

Honorable Chairman and Members of the Committee: I would like to explain why Wayne County has chosen to establish a community development bank as part of its revitalization strategy. In addition, I will discuss the challenge faced in Wayne County's older communities and suggest ways in which the Federal Government can support emerging development banks such as the one we hope to establish.

In other testimony given today and at previous hearings, you have heard representatives of Shorebank Corporation discuss their work with organizations throughout the country who are exploring the establishment of development banks. The Wayne County Department of Jobs and Economic Development is one of those organizations. We have been working with Shorebank Advisory Services for nearly two years to develop a business plan for a development bank based on the Shorebank model. I hope to convey to you today Wayne County's vital interest in forming a development bank.

I. WHY WAYNE COUNTY HAS CHOSEN A DEVELOPMENT BANK

As part of its economic development strategy for the older neighborhoods within and surrounding the city of Detroit, Wayne County has chosen to pursue a development bank holding company. The important characteristics of a community development bank include:

- Combining a bank with entrepreneurial, non-bank affiliates and provides coordinated, comprehensive interventions for community development, not just the provision of credit.
- Leveraging private sector resources and capital by accepting deposits and turning them into development credit.
- Targeting credit, capital, and market information into a geographically defined area to shift perceptions of both residents and outside capital.
- Delivering a wide array of private and public sector resources into disinvested communities by blending foundation capital, credit enhancements, tax credits, and other existing programs in innovative ways;
- Conveying a symbolic legitimacy and authority, which can convince residents of its commitment and confidence in the community and encouraging them to invest their savings, time, and effort in their neighborhood.

With its detailed knowledge of the community and the ability to tap multiple tools and resources, a development bank is an entrepreneurial and capable partner to Government's standard array of incentives and resources.

The challenges facing the older communities of Wayne County are similar to those facing disinvested communities in other American cities. In response to the glaring need in our own communities, Detroit's major banking institutions have committed

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more than $1.6 billion dollars for investment in Wayne County's oldor communities. Our markets have nearly ceased to function, however, and very little of these committed funds have been disbursed. The gap between bankable transactions and the reality of these real estate markets has grown too wide.

Three Major Problems

We have three major problems: non-functioning real estate markets; minimal job creation through business development; and deteriorated social fabric. Each of these is addressed by one or more of the operating units of our proposed development bank: a for-profit real estate developer; a full-service commercial bank; and a non-profit affiliate engaged in housing assistance, small business support services, and non-bank business credit.

First, real estate markets have essentially ceased to function in these communities due to the sustained lack of activity. In 1989, only one mortgage loan was mado per 446 housing units in Highland Park, compared to 5 or 6 mortgages made per 100 units in healthy markets. Only 300 mortgages were made in 1989 in an area of 140,000 persons. The perceptions of crime, violence, and the poor future of these communities has inhibited new investment in homes and businesses by those inside and outside the neighborhoods. While the areas of Highland Park, Hamtramck, and the outer edges of the East Sido of Detroit are characterized by low levels of lending and investment, the housing stock in these areas is very affordable and is a strong base on which to build.

To create visible change on a scale that shifts the perceptions of residents from decay to opportunity, the real estate developer will need to change the microclimate within individual neighborhoods. This can change occurs by undertaking large scale, top-down rehabilitation and new construction projects that have a visible and dramatic impact on the neighborhood. Like any other for-profit development company, the developer will combine an array of Federal, state, and private resources, including collaboration with the Michigan Housing Development Authority and use of the Low Income Housing Tax Credit. By carefully choosing the locations of such projects, the developer can achieve a critical mass of renovation and visible change.

Shorebank's experience in Chicago has been that when a critical mass of development activity is achieved, a group of housing entrepreneurs emerged and began acting in their own self-interest to approach the bank for the financing to purchase and rehab nearby, smaller scale properties.

Although the markets in Wayne County are different from those in Chicago, the following fundamental principle still applies: the creation of attractive housing can change the expectations of local residents and encourage them to invest their savings, time, and energy in the community and in home ownership.

Second, job creation through the growth of small, entrepreneurial firms has been minimal compared to the volume of jobs lost in manufacturing and industry. The population of these communities has declined by half since the 1950's, with much of that loss occurring in the last decade. This dramatic population drop has limited the number of service and franchise firms in these areas, two sectors which have been a source of job growth in other markets. The availability of (1) commercial loans through the bank, along with aggressive use of SBA-guarantees and other credit enhancements, and (2) business support services and non-bank risk capital through the non-profit affiliate will provide a continuum of support for expanding small businesses. These business support services will focus on marketing, new product development, and financial management, complementing tho more general technical assistance resources already in place in the Detroit area.

Third, the social fabric in these communities has been deteriorating over time and must be restrengthened. The non-profit's housing assistance activities will includo block clubs, community safety, and events to sponsor neighborhood pride. These neighborhood-based activities help restore tho bonds among neighbors, reestablish communication networks, and help the restoration of social fabric.

Selection of Target Areas is Key

A development bank serving these communities will not have an easy task. Changing both reality and perceptions (such as deep-seated pessimism about the future of these communities) will take time and persistent effort. To be profitable and self-sustaining, a development bank will have to select its niche markets very carefully and husband its capital prudontly by concentrating its activities in small neighborhoods until they are stabilized and from there, branch outward. Encouraging investment rather than disinvestment is critical to achieving change, but very difficult to accomplish.

Selecting a target area is the hardest step in designing a development finance institution. The location of a development bank dictates its design, the organizational

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structure, the strategies, and the tools it employs. Although the principles of development banking are transferable, a development institution must reflect and build upon its local context. For example, our targeted communities in Wayne County have an abundance of low-cost real estate that makes home ownership possible for households earning less than $20,000 per year. Focus groups indicated that some demand exists for housing within certain sub areas within the target communities. The housing stock is attractive, the cost of land and buildings is low, and rehab expenses are minimal.

In Wayne County, the primary strategy will be to target specific opportunities in housing development within the proposed target communities of Hamtramck, Highland Park, and portions of the East Side of Detroit. In choosing the target areas, management must balance the need for the bank to maintain its profitability with the opportunity to undertake large scale, non-bank development projects in areas of need. Certain parts of these communities have experienced such prolonged and severe disinvestment that they cannot support a self-sustaining development bank.

II. WHY A DEVELOPMENT BANK COMPLEMENTS CONVENTIONAL LENDING

A comparison with the purposes of conventional banks may help clarify the unique properties of a development bank for community investment. As discussed above, development banks bring much more than credit to the task of community revitalization. There are several reasons why conventional banks should not be expected to do the same.

1. *Community development lending is not their primary mission.* Development banks have a specialized mission, structure, management team, and operating plan that all focus on restoring healthy market forces that transform underinvested communities. These institutions evaluate their performance on both financial return and development outputs. If only one of the two goals is met, management has failed to walk the tightrope. In contrast, conventional lenders have a clear primary obligation to generate a financial return to their shareholders. Community development lending is a sideline that is not part of their core business.

2. *Conventional banks do not engage in demand-generating, non-bank activities that compliment the provision of credit.* Through its non-bank activities, a development bank provides support to individuals to narrow the gap between the bank product and what the market needs. If the market needs educating about how to use the product, or how to prepare for eligibility, the non-profit can answer their questions. If the market needs assurance that the community is improving and an investment in a home makes sense, the actions of the real estate developer can send them a signal.

3. *There are legitimate disincentives for conventional lenders.* Distressed economies need smaller loans, a detailed knowledge of local market conditions, and sophisticated lenders who can judge the intent and ability of a borrower to repay. All of these increase the costs of making these loans. They reduce profits and are therefore less attractive to bank management than lending in more familiar and more profitable markets.

4. *Consolidation and heightened competition among banks have desensitized them to the credit needs of local communities.* As industry consolidation has created regional institutions and bank mergers, credit policy decisions are now made in a downtown office and applied in a uniform way to all branches regardless of their local market. The pressure to achieve economies of scale and reduce costs focuses management decisions on uniformity, high volume, and efficiency of loan approvals and administration. Although Detroit has some of the best-capitalized banking institutions in the country, recent mergers and consolidations have greatly reduced the number of small banks serving the city and its adjacent communities.

5. *The shift to uniformity has constrained character lending within larger institutions, as credit decisions are made on the basis of financial ratios and collateral values.* This trend is exacerbated by the regulators who are scrutinizing portfolios for signs of "poor" credit decisions. Banks tend to be product-driven, but when they offer a new first-time homebuyer product and there is minimal demand, their market expectation is confirmed.

The economic challenges facing the older Wayne County communities will require some "heavy-lifting." A development bank will need to work together with conventional banks and private sector leadership. The activities of development banks and conventional lenders are complementary. Development banks nurture and cultivate demand for credit where none existed previously. As the volume of transactions increases and conventional lenders become more familiar with a new market, they can begin to compete with the development lender. From this vantage point, it appears as if Shorebank has kept shifting its niche in response to the changing conditions. The bankers with whom we have met to discuss the development bank for Wayne

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County concur that development banking is a niche business. Since we began discussing the business plan with individuals from the private sector, we have received several telephone calls from individual bankers expressing their support for the creation of a new type of financial intermediary.

III. The Role of Government

As Government, we at Wayne County have had to recognize our limits in the creation and operation of a development bank. Wayne County considers itself to be the convener, bringing the Shorebank model to Wayne County and convincing private sector actors of its merit as an additional tool in the economic development arsenal. Our lessons from the experience of Shorebank include:

- The most effective economic development institutions are market-driven and accountable to the customers and markets they serve.
- There must be a professional management team with a single focus on renewing the underinvested communities in which it works.
- An apolitical institution maintains continuity despite changing administrations and keeps its credit judgment separate from any political influence.
- A development bank is unique in its ability to combine and deliver a wide range of public and private sector resources to disinvested communities.

This last point merits some discussion. Too much effort in turning around urban America has focused on the demands of the political cycle and on programs designed to meet isolated needs rather than to coordinate a response to interrelated problems. Economic development programs tend to be fragmented, run by separate Government agencies, and often with incentives for shallow, short-term investments that fail to cumulate into lasting change. With rare exceptions, there are few institutions in place to drive a long-term development agenda for neighborhoods. These communities have fallen into this disinvested condition over three decades; it will take a sustained, long-term investment to reverse it.

Specific Recommendations

It appears that Shorebank has achieved a great deal with few special privileges and with long-term, patient capital. If experience is any guide, perhaps the Committee should keep in mind 4 or 5 guiding principles as it drafts this legislation:

- First, do no harm. The fundamental premise of a development bank as an entrepreneurial, adaptive, organization able to tap multiple resources and deliver them to disinvested communities must be preserved. Government assistance should take care not to blunt the market-driven approach, its entrepreneurial use of resources, or its ability to define niche markets that evolve over time.
- A separate regulatory structure for development banks sounds suspiciously like the spread of unnecessary bureaucracy. The standards for operation should remain as high as those for other banks.
- Matching Government funds for private capital commitments will allow these institutions to build a sound capital base, a constraint that has limited the creation of new development banks. Such matching commitments should be no more than 1:1 and public funds should not exceed more than 49 percent of total bank capital. Subsequent requests for additional capital should be based on performance of the recipient.
- Grant funds to the non-profit affiliate could also match private sector commitments.
- The organizational and legal costs for a development bank are significant, as are the costs of preparing management and preparing fund raising materials. Grant funds to finance these startup costs for individual development banks might be committed up front, yet disbursed in increments based on achievement of "milestones."
- There should be some funding for the development of a support system for emerging development banks, such as partial funding for a training institute or internships for management existing development banks, or other forms of management and staff development.

In conclusion, this country has established public purpose, permanently capitalized, professionally managed institutions to carry out activities important to society. Museums, hospitals, and universities are all examples. Perhaps it is time to create similar institutions for urban neighborhoods.

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TESTIMONY OF PAULINE NUÑEZ-MORALES, EXECUTIVE DIRECTOR, THE NEW MEXICO COMMUNITY DEVELOPMENT LOAN FUND

FEBRUARY 3, 1993

Thank you, Mr. Chairman, and members of the Senate Banking Committee. My name is Pauline Nuñez-Morales and I am the Executive Director of the New Mexico Community Development Loan Fund, a statewide organization. Today I am representing my own organization and the National Association of Community Development Loan Funds (NACDLF), an association representing 41 community development loan funds.

NACDLF is active in an ad hoc coalition of community development financial institutions (CDFI's) that also includes the Association for Enterprise Opportunity in Chicago, IL, the Center for Community Self Help in Durham, NC, Community Capital Bank in Brooklyn, NY, First Nations Development Institute in Falmouth, VA, the National Federation of Community Development Credit Unions in New York, NY, and Woodstock Institute in Chicago. This coalition comprises representatives of all segments of the CDFI industry that has pioneered the business of community development lending over the past several decades. We have prepared a position paper comprising our best thinking at this time on the issues involved in setting up a Federally supported network of CDFI's. A copy of the paper is attached to my testimony.

The Work of the New Mexico Community Development Loan Fund

The New Mexico Community Development Loan Fund (NMCDLF) is a private, non-profit financial intermediary created in 1989 and dedicated to the economic and social empowerment of the people of our state. The fund borrows capital from 29 socially responsible investors and lends it in support of affordable housing, community-based business, basic human services, and community development in general.

NMCDLF is the only community development lending vehicle in a state that has one of the highest percentages of people living below the poverty level in the United States. As a primarily rural state, New Mexico faces a unique set of economic challenges—for many people, major markets are distant, there are limited job opportunities, and access to all types of services (particularly, financial and public services) is inadequate.

Over a third of the state's population is Hispanic. Native Americans comprise 10 percent of the population. Both populations make up the majority of rural residents. Within these traditional communities, language and racial barriers can contribute to their inability to access traditional capital sources.

The NMCDLF's mission is to help create long-term solutions to poverty by placing resources back into communities to create jobs, retain community services, and improve housing opportunities. To this end, the fund has helped to expand rural health facilities, support organic agriculture, reduce program costs for transitional housing groups, and expand rural enterprises.

NMCDLF currently has $820,000 in capital under management. Our capital has come from Catholic women religious groups, Protestant religious groups, Jewish synagogues, foundation program-related investments, corporations, and Federal economic development programs, as well as individuals.

We have eleven loans outstanding totaling $209,694. Cumulatively, we have made 17 loans totaling $284,571. All loans are current, and the fund has experienced no losses to date.

Like other NACDLF member funds, our role is:

(1) to provide credit to economically disenfranchised and disinvested communities and individuals

(2) to provide technical assistance to help borrowers plan and implement successful development projects

(3) to leverage financing from public agencies and conventional lenders

(4) to give people and organizations the skills, credit histories, and development track records necessary to enter and succeed in the mainstream financial markets.

I would like to give you a few examples of how the NMCDLF works.

- **Homemakers Association of Amalia and Costilla** (HAAC) supports the development and training of local women. A $5,400 NMCDLF loan enabled HAAC to purchase industrial sewing machines to expand a cottage industry creating Southwestern fashions. The new machines helped the organization diversify the kind of contracts it could work on, hire an additional person, and support a unique business venture in an isolated rural Hispanic village in northern New Mexico. The business has diversified its product line and has hired two additional women.

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- We have also participated with other institutions in making loans. Recently, we participated in a loan to a non-profit housing organization, St. Elizabeth's Shelter, that purchased a nine-unit apartment building to house families in transition in Santa Fe. A locally owned bank provided a $170,000 loan for permanent financing, and a local donor contributed $50,000 for the down payment. NMCDLF provided a short-term $80,000 loan that helped to make the project happen.
- Concilio Campesino del Sudoeste, Inc., provides a variety of health and human serves to more than 300 people per day, most of who are farm workers or elderly residents of Doña Ana County in southern New Mexico. With a $25,000 loan from the NMCDLF, the Concilio has been able to correct health safety code problems and add 1,500 square feet to its 8,000 square foot facility. The three-year, 9 percent loan will be repaid by rent revenue paid by La Clinica de Familia, Inc., the rural, migrant health care provider that will occupy most of the new space, and by other tenants.

The Concilio is the lone health, social services, and community center. Without it, area residents—many of whom do not have cars—would have to travel to the town of Las Cruces, 18 miles away.

As you can see, the NMCDLF lends for both housing and business projects, recognizing that distressed communities need to develop both aspects of their infrastructures. We provide as much technical assistance as is required to ensure that our loans and the projects they fund are properly planned and managed. This assistance often precedes underwriting and continues through the life of the loan.

Our underwriting criteria are rigorous but they are not standardized in the way that underwriting is for conventional lending. They are individualized to reflect the unique characteristics of differing communities and borrowers. Our experience highlights the fact that conventional approaches to risk assessment and security must be re-examined when serving borrowers with little or no credit history, business or development experience, or collateral.

Our model is self-sufficiency. We recognize that traditional Federal assistance programs meet the needs of some individuals, but we focus our work on projects that will enable individuals, institutions, and communities to achieve economic and social independence. Our borrowers gain not only a home or a business or a decent income but also the skills they need to participate fully in the mainstream economy.

This approach is different from traditional human service analysis which tends to look at what is wrong with a community to identify its needs. As a community development organization, we go beyond that and question what is right with a community—what are its strengths—and use our dollars to enhance what is there.

The Loan Fund Industry

NMCDLF is a relatively young and small organization in the loan fund industry. The 41 NACDLF member loan funds have loaned more than $100 million, which has leveraged $760 million in public and private capital to finance 15,000 housing units and to create 3,500 jobs for poor Americans. NACDLF members' loss rate on loans is less than 1 percent. Within our chip there is a growth ladder on which small funds seek to grow into large funds, and some of our larger funds are exploring the possibility of adding depository arms and other financial and technical services. NACDLF members serve large metropolitan areas like New York, NY, and Los Angeles, CA, while others work statewide (e.g., New Hampshire, Vermont), or on a multi-state basis (e.g., upper midwest, mid-Appalachia).

NACDLF's strongest member funds such as the Delaware Valley Community Reinvestment Fund (DVCRF) in Philadelphia, PA, the Low Income Housing Fund (LIHF) in San Francisco, CA, the Boston Community Loan Fund (BCLF), and the Cascadia Revolving Loan Fund in Seattle, WA, provide leadership for the NMCDLF and other growing loan funds. They are the pioneers in our field, and their experiences and success are models for growth in our industry. They and other loan funds have demonstrated that non-profit, non-depository revolving loan funds can:

- Aggregate significant amounts of private capital from individual and institutional social investors.
- Successfully fill gaps in credit markets in urban, rural, and Tribal communities.
- Work hand-in-hand with conventional lenders to their mutual benefit.
- Finance new forms of ownership such as mobile home park cooperatives and land trusts.

These institutions are now planning to significantly increase the scope of their efforts. For example, DVCRF is studying the possibility of adding a depository arm. My colleague from DVCRF, Jeremy Nowak, is here today and would be glad to answer your questions about these plans. Other NACDLF members considering similar plans include the Boston Community Loan Fund in Massachusetts, the Federa-

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tion of Appalachian Housing Enterprises in Berea, KY, the Cascadia Revolving Loan Fund in Seattle, WA, and the Vermont Community Loan Fund in Montpelier, VT.

NACDLF's largest member, the Low Income Housing Fund, currently manages $20 million of private capital from social investors, including the Ford Foundation, Metropolitan Life Insurance Company, and the Prudential Insurance Company. LIHF believes that adding a depository arm is not the only way for it to meet its goals. Instead, LIHF has concentrated on building bridges between conventional lenders and distressed communities. Toward that end, the LIHF has created several bank pools in northern California, Los Angeles, and New York City totaling some $21 million. These pools reduce the risk and costs of low-income lending for conventional financial institutions while significantly expanding the credit available in some of the poorest communities.

At the other end of this growth ladder, new and developing funds such as the NMCDLF are models for emerging loan funds and start-up efforts in places like Maine, western New York, Delaware, South Carolina, and Chicago. We share our experiences through an Annual Training Conference and mentoring programs sponsored by NACDLF.

Seven years ago, the 18 loan funds then in existence realized that they needed a national association to set performance standards for the industry, offer financial and technical support, and provide training necessary for the growth of the industry and the creation of new loan funds in under-served communities. Loan funds are uninsured non-profit intermediaries whose growth is contingent on continued strong performance.

Today, the National Association of Community Development Loan Funds has in place rigorous performance criteria based on the "best practices" of the industry over the past ten years. NACDLF enforces these performance standards through:

- *Member fund evaluations* to assess organizational capacity, management systems, financial strength, and lending performance.
- *Performance-based loans and grants* through which NACDLF advances loan capital and makes grants to member funds to build institutional capacity and financial strength.
- Technical assistance and training through an Annual Training Conference, regional workshops, technical assistance publications, and work with individual member funds.

NACDLF believes that a performance-based lending and grants program should be the model used to create a national network of community development financial institutions. It fosters discipline in business activities while allowing institutions the flexibility to provide loan products and related services that are appropriate to the communities they serve.

Let me explain how our performance-based lending and grants program works. NACDLF makes unsecured term loans from its Central Fund to help members finance development projects at the local level. These loan moneys from national investors such as the Episcopal Church and the John D. and Catherine T. MacArthur Foundation can only be accessed once a member fund has achieved certain performance objectives.

In addition, NACDLF recently received a $1 million start-up grant from Citibank, N.A., to launch an Equity Grants Program to build the net worth of member funds. This program Is particularly important to new organizations such as the NMCDLF, which does not yet have the financial strength to qualify for a loan from NACDLF's Central Fund. These moneys are disbursed to the loan funds as loans, contingent on the fund meeting certain performance objectives. At that time, the loan converts to an equity grant which enhances the ability of member funds to attract private capital.

NACDLF plans to increase the Equity Grants Program to $25 million. It is currently negotiating with other potential corporate and foundation donors. For loan funds, as for all CDFI's, equity is critical to continued growth and to the establishment of new institutions. Equity allows us to take the risks inherent in serving first-time borrowers and provides the earnings to pay for the technical assistance so critical to first-time borrower success.

Lack of equity capital is the single greatest barrier to the growth and development of CDFI's at all levels. NMCDLF has only $130,000 in equity capital at present. NACDLF requires member funds to have at least a 20 percent capital to asset ratio. Increasingly, NACDLF and its member funds are realizing that a 30 percent to 50 percent capital to asset ratio may be necessary to serve all borrowers and for CDLF's to raise large amounts of private capital. I know for NMCDLF to serve the start-up, small businesses critical to the revitalization of New Mexico's rural economy, achieving a capital to asset ratio of 50 percent is imperative. Public entities are the only reasonable source for these dollars. Unless CDFI legislation

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deals with this issue, NMCDLF, DVCRF, LIHF, and others will not become the large-scale development finance organizations needed to transform America's poorest urban centers and rural communities.

Strategic Federal Support

On behalf of my colleagues within NACDLF, I want to offer some comments on the creation of a national community development lending initiative.

Collectively, the existing CDFI industry provides a baseline against which the progress of a Federal program could be measured. Capitalized with more than $700 million—much of which is raised from within the communities or constituencies they serve—development banks, credit unions, and loan funds have extended more than $2 billion in loans. Loss rates are comparable to those of tho best conventional lending institutions. We offer a solid foundation for a bold community dovelopment lending initiative that might include new institutions, community organizations, conventional lenders and others.

Our mission before you today is to help build support for a CDFI industry that is: (1) sustainable and growth-oriented, (2) committed to lending in rural, urban, and Tribal communities that have been under-served in the past, (3) complementary to lending by conventional lenders, (4) operated under a domanding system of performance-based investment.

The Ad Hoc Coalition of CDFI's has set forth six key principles in meeting credit needs in lower-income communities, and NACDLF endorses these principles:

1. Community development "banks" should be defined to include the spectrum of CDFI's comprising community development loan funds, community development credit unions, micro-loan funds, and community development banks.

2. Expand the scope of community development lending beyond small business credit to also include housing credit and consumer financial services.

3. Consult experienced CDFI's in crafting legislation, as the Committee is doing today and has done over the past several months, and in setting up and evaluating the CDFI network.

4. Emphasize expansion of existing CDFI's rather than simply undertake wholesale efforts to create new development banks.

5. Recognize that successful development lending institutions are built over time and with incremental performance-based financial support.

6. Clarify the different interests and responsibilities of conventional lenders, public agencies, and CDFI's. NACDLF and the ad hoc coalition strongly believe that the Community Reinvestment Act should be strengthened and expanded. The demand for credit in undor-served communities is beyond the scope of any community development lending program and will remain so for the foreseeable future. Conventional lenders should be required to meet quantifiable lending goals.

Investment in this network of community development financial institutions should *not* exempt banks from fulfilling their full obligations as lenders under the Community Reinvestment Act. Last year, the Federal Financial Institutions Examination Council explicitly stated that banks could qualify for CRA credit by supporting and entering into partnerships with loan funds and other CDFI's, as a growing number of banks are doing. This is *not* and *should not* be an either-or proposition, however. Banks that are involved with CDFI's must also continue lending directly into the communities they serve. In addition, the Federal Government could support community development in general by extending the reach of the CRA to other financial institutions such as finance companies, money market funds, insurance companies, and mortgage banks that are not covered by CRA.

We also believe that creation of a Federal network of CDFI's must be linked to future financial support for and regulation of the conventional financial industry. The substantial restructuring of the conventional industry over the past two decades has been made possible through myriad Government subsidies (e.g., Federal deposit insurance, state insurance guarantee funds, Federal Reserve Discount Window borrowings, etc.). Government subsidies and new powers should be granted to the conventional financial industry only if it meets quantifiable community lending objectives and provides ongoing financial support to the developing national network of CDFI's.

Funding

We believe that Congress and the Clinton Administration must make a clear financial commitment to the CDFI system to signal their support for the long-term viability of the industry, but this should be just one part of the funding mechanism. The $850 million figure reportedly under consideration by the Administration for disbursement over five years seems to be at an appropriate scale. We respectfully suggest that this money should be committed primarily as equity support in increas-

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ing amounts over the five years in accordance with a performance-based lending investment program that provides support to all rungs of the CDFI industry growth ladder. Those CDFI's that perform up to industry standards would gain access to increasingly large amounts of the $850 million. This ensures that the money is not distributed without due accountability measures.

Federal support is just one part of the funding that is necessary for this effort, however. No less important are below-market and long-term deposits and loans that afford CDFI's the ability to properly underwrite their loans, creation of a human capital development training program to prepare a new and expanded generation of CDFI professionals, and support for technical assistance and new loan products customized to individual communities.

We see this funding coming, as I stated, not only from the Federal Government. CDFI funding should also draw on the public responsibilities of federally insured and subsidized conventional financial markets. These institutions that benefit from public subsidy should be expected to contribute in various ways to meeting credit needs they are not addressing directly.

The ad hoc coalition of CDFI's has identified several possible financing mechanisms that merit consideration:

- Commercial bank commitments of equity capital and other support as an outcome of CRA negotiations or mergers that create mega-banks.
- A share of the profits from appreciation of federally sold assets (e.g., a percentage recapture levy on Resolution Trust Corporation properties).
- A share of profits from Government-sponsored enterprises such as Fannie Mae and Freddie Mac.
- CDFI set-asides within major legislation to bail out the savings and loan industry or to inject capital into other parts of the financial services industry.

We also support efforts to encourage commercial financial institutions to provide long-term, low-cost capital to the CDFI sector. Measures such as requiring conventional lenders, pension funds, investment banks, insurance companies, mortgage companies, and finance companies to place a small proportion of their overall assets with CDFI's would yield enormous public benefits in the form of jobs, affordable housing, and increased ownership opportunities. It would also underscore the fact that commercial financial institutions have obligations to see that community credit needs are met.

Tax incentives providing tax-free interest to individuals who make below-market investments in CDFI's would give investors (or depositors) the equivalent of market-rate returns while ensuring a steady capital flow for the CDFI's. Individuals are already the core support for many CDFI's, but a strong incentive such as this would substantially strengthen the CDFI industry.

Human Capital Development

Our greatest resources are our board, our staff, and our committed volunteers. The NMCDLF currently operates with only two employees and as we grow one of our greatest challenges will be recruiting and training loan and technical assistance officers. This challenge is shared across the industry.

Efforts to create a national system of community development financial institutions will only be successful if a generation of directors, managers, and loan officers can be recruited and trained to operate these intermediaries. Development lending and public purpose bank management require specialized knowledge and technical skills, strong social commitments, and extensive community experience, all of which differ in important ways from the skills needed to run a conventional financial institution. Community development lenders should undertake, with Federal support, several initiatives to develop the next generation of community bankers and trustees needed to operate and to govern an expanded network of community development financial institutions. These initiatives could include:

- Creation of a three-year internship/apprenticeship program at community development financial institutions. This internship would be similar to in-house conventional/investment bank training programs but would also attend to the economic, social, and intellectual formation of participants.
- This program could dovetail with President Clinton's plans for a National Service Corps by placing talented young adults in training for productive careers in community development and community development finance.
- Forging cooperative training agreements with select university business schools and conventional financial institutions to complement the apprentice program outlined above.
- Sponsoring regular seminars on capital access, community leadership, public investment, and economic democracy issues for CDFI board and staff members.

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The Federal program also should include a research program to assess the long-term economic and social issues affecting the CDFI industry and the communities its members serve.

Corresponding Federal Policy Changes

An effort to create a national network of CDFI's would benefit by a series of related administrative and legislative initiatives:

- **Simplify public sector credit enhancement programs to non-profit CDFI's.** Partial and full loan guarantees, for example, could significantly increase the ability of CDFI's to leverage both public and private investment dollars. Similarly, non-depository CDFI's could increase their business lending if SBA rules were modified to simplify the requirements on non-bank lenders. This adaptation would also increase the number of minorities, women, and rural businesses receiving SBA support.
- **Require Government-sponsored enterprises (GSEs)—Fannie Mae, Freddie Mac, Ginnie Mae—to develop customized secondary market programs for housing and business loans originated by CDFI's.** To date, GSE's have been almost completely unresponsive to CDFI's. CDFI's performing loans are judged by standardized underwriting criteria that are largely irrelevant to CDFI's lending market. CDFI's cannot grow and prosper unless an active secondary market is fostered for their loans.

That concludes my prepared testimony. Thank you for this opportunity to discuss the work of the New Mexico Community Development Loan and our peers in NACDLF. I would be pleased to answer any questions you may have.

TESTIMONY OF RONALD L. PHILLIPS, PRESIDENT, COASTAL ENTERPRISES, INC.

COMMUNITY DEVELOPMENT CORPORATIONS AND THE COMMUNITY REVITALIZATION SYSTEM

FEBRUARY 3, 1993

Introduction

Senator Riegle and members of the Senate Banking Committee, thank you for inviting me to testify on the proposed Community Revitalization System. My name is Ron Phillips. I am President and principal founder of Coastal Enterprises, Inc., a nonprofit community development corporation located in Wiscasset, ME.

The Community Revitalization System is a strategic step to accelerate job-creating community development initiatives. It is an investment in America that will grow businesses, create jobs, build housing, and generate assets for low-income and working families. The return on taxpayer investment will multiply, and will recycle year in and year out.

We are especially interested how the Community Revitalization System will benefit Maine, including community development banking, partnerships with existing banks, access to venture capital, and resources for micro and community loan programs. I encourage your support for, and crafting of, legislation that is both flexible and inclusive, and that will provide a menu of opportunities for community development banks, credit unions, CDCs, micro and community loan funds, a network which enthusiastically awaits a resurgence of Federal support for their efforts.

Purpose of Testimony

As a practitioner of community development for over 15 years, and board member of the National Congress for Community Economic Development, the 325 member trade association for CDCs (please refer to the attached recent membership list), I want to share with you the exceptional accomplishments of my colleagues and CEI in community development, and our readiness as a national industry to partner with the Federal Government's Community Revitalization System.

My remarks will be brief, focusing on the legacy of CDCs, CEI's accomplishments, and recommendations.

The Legacy of Community Development Corporations

What are CDCs?

CDCs originated in the latter 1960's with the Title VII amendment to the Economic Opportunity Act of 1964—to develop businesses, housing, commercial real estate, and create economic opportunities for disenfranchised residents. This amendment was introduced in the U.S. Senate by the late Senators Robert Kennedy and

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Jacob Javits. What we contemplate today for a national Community Revitalization System is owed, in great part, to the accomplishments of CDCs.

CDCs share in common the mission of targeting development to distressed urban neighborhoods and rural communities and regions to create jobs, decent housing, education and training, and social services. CDCs are in virtually all States. Their development activities are diverse and responsive to the needs of their communities. They develop day care facilities, community health centers, affordable and supported housing, industrial and business parks, small business incubators, and shopping centers. They finance franchises and joint ventures, and provide small, micro and medium size loans and venture capital to businesses that cannot secure conventional capital. They are responding to worker dislocation resulting from defense cutbacks, and the need to create new jobs through economic conversion, business diversification, and investment in new technologies. They are comprehensive in their strategies, knowledgeable about their communities, create, new income and assets for residents, and leverage funds with the economic mainstream.

CDCs are nontraditional financial intermediaries. They work in partnership with the public sector—Federal, State and local government—and the private sector—foundations, banks, private business—to attract investment and lending capital to low- and moderate-income communities. According to our recent research studies, between 1985 and 1990 alone, 1,160 CDCs across the U.S.:
—built or rehabilitated 320,000 units of low income housing
—developed over 17.4 million square feet of commercial/industrial real estate
—made 3,500 business loans
—created or sustained over 90,000 jobs.

CEI Profile

Now let me briefly describe CEI as a model, rural community development corporation. Maine's is a small business economy, with 90 percent of the businesses employing fewer than 20. It also has a high rate of self-employment. Yet Maine has traditionally been at the end of the capital pipeline, ranking among the lowest nationally in bank deposits per capita.

CEI was organized in 1977 to address the capital needs of small businesses and communities, and to create income, employment and ownership opportunities for low-income people. CEI is a private and publicly funded CDC. We provide financing and technical assistance in development of job-creating, value-added, natural resource industries, export marketing companies, start-up and expanding small manufacturers, microenterprises, women in business, family and center-based child care, and affordable housing.

We have loaned or invested $20 million, leveraged $60 million in partnership with banks, and created or sustained some 3,500 jobs. We are an SBA 504 certified lender, and operate the SBA's microloan demonstration, and the FmHA's Intermediary Relending Program. We participate in private foundation Program Related Investments, such as with the Ford Foundation. We are also a certified borrower with the Finance Authority of Maine. We employ 24 people. We are a membership organization, with a 15-member board representative of business, banking, community organizations and the public sector.

Examples of CEI Projects

What are some examples of CEI projects. We have a growing portfolio financed on the *continuum* of capital need, from less than $5,000 to over $300,000 (please refer to the attached chart on CEI funds).

Our smallest loan is less than $700 to Sweet Deceptions in Lewiston, a self-employed starting microentrepreneur producer of sugar-free sweets and baked goods with only a few thousand in sales; our largest, over $400,000 in subordinated debt loan and equity investment to a producer of advanced technology geographic and recreational maps with over 100 employees and sales above $10 million. Examples of our economic development impact are:
—sectorial financing of the natural resource industries, such as the fisheries benefiting over 800 fishermen, crew and employees;
—investment in 70 start-up and expanding small business manufacturing operations employing 1,500;
—loans to 200 small, self-employed and microenterprises representing a range of producer, retail and service businesses;
—development of 50 family and center-based child care operations for over 1,600 pre-schoolers, and 200 jobs for providers;
—business counseling in planning, marketing, and technical assistance in $10 million of financing for over 4,000 small businesses that employ as many as 10,000

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people, including women in business, refugees, dislocated workers, unemployed professionals, and AFDC recipients.

Filling the Credit Gap

What role does CEI play in filling the credit gap? We are a nontraditional financial intermediary, and integrate this role with community development, technical assistance and market research programs. Financing is the last step in the process development process. We are the community development bank without the bank, working in partnership with Maine banks to provide guarantees, subordinated debt and equity capital for the very small, self-employed micro enterprises, to more sophisticated businesses. We make the deal happen by filling the credit gap.

As you know well, the banding industry has undergone significant changes in the last five years that have impacted the availability of credit. In many cases, risk assessment of loans have resulted in the application of more stringent criteria. Even small businesses with long-standing credit histories have seen their relationships with banks strained. These trends have increased the need for alternative sources of commercial credit. CDCs offer flexible, individualized credit attention, and leverage additional loan dollars from banks.

Let me illustrate for you how our funds—flexible, subordinated debt or equity capital—function in the financial structure of a business, over and over again, no matter how small, or how big, to ensure more conventional credit sources are accessed, and that the project has a chance to start up or expand.

Example of Gap Financing

During the Presidential election campaign, Senator Gore visited Moulded Fibre, Inc. in Westbrook. His purpose was to demonstrate the relationship between job creation and environmental sensitivity. Moulded Fibre processes recycled newspapers into a packaging fibre substitute for environmentally destructive styrofoam.

But Moulded Fibre, which now employees 44—and I might add they have hired AFDC recipients, dislocated workers and people with disabilities—was a start-up. To finance the nearly $1.1 million project, $375,000 in equity and subordinated debt was needed. CEI and other investors provided this financing. The SBA 504 program came next with a $325,000 debenture, and only then could the bank provide the balance of $400,000.

Recommendations

And now, let me close with some recommendations that could ensure a successful Community Revitalization System.

1. Provide funding for qualified existing and emerging nonprofit, community-based development organizations using any one of four models listed below:
   a) community development banks and credit unions
   b) partnerships with banks
   c) small-scale, community-based venture capital
   d) micro and community loan programs

These approaches will allow organizations to test strategies to build on CRA to accelerate targeted investment. Partnerships with banks will ensure their participation in the Community Revitalization System.

2. Consider special assistance to nonprofits to form a community development bank, or acquire a troubled bank.
3. Provide technical assistance and planning grants to enable community organizations to analyze their market and develop a business plan for forming a community development bank or partnership.
4. Provide first-year funding for the Community Revitalization System adequate to support 100 projects for community development banking and credit unions, partnerships with banks, micro and community loan funds, planning, technical assistance, and evaluation.

Conclusion

A Community Revitalization System will create jobs, income and ownership opportunities, reinforce CRA and leverage private capital to economic sectors, regions and populations in need of help.

There is a tested, experienced and dedicated network of community development practitioners prepared to renew and expand their roles in development of distressed urban neighborhoods and rural regions. On their behalf, I urge your support for legislation that would enhance and build on the current community development system, community development banks, community credit unions and loan funds, and the 25-year finance development legacy and expertise of community development corporations.

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Neal Peirce, syndicated columnist, and writer Carol Steinbach, in their 1990 *Enterprising Communities* stated that the thought of the community development movement failing is unthinkable. They said:

> "In an age of social fragmentation and indifferent bureaucracies, the movement promises a personalized, neighborhood-based renewal for the most disadvantaged Americans . . . community development corporations are not just a minor local phenomenon. They are an absolute national necessity."

Thank you, and I would be glad to answer any questions or provide additional information.

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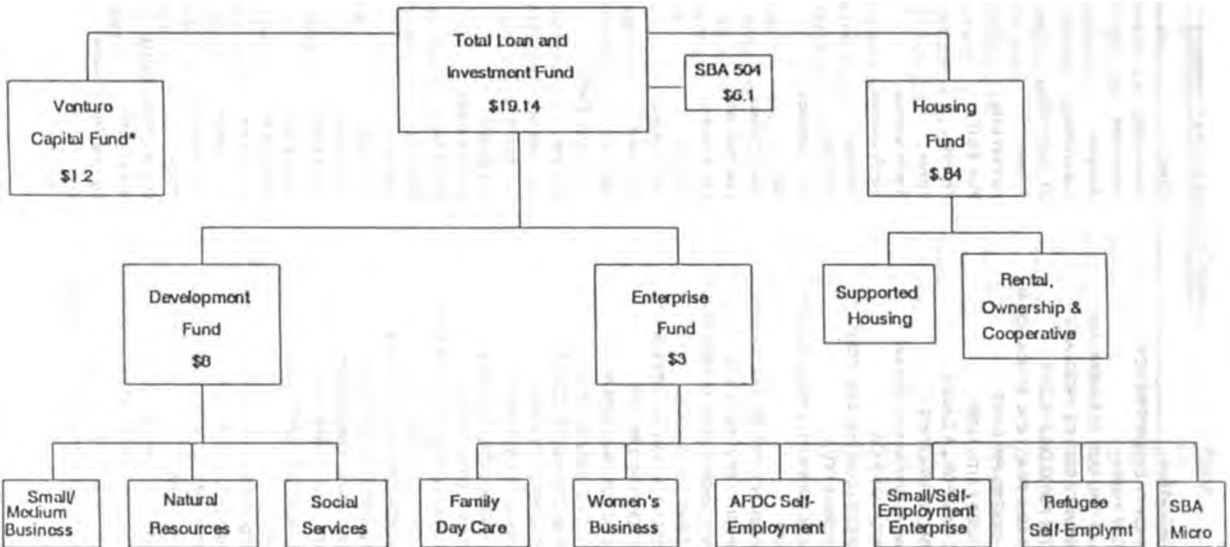
CEI DEVELOPMENT FINANCE FUNDS - 1991

Capitalization (in millions) and Targeted Sectors



*A $5 mil venture fund is in the planning stage

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NCCED Organizational Members

Organization	City	State
COMMUNITY ENTERPRISE DEV.	Anchorage,	AK
CEDC of Alaska	Anchorage,	AK
CAA OF CALHOUN, CLEBURNE AND	Anniston,	AL
COMMUNITY SERVICE PROGRAMS	Tuscaloosa,	AL
CENTER FOR ECONOMIC DEV.	St. University,	AR
PORTABLE PRACTICAL EDUCATIONAL	Tucson,	AR
SCF-MISSISSIPPI RIVER	Forrest City,	AR
THE GOOD FAITH FUND	Pine Bluff,	AR
CHICANOS POR LA CAUSA	Phoenix,	AZ
DINEH COOPERATIVES	Chinle,	AZ
ASIAN NEIGHBORHOOD DESIGN	San Francisco,	CA
BANK OF AMERICA	San Francisco,	CA
CABRILLO ECONOMIC DEV. CORP.	Saticoy,	CA
CALIFORNIA CEDA	Berkeley,	CA
CHINESE COMMUNITY HOUSING CORP.	San Francisco,	CA
CHISPA	Salinas,	CA
COMMUNITY CORP. OF SANTA MONICA	Santa Monica,	CA
COMMUNITY DEV. INSTITUTE	East Palo Alto,	CA
DREW ECONOMIC DEVELOPMENT CORP.	Los Angeles,	CA
EAST BAY ASIAN LOCAL	Oakland,	CA
EL CENTRO HUMAN SERVICES CORP.	Los Angeles,	CA
GREATER RICHMOND CDC	Richmond,	CA
HOUSING FOR INDEPENDENT	San Jose,	CA
HUB CITIES CONSORTIUM	Huntington Park,	CA
KOREAN COMMUNITY CENTER	Oakland,	CA
KOREAN YOUTH CENTER	Los Angeles,	CA
LOS ANGELES COMMUNITY	Los Angeles,	CA
LOS ANGELES URBAN LEAGUE	Los Angeles,	CA
MISSION ECONOMIC DEV.	San Francisco,	CA
NATIONAL CENTER FOR AMERICAN	El Monte,	CA
NATIONAL ECON. DEV.	Berkeley,	CA
NEIGHBORHOOD HOUSING SERVICES	Oakland,	CA
NEW ECONOMICS FOR WOMEN	Los Angeles,	CA
PACIFIC ASIAN CONSORTIUM	Los Angeles,	CA
SANTA CRUZ COMMUNITY	Santa Cruz,	CA
SPECTRUM COMMUNITY SERVICES	Hayward,	CA
TELACU	Los Angeles,	CA
UNITED CAMBODIAN COMMUNITY, INC	Long Beach,	CA
VERMONT-SLAUSON ECON.	Los Angeles,	CA
WARD ECONOMIC DEVELOPMENT CORP.	Los Angeles,	CA
WORLD VISION	Monrovia,	CA
CENTRE FOR COMMUNITY	Sydney, Nova Scotia	CN
COLCHESTER/TRURO/STEWIACKE REDTF	Nova Scotia	CN
NEW DAWN ENTERPRISES, LTD.	Sydney, Nova Scotia	CN
ASSOCIATED NETWORK OF MINISTRIES	Denver,	CO

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Organization	City	State
DENVER COMMUNITY DEV. CORP.	Denver,	CO
HOPE COMMUNITIES, INC.	Denver,	CO
NEIGHBORHOOD REINVESTMENT CORP.	Denver	CO
NEVSED COMMUNITY DEV. CORP.	Denver,	CO
BRIDGEPORT NEIGHBORHOOD	Bridgeport,	CT
BROAD PARK DEVELOPMENT CORP.	Hartford,	CT
NORTHEASTERN CONNECTICUT CDC, INC.	Danielson,	CT
NUTMEG HOUSING DEV. CORP.	New Haven,	CT
SAVE THE CHILDREN FEDERATION	Westport,	CT
ACTION TO REHABILITATE	Washington,	DC
CORPORATION FOR ENTERPRISE DEV.	Washington,	DC
H STREET COMMUNITY DEV. CORP.	Washington,	DC
MANNA, INC.	Washington,	DC
MARSHALL HEIGHTS COMMUNITY	Washington,	DC
NATIONAL COOPERATIVE BANK	Washington,	DC
UNIVERSITY LEGAL SERVICES	Washington,	DC
CODEC, INC.	Miami,	FL
COMMUNITY ECONOMIC DEV. COUNCIL	Jacksonville,	FL
COMMUNITY EQUITY INVESTMENTS, INC.	Pensacola,	FL
DADE EMPLOYMENT AND ECON.	Miami,	FL
FLORIDA FEDERATION OF CDCs	Quincy,	FL
Greater Miami United	Miami,	FL
HALLANDALE COMMUNITY DEV. CORP.	Hallandale,	FL
METRO-DADE COMMUNITY &	Miami,	FL
MIAMI BEACH DEVELOPMENT CORP.	Miami Beach,	FL
MIAMI-DADE NHS	Miami,	FL
NEW CENTURY DEVELOPMENT CORP.	Miami,	FL
NOAH DEVELOPMENT CORPORATION	Belle Glade,	FL
TACOLCY ECONOMIC DEV. CORP.	Miami,	FL
WEST PERRINE CDC	Miami,	FL
First Union National	Jacksonville,	FL
DEKALB COUNTY ECON. OPPORTUNITY	Decatur,	GA
QUITMAN/BROOKS COUNTY CDC	Valdosta,	GA
ALU LIKE, INC	Honolulu,	HI
AMOCO CORPORATION	Chicago,	IL
BETHEL NEW LIFE	Chicago,	IL
CHICAGO ASSOCIATION OF	Chicago,	IL
CITY OF KANKAKEE	Kankakee,	IL
CLARENCE-DARROW COMMUNITY	Chicago,	IL
COMMUNITY ECON. DEV. ASSOC.	Chicago,	IL
COMMUNITY WORKSHOP ON	Chicago,	IL
JANE ADDAMS RESOURCE CENTER	Chicago,	IL
LAWRENCE AVENUE DEV. CORP.	Chicago,	IL
SHOREBANK ADVISORY SERVICES, INC.	Chicago,	IL
THE NEIGHBORHOOD INSTITUTE	Chicago,	IL

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Organization	City	State
BUSINESS OPPORTUNITIES SYSTEMS	Indianapolis,	IN
EASTSIDE COMMUNITY INVESTMENTS, INC.	Indianapolis,	IN
HISTORIC LANDMARKS FOUNDATION	Indianapolis,	IN
HOOSIER UPLANDS ECONOMIC	Mitchell,	IN
INB NEIGHBORHOOD	Indianapolis,	IN
INDIANA ASSOCIATION FOR CED	Indianapolis,	IN
INDIANA CAP DIRECTORS' ASSOC., INC.	Indianapolis,	IN
INDIANAPOLIS NEIGHBORHOOD	Indianapolis,	IN
INTERFAITH HOMES, INC.	Indianapolis,	IN
LINCOLN HILLS DEVELOPMENT CORP.	Tell City,	IN
MARTIN LUTHER KING CDC	Indianapolis,	IN
NEAR NORTH DEVELOPMENT CORP.	Indianapolis,	IN
RILEY AREA REVITALIZATION	Indianapolis,	IN
WESTSIDE COMMUNITY DEVELOPMENT	Indianapolis,	IN
COMMUNITY VENTURES CORPORATION	Lexington,	KY
KENTUCKY HIGHLANDS INVESTMENT CORP.	London,	KY
MOUNTAIN ASSOCIATION FOR CED, INC.	Berea,	KY
NEW DIRECTIONS HOUSING CORP.	Louisville,	KY
CORPORATION FOR NEW	Natchitoches,	LA
DESIRE COMMUNITY HOUSING	New Orleans,	LA
SOUTHERN COOPERATIVE DEV. FUND	Lafayette,	LA
CHINESE ECONOMIC DEV. COUNCIL	Boston,	MA
CODMAN SQUARE HOUSING	Dorchester,	MA
COMMUNITY DEV. CORP. OF BOSTON	Boston,	MA
COMMUNITY DEV. CORP.	Fitchburg,	MA
COMMUNITY ECONOMIC DEV.	Boston,	MA
DORCHESTER BAY EDC	Dorchester,	MA
EAST BOSTON COMMUNITY	East Boston,	MA
FENWAY CDC	Boston,	MA
FIELDS CORNER CDC	Dorchester,	MA
ICA REVOLVING LOAN FUND	Somerville,	MA
INQUILINOS BORICUAS	Boston,	MA
LENA PARK CDC	Dorchester,	MA
MADISON PARK DEVELOPMENT CORP	Roxbury,	MA
MASSACHUSETTS ASSOCIATION OF CDCs	Boston,	MA
MASSACHUSETTS COMMUNITY DEV.	Boston,	MA
NEIGHBORHOOD OF AFFORDABLE HOUSING	East Boston,	MA
NUESTRA COMUNIDAD DEV. CORP.	Roxbury,	MA
QUINCY-GENEVA HOUSING CORP.	Roxbury,	MA
THE SOMERVILLE CORPORATION	Somerville,	MA
URBAN EDGE HOUSING CORP.	Jamaica Plain,	MA
YOUTH ACTION PROGRAM	Belmont,	MA
ANNE ARUNDEL COUNTY	Annapolis,	MD
COMMUNITY ASSISTANCE NETWORK	Baltimore,	MD
DEVELOPMENT TRAINING INSTITUTE	Baltimore,	MD

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Organization	City	State
ENTERPRISE FOUNDATION	Columbia,	MD
SHORE UP INC.!	Salisbury,	MD
SOUTHEAST COMMUNITY	Baltimore,	MD
COASTAL ENTERPRISES, INC.	Wiscasset,	ME
COMMUNITY CONCEPTS, INC.	So. Paris,	ME
CITIZENS COALITION FEDERAL	Pontiac,	MI
HUMAN DEVELOPMENT COMMISSION	Caro,	MI
MICHIGAN COMMUNITY ECON.	Lansing,	MI
MICHIGAN STATE UNIVERSITY	Lansing,	MI
OAKLAND LIVINGSTON HUMAN	Pontiac,	MI
WARREN/CONNER DEVELOPMENT	Detroit,	MI
WAYNE-METROPOLITAN COMMUNITY	Ecorse,	MI
MIDWEST MINNESOTA COMMUNITY	Detroit Lakes,	MN
MINNESOTA CENTER FOR CED	Minneapolis,	MN
TWIN CITIES HOUSING	Saint Paul,	MN
ANHEUSER-BUSCH COMPANIES, INC.	St. Louis,	MO
BLACK ECONOMIC UNION	Kansas City,	MO
CDC OF KANSAS CITY	Kansas City,	MO
CITIZEN HOUSING INFORMATION	Kansas City,	MO
NORTHSIDE RESIDENTIAL HOUSING	St. Louis,	MO
DELTA FOUNDATION	Greenville,	MS
HUMAN RESOURCE DEV. COUNCIL	Bozeman,	MT
CENTER FOR COMMUNITY SELF-HELP	Durham,	NC
DIVISION OF COMMUNITY	Raleigh,	NC
GATEWAY CDC	Henderson,	NC
HAYTI DEVELOPMENT CORPORATION	Durham,	NC
HOUSING ASSISTANCE CORPORATION	Hendersonville,	NC
LAND LOSS PREVENTION PROJECT	Durham,	NC
NORTH CAROLINA ALTERNATIVE	Research Triangle Park,	NC
NORTH CAROLINA ASSOCIATION	Raleigh,	NC
NORTH CAROLINA COALITION OF	Durham,	NC
N.C. REAL ENTERPRISES, INC.	Chapel Hill,	NC
NORTH CAROLINA RURAL CENTER	Raleigh,	NC
REID PARK NEIGHBORHOOD	Charlotte,	NC
ROCKY MOUNT/EDGECOMBE CDC	Rocky Mount,	NC
SOUTHEAST RALEIGH CDC	Raleigh,	NC
UDI COMMUNITY DEV. CORP.	Durham,	NC
WILSON COMMUNITY IMPROVEMENT	Wilson,	NC
OMAHA ECONOMIC DEV. CORP.	Omaha,	NE
NEW HAMPSHIRE COLLEGE	Manchester,	NH
NEW COMMUNITY CORPORATION	Newark,	NJ
NON-PROFIT AFFORDABLE HOUSING	Trenton,	NJ
HOME EDUCATION LIVELIHOOD PROGRAM	Albuquerque,	NM
SIETE DEL NORTE CDC	Embudo,	NM
ACCORD CORPORATION	Belmont,	NY

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Organization	City	State
BRONX VENTURE CORPORATION	Bronx,	NY
CITICORP/CITIBANK	New York,	NY
CED LEGAL ASSISTANCE CENTER	New York,	NY
COUNCIL FOR COMMUNITY-BASED DEV.	New York,	NY
FRANKLIN COUNTY COMMUNITY	Malone,	NY
GREYSTON FOUNDATION	Yonkers,	NY
HOUSING ASSISTANCE PROGRAM	Elizabethtown,	NY
ITHACA NEIGHBORHOOD HOUSING	Ithaca,	NY
LOCAL INITIATIVES SUPPORT CORP.	New York,	NY
PRATT INSTITUTE CENTER	Brooklyn,	NY
ROCKLAND COMMUNITY ACTION	Nanuet,	NY
ROCKLAND ECONOMIC DEV. CORP.	Pearl River,	NY
RURAL OPPORTUNITIES, INC.	Rochester,	NY
SETTLEMENT HOUSING FUND, INC.	New York,	NY
SOUTH BRONX OVERALL ECON.	Bronx,	NY
SOUTHERN TIER OFF. OF SOC. MIN.	Elmira,	NY
STEUBEN CHURCHPEOPLE AGAINST	Bath,	NY
TROY REHABILITATION &	Troy,	NY
URBAN LEAGUE OF ROCHESTER,	Rochester,	NY
WARREN-HAMILTON HOUSING CORP.	Indian Lake,	NY
Rural Opportunities, Inc.	Rochester,	NY
ASSOC. FOR A BETTER COMMUNITY	Canton,	OH
AVONDALE REDEVELOPMENT CORP.	Cincinnati,	OH
CENTER FOR NEIGHBORHOOD DEV.	Cleveland,	OH
CITY OF TOLEDO	Toledo,	OH
CLARK-METRO DEVELOPMENT CORP.	Cleveland,	OH
CLEVELAND NEIGHBORHOOD DEV. CORP.	Cleveland,	OH
COLLINWOOD COMMUNITY SERVICE	Cleveland,	OH
DEV. CORP. FOR CINCINNATI	Cincinnati,	OH
FRIENDS OF THE HOMELESS	Columbus,	OH
JOBS FOR PEOPLE	Cincinnati,	OH
LOWER PRICE HILL CURC	Cincinnati,	OH
NATIONAL CITY CDC	Cleveland,	OH
NDC ASSOCIATION OF	Cincinnati,	OH
NORTHRIVER DEVELOPMENT CORP.	Toledo,	OH
OHIO CDC ASSOCIATION	Columbus,	OH
REHAB PROJECT	Lima,	OH
SRD-NEIGHBORHOOD DEVELOPMENT	Dayton,	OH
STATE OF OHIO CDFF	Columbus,	OH
WALNUT HILLS REDEVELOPMENT	Cincinnati,	OH
WSOS COMMUNITY ACTION	Fremont,	OH
SRD-Neighborhood Development	Dayton,	OH
NORTHEAST COMMUNITY DEV. CORP.	Portland,	OR
NORTHWEST HOUSING	Milwaukie,	OR
OREGON COUNCIL FOR	Portland,	OR

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Organization	City	State
REACH COMMUNITY DEVELOPMENT	Portland,	OR
SOUTHEAST UPLIFT	Portland,	OR
ALLIED HUMAN SERVICES	New Castle,	PA
BUREAU OF HUMAN RESOURCES	Harrisburg,	PA
CENTRAL PENNSYLVANIA COMMUNITY	Clearfield,	PA
COMMUNITY HUMAN SERVICES CORP.	Pittsburgh,	PA
COMMUNITY TECHNICAL ASSISTANCE	Pittsburgh,	PA
DUQUESNE BUSINESS ADVISORY	Duquesne,	PA
EAST OF BROAD COMMUNITY	Philadelphia,	PA
HISPANIC ASSOCIATION OF	Philadelphia,	PA
HOMEWOOD-BRUSHTON REVITALIZATION	Pittsburgh,	PA
MANCHESTER CITIZENS CORPORATION	Pittsburgh,	PA
MAYOR'S OFFICE OF COMMUNITY	Philadelphia,	PA
NORTH SIDE CIVIC DEV.	Pittsburgh,	PA
PENNSYLVANIA DIRECTORS ASSN.	Harrisburg,	PA
PENNSYLVANIA FARMWORKER	Camp Hill,	PA
PHILADELPHIA COMMUNITY	Philadelphia,	PA
ECONOMIC DEVELOPMENT CORPORATION	San Juan,	PR
JUBILEE INNER CITY DEVELOPMENT CORP.	Providence,	RI
OIC OF RHODE ISLAND	Providence,	RI
WAHID COOPERATIVE ENTERPRISES, INC.	Newport,	RI
NORTHEAST SOUTH DAKOTA ECC	Sisseton,	SD
SISSETON-WAHPETON SCHOOL BOARD	Agency Village,	SD
THE LAKOTA FUND	Kyle,	SD
CHATTANOOGA NEIGHBORHOOD	Chattanooga,	TN
EAST TENNESSEE COMMUNITY	Knoxville,	TN
FISK AREA DEVELOPMENT CORP.	Nashville,	TN
M. L. KING BOULEVARD CDC	Chattanooga,	TN
MATRIX, INC.	Knoxville,	TN
TENCO DEVELOPMENTS, INC.	Lewisburg,	TN
TENNESSEE NETWORK FOR CED	Knoxville,	TN
WEST GREENVILLE CDC	Greenville,	TN
AVENIDA GUADALUPE ASSOCIATION	San Antonio,	TX
EAST AUSTIN ECONOMIC	Austin,	TX
FREEDMEN'S TOWN ASSOCIATION, INC.	Houston,	TX
QUIN RIVERS AGENCY FOR	Providence Forge,	VA
RICHMOND BETTER HOUSING	Richmond,	VA
SOUTHWEST VIRGINIA COMMUNITY	Roanoke,	VA
TASK FORCE FOR HISTORIC PRESERVATION	Richmond,	VA
VIRGINIA WATER PROJECT	Roanoke,	VA
TRI-ISLAND ECONOMIC DEV. COUNCIL	St. Thomas,	VI
NORTHERN COMMUNITY INVESTMENT CORP.	St. Johnsbury,	VT
TOWN OF ROCKINGHAM	Bellows Falls,	VT

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Organization	City	State
BENTON-FRANKLIN COMMUNITY	Pasco,	WA
COLUMBIA BASIN MINORITY	Pasco,	WA
EL CENTRO DE LA RAZA	Seattle,	WA
GRANT COUNTY COMMUNITY ACTION	Moses Lake,	WA
PIC OF SNOHOMISH COUNTY	Everett,	WA
PLYMOUTH HOUSING GROUP	Seattle,	WA
THE OPPORTUNITY COUNCIL	Bellingham,	WA
UPPER TACOMA RENAISSANCE	Tacoma,	WA
WASHINGTON ASSOCIATION FOR CED	Seattle,	WA
ADVOCAP, INC.	Fond du Lac,	WI
CAP SERVICES, INC.	Stevens Point,	WI
CENTRAL WISCONSIN CAC, INC.	Lake Delton,	WI
COMMON WEALTH DEVELOPMENT, INC.	Madison,	WI
COMMUNITY RELATIONS-SOCIAL	Milwaukee,	WI
COOPERATIVE WEST SIDE ASSOCIATION	Milwaukee,	WI
DANE COUNTY COMMUNITY	Madison,	WI
IMPACT SEVEN, INC.	Turtle Lake,	WI
INNER CITY REDEVELOPMENT CORP.	Milwaukee,	WI
LA RAZA UNIDA, INC.	Fort Atkinson,	WI
NEWCAP, INC.	Oconto,	WI
NORTHWEST SIDE CDC	Milwaukee,	WI
WEST CENTRAL WISCONSIN CAA, INC.	Glenwood City,	WI
WESTERN DAIRYLAND E.O.C.	Independence,	WI
WISCONSIN COULEE CAP	Westby,	WI
MATEWAN DEVELOPMENT CENTER	Matewan,	WV
TELAMON CORPORATION	Martinsburg,	WV

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STATEMENT OF ROBERT JACKSON, TREASURER, QUITMAN COUNTY FEDERAL CREDIT UNION

Mr. Chairman, members of the Committee, I am Robert Jackson, Treasurer of the Quitman County Federal Credit Union. We are located in Marks, Mississippi, a low-income rural community in the Mississippi Delta about 80 miles south of Memphis. I also serve on the Board of Directors of the National Federation of Community Development Credit Unions, a coalition of credit unions that serve low- and moderate-income communities throughout the United States. The Federation is affiliated with the Credit Union National Association, the national trade organization for credit unions. Speaking for my small credit union and for the larger credit union movement, I would like to express strong support for the new administration's initiative for expanded community development financial institution activity. The story I have to tell you about the situation in the Mississippi delta will show very clearly just how urgent our needs are.

Community Development Credit Unions

Before talking about the particular experiences of my credit union, I would like to say a few words about the national community development credit union movement. Of the 14,000 or so credit unions in the United States, more than 300 serve low-income communities in rural communities, inner-city neighborhoods and Indian reservations. The primary mission of these institutions is to provide credit and other financial services to people who are considered "unbankable" by mainstream financial institutions. The need for credit in these areas is desperate.

One CDCU in central Florida makes loans to migrant farm workers who need second-hand trucks in order to commute to work in surrounding counties. Another CDCU in San Francisco has made small loans that allow newly-arriving Vietnamese immigrants to continue earning a living as fishermen. A Harlem CDCU once lent funds to an entrepreneur who wanted to expand his auto repair business but had been turned down by 10 different banks. In this case, the borrower repaid his credit union loan three years early. In central Appalachia, a CDCU works with public assistance recipients who want to start their own businesses and get off welfare. This group's efforts were recently described in a front-page Wall Street Journal article.

Hispanic and Haitian migrant farm workers, Vietnamese immigrants, small business owners in Harlem and welfare mothers in Appalachia are not the kind of lucrative clients that other institutions are looking to serve. Frankly, in my opinion, many institutions don't even want these folks coming in the front door because they can't make a profit serving this kind of clientele.

The Story of Quitman County

In Quitman County, our credit union was formed 11 years ago in order to cope with a lack of access to credit. Like so many other places in the Mississippi delta, Quitman County is a place where African-American residents are mired in poverty and trying to cope with the legacy of centuries of economic and political discrimination. My town, Marks, was one of the key sites of civil rights activity that was visited by Dr. Martin Luther King, Jr. which was highlighted in newspaper publications across the country on Sunday, January 17, 1993.

To this day, however, there is persistent rural poverty. Unemployment in the area is 18 to 20 percent in the African-American community and 9.8 percent overall. The per capita income in the county is $6,450 annually. The per capita income for African-Americans is $4,133. Many African-Americans are living in substandard housing without running water. They would like to buy new homes or repair the old ones, and they would like to start a small business or borrow money to send a child to school.

Until 1977, there was only one bank in the Marks area and it was owned by a local family that also controlled much of the land and political machinery in the county. Since loans were routinely denied, many poor people, including my parents who were sharecroppers, didn't even bether to go to the local bank.

Out of pure desperation, we organized a grass-roots movement for equality that led to the creation of the Quitman County Development Organization and the Quitman County Federal Credit Union. The credit union has $1,017,000 in assets and serves 850 members and growing. Since the day we were organized, we have lent more than $2,126,000 to local people, most of whom would not have any other access to credit.

I would like to tell you the story of a typical loan that we make—to a family that has stayed on the farm or plantation all their lives up until 1989. The father got sick and couldn't work on the farm anymore, and was asked to move out of the plantation owned house. The family had nowhere to move, no credit history to assume a mortgage, and no breadwinner for the family. The family approached the credit

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union for a housing loan to purchase a $10,000 house. The credit union made the loan because we knew the family. I'm happy to say that they have made their monthly payment like clockwork. An article on CDCU's in Credit Union Magazine, October 1990 issue, tells of this story in more detail. A copy of this article is attached. What would have happened to this family? I'm afraid to think what may have transpired if the credit union had not been there. This is not an exception, this is the rule. Families being displaced from large plantations with nowhere to go, and no money to move anywhere else. No sympathy from the landowners, and no severance pay, no retirement, nothing. I believe that CDCU's are financial institutions with a conscience. And we need more of them.

While we have been successful in providing credit to people who would otherwise be shut out of the capital market, there is a great deal more that we would like to do. We are particularly interested in duplicating the successes of the Nation's largest CDCU, the Self-Help Credit Union of North Carolina. Self-Help has more than $40 million in assets and has extended loans throughout the State of North Carolina. This success is due in large part to an innovative structure that combines the credit union and a non-profit development organization. Working together the two institutions can provide a full spectrum of services needed to further economic development.

We have the same structure in Quitman County. Our credit union provides credit and savings services, while the non-profit, Quitman County Development Organization is able to conduct fundraising and take on larger and higher risk development projects. All this is done in coordination with each other and other non-profits in the area.

I am confident that we can grow to Self-Help's size and scope in a safe and sound manner. But that will require relief from current regulations imposed on us by our regulatory agency, the National Credit Union Administration (NCUA). We also need more technical assistance from them and a strategic investment of Federal resources. In talking about public investment in CDCUs, an important ratio to keep in mind is 10 to 1. For every dollar that a CDCU receives in reserve funds, the institution is able to extend 10 dollars in loans for home acquisitions and repairs, small business development and other purposes. If my credit union had a $100,000 infusion of equity, I can guarantee you that we will make $1 million dollars worth of loans in Quitman County, Mississippi, the poorest section of the United States.

As a county supervisor (commissioner), I understand your budgetary concerns. I also understand the power that you have as a Federal lawmaker to change policy from the top.

As you go about the process of creating a community development banking program, and I'm confident you will, there are a few positive steps that you can take to help credit unions like mine and others throughout the United States. I support the following recommendations of the National Federation of Community Development Credit Unions for steps which Congress can take to improve access to credit for consumers and small businesses.

- Through Community Development Banking legislation, provide equity infusions to CDCUs and other community development lenders. *This is the single most important step that Congress can take*. Despite all the good work that CDCUs are doing, our impact has been limited by our small size. Most CDCUs and other community development lenders will need to be bigger institutions in order to have a meaningful impact on the credit crisis. By providing equity capital to community development lenders, you allow them to expand and sustain their work, which might otherwise be discouraged as "high risk" by regulators.
- Recognize and establish that lending for small and micro-businesses is a valid and valued function of credit unions, especially in low-income and other underserved areas. This would mean, among other things, preserving the tax exemption on credit unions and getting the National Credit Union Administration to ease current regulatory restrictions on business lending. We have seen significant improvement in the treatment of CDCUs by our regulators during the last year. We would like to see legislative action that will enhance, reinforce, and institutionalize those improvements.
- Facilitate access to existing secondary markets, and create, if necessary, a specialized secondary market for community development loans.
- Provide funding for technical assistance to new and growing community development lenders.
- Keep CRA in place. The Community Reinvestment Act (CRA) has been a very important part of our success in the last decade; many of our CDCUs have received financial support—including equity and operating grants, and interest-free deposits—from banks as a direct or indirect result of CRA. While we believe that banks that support community development lenders like CDCUs should get CRA credit,

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we do not want to see CRA weakened. It is an invaluable tool for producing productive partnerships in many low-income communities.

- Increase the level of funding for the Revolving Loan Program for CDCUs operated by the National Credit Union Administration. At present, the program has $6 million to invest among hundreds of CDCUs nationwide. An increase in the program will enable more institutions to be served.

In closing let me again emphasize the importance of easing the current regulatory restraints under which we labor. To effectively do our job, we must never be held back by limits on non-member deposits and we must have additional flexibility in making small business loans to our members. Attached is a CUNA position paper on these issues with amendments which I support.

This concludes my statement. I will be glad to answer any questions.

POSITION PAPER—COMMUNITY DEVELOPMENT BANKING

The Credit Union National Association and Affiliates (CUNA) fully supports the concept proposed by the Clinton Administration to expand the role of community development banking. This paper is to share some of our preliminary ideas and recommendations concerning this important and potentially far-reaching initiative. CUNA is the primary trade association representing this country's 13,400 credit unions and their 65 million members. One of its affiliates is the National Federation of Community Development Credit Unions.

The credit union movement continues to exist separately from the banking system of this country for very basic reasons: (1) it can still demonstrate its unique and different approach to providing consumer financial services; and (2) this unique approach continues to bring substantial benefits to consumers that are worth preserving. Some people are able to get a loan at a credit union when they were unable to find credit elsewhere. CUNA is committed to preserving this credit union philosophy. Certainly the work done by low income, or community development credit unions, exemplifies the credit union difference.

We welcome this renewed interest in providing credit at reasonable rates to those who have been left out of the traditional financial system and especially in providing small business loans to assist in the rehabilitation of low income areas. It is easier, even within the credit union community, to concentrate on the more routine extensions of credit and to lose momentum in the seeking of new avenues to reach those with limited access to credit. This tendency has been exacerbated by changes to the legislative and regulatory atmosphere which have occurred over the past several years. For instance, the National Credit Union Administration (NCUA) and its predecessor, the Bureau of Federal Credit Unions, once placed a high priority on the actual promoting of credit unions and the credit union movement. Awards were given to examiners who had chartered the most credit unions or contacted the most groups informing them about credit unions, technical assistance was given to struggling credit unions, and it was recognized and acknowledged that many differences would exist among credit unions depending on their missions and the agency adjusted itself to accommodate for these differences.

However, circumstances occurred which greatly influenced this agency's perspective. As a result of the savings and loan crisis and the large number of bank failures, the Congress sent strong legislative signals to all financial regulators to vastly increase their supervisory activities. Advocacy roles by regulators came under criticism. This coupled with tremendous growth in the credit union movement and the advent of Federal share insurance for credit unions led the agency to begin operating from a new set of priorities. It retreated from its advocacy role and centered its efforts on eliminating any and all perceived threats to the National Credit Union Share Insurance Fund (NCUSIF). While a healthy concern for safety and soundness is an essential component of the credit union movement, it is not its primary purpose or "raison d'étre." Regulatory pressures have ensued which seek more standardized credit unions and credit union lending. Non-traditional lending activities are often viewed as potential threats to the insurance fund. Unnecessary restrictions have been placed on the amount of non-member deposits which community development credit unions can seek. New charters, especially community development ones, had become extremely cumbersome and rare. Restrictions on small business loans to credit union members are excessive.

Merger and liquidation actions have become so commonplace they scarcely raise an eyebrow. What was formerly resorted to as a last resort is often used now as a supervisory tool to improve the overall safety and soundness scorecard of the credit union movement or to facilitate the movement toward fewer and more standardized credit unions. Because of the virtual elimination of new charters and the ex-

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tremely high merger and liquidation activities, the number of credit unions in this country has gone from a high of 22,200 in 1978 to today's figure of 13,400.

In general, the emphasis has shifted from assisting credit unions to carry out their chosen missions in a safe and sound manner to an over emphasis on safety and soundness at the expense of individual missions. For example, some community development credit unions in existence for a number of years have been liquidated because their measured financial condition was marginal and it was determined that they "would never succeed." This view of what constitutes success is too narrow and fails to see that in terms of struggling to bring hope and change to individuals lacking access to credit and financial services, the credit unions were already demonstrable successes. It is unfortunate that many of these credit unions are no longer in existence. Further, the combined assets of these credit unions is so relatively small as to make any potential insurance losses very limited.

Some would argue that these changes have produced a credit union movement that is more efficient, more standardized, more streamlined, and easier to control and supervise. While these observations are true, that is not necessarily the best public policy. Public policy is best served by a secure financial system that provides opportunity to those of modest means, not simply one that lends itself to efficient regulation. Tens of thousands of credit union volunteers have been eliminated along with their ideas and service at the local level; decision-making has become more centralized and thusly more standardized; communities and groups have lost the closeness and sense of ownership control which their own credit union brought to them; and diversity and uniqueness have been reduced.

Therefore we are pleased that the focus is now on the promotion of imaginative, case-by-case initiatives where individual financial institutions seek to best meet the particular needs of their locales (and their members), rather than seeking standardized methods of delivering only those types of services which have a proven track record. Hearings such as these and the use of a new Government entity such as a National Trust for Community Development Financial Institutions should afford the necessary impetus and advocacy to fully embrace this important objective of reaching out to those communities which are in the greatest need. Under this new plan, we assume that NCUA would continue to charter, insure, and regulate and that the National Trust would designate those credit unions eligible for loans, capital infusions, technical assistance etc. and make decisions on the dollar amounts to be awarded to each institution. These two forces should provide a more balanced approach to the goals of extending credit union services and maintaining safety and soundness. We strongly recommend that credit unions be included as an integral component of the Community Development program. The statement of the National Federation of Community Development Credit Unions gives an excellent overview of the positive benefits of CDCUs as well as some specific models that should be replicated in the future. CUNA concurs with the recommendations which have been made by the NFCDCU.

Attached are three recommended legislative changes to the Federal Credit Union Act designed to add impetus to credit union participation not only in community development activities but other lending activities which could assist in economic recovery.

AMENDMENTS

1. *Expediting charters of low income credit unions (includes CDCUs).*

Amend Section 104 of the Federal Credit Union Act (12 USC 1754) by adding after the current first sentence, a new sentence which reads: "The Board shall give a high priority to considering the organizational certificate of a low income credit union."

Suggested report language: "The Congress intends that the credit union chartering activities be simplified and expedited by NCUA and that special efforts be made in the case of low income credit unions.

2. *Small business loans to members.*

Amend Section 107(5) of the Federal Credit Union Act (12 USC 1757) by inserting immediately after "(5) to make loans," the following: "including small business loans to their members,".

Suggested report language: "The Congress, by specifically including the phrase small business loans to credit union members wishes to signal its recognition that many credit unions serve a membership where their primary focus is not on consumer lending but rather on providing modest size loans for business purposes to their members. NCUA should recognize the needs of such credit unions and pro-

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vide the necessary flexibility to enable these credit unions to meet the needs of their members."

3. *Non-member deposits.*

Amend Section 107(6) of the Federal Credit Union Act (12 USC 1757) by adding at the end thereof the following new sentence: "In prescribing limitations, the Board shall avoid limitations which preclude credit unions (especially low income credit unions) from providing services to their members."

Suggested report language: "The Congress instructs the NCUA to avoid wherever possible the placing of limitations on the receipt of payments (deposits) by credit unions, especially low income credit unions, which would impair the ability of the credit union to successfully carry out its mission."

TESTIMONY OF MICHAEL SWACK, CO-DIRECTOR, INSTITUTE FOR COOPERATIVE COMMUNITY DEVELOPMENT

Community Development Lending and Microenterprise

Microenterprise programs work with entrepreneurial individuals seeking to start or expand small businesses. Microenterprises range from self-employment businesses to businesses employing five people. These businesses usually require small amounts of capital—typically between $250–$10,000 in order to operate or expand.

Microenterprise programs represent a community-based economic development strategy for business development and job creation among those traditionally left out of the economic mainstream. They provide individuals with the capital and skills they need to turn their businesses or business ideas into reality. The individuals served by microenterprise programs are predominantly women, often people of color, and almost all are welfare recipients, unemployed or the working poor. The creation of small businesses is just one goal of microenterprise programs—they are also designed to increase incomes, stabilize families, raise self-esteem and self-confidence, develop skills, create role models, and spark a process of community renewal. Over 150 microenterprise development programs are represented nationally by the Association for Enterprise Opportunity (AEO) in Chicago.

Many microenterprise programs include loan funds or offer financial services through partnerships with local banks or credit unions. Micro loan funds usually are capitalized with grants or loans from foundations or Government agencies. But microenterprises face many barriers. The loan sizes required by microenterprises are typically too small to be considered by traditional financial intermediaries. The cost of transacting such loans is unprofitable for these traditional intermediaries. Additionally, the borrowers are considered to be too "risky"—they do not have much equity to put into the businesses, they have very little collateral, and they do not have histories of running profitable businesses.

Although these loans are considered too "risky" by traditional intermediaries, many community-based organizations have successfully loaned to microenterprises. My own organization, the Institute for Cooperative Community Development has run a program called Working Capital for the past two years. During this time we have made over 425 loans in Northern New England. We have utilized a model of lending called "peer" lending, a model utilized extensively overseas in places like Bangladesh and throughout Latin America. In this model, people join borrowing groups. Members start out by borrowing small amounts of money for their businesses. If any member of the group fails to repay his or her loan, other members or the group must either make this payment or they will be denied access to further credit. We have enjoyed close to a 97 percent repayment rate over the life of the program.

In addition to providing capital, many microenterprise programs provide training, technical assistance and in some cases support services such as child care and transportation to borrowers. The provision of these non-fee generating services, combined with the small loan sizes, means that microenterprise programs are not able to support themselves on fee and interest income.

Although it is not within the purview of this committee, it is important to note that microenterprise programs face barriers other than the barrier of access to capital. For microenterprise programs to succeed the Government must eliminate barriers and penalties for transfer payment and public assistance recipients who pursue self-employment. We need to allow AFDC recipients to accumulate business assets and deduct business related expenses in calculating net income; change unemployment insurance laws to exempt recipients from looking for work while starting a business; and, change public housing rent provisions to minimize increases for residents generating wage or self-employment income.

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Any legislative initiative to create community development financial institutions needs to explicitly recognize and encourage microenterprise lending, whether through microenterprise loan funds or other community-based intermediaries engaged in microenterprise lending. An investment of Federal funds into microenterprise funds could be done in a variety of ways. Our Working Capital program has worked out a unique arrangement with three New England banks (Vermont National Bank, Fleet Bank, and Meredith Village Savings Bank) whereby we have access to bank lines of credit for microenterprise lending. In exchange for access to credit, we establish small loan loss reserve funds at the bank. The small investment into loan loss reserve funds (currently made by foundations) has enabled us to leverage substantial amounts of credit from banks to microenterprises.

A legislative initiative that supports investment in microenterprise funds and training and technical assistance to borrowers could greatly enhance the success and growth of microenterprise programs—programs that have already demonstrated success in improving the quality of life for a wide range of people.

Finally, as someone who has been an active participant in community investment for 14 years—with a variety of institutions (including microenterprise funds, community development loan funds and quasi-public agencies), I have four specific recommendations for any Government-sponsored financial initiative to promote community-based economic development.

1. A wide range of community development financial institutions (CDFI), (including commercial banks, community development credit unions, community-development loan funds, microenterprise funds and specialized public agencies) should be eligible to receive investment from a Federal initiative for community development financial institutions. However, any institution receiving investment from a Federal initiative should specify how they will help achieve goals of community development and community investment. Community investment means more than simply investing money in a particular geographic place. A successful program of community investment will stimulate the demand for development capital by supporting the formation of community organizations (like community development corporations and community land trusts), and encouraging these organizations to develop and plan more housing and economic development projects. Organizations I have worked with, such as the Institute for Community Economics and the New Hampshire Community Loan Fund, have helped create new community development organizations, which have in turn created housing and jobs for low-income people.

2. A key need in community development finance is the need for equity investment in low-income communities. A Federal initiative should provide equity to CDFI's and encourage CDFI's to invest equity in community housing and economic development ventures. Traditional loan products are not sufficient to meet community capital needs. My experience as Chairman of the New Hampshire Community Development Finance Authority (CDFA), a quasi-public agency, has demonstrated how critical equity can be to the success of projects. Through equity investments (such as preferred stock and sharing of net operating income), the CDFA can invest the kind of capital that is typically not available to low-income individuals and projects that are developed by organizations serving low-income communities. CDFA's investment improves the capital structure of the venture, leverages private debt, and enhances the probability of success for the venture.

3. Encourage additional private investment in CDFI's by the private sector and State and local government. The New Hampshire Community Development Finance Authority (CDFA) provides an interesting example of how to encourage investment in community development by the private sector. The State provides a tax credit to businesses that commit funds to the CDFA—the CDFA can then use these funds to make equity and debt investments in community-based housing and economic development projects. Federal legislation should include mechanisms that encourage the private sector to invest in CDFI's.

4. A Federal initiative must seek to promote the development of secondary market mechanisms to support the growth and liquidity of CDFI's. One of the primary problems CDFI's face is liquidity. CDFI's originate loans and investments that are nonstandard—that is, they do not fit the standard underwriting criteria of traditional lenders. We hold these loans in our portfolio for several years—during this time many risk factors are reduced. If we could sell these loans in the secondary market, we would have more capital to originate the kinds of loans that only CDFI's originate. Federal legislation should require Government-sponsored entities like Ginnie Mae and Freddie Mac to serve our market.

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MICHAEL SWACK

Michael Swack is a professor and the Director of the Community Economic Development Program at New Hampshire College where he teaches courses in economic development, finance and negotiations. He is also the Co-Director of the affiliated Institute for Cooperative Community Development (ICCD), a nonprofit organization involved in applied research, technical assistance and training. ICCD currently runs the Working Capital program, the largest peer-lending microenterprise program in the United States and the Capital Networks program, a pilot project that provides assistance and credit to businesses participating in flexible manufacturing networks.

Mr. Swack has worked in the field of development finance for 14 years as a practitioner, consultant and teacher. He is a trustee and past President of the Institute for Community Economics in Springfield, MA, the Chairman of the New Hampshire Community Development Finance Authority, a founding and current board member of the New Hampshire Community Loan Fund, a founding trustee of the National Association for Community Development Loan Funds and a past member of the Housing Advisory Board for the Federal Home Loan Bank in Boston. He received his doctorate from Columbia University, his masters degree from Harvard University and his bachelors degree from the University of Wisconsin.

ADDITIONAL TESTIMONY BY MICHAEL SWACK AND DONALD MASON

THE INSTITUTE FOR COOPERATIVE COMMUNITY DEVELOPMENT

Summary of Priority Issues

1. A wide range of community development financial institutions (CDFI), (including commercial banks, community development credit unions, community development loan funds, microenterprise funds and specialized public agencies) should be eligible to receive investment from a Federal initiative for community development financial institutions. However, any institution receiving investment from a Federal initiative should specify how they will help achieve goals of community development and community investment. Community investment means more than simply investing money in a particular geographic place. A successful program of community investment will stimulate the demand for development capital by supporting the formation of community organizations (like community development corporations and community land trusts), and encouraging these organizations to develop and plan more housing and economic development projects. Organizations I have worked with, such as the Institute for Community Economics and the New Hampshire Community Loan Fund, have helped create new community development organizations, which have in turn created housing and jobs for low-income people.

2. A key need in community development finance is the need for equity investment in low-income communities. A Federal initiative should provide equity to CDFI's and encourage CDFI's to invest equity in community housing and economic development ventures. Traditional loan products are not sufficient to meet community capital needs. My experience as Chairman of the New Hampshire Community Development Finance Authority (CDFA), a quasi-public agency, has demonstrated how critical equity can be to the success of projects. Through equity investments (such as preferred stock and sharing of net operating income), the CDFA can invest the kind of capital that is typically not available to low-income individuals and projects that are developed by organizations serving low-income communities. CDFA's investment improves the capital structure of the venture, leverages private debt, and enhances the probability of success for the venture.

3. Encourage additional private investment in CDFI's by the private sector and State and local government. The New Hampshire Community Development Finance Authority (CDFA) provides an interesting example of how to encourage investment in community development by the private sector. The State provides a tax credit to businesses that commit funds to the CDFA—the CDFA can then use these funds to make equity and debt investments in community-based housing and economic development projects. Federal legislation should include mechanisms that encourage the private sector to invest in CDFI's.

4. A Federal initiative must seek to promote the development of secondary market mechanisms to support the growth and liquidity of CDFI's. One of the primary problems CDFI's face is liquidity. CDFI's originate loans and investments that are nonstandard—that is, they do not fit the standard underwriting criteria of traditional lenders. We hold these loans in our portfolio for several years—during this time many risk factors are reduced. If we could sell these loans in the secondary market, we would have more capital to originate the kinds of loans that only CDFI's origi-

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nate. Federal legislation should require Government-sponsored entities like Ginnie Mae and Freddie Mac to serve our market.

I. FEASIBILITY

a. To establish a certain specific number of community development financial institutions (CDFI's) to be developed over the next four years is irrelevant. No specific number should be set as a goal, instead, the development process should be allowed to proceed based upon the need, the skill and expertise of those developing the institutions, and the level of capital available for the formation of these institutions. Of course, this process will be determined by the nature of the rules, procedures and policies developed through this legislation. It seems more important to develop a process by which community development financial institutions will be encouraged, rather than set a specific goal. However, any CDFI receiving money from the Federal Government needs to specify how they will measure their own success.

b. Community investment means more than simply investing money in a particular geographic place. Community investment involves a commitment to addressing social issues as well; that is, recognizing that the allocation of capital in the community requires a commitment to meeting the needs of those people and groups who have typically been ignored by the traditional capital markets. Promoting local control of local resources and stopping the "leakage" of capital from poor communities are important goals of community investment. Community investment seeks not only to make capital available but to encourage the types of efforts and institutions that will make the best use of capital in the community. A successful program of community investment will stimulate the demand for development capital by supporting the formation of community projects and businesses and encouraging existing groups such as community development corporations (CDCs) to plan more projects.

One of the greatest impediments to the formation of community development financial institutions is the lack of skills within the community economic development world to design, develop, and run community development financial institutions. This is especially true if community development banks have the mission of providing capital to communities, individuals and businesses that have traditionally been shut out of the capital markets. Over the last twenty years, many community economic development practitioners have focused on specific areas of development, i.e. housing, business development, job training, etc. The number of individuals truly committed to community economic development who have the necessary skills to operate a community development financial institution is relatively small. Without a plan to upgrading and training these individuals, such a program as the one proposed runs the risk of being overwhelmed by people who do not have a good understanding of community economic development.

If only traditional financial institutions (i.e. commercial banks) are permitted to become community development banks, we could find that these institutions begin to develop an approach to community lending that is similar to what they already do. This would defeat the purpose of establishing community development banks in the first place. To successfully do community lending in the first place, those involved with the bank must have a broader perspective of the capital needs of a community than that now shared by traditional lenders. Community development financial institutions must be flexible to develop and utilize underwriting criteria that reflects the reality of the people, projects, and community in which they are lending. They must be able to establish underwriting criteria that would not necessarily match the criteria now used by traditional financial institutions. They must be able to offer a wider range of financial instruments including equity and subordinated debt.

If community development financial institutions are really intended as institutions that can fill a needed gap (i.e., lack of capital for control of community resources), then community development financial institutions must provide or have access to a wide range of services including training and technical assistance to business borrowers, organizational development for organizations embarking on housing projects, and other support services for development. Of course, it may not be possible for a CDFI to provide this wide-range of services, but there should be some mechanism for other organizations to fill these roles. Without the ability to provide these services, community development financial institutions will begin to develop underwriting criteria that matches traditional banks, due to their perception of greater risk in lending to underdeveloped communities.

Community development financial institutions must be able to offer a wider range of financing tools than traditional banks. These tools need to include the ability to provide equity, as well as a range of debt instruments. The present regulatory environment would make it difficult for commercial banks to address these financing

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needs. This regulatory environment limits the types of risks that the bank can take, and limits the range of financial tools available to a bank. Development banking is common in many developing countries. These institutions provide financing in a manner that enhances the financial viability of the project or business seeking financing. The goal is a successful business or project, not necessarily a large return on investment.

II. What is Community Development Banking?

a. Community development financial institutions must be permitted to develop and hold a long-term strategy for the economic development of the community that they serve. This will require that community development financial institutions (CDFI) be permitted to engage in long-term investment decisions of the community. This implies necessarily that CDFI's have the ability to actually invest, rather than loan money, to community development ventures. A primary goal of this initiative should be to support those CDFI's that have the ability to acquire equity positions in businesses through instruments such as preferred stock or royalty agreements. A CDFI should also be allowed to be a participating partner in housing and commercial development in the community. Return on equity can be realized in the form of a share of the net operating income of the project. Rather than be only a source of loans for development, a community development financial institution should have the authority and the purpose of truly investing in the community's ventures, and therefore in the community's future. This can not be done if the bank is restricted to lending alone.

One of the primary goals of a CDFI should be to leverage private participation in the financing of ventures through its own investment in that venture. Financing by CDFI's should tie into broader financial markets, and utilize these markets as sources of investment. This can only be accomplished if CDFI's have the ability to utilize a wide range of financing tools suitable to each deal.

b. A CDFI's primary goal should be providing access to capital to individuals, organizations, businesses, and communities that have traditionally be denied capital. Its goal should also be to assist the community in gaining control over the community's own resources. These goals can either take the form of revitalization of distressed areas, as well as improving the well-being of the residents of such areas. However, as a community starts to gain control over its resources through control of its land base, housing stock, and circulation of capital within the community, both of these objectives can be met.

c. Any financial intermediary, profit or non-profit, including commercial banks, community development loan funds and community development credit unions should be eligible to receive investment from a Federal initiative. States and localities that have created or create specialized CDFI's should also be able to participate in a Federal initiative. For example, New Hampshire has created a Community Development Finance Authority (CDFA) that invests both equity and debt into community development projects and businesses. The money from CDFA comes from private business, which gets a tax credit for putting money into the CDFA. The Federal Government should review the CDFA legislation and experience in drafting its own initiative.

d. One of the primary purposes of a community development financial institution should be to leverage and develop partnerships with the private sector. For example, a community development financial institution such as a community development loan fund should be encouraged to enter agreements with traditional lenders so as to leverage its own investment with money from the broader capital markets. The development of secondary market mechanisms is critical for CDFI's. Current secondary market mechanisms have been unresponsive to CDFI loans even when the pool of loans being offered by the CDFI is of extremely low risk. A Federal initiative for CDFI's should target the development of secondary market mechanisms as a priority of the initiative and/or stimulate existing Federally supported secondary markets to be more responsive to CDFI's.

e. CDFI's should be permitted to offer a wide-range of community economic development programs under one roof. They should be permitted to operate micro-loan revolving funds, venture capital funds, housing loan funds, and programs that encourage the acquisition by community based organizations of their community's resources, especially land. They should also be able, through direct investment or loans, to participate in specific infrastructure projects that allow a community to develop. For instance, on many Native American reservations, access to electricity, water and sewers makes economic development difficult. A Community Development Bank should be permitted to become a partner, either through equity investments, or loans, with tribes seeking to develop these facilities.

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III. How to Finance Community Development Banks

a. CDFI's can be financed through capital provided by the Federal Government, State government, private investors, and community organizations. Some of the financing can be through direct grants by the Federal, State and local government for initial capitalization and operating expenses. Other funds could be raised by changing the tax laws and the securities laws.

b. States and local governments could be encouraged to either invest or provide loans to CDFI's through their CDBG funds. For every dollar invested of CDBG money in equity, the state of local government could receive 50 percent of additional CDBG funds. If the CDBG money is a loan, they could receive three (3) points above the interest charged to the CDFI for each year of the loan. In order to qualify, the CDFI must serve either the State or local government making the loan/investment.

c. The Federal Reserve and its member banks should be allowed to loan to CDFI's at the Reserve or Banks' cost of funds. Other banks who make loans to CDFI's should be allowed to borrow money from the Fed or its members at reduced rates.

d. Direct tax credits to private investors should also be considered as a possible way to finance community development banks. While this approach would have an impact on Government revenues, it is not inconsistent with the Administration's position on investment tax credits. The New Hampshire Community Development Finance Authority (CDFA) is a good example for utilizing tax credits to assist in the capitalization of CDFI's. Under this legislation, New Hampshire businesses are able to donate money or property to the CDFA, and receive a tax credit against their business profit tax. This tax credit may be spread out over more than one year, and the total amount any business can receive is limited.

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PRINCIPLES OF COMMUNITY DEVELOPMENT LENDING & PROPOSALS FOR KEY FEDERAL SUPPORT

Association for Enterprise Opportunity
Chicago, IL

Center for Community Self-Help
Durham, NC

Community Capital Bank
Brooklyn, NY

First Nations Development Institute
Falmouth, VA

National Association of Community Development Loan Funds
Philadelphia, PA

National Federation of Community Development Credit Unions
New York, NY

Woodstock Institute
Chicago, IL

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1. Overview

President Bill Clinton has declared his intention to create a national system of 100 community development banks over the next four years. Fortunately, an emerging industry of community development financial institutions (CDFIs) offers a solid foundation for this bold initiative, which might include new institutions, community organizations, conventional lenders, and others, in addition to CDFIs.

The industry lends to low-income and, increasingly, to middle-income wage earners, small businesses, American Indian reservations, and community development projects, complementing the work of conventional lenders. Two factors argue in favor of the CDFI industry playing a lead role in a federally-assisted community development lending program.

(1) The successful track record of community economic development and growth fostered by affordable credit through CDFIs is evidence that good borrowers come in greater variety than traditional underwriting methods often recognize. It is worth noting that CDFIs often provide a bridge between conventional lenders and unconventional borrowers, by creating new borrowers and opening new markets for the lenders while giving the borrowers access to capital sources.

(2) Effective community development lending programs are rooted in the communities they serve and are customized to fit those communities. Such institutions can only be established and grown gradually.

This memo lays out the key principles that we, as community development lenders, believe must guide the Clinton Administration's community development lending program and suggests several ways that the federal government can support the growth of the CDFI industry. To date, with almost no public support, CDFIs have proved that it is possible to mobilize and lend significant amounts of capital for development in low- and moderate-income communities. Our track record and experience can and should serve as a foundation for growth. With appropriate federal involvement, community development lending can help reduce poverty, counter social and political disenfranchisement, and stoke the engines of economic growth.

The CDFI industry has developed over the last fifteen years out of the determination and entrepreneurial spirit of thousands of community activists, social investors, non-profit developers, and small business persons who correctly perceived that lack of access to credit is a principal barrier to social and economic development. This industry comprises diverse institutions that serve a variety of credit needs in urban and rural communities. Included are:

Community Development Banks (CDBs), which are federally insured and regulated depository institutions that have been organized specifically to provide capital to rebuild lower-income communities. Just four community develop-

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ment banks operate in the U.S. today: South Shore Bank in Chicago, Elk Horn Bank and Trust in Arkansas, Community Capital Bank in Brooklyn, NY, and the Self-Help Credit Union in North Carolina. South Shore Bank, Elk Horn Bank and Trust, and Self-Help Credit Union are part of larger bank or non-profit holding companies that include independent, non-depository credit and support mechanisms such as venture capital funds, development loan funds, and technical assistance agencies. These non-depository institutions are able to be more pro-active in their development activities.

- **Community Development Credit Unions (CDCUs), which are regulated financial cooperatives owned and operated by lower-income persons.** Typically, CDCUs provide consumer banking services (e.g., savings accounts, check cashing) that may not be locally available to their members, as well as personal loans for consumer goods purchases, home rehabilitation, and car purchases. A growing number of CDCUs are making development loans for small business expansion and start-up, home purchases, and housing rehabilitation. Prominent development lending credit unions include the Self-Help Credit Union in North Carolina, the Alternatives Federal Credit Union in Ithaca, NY, First Americans Credit Union in Window Rock, AZ, and the Santa Cruz Community Credit Union in California. CDCUs offer deposit insurance up to $100,000 per account through the National Credit Union Administration, which regulates the credit unions' activities. CDCUs are represented nationally by the National Federation of Community Development Credit Unions (NFCDCU) in New York City.

- **Community Development Loan Funds (CDLFs),** which are unregulated financial intermediaries that aggregate capital from individual and institutional social investors at below-market rates and re-lend this money primarily to non-profit housing and business developers in urban and rural lower-income communities. CDLFs place strong emphasis on financing projects that provide new economic opportunities and resources to borrowers and others in their communities. This generates economic leverage, enabling individuals and community groups to have a voice in community business, social, and political affairs. CDLFs have been leaders in financing community land trusts, cooperative housing (including mobile home parks), and worker/community-owned businesses. Prominent CDLFs include the Low Income Housing Fund in San Francisco, the Federation of Appalachian Housing Enterprises in Berea, KY, the Industrial Cooperatives Association Revolving Loan Fund in Boston, MA, and the Delaware Valley Community Reinvestment Fund in Philadelphia, PA. Loan funds are represented nationally by the National Association of Community Development Loan Funds (NACDLF) in Philadelphia, PA.

- Micro-loan funds (MLFs) are most often components of micro enterprise development programs that integrate both economic and human development strategies. These programs are designed to fight poverty, increase incomes, raise self-esteem, stabilize families, develop personal, business and technical skills, create jobs and role models, as well as to spark a process of community renewal. The individuals served by these programs are predominantly women, often people of color, and almost all low-income welfare recipients, unemployed, or the working poor. Loans to micro enterprises range typically between $250 and $10,000 to start-up or expand self-employment or micro businesses employing up to five people, normally family members. These ventures include home day care, alterations and repair, fashion design and tailoring, catering and food service, hair and nail care, engine repair, trucking, retail and merchandising. Many micro enterprise development programs also offer additional financial services through partnerships with local banks or credit unions. Micro loans funds usually are capitalized with grants or loans from

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foundations or government agencies or loans from banks or other financial institutions. Pioneered in the developing world by Accion International and Bangladesh's Grameen Bank, micro loan funds are relatively new to the U.S. Prominent micro enterprise development programs with MLF's include Women Venture (formerly WEDCO) in Minneapolis, Minnesota, the Lakota Fund in South Dakota, Micro Industry Credit Rural Organization (MICRO) in Tucson, Arizona, the Women's Self-Employment-Project Chicago, Illinois, the Good Faith Fund in Arkansas, and the North Carolina Rural Economic Development Center. Over 150 micro enterprise development programs are represented nationally by the Association for Enterprise Opportunity (AEO) in Chicago, Illinois.

There are also a number of hybrid CDFIs that do not fit exactly into these categories but that provide critical financing to community development efforts. These hybrid institutions include New York City's Community Preservation Corporation, which has mobilized capital from banks, insurance companies, and pension funds for low- and moderate-income multifamily housing, and First Nations Development Institute's Oweesta Fund, which serves American Indian reservations. In addition, venture development funds like Northeast Ventures in Duluth, MN, Coastal Enterprises in Wiscosset, ME, and Eastside Community Investments in Indianapolis, IN, finance start-up businesses in urban and rural communities using equity capital raised through foundations and government grants. These institutions are very much a part of the CDFI industry. They serve as models for other community development lenders, and they will be important to any effort to expand credit access in underserved markets.

All of these CDFIs share certain public purpose values:

- to offer credit to the poor and to those whose credit needs are not otherwise being met;
- to spur community-wide economic and social development;
- to provide the necessary technical assistance to borrowers to ensure the success of loans and to build the capacity of borrowers;
- to use the lending process in a way that encourages borrowers to participate in decision-making within their organizations and communities;
- to enable individuals to gain self-sufficiency; and
- to lend primarily for community development.

Capitalized with more than $700 million—much of which is raised from within the communities or constituencies they serve—development banks, credit unions, and loan funds have extended more than $2 billion in loans. Loss rates are comparable to the best conventional lenders. These CDFIs are proving:

- that lower-income people and communities are credit-worthy;
- that efforts to overcome chronic poverty depend on both access to credit and resources for capacity-building by individuals and organizations, and
- that conventional approaches to risk assessment and security must be reexamined when serving borrowers with little or no credit history, business or development experience, or collateral.

2. Statement of Need

The need for CDFIs and the affordable credit they provide has never been greater. Much as access to credit is a precondition for growth in small to large businesses, local access to affordable credit is a necessary antidote to poverty, economic disenfranchisement, and community economic stagnation. Chronic poverty continues to increase in America. Government statistics released in the last quarter reveal that more Americans live in poverty today than at any time in the last twenty years. Common ideas about poverty often overlook the fact that it is as prevalent in rural communities as it is in urban ones, while recent riots in Los Angeles and Washington Heights, NY, are evidence of the desperation such economic and social decline has caused.

Poverty results not simply from a lack of resources or capacity but also from patterns of ownership and

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control of land, housing, businesses, and financial institutions that draw resources out of lower-income communities and limit the ability of local residents and Tribes to invest in their own future. This is exacerbated by credit barriers and social divisions that limit or deny lower-income and working class communities access to capital for community economic development.

Providing development credit in low- and middle-income communities is vital to our nation's economic prospects. Small businesses will provide the greatest employment growth over the next two decades. CDFI lending programs encourage entrepreneurship, self-sufficiency, and creative solutions, qualities that will be essential to economic recovery. CDFIs measure their success not only by their own economic gains but also by their contributions to rebuilding the civic infrastructure of businesses, voluntary organizations, social services, and housing central to revitalization of America's working class and poor communities.

Current economic and political facts—the recent recession, astronomical government deficits, the savings and loan bailout, and the health care crisis—preclude significant increases in federal, state, and local aid for existing community and economic development programs. Bank industry mergers and proposed regulatory reforms have created and will create mega-financial institutions with minimal obligation, and ability to serve poor and middle-income communities. Financial institution consolidations will continue throughout the 1990's, reducing the number of banks in the U.S. from 12,000 to 8,000, while many of the remaining banks will focus not on the conventional banking and credit needs of new and small borrowers but on larger and more profitable customers. Most conventional lenders are further restrained by class and cultural barriers, the high cost of operations, and their commitment to profit maximization.

The 1992 elections made it clear that the American public is looking for new ways to rebuild the civic infrastructure of businesses, voluntary organizations, community services, and housing upon which a strong democracy rests. President Clinton's proposal for a National Service Corps is a reflection of this spirit. It also offers an opportunity to link public service to public support for community development lending by using the corps as the training ground for a new generation of community development lenders (see Section 5.C. below), one of the most important needs that must be met for community development lending to succeed.

3. A Vision for Community Development Lending

To serve the unmet and growing credit needs of local communities, a national network of CDFIs must be fostered. Existing public purpose lenders, particularly community development banks, community development credit unions, community development loan funds, and micro-loan funds, comprise a solid basis for a nationwide network of community development financial institutions.* Initially, efforts should be made to expand and adapt the models pioneered by North Carolina's Center for Community Self Help, Chicago's South Shore Bank, Arkansas's Elk Horn Bank & Trust, and Brooklyn, NY's, Community Capital Bank.

Multi-service CDFIs have the greatest potential for growth, community development impact, and self-sufficiency. The bank or non-profit holding company structure enables the development intermediary to aggregate capital from within and outside the community through an insured depository institution. It also allows the institution to set up other credit and technical assistance affiliates. This type of organization can then pursue a coordinated development strategy that achieves an economy of scale and the significant impact necessary for the revitalization of urban and rural communities. This multi-service model should be considered the first-tier of CDFIs.

* New organizations, conventional lenders, and institutions other than those mentioned here are also expected to be part of this network. This paper focuses on the types of CDFIs described in Section 1.

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At the second tier, the number of CDFIs that have the capacity to step immediately into the multi-service model is limited to some 25-30 institutions. Indeed, significant support for capacity building will be needed to achieve President Clinton's goal of 100 multi-service CDFIs. This support will enable some micro-loan funds to evolve into loan funds or credit unions, small loan funds and credit unions to grow larger, and large, successful CDLFs and CDCUs to become multi-service institutions. A growth ladder of this type will provide an important legacy for President Clinton—a national network of more than 100 multi-service CDFIs, as well as strong and enduring local institutions and revitalized communities across America.

Pilot projects should be launched over the next four years to build on the foundation for 100 multi-service development financial institutions that will, in turn, demonstrate the value and feasibility of a broader community development banking system. These projects must include support at both tiers of the CDFI industry. Strong CDFIs should be selected for these efforts because they have:

- Clear missions of community economic development;
- Demonstrated development lending track records;
- Accountability to investors or depositors and to the communities they serve;
- Effective management, lending, investment, and technical assistance capabilities;
- Established networks of investors and borrowers from which to launch a large-scale community revitalization initiative; and
- Strong community support.

Five factors will be critical to the success of such pilot ventures and to a long-term effort to build a public purpose banking system:

(1) A base of equity or net worth capable of sustaining the organizations as they grow;
(2) Access to and control over longer-term, lower-cost capital;
(3) A long-term strategy for human capital development;
(4) Public sector grants to support borrower technical assistance services and new credit product development ventures; and
(5) Continued access to federal housing, enterprise, and social service development programs, as appropriate.

4. Key Principles in Meeting Credit Needs in Lower-Income Communities

Six key principles should guide Clinton administration officials and Congressional leaders formulating this initiative:

A) Community development "banks" should be defined to include the spectrum of community development financial institutions. A diversity of credit needs exist in poor communities; therefore, a range of institutions has evolved to serve these needs. To be effective, any Federal program must support a spectrum of institutions that have the following common attributes:

1) offer credit to low- and moderate-income people, small businesses, and community development projects whose need for credit is not otherwise being met;
2) provide the necessary technical assistance to borrowers to ensure the success of loans and to expand the capacity of borrowers;
3) make credit decisions within their own institutions so that local, regional, or state factors, as appropriate, are properly weighed;
4) foster community-wide economic and social development; and
5) empower disenfranchised individuals and communities to gain self-sufficiency.

B) Expand the scope of community development bank lending beyond small business credit. The Clinton plan articulated during the campaign seems to assume that community development lending would be primarily, if not entirely, business oriented. We strongly recommend that a successful program must also include housing lending, consumer lending, retail banking, and other credit needs (e.g., working capital and facilities development loans for non-profit social service providers and Tribes) in working class and low-income com-

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munities. Healthy communities are made up of a variety of institutions and persons with diverse credit needs. Failure to respond to this broad range of credit demands will needlessly limit any community revitalization strategy.

C) Consult experienced community development financial institutions in crafting legislation and operating the CDFI network. 42 loan funds, 100 community development credit unions, and 4 development banks manage approximately $700 million in private capital and have proven lending track records.

- South Shore Bank in Chicago, Community Capital Bank in Brooklyn, NY, Elk Horn Bank & Trust in Arkansas, and the Self-Help Credit Union in North Carolina have loan loss rates at or below the level of their peer depository institutions.
- According to the National Federation of Community Development Credit Unions (NFCDCU), community development credit unions have loaned more than $2 billion. NFCDCU's members' loss rate on loans on average is less than 2%.
- NACDLF members have loaned more than $100 million, which has leveraged $760 million in public and private capital to finance 15,000 housing units and to create 6,100 jobs for poor Americans. NACDLF members loss rate on loans is less than 1%.

D) Emphasize expansion of existing community development financial institutions rather than simply undertake wholesale efforts to create new development banks. Existing institutions should be supported to expand their activities because they know their markets and because they have proven that they can lend successfully in low- and moderate-income communities. Most CDFIs are undercapitalized and operate with inadequate net worth levels, requiring them to divert resources from working with borrowers to seeking potential funding sources. At the same time, the demand for affordable credit in most cases far outstrips the supply.

An attempt to franchise or otherwise mass produce CDFIs is not likely to be able to meet this demand. Successful CDFIs are, as we have noted, rooted in the communities, states, and regions that they serve. Most draw their lending capital from their service areas, and their boards of directors reflect the composition of their communities. This makes it possible for them to gain the requisite understanding of credit needs and borrower capacity to gauge their lending properly. Institutions created without these strengths and operating with a mandate to lend quickly and in a safe and sound manner will carry a heavy burden of unachievable expectations. In areas not presently served by a CDFI, the federal government consider fostering development of a new one.

E) Recognize that successful development lending institutions are built over time and with incremental performance-based financial support. South Shore Bank in Chicago and the Center for Community Self-Help in North Carolina have reached their current levels after 20 years and 10 years respectively. Development finance is a highly specialized enterprise requiring uniquely skilled personnel, detailed market knowledge, and local institutional credibility. This skill and trust cannot be bought with massive federal appropriations but must be built over time through sound lending and borrower capacity-building programs. Any other approach invites repetition of past federal antipoverty initiatives that produced fraud and abuse.

F) Clarify the different interests and responsibilities of conventional lenders, public agencies, and CDFIs. The notion that CDFIs will take business away from conventional lenders is not likely to come to pass. Loan funds, credit unions, and development banks operate almost entirely in separate markets from those served by conventional lenders. Historically, CDFIs have been a breeding ground for new borrowers from conventional institutions, serving as bridges giving banks and others access to new markets. The difficulties of gauging credit risk among new or unestablished borrowers, lack of market knowledge, inadequate development lending expertise, and changes in the global financial system pose significant—though not insurmount-

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able—hurdles for conventional lenders interested in playing an expanded role in these communities under the Clinton Administration's community development lending initiative.

Public agency programs often are bureaucratic and highly politicized. Instead of serving borrowers' needs, these programs can stifle the entrepreneurial initiative that community development financial institutions successfully foster. Community development lending requires highly specialized business skills and a commitment to sound business practices. It is often difficult to foster these qualities in the public sector.

As a result, we believe that existing CDFIs should be the foundation for an expanded community development lending initiative, as stated above. Two key responsibilities of conventional lenders as part of this program need to be articulated, however, to ensure that the broader purposes of the Clinton community development banking program are met:

- **Continue the Community Reinvestment Act (CRA) and expand community reinvestment lending.** The creation of a CDFI network under the Clinton Administration must not be a substitute for the CRA. It is our experience that even if the Clinton plan for 100 CDFIs were fully realized in 1993 there would still be an overwhelming demand for affordable credit in America's distressed urban, suburban, and rural communities. New York City alone has a $30 billion affordable housing credit shortfall. The federal government could support community development in general by extending the reach of the CRA.

  At the same time, an expanded CDFI industry will provide conventional lenders with a means to participate in community development lending at substantially reduced risk and lower transaction costs. Many CDFIs have worked successfully with conventional lenders. The Low Income Housing Fund (LIHF) of San Francisco, CA, has pioneered the use of innovative financing mechanisms such as loan packaging to help conventional lenders make community development loans. LIHF currently manages some $16 million in two loan pools in San Francisco and Los Angeles.
- **Link creation of a national system of CDFIs to future financial support for and regulation of the conventional financial industry.** The private banking system and capital markets have undergone a profound restructuring over the past 20 years. Banking industry deregulation, growth in the conventional paper markets, insurance industry expansion, and the increasing role of unregulated financial intermediaries such as mortgage banks and finance companies have left many lower and middle-income Americans, small businesses, and poor communities without access to affordable credit. This restructuring has been made possible through myriad government subsidies to conventional financial institutions (e.g., federal deposit insurance, state insurance guarantee funds, Federal Reserve Discount Window borrowings, etc.). Government subsidies and new powers should be granted to the financial industry only if it meets quantifiable community lending objectives and provides ongoing financial support to the developing national system of CDFIs.

5. Strategic Federal Support

Federal support should be provided to foster the development of a national system of community development financial institutions:

A) Equity Capital or Net Worth Grants: Sufficient levels of equity (for for-profit lenders) or net worth (for non-profit lenders) is critical to the long-term viability of any financial institution. Access to adequate amounts of equity or net worth is the principal impediment to the creation and/or growth of most CDFIs. Only four development banks have been created in the past 20 years, primarily because of the difficulty in raising equity or net worth capital. Distribution of equity funding under a federal program should use a performance-based process (see Section 7).

Equity or net worth capital is critical to all financial institutions:

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- It permits greater risk in lending to borrowers with limited credit histories by providing investors adequate protection;
- It enables flexible loan pricing and longer terms, as needed;
- It permits lenders to refinance balloon loans made to borrowers when designated take-out financing is delayed;
- It protects investors from borrower defaults if allocated loss reserves are exhausted;
- It gives CDFIs the financial clout to attract new investments from sources that traditionally have not supported them—such as insurance companies, banks, mutual funds, and universities—and that require minimum net worth levels; and
- It generates 100% earnings as "spread," giving CDFIs the financial independence to forge creative partnerships with borrowers. The spread subsidizes borrower technical assistance, which makes development lending viable.

B) Below-Market & Long-Term Deposits or Loans: The costs of doing community development lending are higher than the costs of traditional conventional lending, in large part because each loan requires the lender to provide technical assistance to the borrower. In addition, the underwriting process is unique for each loan. To insure borrower success, ongoing technical assistance often is required long after loans are closed. The interest earned on below-market deposits or capital helps to pay for this assistance.

Many CDFIs also face the challenge of using short-term capital (for non-depository institutions) or deposits to fund long-term projects. Housing lenders by necessity often make balloon loans without take-out financing in place. Conventional banks are hesitant to participate in or to refinance these loans for various reasons, including (1) lack of familiarity with the nonconforming, original underwriting of most CDFI loans, (2) terms and pricing that may be unattractive, (3) the lack of credit enhancements such as loan guarantees and interest rate subsidies, (4) the lack of a specialized secondary market for community development loans, (5) lack of experience with development lending markets, (6) high transactions costs, and (7) a misperception of substantially higher risk in development lending. Longer-term deposits make longer-term lending feasible for CDFIs.

C) Human Capital Development: Efforts to create a national system of community development financial institutions will only be successful if a generation of directors, managers, and loan officers can be recruited and trained to operate these intermediaries. Development lending and public purpose bank management require specialized knowledge and technical skills, strong social commitments, and extensive community experience, all of which differ in important ways from the skills needed to run a conventional financial institution. Community development lenders should undertake, with Federal support, several initiatives to develop the next generation of community bankers and trustees needed to operate and to govern an expanded network of community development financial institutions. These initiatives could include:

- Creation of a three-year internship/apprenticeship program at community development financial institutions. This internship would be similar to in-house conventional/investment bank training programs but would also attend to the economic, social, and intellectual formation of participants.

  This program could dovetail with President Clinton's plans for a National Service Corps by placing talented young adults in training for productive careers in community development and community development finance.
- Forging cooperative training agreements with select university business schools and conventional financial institutions to complement the apprentice program outlined above.
- Sponsoring regular seminars on capital access, community leadership, public investment, and economic democracy issues for CDFI board and staff members.

The federal program also should include a

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research program to assess the long-term economic and social issues affecting the CDFI industry and the communities its members serve.

D) Borrower Technical Assistance and New Credit Products Development Funding: CDFIs serve a market of institutions and individuals who have been unable to gain access to credit. Typically, CDFI customers are first-time borrowers with little credit history or development experience. Ongoing technical assistance is critical to successful CDFI lending to housing developers, first-time homeowners, small businesses, and non-profit service providers. The business planning, financial management, and marketing assistance CDFIs provide to their borrowers to build skills is labor intensive and raises transaction costs, ultimately lowering profit margins. It is necessary because it helps to ensure loan repayment and long-term borrower success. To serve this market effectively, CDFIs have created specialized technical assistance programs. CDFIs also continually develop and market new loan products to serve emerging credit needs. The market analysis, product research, and product development costs incurred by CDFIs are substantial. Support for these capacity building programs is essential in three areas:

- Technical assistance to first-time borrowers or organizations undertaking new housing/business development ventures;
- Technical assistance to help secure conventional lender financing for current CDFI borrowers; and
- New credit product development by CDFIs to meet emerging credit needs of new borrowers.

6. Potential Funding Sources

CDFIs offer the Clinton Administration a unique opportunity to demonstrate its commitment to economic programs that eschew the "hand out" model, that encourage and abet entrepreneurship, that foster economic self-sufficiency, that support economic growth at the community level where its impact is greatest, and that reward economic and social accountability.

CDFI funding should not come exclusively from a direct federal appropriation but should draw also on the public responsibilities of the federally insured and subsidized conventional financial markets. Those institutions which benefit from public subsidy of their lending or other financial services (e.g., deposit insurance, insurance and pension fund guarantees) could reasonably be expected to contribute in various ways to meeting credit needs they are unable to address directly.

Several possible financing mechanisms could complement direct Congressional appropriations for the Clinton CDFI program. These include: commercial bank commitments of equity capital and other support to CDFIs as an outcome of CRA negotiations or mega-bank mergers; a share of the profits from appreciation of federally sold assets (e.g., a percentage recapture levy on Resolution Trust Corporation properties); a share of profits from government-sponsored enterprises such as Fannie Mae and Freddie Mac; and CDFI set-asides within major legislation to bail out the S&L industry or inject capital into other parts of the financial services industry. A combination of such modest measures could yield hundreds of millions of dollars of capital needed to build a vibrant, large-scale CDFI sector.

In addition, the Clinton Administration should consider carrots and sticks for commercial financial institutions to provide long-term, low-cost capital to the CDFI sector. Measures such as requiring conventional lenders, pension funds, investment banks, insurance companies, mortgage companies, and finance companies to place a very small proportion of their overall assets with CDFIs would yield enormous public benefits in the form of jobs, affordable housing, and increased ownership opportunities. It would also underscore the expectation that such institutions that receive public subsidies have special responsibilities to see that community credit needs are met.

Finally, the Clinton Administration should consider incentives to increase investment in CDFIs by America's major wealth-builders—individuals. CDFIs have proven their ability to raise private capital for community investment from individu-

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als. This could be significantly enhanced if federal tax laws were amended to provide tax-free interest to individuals who make below-market community development investments or deposits in loan funds, credit unions, micro-loan funds, and development banks. This incentive would be available to individuals at all income levels, would give investors (or depositors) the equivalent of market-rate returns, and would—via CDFIs—strengthen communities socially and economically.

7. Corresponding Federal Policy Changes

A federal policy of supporting community development finance must extend beyond the proposed network of 100 CDFIs. The Clinton Administration can back up its investment in CDFIs by a series of administrative and legislative initiatives:

- **Simplify public sector credit enhancement programs to non-profit CDFIs.** Partial and full loan guarantees, for example, could significantly increase the ability of CDFIs to leverage both public and private investment dollars. The Community Preservation Corporation in New York City has successfully used municipal and state guarantee programs to direct more than $1 billion in bank, insurance industry, and municipal pension fund moneys to affordable housing lending. Farmers Home Administration, Federal Housing Administration, and Veterans Administration programs could be used to replicate this model with CDFIs across the nation. Similarly, South Shore Bank is the largest Small Business Administration (SBA) lender in Chicago. Beneficiaries are primarily minority-owned businesses. Non-depository CDFIs could increase their business lending if SBA rules were modified to simplify the requirements on non-bank lenders. This adaptation would also increase the number of minorities, women, and rural businesses receiving SBA support.

- **Require government-sponsored enterprises (GSEs)—Fannie Mae, Freddie Mac, Ginnie Mae—to develop customized secondary market programs for housing and business loans originated by CDFIs.** To date, GSEs have been almost completely unresponsive to CDFIs. CDFIs' performing loans are judged by standardized underwriting criteria that are largely irrelevant to CDFIs' lending market. CDFIs cannot grow and prosper unless an active secondary market is fostered for their loans. Existing GSEs have an obligation to serve this market aggressively and can do it profitably. CDFIs' lending track record has spurred great interest among social investors—such as religious and municipal pension funds—to purchase performing community development loans through private placement mechanisms.

- **Ensure public accountability of all CDFIs.** Limited federal oversight will be necessary to administer the CDFI initiative and to ensure public accountability. Regulatory and program evaluation standards, however, must be founded in the current policies and practices of the diverse range of CDFIs. We recommend that the Clinton community development initiative rely primarily on performance-based funding to encourage the use of "best available" practices and to enable the industry to grow into a highly effective national system. This approach ensures that recipients of federal support build capacity as they grow. We recommend that two principles should guide this approach:

(1) **Oversight and evaluation should be performance-based.** A new federal community development program would be remiss if it used a strict selection process for participants that excluded a significant sector of the CDFI industry. The only way to build a national network of 100 or more depository CDFIs is to seed the existing industry broadly and then to allocate resources to those organizations that meet negotiated performance targets. This process will allow a range of approaches while ensuring a fair level of return. In addition, it will allow the most innovative and determined

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lenders to grow while the others drop out of the national system.

(2) **Performance evaluation should be outcome-based.** No two CDFIs will operate alike. Each will have unique target groups, activities, methods, procedures, and priorities, depending on the characteristics of the communities in which they lend. A federal attempt to micro-manage all CDFI lending by requiring, for example, federal sign-offs on individual loans or uniform underwriting or loan servicing guidelines will be counter-productive. Ultimately, it will fail. Instead, federal oversight officials should negotiate expected institutional outcomes with each recipient within a range of statutorily acceptable outcomes that are related to the institution's primary mission of providing credit for community and economic development. Performance evaluation should focus on the CDFI's success at achieving these outcomes. Outcome criteria should be established for, among other things, lending volume, portfolio performance, capacity building, and program results (e.g., service to targeted constituencies), and should be measured over an extended time period that allows for accurate assessment of success.

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February 17, 1993

The Honorable Donald W. Riegle
Chairman
Committee on Banking, Housing, and Urban Affairs
U.S. Senate
Washington, D.C. 20510

Dear Chairman Riegle:

I appreciate the opportunity to offer comments on aspects of the Clinton Administration's proposal to create a network of community development banks.

I wish to make absolutely clear that ACORN strongly opposes any initiative that would dilute the community reinvestment obligations of existing insured depository institutions. In particular, we oppose efforts to allow existing institutions to receive "credit" under the Community Reinvestment Act (CRA) for equity investments or loan participations with community development banks.

The Clinton community development bank proposal can be an important vehicle for focusing attention on development needs, targeting funds, and rallying local communities in revitalization efforts. As part of a comprehensive strategy to increase credit availability for underserved sectors and distressed communities, the creation of new community development banks can make a real difference.

The appropriate role of such institutions will, however, probably be to act an incubator of innovation, and to demonstrate to the industry at large that community lending can be done profitably and with minimal risk. Expecting such institutions to solve by themselves the range of credit availability problems in America, however, will be a recipe for failure.

I would like to lay out six broad principles for the Committee as it considers various proposals.

a. Do not lessen the existing community reinvestment responsibilities of depository institutions, and work with the new Administration to realize CRA's immense potential.

Community development banks, whatever their structure, cannot

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Reinvestment Act (CRA) enforcement.

As always happens when a new program is created, the vultures appear on the scene to grab whatever advantage possible. The banking trade groups are clearly seizing on the community development banks as a backdoor means of escaping their responsibilities under the CRA. They want to contribute a few pennies to the new banks --maybe a desk blotter and handful of ballpoint pens-- and then get an "outstanding" CRA rating. This way the bankers figure they'll be free of low-income people in their lobbies and hassles about home mortgages from the wrong side of town.

In addition, providing CRA "credit" for contributions to community development banks would unfairly penalize banks that have learned how to lend in low-income neighborhoods profitably and with minimal risk, and reward the negligent portion of the industry that has never complied with the law.

A report by the Senate Subcommittee on Housing and Community Development last year highlighted how much can be accomplished by a new Administration committed to vigorous enforcement of the Community Reinvestment Act (CRA).

The Report on the Status of the Community Reinvestment Act found in November, 1992 that CRA had had "noteworthy success," and that "[c]community groups working with the private sector have generated more than $30 billion in the last decade for reinvestment in underserved communities." The report credited CRA as "the impetus for developing partnerships between financial institutions and communities; for providing access to capital to communities traditionally underserved; and for creating new, innovative methods for meeting the credit needs of all segments of the community."

The report went on to note that CRA had not achieved its potential because of regulatory malfeasance.

> "It is clear from the Subcommittee's review that the regulatory agencies have yet to fulfill their obligation to ensure that the CRA is properly and completely implemented. The supervisory agencies record of inconsistent and lax enforcement has encouraged the indifference and disinterest by the financial institutions. As a consequence, the agencies bear significant reponsibility for the poor performance of many of the financial institutions . . . Inconsistent implementation and enforcement diminishes the CRA's tremendous potential, deprives neighborhoods and communities of one of the most effective Federal tools available to assist in meeting their credit needs, and denies financial institutions the benefits of a consistent, fair regulatory regime . . . The message is clear. CRA is a law whose purpose is as relevant today

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as when it was written 15 years ago. The issue is not the law, but its implementation and enforcement."

Among the flaws in regulatory performance identified by the report were: grade inflation, uneven quality of evaluations, lack of clarity about CRA's goals, inattention to identified cases of discrimination, infrequent use of enforcement powers, lack of attention to lending data in assessing performance, and obstruction of community input into the regulatory process.

With reference to community development banks, the report specifically cautioned that "community development banks can only be one component of a CRA program. Financial institutions cannot "buy out" of their CRA responsibilities to the entire community by simply participating in a community development bank."

Great strides can be made in increasing credit availability for distressed urban and rural communities by strengthening enforcement of the CRA. Specifically, the Committee should work with the new Administration to:

*require the agencies to conduct more rigorous evaluations of lenders, and establish more rigorous standards for evaluations;

*make greater use of performance data in examinations and evanaluations;

*conduct more frequent exams, particularly in the case of the OCC, and provide better training for examiners;

*make more frequent use of available enforcement tools, such as cease and desist orders and the denial of merger applications;

*facilitate, rather than obstruct, community input into the CRA process, and recognize partnerships between community groups and other local groups with lenders as an important component of a sound CRA program;

*collect more data in a more useful form, particularly on lending to small businesses; and

*in the case of banks operating in multiple MSAs in a state, conduct separate CRA evaluations for each MSA served by the institution, and one for rural portions of the state.

b. Use federal funds to support a range of community lending initiatives.

Different communities have different needs, and no "cookie cutter" solution imposed from Washington, D.C. will solve the problem. Community development banks, credit unions, and loan funds, as well as credit programs established by non-profit community and housing development organizations are all legitimate mechanisms to increase the flow of credit into underserved

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communities. Specifically, the proposal could:

*dramatically increase the $6 million available at the National Credit Union Administration for promotion and creation of CDCUs.

*explore ways of focussing the National Cooperative Bank -- created and capitalized by the federal government in 1978-- on providing credit and technical assistance in underserved areas.

*allow local communities that wish to apply for federal funds to select the most appropriate vehicle for extending credit: a community development bank, a community development credit union, a community development loan fund, or a credit program run by a community or housing development organization.

c. Maximize participation of local residents in the creation and governance of new institutions in low-income neighborhoods.

Credit programs imposed on communities by outsiders are doomed to failure. Community ownership, control, and governance must be at the heart of any community development bank proposal. Low- and moderate-income and minority neighborhoods have suffered for too long from loan policies imposed from downtown by boards of directors and loan officers who cannot grasp the realities of life in their communities and cannot understand why "one size fit all" loan standards impose unnecessary barriers. We must have people on the boards of directors of these new institutions who are from the community and have a lifetime commitment to improving it, and who know the neighborhoods and its needs.

We recognize the importance of having qualified management to run these institutions. But the directors --the policy makers-- must be drawn from the community if these institutions are to truly contribute to neighborhood revitalization, and indeed if they are not to be resented.

Sufficient funding must be provided for a strong outreach and technical assistance program. The administrative entity overseeing the disbursement of federal funds --HUD or a new independent agency-- must have field staff whose job is to work with residents of low-income neighborhoods, organize meetings, build support and ownership, and assist in the development of proposals to establish new institutions.

d. Prioritize the creation of new institutions in truly distressed areas, and require applicants for federal funds to direct the bulk of their lending to projects which benefit low-income families.

There is an "upward creep" with regard to many federal programs, so that initiatives that start with inner-cities in mind often end up serving a middle- or upper-income constitutency in practice. It is essential that priority in funding be given to

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proposal that will serve a demonstrably underserved population. We strongly urge the Committee to target funds for new institutions only to communities with a median income that is less than 80% of the Area Median Income (AMI).

In addition, applicants for federal funds should be required to state a commitment to directing the overwhelming bulk of their lending to a target distressed community, and be held accountable for failing to meet those targets. We suggest that applicants for federal monies be required to commit that no less than 80% of their total originations be in neighborhoods at or below 80% of AMI, and further than they maintain a loan-to-asset ratio no less than 70%..

<u>e. Recognize the constraints facing many community-based organizations, and do not impose unreasonable "match" requirements on them.</u>

Many underserved communities may be able to "match" public equity contributions with private capital. Given, however, the scarcity of socially responsible investors --upon which many existing alternative financial institutions rely-- and the realities of low- and very-low income communities, a 1:1 or 2:1 match may not be realistic in all cases.

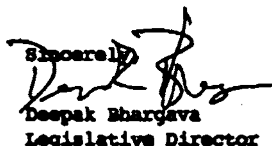
We suggest allowing for a reduced match --or a waiver-- for applicants proposing to serve a low- or very-low income community.

<u>f. Fund the program at a reasonable level, to ensure the viability of new institutions.</u>

We have been disturbed by news reports that suggest that the President might allocate only $850 million for 100 development banks. This would suggest almost a boutique, demonstration program, creating institutions with little equity capital and therfore with little lending muscle. These institutions must not be established on a shoe string. They must be put on a solid footing, even if that means proceeding at a more deliberate pace or creating fewer institutions.

We appreciate the opportunity to comment, and look forward to working with the Committee as it crafts community lending legislation.

Sincerely,



Deepak Bhargava
Legislative Director

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STATEMENT

OF THE

NATIONAL ASSOCIATION OF HOME BUILDERS

SUBMITTED TO THE

SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

CONCERNING

COMMUNITY DEVELOPMENT BANKS

FEBRUARY 3, 1993

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The National Association of Home Builders (NAHB), representing 157,000 member firms, would like to take this opportunity to present its views on the role of community development banks in alleviating the credit crunch for small business and creation of economic growth. As an Association which is comprised of builders who are primarily small business persons, NAHB supports the concept of "community development" banking. Some institutional structures to support community development banks already exist. Specifically, the Federal Home Loan Bank (FHLB) System could provide not only a supportive structure, but a variety of programs and services, which would enable community development banks to better carry out their mission. This could be accomplished with no budgetary impact.

HOME BUILDERS ARE PRIMARILY SMALL BUSINESS PEOPLE

The nation's home building industry is dominated by a great many small builders operating in limited geographic areas, generally local markets. The last census of the construction industry (1987) estimated the number of residential builders with at least one employee on the payroll at about 120,000 firms. About 75 percent of home building companies build 25 units or fewer per year, and more than two-thirds of these build only ten units or fewer. Only 8 percent of home builders are considered to be "large;" that is, building 100 or more units per year. In addition, most of the subcontractors and many of the suppliers to these builders are small businesses themselves and are heavily reliant on home builders for their livelihood. In view of the structure of the industry and the heavy reliance of builders on thrifts and banks for housing production credit, it is not hard to see why home builders have been particularly hard hit by the credit crunch affecting small businesses.

THE CREDIT CRUNCH AS A FACTOR IN THE NATION'S ECONOMIC RECOVERY

The impact of the credit crunch on small business and the resulting debilitating repercussions throughout the economy has been widely acknowledged both during the presidential campaign and by the current Clinton administration. On November 18, 1992, Alan Greenspan, Chairman of the Federal Reserve Board made the following observations about the credit crunch, its impact on small business and the nation's economic recovery:

> "One of the most disturbing elements of the current subpar recovery has been the extraordinary debilitation of our financial intermediation process...This is especially distressing because banks are the major, and in many areas, almost the sole marginal suppliers of credit to small and medium sized businesses. Small firms are the core of entrepreneurial effort in the American economy and historically have been ...a major force for job creation.

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Hence, it is essential that the bank loan markets be restored to a semblance of vigor if adequate financing of overall economic growth is to reemerge...the credit crunch is not the only reason for the disappointing performance of the economy...But the state of bank loan markets certainly is a key element...

An impressive number of worthy applicants has been rejected...When real estate loans became a black mark against bank credit ratings, such loans were reduced, not only by write-offs but by pressing solvent borrowers to repay because they were tha only ones who could. That sounds more lika fear than sound banking practice."

As Chairman Greenspan points out, residential lending has been particularly hard hit in the past three years as many loan worthy applicants have been rejected by banks because of their association with commercial real estate loan problems. This failure to distinguish residantial real estate loans from commercial real estate loans has added insult to injury for small business persons, who are also home builders. First, as small business persons, to whom lenders have tended toward extreme caution when making loans, and second, as home builders seeking real estate loans.

HOME CONSTRUCTION AND ITS IMPACT ON ECONOMIC GROWTH

Economic data provide salient evidence that home construction can provide a powerful stimulus to the economy. The home building industry stands poised to spawn such economic growth. According to the Bureau of Labor Statistics, the direct and indirect impact of construction of one single family home with a median price of $120,00 and a median size of 1,890 feet, generates 1.759 work-years of employment in construction and related industries. Construction employment accounts for .627 work-years, land development for .235 work-years, and other industries for.897 work-years. Based on the average wages for these industries in 1990, this employment impact translates into an additional $45,700 in wages and $18,800 of tax revenues at all levels of government. (For additional details, please see Table I on page 9 and accompanying explanation.)

The cumulative annual impact on the economy as a whole can be determined by using 1990 figures for single-family housing starts and hourly wages. In 1990, there were 895,000 housing starts and the "average" price of a single-family home was $128,000. The construction of one average priced home generates 2.15 work-years of employment in construction and related industries. Based on the average wages for these industries in 1990, this employment impact translates into a total of 1,924,000 labor years which generates $226.6 billion, or 4.1% of the gross domestic product.

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COMMUNITY DEVELOPMENT BANKS

Since the presidential campaign, the public has heard a great deal of President Clinton's vision for a nationwide system of 100 "community development banks". The concept of "community development banks" and their place in the overall banking scheme is still taking shape. However, the general consensus appears to be that "community development" banking would spawn development, and the ripple effect would be felt throughout the community in terms of credit availability, growth and development, employment and wages, leading to greater prosperity. These banks would receive some federal assistance in the form of grants, to be matched by the individual bank, and would restrict their lending to true community development activities such as housing and small business loans in their areas. As a presidential candidate, Mr. Clinton frequently pointed to the South Shore Bank of Chicago as the model for his vision of a "community development bank".

CHARACTERISTICS OF THE SOUTH SHORE BANK OF CHICAGO

The South Shore Bank is a subsidiary of a bank holding company, which is regulated by the Federal Reserve Board. The South Shore Bank is a state-chartered, full-service commercial bank whose investors and depositors are willing to accept less competitive returns in order to promote community development. The bank is owned by a holding company whose affiliates include: (1) a for-profit real estate development corporation; (2) a non-profit subsidiary providing technical and community services; and (3) a small business investment corporation. Although the bank restricts itself to community development lending, it operates under a traditional charter and does not require a new chartering system.

RECOMMENDATIONS OF INNOVATIVE FEDERAL SUPPORTS FOR HOUSING PRODUCTION CREDIT

Public and private institutional structures that can support housing production are already in place and may be built upon with little or no federal budget outlays. These structures already provide a variety of federal supports for the home mortgage finance system, including mortgage insurance and guarantee programs, secondary market agencies, and the Federal Home Loan Bank System that lends to member depository institutions that provide housing finance. However, the federal government has provided virtually no support to the markets for housing production loans. Thus, when the credit crunch developed at the traditional sources of housing production finance--thrift institutions and commercial banks--there were no secondary market channels or credit instruments to attract funds from alternative sources.

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Enhanced credit supports that are grounded on loan guarantees, purchases of loan participation or loans to private lenders would be powerful supplements to housing production lending by thrifts and banks operating in a more positive regulatory environment. Such support mechanisms would be important factors in achieving the goals of community investment initiatives, such as community development banks. NAHB believes that a network of "community development banks" could be sustained and enhanced by the Federal Home Loan Bank (FHLB) System.

THE FEDERAL HOME LOAN BANK SYSTEM

The Federal Home Loan Bank System, comprised of 12 regional Federal Home Loan Banks, was established in 1932 to bolster housing lending by providing a credit support mechanism for home mortgage lending by depository institutions. The membership of the System has traditionally been dominated by savings institutions. In 1989, commercial banks and credit unions were given the option of membership; and now comprise one-third of the System's members. Nevertheless, thrift members continue to enjoy more beneficial treatment in borrowing than bank and credit union members.

The FHLB System has been an important component of the nation's housing finance system for decades. However, shrinkage in the number of savings institutions, and the impediments to banks' more recent participation in the System, have made it difficult for the FHLBanks to fully utilize their resources in support of housing. The nation's housing credit needs have also changed and restructured, and the System finds itself in search for new roles to play as demand for its traditional services declines. The System has a strong capital base. Under current operating limitations, however, it is unable to generate the levels of business and earnings needed to attract new members and maintain its vital role in supporting the funding of housing.

The FHLBanks currently may invest in only one type of credit product to their member thrifts and banks -- advances that must be fully secured with narrowly defined collateral. The types of residential real estate collateral that members currently can use, without restriction, to secure advances are limited to whole first mortgages and mortgage-backed securities. If the FHLBanks are to take a more positive role in supporting housing, then their credit products for their members and their collateralization requirements must be expanded. Although new credit products and more flexible collateralization requirements would mean that the FHLBanks could assume some direct or indirect credit risk, the FHLBanks have more than enough capital to support such expanded services. Furthermore, the FHLBanks are capable of successfully managing and diversifying additional activities having favorable risk-return relationships that are needed to attract and retain members.

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CREDIT SUPPORT FOR HOUSING PRODUCTION LENDING

An area of great need for the housing sector, and of great potential for the FHLB System, is housing production credit. There are several ways in which the FHLBanks' current operating authority needs to be changed in order for them to be an effective support for housing production lending by their members.

Loan Participations and Credit Enhancements. A change in the FHLBanks' investment authority, to let them invest in more types of credit products than just the existing type of advance, would allow member institutions greater flexibility in structuring loans. In particular, the FHLBanks should be allowed to purchase participation interests in housing production loans originated by member lending institutions. The FHLBanks could hold these participations interests as investments, or resell them to outside investors. This function would allow member institutions to better leverage funds for housing production while observing regulatory constraints on loans to one borrower, asset concentration, and geographic concentration.

In addition, the FHLBanks should be able to provide credit enhancements, such as subordinated interests, for loan participations that they resell. This authority would facilitate secondary market activity and liquidity for housing production loans.

Flexibility in Collateral for Advances. Advances must be fully secured by government securities or certain housing-related assets. Currently, the only types of housing assets that may be used, without restriction, are fully disbursed whole first mortgages and mortgage securities backed by such mortgages. Member institutions may also secure advances with real estate-related participation interests, residential production loans, nonresidential real estate, and other types of mortgage-related securities; these are very limited, however, and, in combination, cannot exceed 30% of the member institution's capital.

Restrictions on the use of housing production loans and residential real estate related participation interests as collateral for FHLBank advances should be removed. In fact, all residential-related collateral should be eligible to secure Federal Home Loan Bank advances.

EQUITABLE ACCESS TO ADVANCES BY NONTHRIFT MEMBERS

The Federal Home Loan Bank Act (FHLBA) establishes a maximum borrowing limit for all members of twenty times the amount of FHLB stock owned by the member. However, access to advances by nonthrift members is actually curtailed by a subsequent provision, which imposes different borrowing limits tied to the level of the Qualified Thrift Lender (QTL) test that thrifts must meet as part of their charter requirements. Thus, while QTL thrifts may borrow $20 per $1 of stock owned,

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nonthrifts (which almost by definition will not meet the QTL) may borrow only at ratio that declines significantly in proportion to the size of their actual mortgage asset portfolio. For example, a bank that has 10% of its assets in mortgages can borrow only $2 for every $1 of stock owned. This inequity makes it more costly for banks and credit unions to use the FHLB System as active borrowers. Thus nonthrift members may not avail themselves of the special Community Investment and Affordable Housing Program advances to the same extent that thrift members can.

MEMBERSHIP IN THE FHLB SYSTEM

If the FHLB system is to be a true credit support system for housing, rather than just for thrifts, then membership should be opened, on equivalent terms, to all depository and nondepository lending institutions with a residential housing finance focus. Such members would include mortgage banking companies, state and local housing finance agencies, pension funds and housing-related lending affiliates of insured depository institutions. (The FHLB System has been open to life insurance companies since its inception.)

Transition to an entirely voluntary membership system will be necessary for the FHLB System to serve as a comprehensive credit support mechanism for housing over time. Currently, most savings and loan associations are required to be members, but non-thrift membership is voluntary. The change to universal voluntary membership must be accompanied by a transition process that will assure financial soundness for the System and be fair to all members.

THE FHLB SYSTEM PROVIDES INSTITUTIONAL SUPPORT FOR COMMUNITY DEVELOPMENT BANKS

The South Shore Bank of Chicago has a membership application pending before the Federal Home Loan Bank of Chicago. NAHB applauds this step to join the System. The policy objectives of the FHLB System and community development banks are consistent in that lending activities focus on housing and community revitalization. A nation-wide network of community development banks, as envisioned by the Clinton Administration, could be sustained and enhanced by the FHLB System.

The FHLB System offers services and programs that would potentially buttress the endeavors of community development banks. The FHLBanks are currently active in low- and moderate- income housing initiatives through special, below-market lending to member institutions under their Affordable Housing Program (AHP) and Community Investment Program (CIP). The latter program is also directed toward small business and community revitalization. Such pursuits are a natural adjunct to the activities of "community development banks", and the ability of both entities to leverage their funds should be enhanced by their working together.

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The existing institutional framework of FHLBanks would provide other benefits to "community development banks" such as ready access to capital markets at very favorable rates which could be passed on to "community development banks". Also, the regional network of FHLBanks could provide technical assistance and services to "community development banks" and serve as an information clearing house for loan participants as well as provide a secondary market for community development loans.

RECOMMENDED LEGISLATIVE MODIFICATIONS TO ALLOW THE FHLB SYSTEM TO SUPPORT COMMUNITY DEVELOPMENT BANKS

In order to allow all community-based lenders, including "community development banks" to derive the benefits of the FHLBank System, legislation is required. First, Congress should expand FHLBank authority to invest in participation interests in residential construction loans originated by their member institutions, and to provide credit enhancements for any such interests that they resell. Second, Congress should expand the types of residential assets that may be used without restriction to collateralize advances to include residential real estate-related participation interests, residential production loans, and other types of mortgage-related securities. Third, the current disparity between the borrowing requirements for nonthrift institutions and thrifts should be eliminated. Currently, nonthrift institutions, including community development banks, are at a competitive disadvantage with respect to their access to advances, including those made under the Community Investment and Affordable Housing Programs. Finally, authority to broaden membership in the FHLB System is necessary to include all lenders with a housing focus.

NAHB was pleased to see two important provisions included in S. 265, the Economic Growth and Regulatory Paperwork Reduction Act of 1993, recently introduced by Senators Shelby, Inouye, Wallop, Mack, and Heflin. A House of Representatives counterpart will be introduced shortly. The provisions included in S. 265 would permit member institutions to use housing production loans to collateralize advances and authorize FHLBanks to invest in loan participations in residential construction loans made by their member institutions.

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Economic Impact of Construction of One Single Family Unit

Characteristics of Individual Unit:	National	Local
Equivalent to Median Priced Unit:	$120,000	
Less: Value of Raw (Undeveloped) Land	($15,200)	
Equals: Base for Multiplier Calculation	$104,800	$76,744
Times: One Year Multiplier(1)	1.98	1.45
Equals: Income Multiplier	$207,600	$111,300

Wage Impact:	National		Local
	Labor Years	Wages	Wages
Land Development	0.235	$6,110	$6,110
On Site Construction	0.525	$13,650	$13,650
Off Site Construction	0.102	$2,652	$2,387
Other Industries:			
Manufacturing	0.397	$10,322	$4,129
Wholesale Trade, Transportation, and Services	0.355	$9,230	$6,461
Mining and All Other	0.145	$3,770	$754
Total	1.759	$45,734	$33,491

Tax Impact:	National	Local
Federal Personal Income Tax	$9,604	
Social Security Tax	$1,829	
State Personal Income Tax	$1,329	
Federal Corporate Income Tax	$3,690	
Local Real Estate Tax	$1,597	$1,597
Total	$13,049	$1,597

(1) Laurence H. Meyer and Associates

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Direct and Multiplier Impact of Home Construction

The estimates of labor requirements included in this table were developed by the Bureau of Labor Statistics[1] and have been updated to recognize current wage levels and prices. We estimate that the construction of a median-priced single-family house with a median size of 1,890 square feet directly generates 1.759 work-years of employment in construction and related industries. Construction employment accounts for .627 work-years, land development for .235 work-years, and other industries for .897 work-years. Based on the average wages for these industries in 1990, this employment impact translates into an additional $45,700 in wages and $18,800 of tax revenues at all levels of government.

The top panel of this table calculates the full economic impact of the increase in residential construction. The impact is calculated by applying a consumption multiplier to the adjusted median sales value of a single-family unit.

The item "multiplier" is used to reflect secondary economic effects, primarily affecting consumption, over and above the direct impact on income of home construction. For example, construction workers purchase goods at local stores, and the stores step up hiring and purchases which creates a "multiple" of the original stimulus. Eventually the stimulant declines unless continually renewed.

The stimulant resulting from the multiplier is greater in the earlier periods since the stimulant "leaks" away. A recent study by Price Waterhouse, conducted on behalf of The National Association of Realtors,[2] suggests that the first-year consumption multiplier substantially varies based on the economic model employed. The model of Laurence H. Meyer and Associates is used by NAHB for economic and housing forecasts. The first-year multiplier impact, assuming that interest rates are held constant, is 1.98 in the Meyer model and we have applied that multiplier to the median housing unit after adjustment for the value of raw land.

The local impact that appears in the right hand column adjusts the national impact since some of the direct labor and materials are purchased from other regions and therefore do not directly benefit the local economy. The multiplier effects are also adjusted to reflect the import of "imports" from other regions.

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[1] Robert Ball, "Employment Created By Construction Expenditure," Monthly Labor Review, December 1981.

[2] Price Waterhouse, Contribution of Single-Family Home Resales to the U.S. Economy. Prepared for the National Association of Realtors 1992.

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BANKING ON COMMUNITIES:

DEVELOPMENT BANKING IN

THE UNITED STATES

(Working Paper)

By

Kathryn Tholin

February, 1993

Woodstock Institute, 407 S. Dearborn, Chicago, IL 60605 (312) 427-8070

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The Woodstock Institute

The Woodstock Institute is a not-for-profit organization based in Chicago. For the past twenty years, the Institute has carried out applied research and developed and implemented programs which increase private sector investment in modest-income and minority communities for the benefit of those who live there. It designs programs which bridge the gap between the needs of communities and the resources of banks, savings and loan associations, foundations, and others.

The Institute provides a variety of services to community-based organizations, financial institutions, foundations, and government agencies, including applied research, policy analysis, program design, and evaluation.

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This publication is a working paper, written and published by Woodstock Institute. The complete paper will be published in March, 1993, and is the fourth in a series of Woodstock Institute case studies on community development financial institutions. Other titles in this series are:

Banking Services for the Poor: Community Development Credit Unions

Lenders of First Resort: Community Development Loan Funds

The Business of Self-Sufficiency: Microcredit in the United States

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For copies of these publications contact: **Woodstock Institute, 407 S. Dearborn, Suite 550, Chicago, Illinois 60605, (312) 427-8070.**

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Section I: Introduction

In 1985 the Workers Owned Sewing Company (WOSCO) was in trouble. Located in Bertie County, a low-income rural county in Eastern North Carolina, the company's business came from contracts with other apparel companies for their overflow work. This type of business was sporadic, unpredictable, and highly competitive, operating on very thin margins.

To grow, the company needed to be able to by-pass the middleman and bid directly to retailers. To do that, however, required credit for necessary materials and supplies. The company had been unable to get credit from its suppliers, and managed its existing business with a $10,000 line of credit from a small local bank.

The local bank, however, was purchased by a large regional bank, which cut off the company's line of credit. Without a new source of credit, the company would not be able to continue its current work, let alone expand.

With no other prospects for credit, WOSCO turned to the Center for Community Self-Help, which had been providing technical assistance to the company for several years. Through its credit union and ventures fund, Self-Help made the company a $50,000 loan. They also continued to provide assistance in the areas of marketing, financial management, business planning, and staff development. Once the first loan was paid off, the Center continued to provide working capital loans to the company.

Today WOSCO, with 80 workers, is the second largest employer in its county. Seventy percent of its work is now direct contracts with retailers rather than other manufacturers. It has secured contracts with Sears and K-Mart as well as a regional department store chain. The company increased its sales from $760,000 in 1985 to $1.8 million in 1992. At the end of 1990, the company was able to distribute $27,000 in profits to its workers, who are also its owners.

In Chicago's South Shore community, Vivian Wilson's $1 million city contract to provide security services almost cost her 70-year old company when the city's slow payments exhausted her operating reserves. When her bank wouldn't make her a loan, and she was within two week of running out of cash, she turned to South Shore Bank.

Ms. Wilson did not have the personal assets banks usually require an applicant to pledge for such a loan. South Shore Bank lending officers, however, were impressed by her business management, believed she would be able to deal with the city bureaucracy, and went to work to structure a loan.

In two weeks, the bank was able to package a $250,000 line of credit that was partially secured by an apartment building owned by Ms. Wilson, with half the loan

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guaranteed by a fund established by a purchasing managers' group to help minority-owned businesses. The bank's commitment to move quickly, willingness to work with external credit-enhancement programs, and ability to spend the time to package a deal that was good for both the bank and the applicant meant that Ms. Wilson was able to make payroll and keep her business operating.

The institutions that made these loans were not ordinary financial institutions. These are institutions that have staked their claim in markets that are not seen as desirable and borrowers that are often not seen as creditworthy by conventional financial institutions. They are among a small number of depository institutions organized both to address the credit needs of disadvantaged communities and to have a lasting impact on the development of those communities, the growth of local economies, and opportunities for advancement and economic security for low and moderate income individuals and families.

While today there are only a handful of community development banks in the United States, these institutions are demonstrating that a development bank can be a powerful tool for building communities and strengthening local economies.

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Section II: What Is A Community Development Bank?

The Need for Credit

Urban and rural community development practitioners have demonstrated that access to capital and credit is critical to revitalizing housing and creating and retaining jobs in disadvantaged communities. These communities may be inner city neighborhoods, low-income rural areas, or particular groups of people (women, minorities, low income families) across several geographic communities.

One way to see the critical role of credit is to look at a disinvested community--that is, a community in which credit has stopped flowing. When credit is not available for everyday community investment needs, the local economy starts to fall apart at the seams. Buildings deteriorate when rehabilitation funds are unavailable; housing values decline if buyers can't find mortgages; modest income people can't purchase a home; businesses stagnate or relocate when they can't get loans to expand or modernize. Disinvestment ultimately destroys the economic assets of a community.

When it is available, however, credit serves as a catalyst for investment in a community. the extension of credit by a financial institution is viewed by others as an expression of confidence in the future of that community. Loans to housing and economic development projects result in visible improvements which become symbols of community improvements. The availability of credit has a multiplier effect, leading to additional investment by developers, other financial institutions, and homeowners, landlords, and business people within the neighborhood.

Credit gaps exist when lenders perceive particular markets or borrowers as entailing higher risks or lower returns than other types of lending or when racial or cultural barriers interfere with lending judgments. Such perceptions have resulted in the disinvestment of entire communities, but they have also resulted in a lack of available credit to lower income homebuyers, minority borrowers, small businesses, and other types of unconventional borrowers. Financial institution consolidation and increasing standardization of loan products further constrains the availability of credit and the possibilities of economic development for distressed communities and individuals.

While conventional credit can keep a healthy economy working, rebuilding a deteriorated economy or making loans to people who have historically not had access to credit requires more than conventional lending techniques. Borrowers need more assistance, projects may need unconventional terms. These borrowers and communities need lending institutions that understand local credit needs, have

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a commitment to community economic development, and have underwriting standards that address local market realities. Perhaps most important, they need institutions with an array of financial and non-financial interventions that reinforce each other and rebuild or strengthen a local economy.

Community Development Financial Institutions

Over the last two decades a range of types of community development financial institutions have developed to address the need for equal access to traditional credit and the need for development credit. Beginning as individual experiments in local areas across the country, these institutions have become an emerging community development industry. They include community development banks, community development credit unions, and community development loan funds. In some cases these institutions are defined with a broad economic development focus, in others they are narrowly focused on delivery of a small number of development credit products.

Community development financial institutions share several common characteristics:

- They are organized to serve economically distressed communities
- They serve a targeted geographic area or sometimes a targeted constituency
- They have as their primary mission the development of communities and their residents, utilizing the provision of credit and other development activities as a means to achieve that mission.
- They fill credit and in some cases financial services gaps that are not met by traditional financial institutions.

Earlier Woodstock Institute publications have examined in detail the work of community development credit unions, community development loan funds, and microenterprise funds. This paper provides a definition and overview of community development banks.

What is a Community Development Bank?

A community development bank is the most broadly defined, and potentially the most comprehensive, of the community development financial institution

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models. While other community development financial institutions tend to specialize in a particular type of product or credit activity, a community development bank can incorporate both a range of lending services and a broader range of development-oriented activities.

A **community development bank** is a community development institution that utilizes a commercial bank, credit union, or savings and loan as a vehicle for providing development credit for a targeted community or population, and which has proactive, development-oriented subsidiaries and affiliates. Community development banks are the most extensive and best capitalized type of community development financial institution. The depository institutions of community development banks are chartered, regulated, and able to engage in the same types of business as their conventional commercial financial institution counterparts.

A community development bank is distinguished from a traditional bank, however, in two fundamental ways. First, a development bank has chosen as its primary corporate mission the comprehensive development of a community or communities, not the provision of credit and financial services. Second, a development bank is based on an understanding that access to credit alone can not revitalize a distressed economy; that additional development activities and efforts are necessary to promote economic activity in disinvested communities.

Mission

A community development bank, like any financial institution, must be concerned about the sound operation of a regulated financial institution. While operating a sound and successful financial institution is essential for the success of a development bank, the primary goal is focused on the impact that institution, and its other activities, have on the institution's targeted community(ies). A development bank has a dual standard of performance; it must successfully operate a financial institution, and it must foster community development and renewal. Ultimately, a community development bank seeks to demonstrate that these are not inconsistent goals.

Additional Development Activities

A regulated financial institution is limited in its ability to have a significant community development impact through credit alone. A development bank has targeted communities and populations with needs that go beyond traditional credit. A bank's lending is constrained by regulatory standards designed to protect depositors and the public from losses. While a bank is not simply a passive actor, a conventional financial institution cannot easily play a proactive development role in a community.

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For example, a bank can declare its willingness to make multifamily building rehabilitation loans in a particular area. It can market this product aggressively in this area. But it cannot on its own purchase and rehab the big abandoned building on the corner, even though this would give other investors the confidence to invest in surrounding buildings.

A bank can make loans to small businesses in its area, but it can't make the equity investments needed to start new businesses, and it can't provide the training and job placement services to help ensure that local residents get the jobs created through expanded business activity.

Without an approach which incorporates some of these types of activities, a bank may make some loans, but not have a long term impact on the overall development of a community or targeted area.

This blend of activities and goals means that a development bank combines the structure and expertise of a for-profit financial institution with the commitment to people and to place one normally sees in community-based non-profit organizations.

Structure

A full-fledged development bank is formed by a holding company or parent organization which owns (or, in the case of a credit union, operates) an insured depository institution, and has subsidiaries and/or affiliate organizations which can supplement the bank's lending with technical assistance, direct community development activities, and/or higher risk or more flexible financing.

The community development bank is able to utilize a depository institution to channel ordinary deposits into community development lending. The subsidiaries and affiliates allow the development bank to move beyond the limits of a bank structure, address deeper credit needs, make higher risk investments, and more proactively address a broader range of community development needs.

Affiliated development activities are determined by the mission of the institution, and the particular needs of its targeted communities. They may range from enterprises designed to provide equity financing to small businesses or real estate development companies to efforts to provide education and job training to community residents. Their purpose is to build capacity and resources within the targeted community or constituency.

Through their ability to use the lending and deposit gathering properties of insured depository institutions and the proactive community development

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properties of various types of subsidiaries, development banks can implement a broad economic development strategy and achieve a critical scale of impact in a targeted area or with targeted populations. One primary premise of a development bank is that mobilizing a large volume of capital for development lending is key to the revitalization of a particular community/geographic area and the reestablishment of market forces to sustain the community and its residents.

The sum total of these activities, both the regulated financial institution and its affiliated activities, is the development bank.

There are only a few full-fledged development banks operating in the country today. Shorebank Corporation, which owns South Shore Bank in Chicago, and Southern Development Bankcorporation, which owns Elk Horn Bank and Trust in Arkadelphia, Arkansas, are the two largest development bank models. Self-Help Credit Union, operated by the Center for Community Self-Help in Durham, North Carolina, is also organized on the development bank model. Community Capital Bank in Brooklyn is the newest of the development banks. It is not currently organized on the holding company model, but has established affiliated community development activities.

The three oldest community development banks are profiled in the following section.

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Section III: The Current Experience Of Commmunity Development Banks

Each existing community development bank has a unique story. For a development bank, location dictates design. Each community development bank has chosen its specific focus and market based on the needs of the community it seeks to serve. The existing development banks have chosen different development strategies and developed differing types of lending and development expertise. South Shore Bank's largest concentration is in housing purchase and rehabilitation loans, particularly for multifamily buildings. Southern Development Bankcorporation's mission is to catalyze economic development in a rural area through financing for small, locally-owned businesses. The Self-Help Credit Union focuses on business development and homeownership lending.

The three institutions profiled here have these key features in common:

- A holding company or parent organization owns or operates (as legally appropriate in each instance) the financial institution. This means that the corporation's overall vision is held outside as well as within the financial institution itself. While this may not be essential to a community development bank model, it helps to ensure the financial institution's long term accountability to the community development mission, despite the pressures of operating a sound financial institution. The umbrella structure enables the coordination of multiple efforts towards the same goals.

- Each institution has multiple strategies for community development. This is true both within the financial institution subsidiary, where different types of loan programs have been developed, and in affiliated non-bank development activities.

- The development banks have chosen their lending markets and their development activities based on an assessment of the specific needs of their targeted area and constituencies. Based on the particular needs of their targeted communities, these three development banks have very different lending strategies and different configuration of nonlending development programs.

- The institutions seek to capitalize on the synergies made possible through the combination of their lending and development activities. Both are designed to reinforce each other in building local markets and capacities.

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- The holding companies reinvest a portion of the return on revenue-generating activities into other areas of their activity that require capitalization or development funds.

- The banks have evolved their current focus and activities over time as they develop new programs and build their capacities, as their knowledge and understanding of their target communities and constituency deepens, and as their development activities themselves generate new opportunities for lending.

Shorebank Corporation

The oldest and best known community development bank, Shorebank Corporation was formed in 1973, when a small group of investors purchased a troubled bank in a rapidly deteriorating inner-city neighborhood that had changed from 90 percent white to 90 percent black in ten years. The flight of white residents was accompanied by a flight of capital; banks redlined the area, landlords stopped maintaining apartment buildings, store owners stopped improving their businesses, people stopped upgrading their homes, and the community entered a spiral of economic and physical decline.

Shorebank's founders, four bankers working in an adjacent, stable neighborhood, formed a holding company and purchased South Shore Bank. The community's last locally-based bank, South Shore Bank, had quit lending in the area and its owners had unsuccessfully sought regulatory permission to relocate downtown. The new owners set out to demonstrate that a regulated bank holding company could serve as a vehicle to reach a scale of investment and targeted activities which could stabilize and revitalize a community suffering from disinvestment.

Barely able to raise enough capital from investors who shared this untried vision, Shorebank began with the operation of the bank alone. Five years later, in 1978, it was able to raise additional capital to create two other for-profit subsidiaries and one non-profit affiliate. Since 1985 it has added three additional subsidiaries and affiliates.

Shorebank's affiliates and subsidiaries provide a multifaceted package of development components. South Shore Bank is a full-service commercial bank offering both commercial and residential loans. City Lands Corporation is Shorebank's real estate development company. It develops and manages residential and commercial real estate for the benefit of low and moderate income residents. It can target key anchor properties for development, opening the market to more conventional investors who can receive financing from the bank to rehab smaller properties nearby. The Neighborhood Fund is an SBA-licensed Minority

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Enterprise Small Business Investment Corporation, which finances businesses with equity investments and long-term subordinated debt.

The Neighborhood Institute (TNI) is a nonprofit, exempt affiliate of the holding company. TNI focuses on human development as well as housing development. TNI operates GED and job training programs, job placement programs, and manages three small business incubators. It also includes community organizing, cultural activities, and senior services. TNI Development Corporation, its for-profit subsidiary, develops rental and cooperative housing for low income residents.

Shorebank Advisory Services is a consulting firm that offers technical assistance nationwide on development banking and other community economic development strategies.

In addition, Shorebank expanded in 1992 by establishing two business development affiliates, which, combined with the loan production office of the bank, will be providing lending and services in the Upper Peninsula of Michigan.

South Shore Bank itself makes both housing and business loans, but it is the bank's unique approach to lending for multifamily purchase and rehabilitation that has had the greatest impact on the community. The bank has successfully fostered a large group of small-scale rehabbers who rehab, hold, and manage 24-36 unit apartment buildings. In making these loans, the bank focuses on market and character judgments more than on standard ratios--is the borrower paying a fair price, can he/she stretch a rehab dollar, manage the building, deal with tenant problems? All the bank's mortgages include rehabilitation. The bank's detailed market knowledge, its status as the primary lender in this market, and its commitment to say no to deals where the purchase price, rehab costs, or the after-rehab rents are too high means it has been able to significantly improve the housing stock without gentrifying the neighborhood.

Since 1973, the holding company has made $ 340 million in development financing. It has financed purchase and/or rehabilitation of more than 30 percent of all housing units in South Shore. At the end of 1992, it had $55 million in business loans. The bank has grown from $40 million to $211 million in deposits, 55 percent of which come from depositors outside the South Shore community who support the bank's development efforts. The bank itself has operated at a profit every year since 1975. In 1991 alone, the bank's development subsidiaries rehabilitated more than 1400 units of housing, and placed hundreds of residents in jobs. In 1986, the bank expanded its lending operations into Austin, a west side Chicago neighborhood suffering from longer-term disinvestment and deterioration.

Most importantly, Shorebank has stabilized the economy of South Shore, created dramatic improvements in the quality of housing, brought in new business

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activity, and instilled a new outlook on the neighborhood by both residents and outsiders.

While operating successfully and profitably, Shorebank has had to rely on patient investors willing to see profits reinvested in bank expansion and in subsidiary operations. In 20 years, its common stock investors have not received a dividend. The value of their investment, however, has grown at an average annual rate of 16.5 percent. Shorebank's investors include foundations, religious institutions and a number of individuals.

Shorebank managers know their package works, but are the first to point out that their specific formula won't work everywhere. "Our organization...is not a cure-all for the most depressed places in America", says Ron Grzywinski, a founder of the bank and chairman of Shorebank Corporation. "Our strategy relies on being able to cultivate a group of private individuals who are working in their own self-interest, which happens to be the best interest of the community." Shorebank has successfully targeted the development needs and opportunities of its particular community. The interventions and development activities it chose have had a substantial impact.

Center for Community Self-Help

In 1984, the Center for Community Self-Help, a four-year-old nonprofit organization working to create economic opportunity for disadvantaged North Carolinians, formed the Self-Help Credit Union. Starting with $77 raised at a bake sale, Self-Help has grown to more than $40 million in assets, becoming the nation's first statewide community development bank.

Self-Help's development strategies have targeted the creation of affordable housing opportunities; assistance to women- and minority-owned enterprises, especially in rural areas of the state; facilities development for nonprofits serving low income and special needs families; and promotion of statewide programs by both public bodies and private financial institutions to create development lending programs on a broader scale.

The Center has developed an integrated set of tools to address this range of development activities. The Center began its work in 1980 offering technical and managerial assistance to struggling small businesses in the state. After four years it concluded that it needed to provide access to capital as well, and in 1984 created two lending vehicles--Self-Help Credit Union, a regulated depository institution, and Self-Help Ventures Fund, a nonprofit revolving loan fund.

Self-Help Credit Union is the banking center of the Center for Community Self-Help. Self-Help Credit Union is a state-chartered, federally insured credit

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union, whose membership is open to all members of the Center for Community Self-Help. The credit union limits its lending to the state of North Carolina. The credit union's main office is in Durham, with branches in Asheville, Charlotte, and Greenville.

Unlike most credit unions, Self-Help Credit Union does not see retail services as key to its mission. Instead, the credit union's primary function is as a proactive lender gathering capital from supportive depositors across the country to use for loans. As a result, the credit union offers only basic savings and checking accounts (called share accounts and share draft accounts in a credit union), does not provide cash transactions, and does not place a priority on offering the highest possible rates to attract depositors.

Self-Help's nonprofit loan fund allows it to extend credit that would not meet the regulatory standards of the credit union. It attracts investments from socially-oriented investors both within and outside of North Carolina. Its investments, unlike the credit union's deposits, are not insured.

The parent organization for Self-Help engages in non-financial activities which address its overall mission. These include extensive educational and technical assistance to borrowers, development of new lending programs which it promotes with other lending institutions and public bodies, and training for loan officers in conventional banks, among others.

Though very small by conventional financial institution standards, Self-Help has grown rapidly to a level where it is able to have a substantial development lending impact. By the end of 1992, Self-Help development bank made a total of $40 million in loans, and is poised to make at least $12 million in additional loans per year. It has made more than 450 mortgages for first-time homeowners who were unable to receive conventional mortgages, predominately single minority female heads of households. Self-Help piloted an innovative mortgage product, with low down payments and relaxed debt-to-income requirements, which Fannie Mae now offers nationwide. In Charlotte, more than 125 public housing residents became homeowners through Self-Help programs.

Self-Help's 1992 business lending provided loans for 138 small enterprises, with loans ranging from a few hundred dollars to several hundred thousand dollars. Self-Help now manages government-funded pools of capital from state and federal programs. It also provides small loans to day care providers to enable startup and expansion of child care services. The loan fund's microenterprise program provides loans to very small, often home-based businesses.

Despite its exclusive focus on borrowers who are unable to access conventional credit, Self-Help's lending has performed extraordinarily well. In 1991, the credit union averaged one percent delinquency, less than the industry average.

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Average annual losses have been less than 0.1 percent of average annual outstanding loans.

Southern Development Bancorporation

Southern Development Bancorporation was established to address the economic development needs of rural Arkansas. Southern's mission is to stimulate and expand the regional economy for the benefit of low and moderate income residents by assisting people to establish and expand locally owned small businesses.

Organized on the South Shore Bank holding company model, Southern was established by 26 private, public, and non-profit investors, led by the Winthrop Rockefeller Foundation in Arkansas. Southern began operations in 1988 with the acquisition of the Elk Horn Bank and Trust Company in Arkadelphia, Arkansas.

Like Shorebank and the Center for Community Self-Help, Southern utilizes for-profit and nonprofit, financial and nonfinancial vehicles to address its business development mission. Southern's affiliates and subsidiaries assist enterprises ranging from microenterprises employing only the owner to a company employing 165 people.

There are five components of Southern's development bank. Elk Horn Bank and Trust is a regulated commercial bank which makes consumer, residential, and business loans. Elk Horn's "development loans" are business loans which would not be made on similar rates and terms by other banks. Opportunity Lands Corporation is a developer of commercial and residential real estate.

Three components are grouped together within the Arkansas Enterprise Group, a nonprofit affiliate of Southern. Southern Ventures, Inc. is a small business investment company licensed by the SBA. It is the only active venture capital company in Arkansas for investments of $50,000-$250,000. The Good Faith Fund is a microenterprise loan fund inspired by the Grameen Bank of Bangladesh. It provides extensive technical assistance and very small loans ($1000 average) to low income individual entrepreneurs. AEG Manufacturing Services provides nonbank financing (long term loans, leases on equipment, and working capital), as well as financial consulting, market assistance,and accounting services for small manufacturers.

Southern managers believe that it is critical to provide a range of development resources for rural enterprises in order both to be successful with individual companies and to improve the local economy. They also believe that it is critical to provide these services for several levels of enterprise--from individual microentrepreneur to medium-sized firms.

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Between May, 1988 and June, 1992, the Southern companies have extended over $14 million in development investments in 145 enterprises and family farms in rural Arkansas. (This does not include the conventional lending activities of Elk Horn Bank.) Slightly more than half of the borrower businesses are minority owned. The bank has lost less than one percent on the development loans it has originated, and delinquency rates are below the industry-wide rates. Losses in the nonregulated components of the development bank are somewhat higher, but in line with expectations for these more risky loans. From 1989-1992, Southern has earned at or above the industry bench mark of one percent return on assets.

Southern's integrated approach to business development has demonstrated benefits in individual companies. Only in operation for four years, Southern cannot yet measure its impact on the overall economy of rural southern Arkansas. Ultimately Southern will measure its success on the extent to which it is able to create jobs, diversify the economy and ownership of wealth, build stronger companies, increase exports and decrease imports into the local economy over the long term.

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Section IV: Key Components Of Development Banks

Each of these institutional models share a number of common components and structural characteristics. Each of these common characteristics play a crucial role in the success and the impact of the overall enterprise.

- For these three institutions, the holding company is the creative center of the model (in the case of the Center for Community Self-Help, the 'holding company' is the parent nonprofit organization). It coordinates and manages the activities of the overall enterprise. It is the place where the institution's overall community development mission is formulated and redefined.

  As the umbrella structure of the development bank, the holding company has responsibility for business planning's strategic planning and development for the depository institution and other subsidiaries or affiliates. It seeks to coordinate the work of the various components of the institution, both with each other and the overall mission. It reviews and evaluates the work of the institution and its impact on its targeted communities.

  Another key responsibility of the development bank holding company is fundraising: primarily the raising of investment capital for the bank models, or in the case of the Self-Help model, the raising of funds for operations, capital grants, and social investments. The holding company or parent is also likely to be the mouthpiece for the organization, telling the story of the institution and its work to a broader audience.

  In the case of Self-Help, the parent organization also directly operates the development bank's non-financial programs. In addition, the parent organization advocates for increased resources and supportive policy and regulation for the types of programs it has implemented, both from state government and from conventional financial institutions.

- The insured depository institution is the economic engine which grounds the development lending and financial services of the development banking operation.

  There are several attributes of a depository institution which make it a strong tool for community development. Depository institutions are

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known and trusted models. The actual presence of a financial institution can increase community confidence in a disinvested community. And, a regulated depository institution can convert ordinary individual and institutional deposits into development lending. This ability to utilize ordinary deposits can provide a development bank with access to capital from outside, as well as within, its targeted lending area, and provides access to deposits which would not otherwise be available for this purpose.

Using a regulated financial institution as a community development vehicle requires a market discipline not usually found in a community development institution. Community development bank organizers feel that this is an important aspect of their operation. The bank (or credit union) must safeguard its depositors' money, make sound loans, and be profitable. It must submit to regular examinations and keep its performance in line with other banks and credit unions. The profitable operation of the banking institution is what enables the development bank to be self-sustaining and to expand. In addition, its presence in a community itself develops confidence in the community, and sends a message that the community is worth doing business in.

Because a development bank's primary mission is community development, however, it does not seek to maximize profits for its investors (or income for its members, in the case of a credit union). A development bank utilizing a for-profit holding company structure seeks investors willing to see the profits from bank operations partially reinvested in subsidiary and affiliate operations. A development bank utilizing a nonprofit depository institution seeks low cost deposits and grants to capitalize its operations and reinvests net income in its development programs.

As these examples show, the insured depository institution can be either a bank or a credit union. It could also be a savings and loan or mutual savings bank, although none of the existing development banks are organized in that way. The permitted activities and operating requirements differ somewhat between these types of institutions, and each one brings both opportunities for and restrictions on development lending activities. Credit unions and savings and loans, for example, operate under more restrictions on business lending activities than banks. The reduced capital requirements for starting a credit union,however, mean that they are sustainable at a smaller scale than banks, and are therefore more suited for making very small loans or marketing to smaller depositors. The development mission of the institution, available resources, and specific local opportunities determine the most appropriate or feasible model in a given situation.

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- As the examples in this paper indicate, while the availability of credit is necessary for a healthy local economy, the existence of credit in and of itself has a very limited development impact. In these institutions, the proactive affiliates and subsidiaries play several essential development roles:

  They allow the institution to develop new lending, capacity building, or technical assistance programs to address community development needs.

  The affiliates and subsidiaries are the development vehicles for making deals happen. The development corporation can proactively create and help implement new development projects. A bank alone cannot play these roles.

  They can mobilize existing sources of subsidies available from public and private sources to make sure that programs and projects can serve their targeted constituencies.

  They are the vehicles for leveraging grant support for nonprofitable development activities and expansion into new programs which may eventually be profitable. In addition to grants, the nonprofit arms of development banks are attractive vehicles for contributions of real estate, donations of in-kind services, and other resources.

  They most clearly demonstrate the institution's commitment to its mission to depositors, investors, and contributors

  All of these roles can be played by for-profit and non-profit development organizations unconnected to a depository institution. The power of a community development bank, however, comes from the combination of the depository and nondepository components. The depository arm can leverage substantial resources through its ability to offer deposit insurance, and, once established, is a self-sustaining institution which can operate without subsidies. This gives the community development bank the potential for considerable scale and impact, as well as the staying power to address access to credit and non-financial assistance.

- For each of these institutions, targeting lending and other activities ensures that the development bank can have a significant impact in its chosen areas. Targeting provides a means of concentrating investment in a defined area so that its impact can be both measured and felt. It is also a form of specialization which allows the institution to build the detailed market knowledge necessary for successful development

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lending. Targeting can be either geographic or focused on particular types of lending or constituencies (e.g., minority-owned businesses, microenterprise loans). A development bank's specific targeting is a strategic choice governed by location, mission, and available resources. The community development banks profiled here have each taken a somewhat different approach to targeting their development programs.

For example, the focused geographic targeting of Shorebank reflects the realities of neighborhood disinvestment patterns in Chicago. The bank's early exclusive focus on South Shore allowed it to concentrate its efforts on its primary goals--stabilizing and improving the housing stock and restoring market forces into a disinvested local economy. The bank has expanded its lending efforts as it determined that it had sufficient resources to have a substantial impact in another neighborhood or lending area.

The bank's specialization has given it unique knowledge of its target markets, developed its reputation with potential borrowers, and focused its limited resources for maximum impact.

The Center for Community Self-Help, in contrast, has not limited itself to a single geographic area, but has targeted particular lending niches statewide. This strategy has enabled Self-Help to specialize in very specific types of lending while creating necessary economies of scale, as well as to "cross-subsidize" more disbursed and therefore more costly rural lending with loan volume from denser urban markets. In addition, its statewide focus has enabled Self-Help to obtain significant levels of state government support which would not otherwise have been available and to effectively advocate for supportive policies and programs on the state level.

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Section V: Conclusion

The experience of these institutions over the past 20 years has demonstrated that well-managed, adequately supported community development banks can successfully provide credit to address specific types of community development needs which have been neglected by traditional financial institutions. They have created and defined a new type of financial institution: a private, profitable, public purpose institution.

The experience to date has demonstrated:

- A community development bank can have broad economic impact, and under the right conditions has the power to restore a functioning market economy to a disinvested area.
- Unconventional borrowers can be creditworthy--a community development bank can target its lending to disadvantaged communities and borrowers without access to conventional financing while meeting or exceeding industry loan performance standards.
- A community development bank can be operated profitably, and be a self-sustaining institution able to deliver services over the long term in its target markets.
- Successful development banks require a clear understanding or local community development needs, a variety of tools to meet those needs, and creative approaches to filling credit gaps not being met by conventional financial institutions.

Notwithstanding the successes of existing community development banks, these institutions face enormous challenges in startup and operation. The existence of only a handful of community development banks twenty years after the establishment of the first successful model is testimony to the difficulties. Those banks now in operation have built up to their existing capacities through careful, incremental growth over an extended period.

While the growth of a community development banking industry depends on many factors, three stand out as the most critical:

1. **Capital for startup and expansion.** The availability of capital is the greatest economic barrier to the establishment and growth of

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community development banks. Community development banks require long-term, patient investors to enable startup and expansion. Because investments in community development banks have not been structured to maximize or provide market returns, the availability of capital has been limited and therefore limited the expansion or replication of development banks. A strong capital position also allows a community development bank to grow and engage in more development activities. The most recent start-up community development bank, Community Capital Bank in Brooklyn, required $6 million to capitalize the bank alone.

2. **Long-term or stable deposits.** A stable deposit base is important to community development financial institutions. It enables long-term or fixed-rate lending, particularly when no secondary market is available. In some cases, lower cost deposits allow particular lending programs or products which can target special financing needs.

3. **Management development.** Community development banks require financial expertise, management skills, understanding of community development needs, and creative, financially sound approaches to addressing those needs. While conventional banks and community development institutions develop persons with specialized skills in one or more of these areas, this combination of expertise is rare. A major expansion of institutional capacity will require identification and training of a next generation of community development financial institution managers.

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Statement of
Francine C. Justa, Ph. D., Executive Director
Neighborhood Housing Services of New York City, Inc. (NHS-NYC)
February 3, 1993

INTRODUCTION:

I am pleased to be able to offer testimony to the Senate Committee on Banking, Housing and Urban Affairs. Thank you for this opportunity.

My testimony is based on my experiences as the Executive Director of NHS-NYC, a 10-year old community development volume lender operating citywide and in multi-neighborhood settings, a member of the Advisory Board of Community Capital Bank which opened in Brooklyn, NY in January 1991, and a past faculty member in the Urban Studies Department of Queens College.

NEIGHBORHOOD HOUSING SERVICES OF NEW YORK CITY, INC. (NHS-NYC) AS A COMMUNITY DEVELOPMENT LENDER:

NHS-NYC operates a revolving loan fund for clients who fail to qualify for conventional bank financing. NHS-NYC lends money for rehabilitation to low-and-moderate-income owners of small homes (1-4 units) and to owners of mixed-use and multi-family buildings. We also make emergency loans of up to $5,500 within 72 hours to income eligible homeowners citywide. Loans are made at flexible interest rates and terms, based on the borrower's ability to repay.

In 1992 NHS-NYC directly lent $4,114,183 by closing 226 loans targeted to the rehabilitation of 477 residential units throughout eligible neighborhoods of New York City. In the 10 years since 1982 NHS-NYC has directly lent over $11,500,000 by closing 1,012 loans targeted to the rehabilitation of nearly 2,000 residential units. Our delinquency rate is less than 2%.

We are a lender of last resort helping residents fix their roofs, repair a heating system or keep the bathtub from falling through the ceiling. We provide a remedy for the ills of deferred maintenance and we stem the tide of neglect turning credit-starved neighborhoods into neighborhoods of choice.

NHS-NYC also purchases, rehabilitates and sells vacant buildings to low and moderate income families. NHS-NYC was a successful co-applicant with the City of New York Department of Housing, Preservation and Development (HPD) for a HUD-funded HOPE 3 award to develop 55 single-family homes for low-moderate income first-time homeowners beginning in 1993.

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In 1992 NHS-NYC began 2 new programs. One is a homeownership counseling program which will help low-income people establish credit histories and prepare for homeownership. The other is a Foreclosure Prevention Program which will help forestall foreclosure on the homes of low-and-moderate -income homeowners. Both programs rely on partnerships with conventional lending institutions which recognize the ability of NHS-NYC to do outreach and establish trusting relationships with community residents and provide counseling and other assistance in order to qualify them for eventual participation in the conventional market. In 1992 over 200 individuals received these services.

Over two thirds of NHS-NYC clients are minority, nearly half are female headed households and nearly one third are elderly. All are low-moderate income individuals who have tried and failed to obtain loans from conventional sources.

Our clients require more attention than conventional sources allow for and so help from NHS-NYC is comprehensive. We provide extensive financial counseling to each of our clients. We monitor construction quality throughout the job. We offer intensive, hands-on workshops in topics such as carpentry, electrical wiring or plumbing that meet on a weekly basis. We also offer educational workshops which cover a subject in one presentation discussing issues such as home maintenance, foreclosure prevention, financial management and meeting insurance needs. In 1992 NHS-NYC educational programs reached 1,303 individuals.

This type of "full-cycle" lending -- counseling, lending, rehabilitation monitoring and post-purchase education -- is time consuming and costly. It is also necessary when dealing with individuals and property that have credit issues, title problems, rehabilitation needs, legal entanglement and overall lack of success with conventional credit borrowing. Full-cycle lending is a critical component to a successful community revitalization financing system; NHS-NYC serves this vital niche.

NEIGHBORWORKS NETWORK - A NATIONAL COMMUNITY DEVELOPMENT LENDING SYSTEM:

NHS-NYC is part of a national system of community development lenders - the NeighborWorks Network - which is monitored by the congressionally-chartered Neighborhood Reinvestment

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Corporation. This network, comprised of 180 community-based development organizations, is active in over 150 cities serving 350 neighborhoods containing 4.5 million residents. In 1992 this network directly lent $26 million and retained or secured 6,500 affordable residential units. In addition, $17.5 million in loans were sold to our national secondary market - Neighborhood Housing Services of America (NHSA).

Neighborhood Reinvestment provides 2 essential elements to our network. It establishes national standards for the network in the areas of lending, service delivery and financial management. Each NeighborWorks organization is held accountable to these standards. To ensure that the local NeighborWorks organizations are best equipped to meet the needs of their distressed communities, Neighborhood Reinvestment also provides ongoing technical assistance, training and seed capital. These elements provide quality control enabling safe and sound lending practices.

The national asset base of the network's local revolving loan funds, seeded by Neighborhood Reinvestment and further capitalized by the private and public sectors, is nearly $200 million. The NHSA national secondary market leverages these investments. This secondary market purchases at face value rehab loans and first mortgages for home ownership issued by local NeighborWorks organizations' revolving loan funds. NHSA pools the loans and sells securities backed by these loans to private institutional investors at interest rates slightly below market. The cash proceeds from the sale are returned to the local NeighborWorks organization's loan fund, thereby allowing more loans to be made. To date, a cumulative total of $75 million has been purchased.

THE IMPORTANCE OF THE COMMUNITY REINVESTMENT ACT (CRA)

Low and moderate income and minority communities are hurting after years of disinvestment and neglect. People in these communities, working through NHS-NYC, the NeighborWorks Network and other community-based organizations and networks are working hard to improve conditions, but they need the support and cooperation of government and business. In particular, banks and thrifts play a vital role in a community revitalization financing system.

Thanks to the Community Reinvestment Act and Congress' recent improvements to that law, conventional lenders are beginning to play a bigger role in community development efforts. One way that these lenders are becoming more involved is through partnerships with non-conventional community development

lenders such as NHS-NYC and the NeighborWorks Network.

During NHS-NYC's early history we only had the capacity to make small loans exclusively with government - originated funds. These funds came with target-area and other restrictions and so our ability to make a truly significant impact in Urban Redevelopment was limited. But with a strenghthened CRA, NHS-NYC has been able to leverage private conventional funds for both capital and operating support and has become a truly significant force in the financing and community revitalization of NYC's distressed neighborhoods. Private lenders, encouraged by CRA, realize that through partnership with NHS-NYC loans can be made in markets - both geographic and economic- that they otherwise would not have penetrated, at a cost they can afford.

For example, due to CRA, the private dollars invested in NHS-NYC loan pools grew each year between 1989 to 1992 and so did the number of loans made, $ volume lent and units rehabbed. In 1989, NHS-NYC directly invested $648,000 in the rehabilitation of 1-4 family units. These were all government-originated loan funds and they were targeted to 67 projects. In 1990 the direct investment increased to $1,256,593 which was targeted to 121 projects. There were some private funds involved in these projects. In 1991 we directly lent $1,366,138 targeted to 132 projects (208 units). This included about 20% private funds. In 1992, directly as a result of CRA, NHS-NYC invested $4,114,183 targeted to 226 projects (477 units); 48% of these funds were private dollars reinvested in housing in NYC to individuals with buildings that were turned away by banks. Yet, we have not had $1 of private funds default to date!

In addition, NHS-NYC has been able to raise $5 million in a line of credit at prime from 13 different conventional lending institutions for a mixed-use and multi-family lending program and another $2 million in funds available for loans from 9 wholesale banks which never would have been procured without CRA.

The Community Reinvestment Act is making a difference. Even when banks lend NHS-NYC only $50,000 we can relend these dollars to 5 to 10 families who may have small repair or emergency needs and not be able to get financing anywhere else. Without the encouragement provided by CRA, our distressed communities would remain credit-starved.

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TESTIMONY TO THE SENATE COMMITTEE
ON BANKING, HOUSING AND URBAN AFFAIRS
BY FRANCINE C. JUSTA, Ph. D.
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DO WE NEED NEW COMMUNITY DEVELOPMENT BANKS?:

There has been considerable talk about the possible creation of up to 100 new community development banks across the nation. Yet, we have across the nation many existing institutions and networks that perform community development lending. There is a significant need to recognize the existence of these entities and properly support them so that they can better fulfill their lending mission. NHS-NYC and the NeighborWorks Network stand as a prime example of non-conventional community development lenders poised to make even greater impacts in the communities we serve if provided proper resources.

Other existing institutions that do community development lending include: state-chartered thrifts, S + L's, commercial banks, many with CDC's, (and among these 106 minority banks), church lending organizations, community development credit unions, community development loan funds, micro-enterprise loan funds, city and state lending programs, national intermediaries, program related investments (PRI's) by foundations, SBA related lending organizations, social services organizations such as Settlement Housing Funds.

What we all need is appropriately priced capital and subsidy funds to support loan originations, financial counseling, rehabilitation assistance, loan servicing and organizational infrastructure (administration, overhead, space, equipment, training, marketing). We do not need another type of institution.

The regular banking system already has the means and the obligation to serve all of the community, including minority and low income neighborhoods. While there are some parts of the population where the transaction costs (outreach, counseling, and other support services) are so high that loans become unprofitable, as well as continuing systemic racism, there also exists NHS-NYC and the NeighborWorks Network, and the institutions noted above with considerable experience and commitment to serving these people.

A strenghthened and enforceable CRA encouraging banks to fulfill their community responsibilities through direct lending as well as lending through existing non-conventional lenders (NHS-NYC et al) combined with more Federal funds for capital and administrative costs is the most cost-efficient and effective way to develop a community revitalization financing system.

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To the degree that new community development institutions are created, they should only be promoted where it is not possible to access any existing lending entity. Furthermore, there must be a strong commitment to networking - the goal of moving the urban and rural poor into the economic mainstream requires relationships with mainstream institutions. I have a strong fear that community development banks can become marginal banks for marginalized people and rather than bringing people into the mainstream they will create a separate (and unequal) stream.

The concept of community development banks, and the role of non-conventional lenders, must go beyond the provision of credit. As we provide financing to distressed areas we need to be considered as stepping stones to the larger conventional banking system which has the responsibility of serving the whole community.

SUMMARY:

+ There are existing systems and channels, such as NHS-NYC and the NeighborWorks Network, as well as other non-conventional lenders that are delivering residential community development loans to bankable and unbankable clients aimed at renewing distressed communities.

+ There are real costs to originating smaller loans that need to be recovered but can not be absorbed by the loan client.

+ Existing systems require additional equity, operating support and appropriately priced and flexible capital to meet the needs of marginally bankable clients and the larger unmet market of responsible, yet unbankable clients.

+ The resources of the non-conventional lenders need to be leveraged by secondary outlets such as NHSA, and the non-conventional lender needs to adhere to high quality standards, both financial and programmatic.

+ The Community Reinvestment Act and anti-discrimination laws must be strengthened and more effectively and aggressively enforced to encourage broader community lending and possible linkages with non-conventional lenders.

+ Community development banks should be promoted only in areas where there is no other source of credit available.

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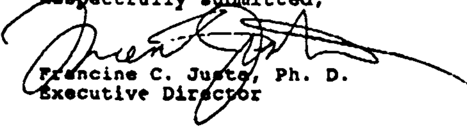
SUMMARY CONTINUED -

+ Community development banks must be stepping stones to the economic mainstream and not marginalized institutions serving marginalized people.

Thank you for the opportunity to submit this testimony. I am available for any follow-up or additional hearings that may be held on the topic of "Urban Redevelopment Initiatives".

Respectfully submitted,



Francine C. Justa, Ph. D.
Executive Director

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Consumer Federation of America

STATEMENT OF CONSUMER FEDERATION OF AMERICA

before

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

on

COMMUNITY DEVELOPMENT BANKING

February 16, 1993

The Consumer Federation of America is pleased to submit this statement for the record on community development banking. CFA would like to commend Chairman Riegle for scheduling hearings on community development banking in the first weeks of the 103rd Congress. The Committee's early focus on the financial needs of distressed communities confirms that community development initiatives will be a top priority of this Congress.

Since the founding of the Consumer Federation of America in 1967, our national, state and local members have been deeply concerned about the availability of financial services for low- and moderate-income consumers. While these consumers, many of whom live in inner-city and depressed rural communities, may not have the vast financial assets that the banking industry is wont to chase, their needs for basic banking services have never been lacking.

Tragically, today, millions of households are non-participants in our nation's subsidized, regulated and insured banking system. These consumers strive to make ends meet without benefit of simple checking accounts -- payment mechanisms most Americans take for granted -- and suffer the debilitating consequences of growing credit famines within their communities. Such exclusion is intolerable and unconscionable under a deposit insurance system that is subsidized and supported by all taxpayers.

CFA is concerned that the people least able to pay are required to pay the most in a financial system that sends millions of citizens into the arms of high-priced check cashing operations, loan sharks, pawn shops and money order firms just to meet day-to-

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day financial needs. This is a situation that should not be tolerated in a proud nation like ours.

However, we are pleased that from the campaign trail there has come a Presidential finding that commercial banks, despite the Community Reinvestment Act, the Fair Housing Act and the Equal Credit Opportunity Act, have left an enormous gap in financial services for millions of Americans in many of our nation's inner cities and rural towns. The President in his campaign, and his advisors since, have talked about the great gulf of credit and banking services that have left deep financial scars on the nation. The President and his advisors have also repeatedly spoken of the dire need for immediate national action to heal these wounds.

CFA knows that rehabilitating the Nation's financial wounds will require a concerted and comprehensive effort to ensure that the existing banking system strives to better meet the needs of underserved communities, that Federal credit facilities be upgraded and rallied behind revitalization efforts and that the Nation experiment, as the President has proposed, with non-traditional community development banks to stimulate economic activity and job creation in communities that the banking industry has abandoned at great cost to the Nation.

CFA strongly believes that the community development banks that the President has proposed must be a supplement to existing banking facilities for low- and moderate-income and particularly minority consumers and neighborhoods, and not a replacement for the major source of mortgage, consumer and commercial credit -- the nation's commercial banks and savings and loan associations. It is our belief that the President's pledge to create community development banks is rooted in the goal of full-service banking for all Americans.

The President's community development bank initiative is an effort to expand financial resources in distressed communities -- not an effort to collapse or to replace existing resources. The resources within the banking and thrift industries, credit unions, and Government Sponsored Enterprises like Fannie Mae, Freddie Mac, the Federal Home Loan Bank System and the National Cooperative Bank must continue to be utilized, strengthened and targeted if the problems of these consumers and communities are to be responsibly addressed. This is not a simple task and there are no simple solutions.

COMPREHENSIVE APPROACH REQUIRED

In order to stimulate the economic revitalization of these distressed communities, CFA believes that a comprehensive approach must be developed. In broad outline, a comprehensive approach will require maximum local flexibility in the utilization of Federal

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resources, the commitment of substantial support for outreach and technical assistance to build capacity among all participants, strict targeting of subsidy monies and the requirement that the full array of existing financial institutions -- both public and private -- be called upon to be partners in the effort.

The development of a full-service financial infrastructure in these distressed communities will require the that the following minimal actions be taken:

1) Mandate Basic Banking and Government Check Cashing.

The community development bank initiative must be integrally linked to efforts to provide access to basic banking services for all consumers in the mainstream banking system. This is not too much to ask of an industry subsidized and backed by the taxpayers.

Since the deregulation of interest rate controls on deposit accounts beginning in 1980, US banking institutions have embarked on deliberate strategies of improving their profitability at the expense of consumers and the well-being of local communities by vastly increasing income from fees and charges for banking services. Bank services that used to be free are now honeycombed with fees and those for which there used to be nominal charges have been subjected to substantial and often prohibitive increases.

The net result of these changes has been to send millions of lower income and elderly consumers out of the lobby and into a growing market- place of alternative and unregulated high-cost fringe banking.

Basic banking is the first step of including the poor, working poor and elderly in the nation's publicly subsidized banking system. A deposit account has important intangible values necessary to conduct day-to-day personal business and to organize a consumers' financial affairs. It is difficult, if not impossible, to build a credit record -- the key to economic opportunity in our society -- without a banking account. For consumers, a banking account is more than just getting your check cashed. It is the very means of financial empowerment.

2) Preserve Bank Representation in Low-Income Communities.

A bank branch is an integral part of the economic well-being and development of a local community. When a bank branch closes, it is more than an inconvenience -- more than an expense; a feeling that a community devoid of banking services is a community at risk sets in. When the teller, the loan officer and the branch manger disappear, consumers and small businesses alike assume new costs and new burdens to meet their day-to-day financial needs. Hardly a week goes by today without a major metropolitan newspaper

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chronicling the growing epidemic of bank branch closures in lower income communities.

To ensure that there is no further erosion of banking services for consumers and communities that are on the ragged edge, CFA calls for an immediate moratorium on branch closures in low-income communities. A prohibition on branch closures should remain in place until firm policy is in place at regulatory agencies for evaluating claims that there is an economic need to close any existing branch and a system is developed to guarantee the availability of alternative and affordable banking facilities for impacted communities.

A solution may involve getting the National Credit Union Administration to determine if a credit union could be established in the community. It may mean working with local governments and agencies to secure municipal deposits and coordinated economic development strategies. But, clearly, we are not being a very imaginative government if we are allowing the loan window to be shut and the branch door to be padlocked without trying to ensure that communities are not cut off from access to basic banking services.

3. Upgrade Existing Federal Credit Programs.

Upgrading Federal credit programs and credit institutions that support private sector lending by both for-profit and not-for-profit firms -- like those on the books at the Federal Housing Commission, the Small Business Association, the Economic Development Administration, the Federal Home Loan Bank System, the National Cooperative Bank and the National Credit Union Administration -- should be integral components of a comprehensive community development banking initiative.

For example, as other witnesses have testified, the National Credit Union Administration could enhance its program for the promotion of Community Development Credit Unions to provide needed depository and credit services in many areas. Similarly, the National Cooperative Bank could use its "development window" to provide loans and technical assistance for consumer-owned enterprises ranging from business to housing and health care cooperatives. And, the 12 regional Federal Home Loan Banks have, in addition to being a ready source of below-market funds, considerable technical assistance capabilities that could be utilized to spur economic development through the system's over 3,600 member institutions.

4. Enhance Enforcement of Community Reinvestment and Fair Lending Law

No community development initiative can overlook the importance of requiring the regulatory agencies to put special

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emphasis on examinations, regulations and guidelines that will ensure full enforcement of statutes, such as the Community Reinvestment Act, the Fair Housing Act and the Equal Credit Opportunity Act, which have been placed on the books to promote economic development, job creation, fair lending, credit availability and the provision of banking services to all sectors of the economy.

Each of these initiatives should be included in a comprehensive strategy to realize the President's goal of placing these financially distressed communities on sound economic footings.

THE PEOPLE IN COMMUNITY DEVELOPMENT BANKS

CFA believes that the single most important consideration for the Congress as it molds the President's community development banking initiative is to be guided by the new Administration's motto of "Putting People First". We recommend that consumers be actively consulted, represented and involved in the development and day-to-day operations of community development banks. The only way community development truly takes hold is when the residents of a community believe they have a real stake in their communities' growth.

There are three key elements to consumer empowerment that should be at the core of a community banking initiative:

1) Place real people on the boards of new community development banks.

In 1989, CFA urged that the Congress revitalize the Federal Home Loan Bank System by placing consumer representatives on the board of each Home Loan Bank and that each bank create an advisory council composed of low-income housing advocates and consumers. The Home Loan Bank Affordable Housing Programs are today a model of public-private partnership because these programs have been developed and overseen by these consumer representatives. This successful model of consumer representation should be imported into this Committee's legislative product on community development banks.

2) Provide support for consumer controlled financial institutions.

Consumer controlled financial institutions like credit unions and consumer cooperatives are institutions that for years have stabilized the financial health of local communities. Credit unions and cooperatives are the epitome of financial empowerment from the

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ground up. They deserve a significant role in ultimate legislation and should have substantial funds earmarked for their development.

3) Investment in outreach and technical assistance.

The importance of technical assistance, including consumer education and counseling cannot be overemphasized. The communities that the President identified as short on capital, credit and banking services are in need of lots of hands on help -- from consumer education on the value of a savings account to how to start a family small business.

These elements are critical components of a successful community development banking program.

COMMUNITY DEVELOPMENT BANKS AND CRA FORBEARANCE

CFA is aware that many within the banking industry have seized upon the President's community development bank initiative to promote CRA forbearance. These are misguided and unproductive suggestions which will only exacerbate the very problems that the President's initiative is designed to solve. As a result, CFA will be compelled to oppose any legislation that links community development bank capitalization to CRA forbearance.

The idea that the establishment of a network of community development banks will relieve banks of their existing responsibilities would defeat the basic purposes of the Administration's proposal -- the expansion of credit and banking services in low- and moderate-income communities. As this Committee is well aware, for many years, banks -- particularly the larger institutions -- have suggested that they be allowed to make one-time contributions to CRA compliance and then be excused from further concern or participation in the low- and moderate-income areas of their communities. This has been unacceptable in the past and remains so today.

Some of the proposals that have been circulated on community development banks propose that commercial banks could help finance or provide capital for the community development banks and let this contribution serve as their complete CRA program. With this contribution, as the suggestion has it, banks would expect to receive a "gold star" and an outstanding rating for their check to the local development bank. Such a proposal would not create more credit or more service -- it would simply shift the responsibility of CRA compliance to a community development bank at a net loss to the President's goal of expanding financial resources.

Suggestions have been made that commercial banks be granted CRA forbearance for equity investments in community development banks up to 5% of their core capital, or an amount equal to less

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than 1% of their assets. Under this proposal, far less would be leveraged than that under today's CRA -- a CRA that many, including CFA, believe is woefully under enforced by regulators and disregarded by the industry.

For example, last month Sumitomo Bank of California announced a CRA commitment equal to 10% of its assets. Similarly, last year Nations Bank, one of the country's largest institutions, committed to deliver $10 billion in new community development loans on top of its existing CRA portfolio. Again, an amount approaching 10% of its assets. Even under the existing enforcement regime, CRA is capable of leveraging ten times the most optimistic projections of these forbearance proposals.

There is nothing to be gained by enacting proposals that would result in less leverage than is currently achieved under the CRA. Clearly, this is not what the President has in mind nor should it be a serious consideration of this Committee.

In addition, the suggestions of the forbearance advocates fly in the face of existing regulatory policy on the treatment of these types of equity investments. Since 1971, the Federal Reserve Board has permitted bank holding companies to make equity investments in community development projects. These investments have been valuable components of many local economic development and job creating projects. Yet, the Federal Reserve has carefully advised holding companies that community development "investment activities alone are no substitute for comprehensive, ongoing bank CRA programs" (Community Development Investments, Board of Governors of the Federal Reserve System).

The Director of the Division of Consumer and Community Affairs at the Federal Reserve, Griff Garwood, recently clarified, in testimony before the House Banking Committee, the Board's policy on community development investments:

> "The Federal Reserve believes that the use of community development corporations and investments has limitations and that these mechanisms should not be oversold.... [B]ank related CDCs should not be viewed as a panacea for the ills of out urban neighborhoods and rural communities, nor as the main vehicle for bank activity....[T]he community development equity investment option is an important and useful tool, one that we believe can effectively supplement ongoing bank lending programs....Under current provision of the CRA, CDCs and project investments can provide positive contributions to an institution's CRA performance, but they are not considered to be a substitute for the institution's CRA program."

Finally, CFA is concerned that these proposals would not only

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not produce more credit, but would institutionalize the very economic divisions within local communities that generated the President's call for community development banks in the first place. These proposals would literally leave the nation with a separate but unequal banking system. The commercial banks, with their Federal insurance, would send their check across town to the community development bank and that would be all -- the banks, with their vast resources, would be *invisible* in those areas of their community.

Such a separate system would have a corrosive impact on development in the inner-city much as the separate educational facilities did on the population of the South prior to Brown v. Board of Education in 1954.

It is absolutely essential that commercial banks remain part of the entire community. The Community Reinvestment Act requires that banks help meet the credit needs of the entire community including low- and moderate-income neighborhoods. Allowing banks to meet this requirement by simply sending a check across town would defeat the letter and certainly, the spirit of CRA.

Banks, whether we like it or not, carry considerable clout in every community in this nation -- tremendous economic and political clout. It is important that the banks, their officers and directors have a stake in all areas of the community. As intended by the CRA, we want to see relationships develop between banks and all the sectors of the community. Only with this ongoing dynamic will banks at long last develop a "feel" for the community and an understanding of the differing cultures and economic circumstances that exist on both sides of the tracks within their communities. Community development banks cannot fill this gap of understanding alone and real economic development is impossible without it.

As has been true in increasing cases, banks have discovered that citizens of inner-city neighborhoods can be good credit risks and that they can be the source of profitable lines of business. Great Western Savings and Loan of California has testified before this very Committee that it makes money in the inner-city and it finds the lowest default rate among mortgages in the low- and moderate-income ranges. It is a learning process that would not have been possible had Great Western simply been allowed to send a check across town to a community development bank.

CONCLUSION

A final note. It is critical that a community development banking initiative not result in the stigmatization of consumers and communities who will become targeted populations of the effort.

This is why opening up the mainstream commercial banking

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system through the provision of basic banking services and ensuring adequate enforcement of the CRA are critical elements of a successful comprehensive approach.

No one can build assets without a means to cash a paycheck, pay monthly bills and safely save what is left over -- however meager. Ensuring access to basic banking services is the prerequisite of financial empowerment and lasting community economic development.

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The Oweesta Program

American Indians living on reservations face many barriers to economic development. Since capital has always originated from large infusions of federal funding, small-scale financing is virtually non-existent. Most Indian land on reservations is held in trust and tribal members have no access to mortgages or home equity loans. Reservations lack the vehicles and familiar forms of financing available to most other American populations.

The Oweesta Program is one such vehicle. Named for the Mohawk word for money, the Oweesta Program was developed in 1987 by First Nations Development Institute. The Oweesta Program is the only national program that assists tribes in reservation-based lending and capital management. The Program does so for a variety of purposes and always in culturally-appropriate ways. The Oweesta Program helps tribes manage trust settlements and other financial assets. More importantly, it helps tribal members form equitable and long-lasting relationships with border town banks and other financial institutions.

New, improved housing was just one of the results of the First Nations' work with the Saginaw-Chippewa Tribe through the Oweesta Program.

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The Oweesta Fund:

Your Investment in Reservation Economic Development

PHOTO: TIM RICE

The Blackfeet National Bank in Browning, Montana benefits from Oweesta Fund investments. The bank is Indian-owned and managed.

An investment in the *Oweesta Fund* puts capital directly on reservations throughout the United States. The *Oweesta Fund* was used to start the Lakota Fund on the Pine Ridge Indian Reservation in South Dakota, the first micro-enterprise loan fund in this country. The *Fund* has also made investments in the Cherokee Community Loan Fund in Tahlequah, Oklahoma, the Tlingit and Haida Tina'a Fund in Southeastern Alaska, the Navajo Community Fund in Shiprock, New Mexico, the Sisseton-Wahpeton Credit Union in South Dakota, and the Blackfeet National Bank in Browning, Montana.

The *Fund* is also being expanded to help provide affordable housing for 12 tribes in Northern California, to help the Fort Belknap Community Coop secure much-needed land for their sheep farming and to aid the Umatilla Tribe in restoring the land base on their reservation in Pendleton, Oregon.

The *Oweesta Fund* is funded by a pool of interested and dedicated investors who lend money at low or no interest to First Nations for re-lending. In return, First Nations works with tribes to insure goals and objectives are met. Investors include private individuals and religious groups, along with the Ford Foundation, MacArthur Foundation and other philanthropic organizations.

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The Oweesta Program, and its lending component, the *Oweesta Fund* are administered by First Nations Development Institute, a not-for-profit reservation-based economic development organization. First Nations is a Native American organization dedicated to advancing culturally-appropriate development. First Nations' President and Founder, Rebecca Adamson, a Cherokee from North Carolina, is an internationally known expert in economic development. Ms. Adamson also sits on the Board of Directors of the Calvert Social Investment Fund, the Ms. Foundation and the National Center for Indian Enterprise Development.

Though headquartered in Falmouth, Virginia, First Nations does all of its work on reservations throughout the United States. The Oweesta Program is one of 6 ongoing program components. Other program areas include Field Sites, Policy, Education, Research and Marketing. First Nations has a staff of twenty and an annual budget of $3 million.

First Nations is classified by the Internal Revenue Service under Section 501(c)(3) of the IRS Code as a charitable, tax-exempt organization. Contributions to First Nations are deductible to the extent permitted by law. Financial support for our work comes from private foundations, corporations, religious organizations and our own earned revenue. First Nations is not supported by any governmentnor does it receive any Federal funding.

First Nations is proud of its record as one of the most successful and oldest Indian economic development organizations in the country. Answers to the most commonly asked questions are included on the following pages. For more information, contact Debra Levy or Sherry Salway Black, First Nations Development Institute, 69 Kelley Road, Falmouth, VA 22405, 703/371-5615.

The Lakota Fund on the Pine Ridge reservation, was the first Oweesta site and the first micro-enterprise loan fund in the United States. Here an artist sells her artwork. Many artists borrow from the Lakota Fund.

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about your investment in Indian Country

Who Administers the Fund?

The *Fund* is administered by First Nations Development Institute as the capital pool for its Oweesta Program.

How large is the Oweesta Fund?

It is currently capitalized at $1.3 million. The *Fund* should reach $3 million by 1995.

What is the minimum investment?

First Nations prefers to work with amounts of $25,000 or more, although some exceptions have been made in the past for lesser amounts. The minimum term is three years.

What is the interest rate paid?

Most investors provide interest-free loans. Interest can be paid up to the Federal Reserve Bank's Discount rate in effect at the time the loan is made. Please check with our offices for further explanation.

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How is the money invested?

Funds are put to work in Indian Country immediately. Your investment will be used to start loan funds, finance housing and land acquisition, and leverage local financial power. Funds awaiting disbursement are invested in a combination of the following vehicles:

(1) Indian financial institutions, credit unions and banks that work well with tribes, socially-responsible banks and other instruments;
(2) Obligations issued or guaranteed by the United States of America or by an agency of it;
(3) Certificates of deposit, times deposits or investments fully insured by the Federal Deposit Insurance Corporation of the Federal Savings and Loan Insurance Corporation in any banking or savings institution;
(4) Certificates of deposit or accounts with banks or corporations endowed with trust powers having capital and surplus in excess of $50,000; and
(5) Commercial paper at the time of investment rated at least A-1 by Standard & Poors Corporation or Prime-1 by Moody's Investors Service, Inc.

When is interest paid?

Interest is paid yearly or twice yearly.

Can the loan be assigned to another party?

Our standard investment agreement allows for the assignation of the loan to another party after one year of investment. Exceptions can be made.

PHOTO: VERN KORB

The Oweesta Program includes access to capital through the Oweesta Fund and access to information and education through the program. Top: The Oweesta Fund is expanding to help finance projects such as housing for a 12 Tribe consortium in Northern California. Below: The Oweesta Conference is just one of the many educational programs offered.

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The Oweesta Fund is used to capitalize culturally-appropriate economic development. The Oweesta Program helps tribal members hone their business skills and distribute their products to a wider audience.

How secure is my investment?

As with most types of socially-responsible investments, your investment is an unsecured loan to the *Oweesta Fund* and should be thought of as a high-risk investment. In five years of existence, the *Fund* has never defaulted or failed to repay a loan. In fact, most investors "rollover" their investments when they come due. Your rights as a creditor are neither superior nor subordinate to any other investor in the *Fund*.

What types of safeguards exist?

First Nations invests only in programs that meet our standards. Loan funds, for example, must have large loan loss reserves; individual loans made by the fund cannot exceed $10,000, etc. As was mentioned, the *Oweesta Fund* has never defaulted or failed to repay an investment on time.

What types of reporting mechanisms are there?

The *Oweesta Fund* is audited annually and copies are available to any investor. The *Fund* is administered through the Trust Department of the Kellogg Bank, Green Bay, Wisconsin. Groups that have received loans provide quarterly financial and semiannual program reports to First Nations. They are required to re-pay interest quarterly.

What types of reports will I receive?

All investors receive copies of First Nations' BUSINESS ALERT every other month and copies of any annual or other reports produced.*

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RESPONSE OF MILTON O. DAVIS TO WRITTEN QUESTIONS FROM SENATOR RIEGLE

Question 1—Community Lending:

(A) Are these institutions addressing fully the credit needs of distressed communities?

(B) What credit needs are not being met and why?

Answer 1:

A broad range of credit needs in distressed communities continues to be significantly underfinanced. These needs include, among others, small- and middle-sized business start-up and expansion loans, micro business transactions, conventionally financed mortgages for the purchase and/or rehabilitation of rental housing, and credit for community organizations, home improvement and single-family mortgages.

The reasons for this lack of credit fall broadly into three categories. The first set of reasons includes many deals which should be bankable by conventional standards but are not financed due to racial and cultural obstacles. Other deals are avoided because most banks seek what appear to he more attractive markets. Conventional banks, with the proper incentives, could meet these needs.

Second, many deals in distressed communities are only bankable by specialized institutions with sufficiently targeted market knowledge and expertise to evaluate, structure and finance them appropriately. Distressed communities need access to credit from lenders that are willing to find ways to make this lending a source of good business. These credit needs in distressed communities often do not fit the standards set by traditional lenders: the loans are too small, the borrowers are less financially sophisticated; lenders are unfamiliar with the neighborhood; and lenders are unwilling to partner with other sources of financing or enhancements to enable comprehensive redevelopment efforts. Specialized finance institutions with a focus on and commitment to community development such as community development banks or loan funds are designed to meet these needs.

The third category is less about credit than about comprehensive community development—the purpose of development banks. Access to credit by itself is insufficient to revitalize a distressed community. Disinvestment is a market phenomenon and, consequently, will only be reversed by fundamentally reinvigorating local markets. Permanent, self-sustaining community renewal results from creating an environment where private investors inside and outside the community are confident their investments will be rewarded as healthy community dynamics are restored. If the focus is community development, perhaps the largest category are nascent credit needs: deals which are generated by supporting entrepreneurial energy through extended, mutually reinforcing, financial and non-financial community development interventions. Comprehensive community development financial institutions can be designed to meet these needs. Community development bank holding companies, which include a comprehensive set of nonbank affiliates, are particularly suitable for this purpose.

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Question 2—CRA Enforcement:

(A) Can the credit and revitalization needs of distressed neighborhoods be satisfied completely through better enforcement of CRA? If not, why?

(B) How can we strengthen enforcement of CRA to better meet the credit needs of distressed communities?

Answer 2:

As suggested by the prior answer, credit needs in distressed communities cannot he completely met through CRA enforcement. Disinvested communities frequently require far more intensive intervention than can be provided through conventional banking institutions. Indeed, even community development banks function only in communities which retain or attract some working class base.

However, a large portion of the credit needs (the first category identified in the answer to question #1) could be met by conventional banks subject to rigorous CRA enforcement. Incentives for conventional banks to meet those needs are critical, and would complement and reinforce specialized efforts to meet the other categories of unmet need.

There are 11,000 commercial banks in the country. Each of these institutions employs seasoned loan underwriting talent, has proven credit mechanisms and controls, and knows how to operate within a prudent and regulated context. Regulatory enforcement of CRA, an Act in force now since 1977, has not yet succeeded in motivating the vast majority of these institutions to apply this talent to adequately addressing the credit needs within disinvested communities. Alternative financial institutions do not operate on a national scale or magnitude that would enable them to fill the void left when conventional banks do not adequately invest in their communities. Clearly, a successful reinvestment strategy should engage commercial banks, through CRA implementation and other mechanisms, in initiatives that provide credit to distressed communities.

In order to ensure that there is access to conventional credit in disinvested communities, clearer CRA guidelines and better enforcement are needed, particularly to reverse racial disparities within some lending markets. CRA examiners need to analyze lending patterns within individual institutions and pay particular attention to the lending policies and practices of those institutions that have fewer loans in minority areas and/or higher denial rates for minorities. The evidence of disparities in some lending markets, particularly in home mortgage lending markets, is mounting. It is imperative that Congress and banking regulators work to ensure that every borrower has equal access to credit, regardless of race or gender.

CRA regulators need to better educate safety and soundness regulators to the variety of tools used to make loans in low- and moderate-income communities so that financial institutions do not feel there is a conflict between the requirements of CRA examiners and the requirements of safety and soundness regulators in terms of the evaluation of loan portfolios. Small business lending, in par-

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ticular, has recently been negatively affected by these kinds of discrepancies.

The regulatory agencies, or the Congress, should consider two procedural changes to CRA to improve its effectiveness. First, regulators could partially apply the practice of the educational and medical professions, which rely on peer review, by adding a banker and a qualified community-based representative as members of every CRA examination team. In addition, an annual working session should be convened to make specific recommendations on improving CRA enforcement. The working session should include approximately fifteen representatives of regulatory agencies, bankers (and/or banking associations), and community-based organizations.

CRA should be more performance and output driven: less concerned about appearance and more about the amount of credit that gets extended—*directly or indirectly*—to low- and moderate-income communities. This requires, among other things, more clarity from banking regulators on what counts for CRA "credit." Examiners and banks need to be reminded that compliance with the law requires assuring the actual making of loans (by the institution and, in some circumstances, through intermediaries) in low- and moderate-income areas, i.e., getting dollars into communities that have been significantly underserved by financial institutions. Thus, while documentation of compliance is important, lending is more important and, of course, the factor that ultimately counts in achieving CRA's public policy objective.

Because some credit needs can most efficiently be met through specialized institutions, regulators need clearly and specifically to recognize that financial partnerships with intermediaries can help extend the ability of some banks, especially those institutions without retail lending operations, to meet the credit needs of low- and moderate-income people. These partnerships could include community development banks, community development loan funds, community development credit unions and micro credit programs as well as nonprofit community development corporations.

Finally, positive financial incentives should be created to further encourage community reinvestment lending by conventional banks. New, much sought after, banking and non-banking privileges should be awarded to institutions that meet specific, high thresholds of CRA performance.

Question 3—Distinction:

(A) Can you explain to the Committee what factors make CDBs distinct from other institutions?

(B) Why do you feel that the creation of a CDB was necessary to address the needs of your community?

Answer 3 (A and B):

Community development banks are generally distinguished from conventional banks by their development specialization and targeted comprehensiveness of banking and non-banking activities. They tend to be distinguished from other community finance institutions by scale (as regulated depositories) and, again, often by comprehensiveness of activities.

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Shorebank defines a community development bank as a bank holding company with a specialized structure which is organized to transform the market dynamics of a geographical target area. This structure, including a bank and community development subsidiaries, has a number of attributes which make it particularly well-suited to promote the revitalization of distressed communities.

1. A community development bank is designed, to be, a comprehensive community development institution which, in addition to a bank, includes other development subsidiaries and affiliates that complement the investment activities of the bank. These subsidiaries and affiliates enable a development bank to aggressively identify and better evaluate opportunities and initiate development activities; and to address multiple dimensions of community renewal, ranging from developing retail shopping centers to upgrading labor force skills, Through its non-bank development affiliates, the institution can invest equity capital in businesses owned by others, rehabilitate and construct residential and commercial real estate, operate social development and business technical assistance programs, attract other private and public investors, and generally link residents, financial resources and Government programs into a coherent renewal effort.

2. A community development bank is further distinguished from conventional banks by its specialized commitment to the revitalization of a targeted area for the benefit of current residents. Through its leadership, ownership and governance structure, the development bank makes its mission the long-term development of a community. It measures its success in terms of the development impacts it has on that community. It becomes a permanent institution whose success is joined with the improvement of the community. In order to accomplish its mission, the development bank's leadership and staff must bring together highly localized knowledge of the community, technical banking skills, and a broad understanding of the strategies and process of economic development.

3. A development bank combined the structure and expertise of a for-profit financial institution with the commitment to place one normally sees in community-based non-profit organizations. By developing specialized expertise in carefully targeted areas, and achieving synergies through comprehensive coordinated interventions, a development bank is able to manage the tensions between the goals of profitability and community development impact, making development profitable. In contrast to many community-based organizations, profitability is an essential feature of a development bank. Profits enable the bank to be self-sustaining and to grow and assure that continuing business discipline will be brought to the task. However, while profitability is essential, the shareholders and management of a development bank recognize that its goal is not to maximize profits, but to help effect lasting community renewal.

4. A development bank also combines the qualities of a community-based, market-driven, private institution with unusual scale, expertise and ability to leverage resources. A development bank is a uniquely capable delivery agent for external public and private resources. Many private and Government programs are not fully available in the communities for which they are intended because of lack of sophisticated, market-based delivery systems. A develop-

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ment bank uses foundation investments and grants, Federal loan guarantees, secondary markets, low-income housing tax credits, JTPA and numerous other programs to accomplish common objectives. A development bank can be considered a "handyman" of sorts, intimately familiar with particular local problems, equipped with a "toolbox" of varied Government and private "tools" to address them, and possessing the expertise to select and productively use the appropriate tool.

5. Finally, a development bank can be flexible and innovative. Location dictates strategy and design: the organizational structure and the strategies or tools it employs can be adapted to a wide range of circumstances. Thus, whether a bank or other kind of large scale, regulated depository institution is most appropriate, and what affiliated activities are needed, will vary from community to community. For example, Shorebank's structure reflects its goal of revitalizing older urban neighborhoods. Southern Development Bancorporation uses a different array of affiliates than Shorebank, because it has been designed to specialize in business and rural development rather than urban community reinvestment.

Conventional banks and community development banks do not compete; they are natural partners. Community development banks operate in a market niche which is generally not "bankable" except by such specialized, comprehensive institutions. In effect, they "grow" the market for conventional banking much more than they take a "slice" of the existing "pie."

Question 3:

(C) How do CDBs fit within the spectrum of all community lending institutions?

Answer 3 (C):

CDBs tend to be the most comprehensive and well-capitalized model. Through their ability to use the lending and deposit gathering properties of insured depository institutions and the proactive community development properties of various types of subsidiaries, development banks offer unusual potential to affect a broad economic development strategy and achieve scale of impact. Unlike traditional banks, development banks are extraordinarily proactive in the design and delivery of coordinated bank and non-bank products to meet the credit and community development needs of distressed communities.

However, it should be recognized that "disinvested" communities are not all alike. The degrees and categories of credit need vary. In response to different needs, a variety of types of community development financial institutions has emerged to fill the credit gaps in low- and moderate-income communities. These institutions provide a critical, alternative and accessible source of financing for meeting the capital and credit needs of distressed communities in ways that increase employment, income or housing opportunities over the long term and with broad-based impact.

Each of these types of community development financial institutions plays a separate and distinct role in meeting community capital and credit needs. Some are defined with a broad economic development focus, others are narrowly focused on the delivery of a

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small number of development credit products. Generalized descriptions (which cannot do justice to the individual institutions) reflecting some of their distinctions follow.

1. Community development credit unions are a particularly effective vehicle for connecting very low-income people to mainstream money management techniques. The deposit and financial transaction services of CDCUs make mainstream banking services accessible and affordable to people that otherwise might have to use expensive and unregulated check cashers and "under the mattress" savings accounts. The consumer lending done by CDCUs is often the only source of loans for expenses like education, home improvements, or used cars that enable people to get and keep jobs. Lending to individuals can have a significant impact on a community scale as opportunities for individual advancement make local community economic development a reality.

2. Community development loan funds specialize in making loans for "unbankable" deals. Through their lending, they often make projects bankable, train borrowers to use credit, and fill a credit gap that cannot be filled by conventional banks. CDLFs serve as a delivery mechanism for social investment capital that is willingly invested at risk for a financial return that is generally below market rates, in order to further the goals of community development. Through their willingness and ability to make loans to community projects that are unable to attract conventional bank loans, CDLFs fill a development credit gap that often stands in the way of community-based development. CDLFs foster new borrowers, make new loans that enable borrowers to establish relationships with traditional financial institutions, and provide technical assistance to help borrowers establish the kind of experience and track record necessary to secure future loans from banks.

3. Microcredit programs provide a very specialized type of development credit to individual entrepreneurs who seek to be self-supporting through income from their businesses. Although not a community-wide strategy for economic development, microcredit programs do provide access to capital to very small businesses owned by low-income persons, often women or minorities, who are otherwise unable to borrow. Because microcredit programs are designed to provide tailored, extensive technical assistance and are not limited by the regulatory constraints of depository institutions, they have the potential to make a deeper impact on truly disadvantaged populations.

Question 3—Follow Up:

One concern raised about the creation of a network of CDBs or other community-based lenders, is that it will create a two-tiered banking system—one that serves the needs of poor communities and the other that serves everyone else. Is this a legitimate concern? Why or why not?

Answer 3—Follow Up:

This concern is not legitimate if, as has been proposed, CDBs are not established as a wholly distinct "system" with a special charter. An essential feature to CDBs' success is precisely that they are fully regulated commercial banks operating by the same stand-

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ards—and with the same legitimacy, credibility and business discipline—as any bank. They are distinct from conventional banks because they are specialized in community development (as, indeed, many other banks specialize in particular markets), but recognition that this specialization serves public purposes, and so is particularly deserving of support, need and should not constitute them as a different and certainly not a *lower* tier—system.

[Question 4 was missing on our copies]

Question 5—Impediments:

(A) Why are there so few CDBs and what are the impediments to the formation of new institutions?

Answer 5 (A):

Shorebank was created in 1973 by a management team and investors interested in testing the theory that a bank holding company, as a self-sustaining, large scale, permanent institution, could engage in multi-faceted community development, simultaneously helping revitalize communities while operating profitably. For nearly fifteen years, its owners and managers concentrated on refining, implementing and learning the lessons from application of this model in the South Shore community. The last five years have witnessed significant expansion and replication, and at least a dozen communities are currently in varying stages of planning development banks. The perspective gained from almost 20 years of experience inventing the techniques and methods needed to succeed leads us to believe that this model can be broadly replicated in other communities. However, the challenges remain formidable.

Experienced personnel with the requisite skills and commitment, capital, and funds for organizing costs are all equally great impediments. Community development banking is a difficult and specialized business that is not for everyone. It requires specialized skills, flexibility and a long term commitment to the dual goals of profitability and community development. Formal bank training programs are not sufficient preparation for management of a community development bank. Establishment of and support for training programs, and perhaps ultimately of a trade association type network of CDBs, deserves consideration.

Compared to most community development institutions, development banks are complex and large scale, requiring commensurate amounts of organizational resources and capital. At the same time, community development banks have required patient and dedicated investors who are willing to take greater risks associated with start-up and a new institutional model; who have been willing to forgo dividends and liquidity in favor of reinvestment of profits in development activities; and who support a development agenda. Shareholders willing to fund start-up of and invest in community development banks on this basis are a relatively narrow group, consisting largely of foundations and socially responsible religious institutions, corporations and individuals. Start-up and risk factors generally should decline as experience grows, but considerable obstacles remain. With new Federal programming and appropriate

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incentives, it may become possible easier for CDBs to attract funding and capital from a broader investor base.

Question 5:

(B) Are their other community lending models that should be explored as part of a Federal community development banking initiative?

Answer 5 (B):

Each disinvested community has unique capital, credit and community development needs, as well as strengths and resources. To have an effective impact on these needs, each community development initiative must be tailored to these unique community characteristics. As stated above, the community development bank model has unusual capacity for managing a comprehensive, community development approach. However, other models may be more appropriate for particular communities with differing, or fewer, needs. For example, a disinvested community with a strong community development corporation and good access to an aggressive community-oriented bank and non-bank financing, may be better served by a community development credit union that provides low-income people with access to retail deposit and loan services.

While Federal community development initiatives should recognize and support the whole range of community development institutions, it is critical that a "least common denominator" approach not result in folding all of the institutions into one program, which necessarily could not then be appropriately tailored for the particular structures, purposes and needs of the diverse institutions. A community development *banking* initiative should, for the reasons detailed in my testimony, concentrate on comprehensive depository institutions. Complementary initiatives should be designed for the other institutions, and specific programmatic incentives and support should be created, which could be accessed by any of these institutions.

Question 6—Limits of CDBs:

(A) Are CDBs a panacea for these ills?

Answer 6 (A):

While community development banks can be a very effective model with high development impact, they are far from a panacea for urban and rural problems. CDBs are, in part, delivery mechanisms and mediating institutions, succeeding because they attract and foster productive application of human and financial resources from within and without the targeted community. They complement, and cannot supplant, the broad array of Government and private activity which is necessary to restore distressed communities. Furthermore, as discussed below, they can play even this limited function only in certain types of community environments.

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Question 6:

(B) What are the limits of CDBs? (C) What factors or conditions must be present in a community for a CDB to be successful?

Answer 6 (B & C):

Considering the successes of the few currently operating CDBs, the limits of their capacity are as yet unknown. However, the model is premised on facilitating entrepreneurial energy and potential development opportunities to restart healthy market forces while supporting, among other things, profitable operation of a bank. Some communities have been so devastated by years of neglect, disinvestment and destructive forces that the environment no longer exists for a community development bank to operate or even begin the renewal process. There are other neighborhoods whose markets may simply be too small to support a community development bank.

Numerous factors affect how and whether a CDB can be designed appropriately for a particular community. These include the volume and quality of the housing stock; business presence and development opportunities; the presence of a sufficient working class and entrepreneurial population; community and public amenities making it possible to attract residents and investors; access to capable public and private sector partners; and others.

Question 6:

(D) What other initiatives should we be examining as part of a Federal community lending strategy?

Answer 6 (D):

As mentioned elsewhere, incentives and accountability under the Community Reinvestment Act provide necessary, enormous and complementary opportunities to contribute to revitalization of distressed communities. Distinct programs to support start-up of alternative community lending and development institutions should also be created. Finally, a broad range of specific programmatic support for development products (such as the SBA loan guarantee program) should be enhanced and coordinated, including support which could be utilized by the nonbank affiliates of CDBs.

Question 7—Safety and Soundness:

Do institutions dedicated to community lending pose safety and soundness problems or create significant risks to the bank insurance funds? How do existing community development banks compare to their peers in terms of loan losses, delinquencies, defaults, returns on assets or earnings, or other indicators of the health of the institutions? What role should the Federal financial regulatory agencies play with respect to regulating institutions that might receive Federal assistance?

Answer 7:

Shorebank's and Southern's experience suggest that CDBs do not pose special safety and soundness risks. The same safety and soundness regulations currently applied to all banks adequately ad-

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dress the risks, and should continue to be applied to CDBs. Careful selection and monitoring processes by the investing (*non*-regulatory) "Entity," as described in my testimony, will also mitigate any risks. Finally, to the extent other support, including capital and training, is provided by the program to strengthen CDBs, it will further decrease their risk of failure.

The well-documented problems in the thrift and banking industries did not stem from reinvestment in distressed communities. In fact, the institutions that failed or got into serious trouble were generally not active lenders in low- and moderate-income communities.

The charts of Shorebank and South Shore Bank performance submitted with the written testimony demonstrate that their performance compares favorably to their peers, including:

—South Shore Bank has been profitable every year since 1975.

—1992 was the tenth consecutive year in which the Bank achieved double-digit return on equity.

—The Bank's low 1992 net loan losses of just cover one third of one percent (.38 percent) on a $161.2 million loan portfolio continue a trend of outstanding performance at a level that has equaled or surpassed the performance of peer group banks during five out of the last seven years.

Additional Questions Concerning CRA:

To what extent should insured depository institutions receive credit toward fulfillment of their CRA requirements for contributions to or investments in community development financial institutions? Should contributions to or investment in community development financial institutions be sufficient to fulfill an insured depository institution's CRA obligations? Would it be appropriate to exempt institutions from CRA examinations and requirements if they contribute a sum equal to approximately .05 percent of their assets of 5 percent of their capital to a community development financial institutions?

Answer to Additional Questions Concerning CRA:

Since CRA should be clarified and enforced to emphasize performance objectives—outputs of financing to low- and moderate-income markets—examining the extent of CRA credit should not be focused on whether the financing is extended directly, or indirectly through intermediary community finance institutions which often can more effectively extend it in particular markets. Rather, the extent of CRA credit for such investments should reflect the extent to which the investments result in provision of financing to underserved markets. Considering the limited opportunities for and attractiveness of most indirect investments; the enormous assets of the conventional banking system; and the extent to which many credit needs can be better met by the conventional banking system, and would be with appropriate CRA enforcement and incentives, the proportion of total CRA activity which would ultimately be met through indirect investments would remain miniscule.

It is extraordinarily unlikely that indirect investment could entirely fulfill appropriate CRA requirements. The extent to which it could do so will depend on the nature of particular institutions and indirect investment opportunities. For example, banks that do not

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have retail lending operations because they have defined themselves as wholesale banks, investment banks or specialty banks like trust companies would more efficiently fill more of their CRA lending requirements through capital investments in CDBs, if such investments were available. The threshold should be high enough to ensure that the investment is on a par with those banks that have retail lending operations. With respect to banks that have a retail lending operation, investment in a CDB would primarily supplement community lending activities.

CRA should be restructured to create, in addition to minimum required thresholds, incentives for much higher levels of community financing. Such incentives might be structured in tiers, such that financing at some multiple of the minimum would create a "safe harbor," and financing at various established higher multiples would entitle the institution to access additional special privileges, such as interstate banking, insurance sales, and securities underwriting. Among other reasons, because the amount of CRA credit for indirect investments will depend on the nature of the institution, its markets and the investee institution, a blanket "buy-out" would not be appropriate, particularly not at levels as low as the percentages suggested in the question.

RESPONSE OF LYNDON COMSTOCK TO WRITTEN QUESTIONS FROM SENATOR RIEGLE

Question 1—Community Lending:

Are these institutions addressing fully the credit needs of distressed communities? [referring to existing "commercial banks, savings and loan institutions, non-profit organizations, and public agencies"] What credit needs are not being met and why?

Answer 1:

Capital starvation is a principal cause for the economic devastation faced by so many low- and moderate-income communities in the U.S. There is not nearly enough capital investment taking place to support an appropriate level of business development and job creation, housing development, and consumer credit in lower income urban and rural areas.

As to the reasons for this situation, we have to begin with examining the performance of the institutions that have the capital base and mission to supply investment for small businesses, housing development, and consumer credit.

The most important pool of savings in this country, and the most important source of investment for small businesses, housing development, and consumer credit, is the nearly four trillion dollars in the commercial banking system. What proportion of this pool of savings is invested in ways which benefit the low- and moderate-income population of the United States? I refer now to the combination of all of the loans for housing in low- and moderate-income communities, all of the loans for small businesses located in those communities, and all of the consumer credit provided to low- and moderate-income individuals by commercial banks.

My estimate is 1 percent.

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I've come to that conclusion by looking at Community Reinvestment Act data for New York City, and would be happy to share with you the basis for my estimate. If there have been any studies of this question which could give us a further refinement of this number, I would like to learn about them.

As to the reasons for the low proportion of total bank assets invested in low- and moderate-income communities, I suggest that it is only partially related to loan risk. I have yet to see any evidence that this type of lending is unacceptably risky when handled appropriately.

I also find it highly interesting that South Shore Bank has been more profitable over the past ten or fifteen years, on a return on assets or return on equity basis, than literally thousands of banks in the U.S. The South Shore story is quite well known in the banking industry by now, yet there is a remarkable paucity of imitators. One is forced to conclude that other banks either don't believe they're capable of replicating the South Shore success, or simply don't wish to focus on community development even if it is a profitable activity. Whatever the reasons may be, I have yet to hear anyone dispute that there is an extremely low level of capital investment taking place in low- and moderate-income communities.

Question 2—CRA Enforcement:

Can the credit and revitalization needs of distressed neighborhoods be satisfied completely through better enforcement of CRA [Community Reinvestment Act]? If not, why?

How can we strengthen enforcement of CRA to better meet the credit needs of distressed communities?

Answer 2:

We at Community Capital Bank support full enforcement of the Community Reinvestment Act. I believe that all of my colleagues in the community development financial institution (CDFI) sector share that view. Whatever community benefits are generated by the CRA need to continue and be enhanced.

A coalition of CDFI practitioners has put forward a position paper on "Principles of Community Development Lending," which was entered into the Committee hearing record on February 3. All of the members of that coalition have agreed that community reinvestment ought not to be viewed as an either/or situation between conventional banks and CDFIs. Our low- and moderate-income communities need all of the help they can get.

The existing CDFIs are dedicated to community development, and have proven to be good at it. Community development lending, like any other form of lending, requires skill and dedication to make it work. Purpose, focus, and skill are the attributes that make CDFIs effective contributors.

The problem is that the entire CDFI sector is too small to be able to address the scale of needs of low-income communities. That's why CDFI practitioners have asked for help in our efforts to expand the capacity of the CDFI industry as fast as can be accomplished without sacrificing quality. Nonetheless, even a greatly expanded CDFI sector will be insufficient relative to the total capital needs of low- and moderate-income communities. CDFI practition-

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ers know that and most actively seek to use their institutions to help leverage greater community reinvestment by conventional banks.

There is an opposite problem with conventional banks. There are enormous resources in the banking sector, but it has not been deployed in low- and moderate-income communities.

In the seventeen years since CRA was first passed at a Federal level, I believe it has had only a minor effect on community lending patterns. As far as I'm aware, the quantitative amount of total community reinvestment lending has not significantly increased over that period of time. If that performance analysis is correct, the Community Reinvestment Act must be judged a failure so far. Nonetheless, we shouldn't drop it, because whatever help it does provide is desperately needed.

To strengthen enforcement of CRA, I highly recommend that the new CRA proposal of the New York State Banking Department be examined. The most important element of this proposal is quantitative measurement of CRA compliance. Quantitative standards for CRA, which could be analogous to the capital adequacy standards of safety and soundness regulation, are long overdue, in my opinion.

The New York proposal has not yet been implemented, and the details, including the all-important CRA rating ratios, have not yet been set. The principles of the proposal reflect, however, what would probably be the most significant, and positive, change in CRA since the law was first passed.

Capital ratios have been proposed as a basis for both restrictive measures on banks, and for providing greater business latitude to those with excellent capital ratios. A similar approach, combining both "carrot" and "stick," could be taken with community reinvestment ratios.

Perhaps greatly improved CRA compliance could lead to a doubling or tripling of community reinvestment lending by conventional banks. This would be a significant change, and well worth pursuing. To think that changes in CRA could cause a greater effect than this seems highly implausible to me, so long as there is a continuing lack of fundamental interest in community reinvestment. There is only so much that can be accomplished with regulatory enforcement and incentives. The problem is that even a tripling of conventional bank community reinvestment would still be grossly inadequate relative to community needs. Again, the central point is that our communities need all of the help that they can get.

Question 3—Distinction:

Can you explain to the Committee what factors make CDBs [community development banks] distinct from other institutions? Why do you feel the creation of a CDB was necessary to address the needs of your community? How do CDBs fit within the spectrum of all community lending institutions?

Follow up: One concern raised about the creation of a network of CDBs or other community-based lenders is that it will create a two-tiered banking system—one that serves the needs of poor commu-

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nities and the other that serves everyone else. Is this a legitimate concern? Why or why not?

Answer 3:

As to community development banks specifically, they operate under the same regulatory framework as other banks. Nor have I heard any request from practitioners that a separate regulatory structure be created. There are major differences between community development banks and other banks, however.

I would summarize these differences as: focus, which can help lead to a skill at this work; relationships with complementary community economic development services such as technical assistance and equity investment; supportive shareholders and depositors; and commitment.

To elaborate, one of the most important differences is focus. At Community Capital Bank, we have the entire resources of the organization aimed at providing community development loans in low- and moderate-income areas of New York City. Our board of directors, our senior management, and our loan officers all concentrate on community development lending. This creates an environment where we not only have the motivation to succeed at community development lending, since our entire bank depends on it, but we have used the concentration of effort to give ourselves the best possibilities of success.

Bank loans are only one part of the spectrum of community development finance needs. The existing community development banks have explicitly recognized this by use of the bank as the anchor for related community development affiliates. In the case of Community Capital Bank, while we have not yet formed a bank holding company, we do have a nonprofit venture development organization, LEAP, operating from the Bank's office. I am the Chairman of LEAP as well as Chairman of the Bank. Shorebank, Southern Development, and Center for Community Self-Help have all been able to been more fully articulate this strategy as they have been in operation for a longer period of time.

The shareholders at Community Capital were recruited to the Bank specifically on the basis of the Bank's community development mission, as Shorebank and Southern Development had done. Shareholders and depositors who specifically support the community development mission will object to too few loans in low- and moderate-income communities, not too many.

Community development is a long-term process that requires sustained commitment. Institutions that have that commitment are essential.

Community Capital Bank was created for the sole reason that adequate bank support for community development has not been present in New York City.

Community development banks are only one of a range of community development financial institutions. I also include community development credit unions, community development loan funds, microenterprise funds, and venture development organizations as CDFIs. There are other, related, types of community development organizations that CDFIs interact with, or which could be

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included in a community development bank holding company. An affordable housing development company is an example.

Not only are the needs for community development finance broader than just bank loans, but a particular community's resources may be better suited to some CDFI vehicles than others. For example, a community development bank tends to have the best capital access of CDFIs, largely because of access to insured deposits, but it also requires a large amount of capital to start one.

As to a two-tiered banking system, we should realize that would be an improvement over what we have now. Right now we effectively have no banking system at all in most poor neighborhoods.

A "two-tier" system could imply that there will be a separate regulatory status for CDFIs. I don't recommend that course. However, I do think that institutions who specifically adopt a program of community economic development as their principal purpose should be assisted as to their startup and expansion, and that it is in the public's interest to do so.

The problem with the "two tier" approach is that it implies that conventional banks will not or need not operate in low- and moderate-income areas. That is not acceptable. We should encourage and require conventional financial institutions to participate in community development. To focus only on CDFIs and give up on that effort would be a serious mistake, and would ignore the efforts that CDFIs themselves make to involve conventional banks.

Question 5—Impediments:

Why are there so few CDBs and what are the impediments to the formation of new institutions? Are there other community lending models that should be explored as part of a Federal community development banking initiative?

Answer 5:

The most important obstacle to the creation of more community development banks has been the great difficulty in obtaining sufficient equity capital. The social investment capital market, which has been the only plausible source for obtaining this equity, is in a formative state and includes no underwriting capability. A further limitation is the relatively small number of experienced bankers, especially those at a senior management level, with experience and an interest in community development. Yet a further problem is the shortage of technical assistance available to groups who would like to start a community development bank.

The coalition of community development financial institutions that I referred to earlier includes a variety of types of organizations. I urge that any Federal support program be made available to the full range of CDFIs. Eligibility ought to be defined by an organization's degree of commitment to community development, the relative importance and likelihood of success for its programs in supporting community economic development, and the need for Federal support in achieving that success.

Question 6—Limits of CDBs:

Are CDBs [community development banks] a panacea for these ills [in urban and rural distressed communities]? What are the lim-

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its of CDBs? What factors or conditions must be present in a community for a CDB to be successful? What other initiatives should we be examining a part of a Federal community lending strategy?

Answer 6:

No one has ever suggested that community development banks, or community development financial institutions generally, are a panacea for poverty. Banks are extremely useful tools for marshalling capital and investing it as senior debt. Reasonable access to that form of credit is essential, but not sufficient. Other factors that may be necessary to address community development range from the financial (other forms of debt, various types of technical assistance, and equity capital), to the managerial (programs to help create a sufficient pool of potential entrepreneurs and business managers), to basic issues of physical security, transportation access, health care, child care, education, and cultural stability.

As I noted above, there is also the issue of the limited number and scale of community development financial institutions relative to the scale of need. CDFIs are accomplishing important work, and could do more of that work. It's in the public's interest to help that happen, but that should not be confused with a solution to poverty.

Community development banks, like other banks, require the income from a portfolio of quality loans to support the overhead of the institution. The amount of loans needed will vary according to the size of the institution, but even a very small bank will typically need $10 million or more of performing loans to achieve breakeven. Further, a bank ought to maintain at least some minimal diversification in that loan portfolio. Smaller scale organizations, such as a loan fund or credit union, can succeed with a smaller loan catchment area and deal flow.

It's important that any Federal support that may be forthcoming for CDFIs be flexibly structured. New forms of CDFIs have continued to spring up in the past several years, such as CDFIs that specialize in raising equity for community development. These types of organizations, which have the same degree of community development commitment and focus as a community development bank, should be eligible to apply for a Federal CDFI capacity expansion program.

Question 7—Safety and Soundness:

Do institutions dedicated to community lending pose safety and soundness problems or create significant risks to the bank insurance funds? How do existing community development banks compare to their peers in terms of loan losses, delinquencies, defaults, return on assets or earnings, or other indicators of the health of the institutions? What role should the Federal financial regulatory agencies play with respect to the regulating institutions that might receive Federal assistance?

Answer 7:

The four institutions that are usually described as community development banks (South Shore, Elk Horn/Southern Development, Community Capital, and Self-Help Credit Union) have strong financial records according to their published financial information

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and also from anecdotal reports. No doubt the Committee could confirm this information with the relevant regulators.

As to Community Capital Bank specifically, at two years old, we are too young for me to make a statement as to our financial success. We do feel that we are on the right track so far. We have no delinquent, nonperforming, or classified loans to date. Our operations area has run smoothly and quite efficiently. Our assets to employee ratio, for example, is ahead of median for all banks, let alone startup banks. Our deposit base, which now exceeds $16 million, has been highly stable and continues to expand.

We have not yet reached breakeven, a situation which is normal for a two year old bank. We started out with the expenses of a full bank, but with no loan income to cover those expenses. The growth in our loan portfolio has reduced our monthly operating loss, such that we anticipate profitable operations within a reasonable time frame. In the meantime, we continue to be extremely well capitalized.

Accordingly, I don't believe the existing community development banks pose any safety and soundness problems. Further, I don't believe that small business and affordable housing lending in low- and moderate-income communities has posed safety and soundness problems for the banking industry generally. In general, I believe these types of loans have been made according to appropriate banking practices, reviewing the debt capacity, collateral, and character of the borrower. That can not be said, however, for many of the abusive lending practices which have caused immense losses in the banking and thrift industries.

No special intervention by banking regulators will be needed because of capacity building measures by the Federal Government for the CDFI industry. Those CDFIs that are supervised by banking regulators should continue in the same vein. Any Federal agency distributing support to CDFIs will presumably use an annual compliance and audit procedure to determine whether the support was used as agreed. That has no bearing on safety and soundness regulation.

Additional Questions Concerning CRA:

To what extent should insured depository institutions receive credit toward fulfillment of their CRA requirements for contributions to or investments in community development financial institutions? Should contribution to or investment in community development financial institutions be sufficient to fulfill an insured depository institution's CRA obligations? Would it be appropriate to exempt institutions from CRA examinations and requirements if they contribute a sum equal to approximately .5 percent of their assets or 5 percent of their capital to a community development financial institution?

Answer to Additional Questions Concerning CRA:

I believe that depository institutions already generally receive CRA credit for contributions or investments in community development financial institutions. On the basis that CDFIs are using those funds to promote community economic development, this is an appropriate regulatory practice. As to the appropriate amount of credit for this activity, it ought to depend on the relative cost

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and/or risk to the investor bank. A market rate, FDIC insured deposit does not have the same cost or risk to the investor or benefit to the investee as an equity investment, let alone a grant.

If the new CRA proposal put forward by the New York State Banking Department were universally adopted, then a quantitative measure of CRA compliance would be established, which I refer to as the "reinvestment ratio." This would be the bank's amount of community reinvestment loans, adjusted for related community reinvestment activities, divided by the total insured deposits. In the State Banking Department proposal, a "safe harbor" from CRA would only be provided to those banks that had received an "outstanding" rating for three years running.

I recently submitted testimony to the New York State Banking Department suggesting extra credit formulas for various CRA activities, including support for community development financial institutions. I further testified that the reinvestment ratio standards ought to be consistent with the needs of the community. For example, I suggested that an "outstanding" CRA rating should require a reinvestment ratio of no less than 10 percent at the very least, and perhaps more. Accordingly, I believe that .5 percent of assets ought to be a totally insufficient community reinvestment ratio to provide a safe harbor from CRA.

Using a quantitative approach to CRA, it would be theoretically possible for a bank to achieve all of its CRA compliance just by investing with CDFIs. In actual practice, however, there wouldn't be nearly enough CDFI investments available for a bank of any size to satisfy CRA through this method, assuming community reinvestment ratios on the order of magnitude I suggest were adopted.

I understand very well that banks feel that CRA has saddled them with a social burden that is not imposed on other corporations. Banks, however, have chosen their regulated status to obtain easy access to capital through the bank charter and Federal deposit insurance. Because insured deposits, are our country's most important pool of savings, it's critically important that the manner in which those savings are invested benefit our entire population. One-half of one percent of our Nation's major pool of investment funds going toward low- and moderate-income communities seems impossibly low.

Thank you for inviting my participation in your deliberations on these important issues.

RESPONSE OF STEVEN W. LOPEZ TO WRITTEN QUESTIONS FROM SENATOR RIEGLE

Question 1—Community Lending:

Q.1.a. Are these institutions addressing fully the credit needs of distressed communities?

A.1.a. No. The majority banks have found ways of loopholing CRA regulations through mere public relations and self serving minority organizations or leaders.

Q.1.b. What credit needs are not being met and why?

A.1.b. Minority business persons have a difficult time obtaining business loans from the established banks. The reason they don't

make loans to minority business people or residence of the inner cities, is because the inner city is perceived as a high risk area and the majority banks don't like making small loans. It takes as much time to package a small loan, as it would a large loan to a well known borrower in an acceptable area.

Question 2—CRA Enforcement:

Q.2. Can the credit revitalization needs of distressed neighborhoods be satisfied completely through better enforcement of CRA? If not, why?

A.2. No, because of the following reasons?

(1) The lenders from the major banks do not understand how to lend to minorities.

(2) If clear directives or commitments to lend to qualified minorities does not come from the Chairman or Presidents of the major banks, the minority communities will continue to be kept outside the economic beltway—no lending will be done.

(3) The major banks prefer to make larger loans to well known companies or to well connected referrals.

Q.2. How can we strengthen enforcement of CRA to better meet the credit needs of distressed communities?

A.2. (a) Before the regulators such as the OCC perform audits on a particular bank they should contact the various credit agencies for recent loan applicants based on zip codes. They can then send out confirmation letters to the applicants to verity loan decision, so when they audit the bank in particular or branches, they would know which log books to ask for. All loan applications should be entered in a log book. In most instances though, minorities get verbal turndowns, without their application being logged, or a credit report drawn.

(b) The CPA as it stands today based on the above circumstances is difficult to quantify. Some banks get satisfactory ratings, just by merely underwriting NAACP, Urban League dinners and sponsoring little league teams. Maybe it'd help if quantifiable standards can be delineated and legislated. For example, if Chase Manhattan were to invest 10 percent of its' capital into a minority financial institutions, it could be then exempted from CPA.

(c) As much as possible, regulators who understand inner cities should audit urban banks or branches for CPA purposes.

Question 3—Distinction:

Q.3. Can you explain to the Committee what factors make CDBs distinct from other institutions?

A.3. The following factors distinguishes the CDB from regular banks:

(1) Apart from the bank owned by the Holding Company, it can become an equity partner in a viable venture—bringing needed managerial expertise to a project in most cases.

(2) The mission of the CDB is to make a distressed area bankable. It is a niche bank.

Q.3. Why do you feel that the creation of a CDB was necessary to address the needs of your community?

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A.3. (a) Due to blatant redlining.

(b) The time minorities spend complaining about the mainstream banks they could be practicing capitalism and creating jobs in Grand Rapids, where inner city banks obtained $508 million in deposits from inner city residents, in 1989 they loaned barely 1 percent of it in the neighborhood for mortgages. No business loans were made.

Q.3. How do CDBs fit within the spectrum of all community lending institutions?

A.3. The mission of the CDB is to groom small businesses into bigger businesses. So there should be no apprehension as to the subsequent participation of major banks—Natural banking market progression should be allowed to take place. The CDB will also need the major banks in the following manner:

(a) Loan syndication wherever possible.

(b) Farming out some backroom operations to the major banks.

(c) Correspondent banking—all of the above can derive profitable fees and earnings for the major banks.

The perceived two-tier banking system should not be a concern. The main concern should be to bring African Americans into the capitalistic beltway. This would help to grow the economy and expand our taxable base. The greatest crime that can be perpetrated is to believe that the major banks will change the error of their ways.

Question 4—NONE.

Question 5—Impediments:

Q.5. Why are there so few CDBs and what are the impediments to the formation of new institutions?

A.5. It takes approximately $600,000 to start a bank from scratch.

(a) Established law firms are typically beyond the financial reach of the organizers.

(b) The offering is invariably too small for the brokerage houses—so the organizers and the President of the Bank to be, have to market the stock.

(c) The organizers have a limited budget that cannot sustain a coordinated marketing attack to support the capitalization process.

(d) Educating the community as to the benefits of owning their own banks.

(e) Opposition from Main Street—here in Grand Rapids, two major banks and several corporations have quietly campaigned against the rise of Southside Bank, on the grounds that it is unnecessary. In a predominant republican enclave, one would feel that a self-help project with some assistance would be easily understood.

Q.5. Are there other community lending models that should be explored as part of a Federal community development banking initiative?

A.5. At this time, myself and the Board members are emulating the Southshore Bank model.

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Question 6—Limits of CDBs:

Q.6. Are CDBs a panacea for these ills?

A.6. Although CDB may not be a cure all, their benefits could be the following:

(1) Recycling indigenous capital throughout the neighborhood to qualified borrowers to help create jobs.

(2) Gradually changing the image of distressed areas from welfare to one of a generation of entrepreneurs.

(3) Witnessing the building of economic blocs in the community by a younger generation—so they can also be imbued with a *"can do spirit."*

Q.6. What are the limits of CDBs?

A.6. (a) They cannot afford to get involved in unprofitable ventures.

(b) They have got to be selective about the ventures they finance based on the competency of the support staff.

Q.6. What factors or conditions must be present in a community for a CDB to be successful?

A.6. A structure that can provide capital to help create economic development.

Neighborhood groups psychologically seeing or experiencing the need for economic development.

Evidence of a viable income and deposit base.

Existence of small businesses waiting to be brought out of incubators.

Existence of a core of skilled managerial expertise.

Potential for growth in various industries.

Q.6. What other initiatives should we be examining as part of a Federal community lending strategy?

A.6. (a) SBA loans should be underwritten at bank discretion.

(b) If the project financed is viable a two year period of interest payment only, should be an option.

(c) If the above suggestions were to be accepted, they should be subjected to periodic audited statements, and strict compliance with SBA audit guidelines.

Question 7—Safety and Soundness:

Q.7. Do institutions dedicated to community lending pose safety and soundness problems or create significant risks to the bank insurance funds?

A.7. They can if the following characteristics are not in place:

(1) A strong President/CEO who has familiarity of the operational infrastructure of banking.

(2) A strong comptroller CPA type who has worked in a major bank as a comptroller to help plan and budget for the bank, monitor cost, etc. and product profitability.

(3) A strong and experienced senior lender who is familiar with a variety of loans: Construction, commercial finance, floor planning, letters of credit, mortgage warehousing, etc.

(4) A strong and experienced branch manager who knows lending and branch operations.

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(5) With an experienced competent management staff, support staff training would be ongoing.

Q.7. How do existing community development banks compare to their peers in terms of loan losses, delinquencies, defaults, returns on assets or earnings, or other indicators of the health of the institutions?

A.7. The only model that I am familiar with is the Southshore Bank, and they appear to be profitable based on financial reporting. Loan losses, delinquencies, defaults are within industry norms.

Q.7. What role should the Federal financial regulatory agencies play with respect to regulating institutions that might receive Federal assistance?

A.7. They should be treated just like the major banks: Audits by FDIC, OCC and State Banking Departments.

Additional Questions Concerning CRA:

Question A. To what extend should insured depository institutions receive credit toward fulfillment of their CRA requirements for contributions to or investments in community development financial institutions?

A. To the extent that the "investment" is quantifiable, so it can be given a rating—poor, satisfactory or excellent.

Question B. Should contribution to or investment in community development financial institutions be sufficient to fulfill an insured depository institution's CRA obligations?

B. If there are quantifiable CRA regulations in place to measure a satisfactory CRA rating or an excellent CRA rating, then there shouldn't be any problems.

Question C. Would it be appropriate to exempt institutions from CRA examinations and requirements if they contribute a sum equal to approximately .05 percent of their assets or 5 percent of their capital to a community development financial institution?

A. I prefer to confine myself to investment instead of contributions. I think the most important thing is to get the majority banks to start cooperating with the minority banks by investing in them; to tackle the major tasks of making distressed neighborhoods bankable. Any target number, that will help to capitalize a CDB and make it viable, should be a good start. If 5 percent of capital will do it, then let it be 5 percent.

RESPONSE OF EDWARD H. McNAMARA TO WRITTEN QUESTIONS FROM SEANTOR RIEGLE

Question 1—Community Lending:

Are commercial banks, savings & loans, non-profit organizations, and other lending institutions addressing fully the credit needs of distressed communities? What credit needs are not being met and why?

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Answer 1:

Although these institutions meet the credit needs of several "layers" in the spectrum of credit needs, the credit needs in distressed communities remain unmet. In housing, for example, these unmet needs include financing for multifamily housing projects, single family mortgages, home improvement loans, and purchase and rehabilitation loans. In enterprise development (or small business), the needs include, among others, small business working capital and term financing, early stage expansion credit, and microenterprise lending.

The reasons for this lack of credit are two-fold: First, the primary purposes or missions of these organizations are broad and not focused on a neighborhood's development (with the exception of non-profits). Second, distressed communities need more than just credit. They need coordinated interventions that will create demand for credit and make lending activity less risky. The effective delivery of credit in these neighborhoods often requires a specialized knowledge and experience to identify and structure transactions that provide access to credit yet minimize risk to the lender.

The primary obligations of commercial banks, savings and loans, and credit unions are to their shareholders. The consolidation in the financial industry has put increased pressure on these institutions to meet the expectations of their shareholders, Wall Street, and regulators and seek the most attractive markets possible. These organizations are not the best-suited to meet the developing credit needs in distressed communities for several reasons:

—*Loans in these communities are less profitable* due to their smaller size, the time needed to work with less financially experienced borrowers, and the lender's unfamiliarity with the local market. Finding good business opportunities in distressed communities requires time, patience, and effort, all of which are additional costs to be borne by the lender.

—*The institutions are less familiar with distressed and minority communities* and therefore less able to assess risk. Many loans that would be bankable by conventional standards are not being made for a variety of reasons, a situation which should change gradually over time. Second, finding good lending opportunities in these markets requires local market knowledge to evaluate and structure loans to maintain a reasonable degree of risk.

—*Regulated institutions build a diverse portfolio of loans rather than concentrating resources* in a particular geographical area or community. In contrast, distressed communities need concentrated and heavy investment to create change. An institution that targets a particular area is forced to find, or make, good business opportunities in that community rather than seeking the best possible opportunities around a broad service area.

Many of the credit needs in distress communities are met by non-profit organizations. Although several non-profit organizations are very sophisticated lenders, many do not have the lending experience or capital to provide a comprehensive set of resources. They are not regulated depositories and cannot leverage their capital into a significantly larger amount of development credit.

As a public agency, Wayne County is very aware of Government's capacities and limitations. Public sector agencies face pressure

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from various political agendas, a cycle of frequent change, and high competition for public resources. Government does not face the sink-or-swim discipline of the marketplace that forces a business to adapt and succeed or fail. A non-governmental, permanent organization can make the revitalization of a particular community its primary purpose. In addition, it can efficiently combine public and private resources to achieve that long term goal.

The second point is perhaps even more important in Wayne County. If a community is fortunate enough to have conventional, non-profit and public sector lenders and no visible credit gap, there may remain a need for a proactive, initiating activity to create new demand. Unlike most lenders, a community development bank combines a regulated bank with non-bank tools designed to create change in a particular community. As the non-bank affiliates undertake "top down" development projects, they encourage local residents to invest in the neighborhood as well. This confidence evolves into new demand for credit which can be met by the bank.

Question 2—CRA Enforcement:

Can the credit and revitalization needs of distressed neighborhoods be satisfied completely through better enforcement of CRA? How can we strengthen enforcement of CRA to better meet the credit needs of distressed communities?

Answer 2:

As described above, the revitalization of distressed neighborhoods requires more than just credit. Therefore, increased enforcement of CRA can only go so far in addressing the complex challenges posed in these communities.

Although improved enforcement of CRA would meet more of the credit needs in these communities, banks would continue to see it as a burden to be minimized. Banks and S&Ls might be more motivated to ensure access to conventional credit in distressed communities if certain changes were made.

(1) *CRA guidelines should be clarified and performance evaluations should focus on the amount of dollar invested, both directly and indirectly.* At present, CRA compliance is not driven by outputs. Guidelines should be clarified so banks know what activities earn "CRA credit." For example, lenders might coordinate with a community-based organization with specialized market knowledge as a way to deliver credit effectively. Regulations should be streamlined so banks can focus on funding ways to increase lending and investment opportunities rather than on documenting community needs and bank research efforts.

(2) *There should be positive rewards for banks with outstanding CRA performance.* The motivation to meet community credit needs might be heightened by using incentives rather than only punishment. Banks with an exceptional CRA performance might earn access to desired activities or broadened powers. Incentives should not substitute for enforcement, as many smaller banks may not respond to the incentives.

(3) *CRA regulators should be better educated about the range of tools used to make loans in low- and moderate-income neighborhoods.* The safety and soundness regulators tend to be unaware of

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the various tools used to manage the risks of lending to these markets and often contradict the recommendations of the CRA regulators. Regulatory agencies should give their staff methods to evaluate the effectiveness of character lending rather than a sole reliance on collateral values and financial ratios.

Question 3—Distinction:

Q.3.A. What factors make Community Development Banks distinct from other institutions?

A.3.A. A community development bank differs from conventional lending institutions in several ways:

—Targeting of resources within a particular geographic area with the goal of renewing the market forces and economy in that particular area.

—The combination of banking with specialized, non-banking activities designed to meet the particular needs and opportunities of that particular community. A CDB might use a real estate developer, for example, to undertake top-down housing and commercial rehabilitation projects to make a visible impact on the community and to change perceptions and confidence. It might use a non-profit affiliate to train and place residents in jobs, provide non-bank credit and training to very small businesses, or design support services for apartment building tenants or homeowners.

—A singular purpose of long-term revitalization of a particular community and a commitment to permanence. A CDB has an identity of interest with the health of the community in which it operates. If the community improves, the business risk of lending and investing will decline; if the community falters or continues to slide, loans become more risky. In effect, a CDB combines the expertise and commitment to profit of a bank with the neighborhood level commitment of a non-profit community organization.

—Creative use of multiple forms of resources, ranging from philanthropic money to public subsidy to depositors funds. A CDB is an efficient user of a wide range of tools and resources to best serve community needs.

—A CDB attempts to create new demand for credit by changing perceptions and confidence within a targeted community. The non-bank affiliates enter the market first with large scale, top down development projects. As the market begins to change, local demand for specialized credit (such as purchase and rehab financing) increases. As the market becomes more stable, credit risk declines. These coordinated interventions essentially "open" the market and allow normal competition and market supply and demand to resume.

A community development bank is distinguished from non-regulated community based lenders by its larger capitalization, its ability to leverage that capital by accepting deposits, and the regulatory oversight that ensures prudent and sound lending practices. Profitability is a critical feature of a development bank. To be a permanent institution within the community and to meet the future credit needs of its customers, a community development bank must earn profits to grow its capital base.

By combining the community-based commitment and social/financial approach of a non-profit with the resources and technical

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capabilities of a regulated bank, a CDB is a uniquely capable delivery agent for public, private, and philanthropic resources. A development bank can marshall resources that would not otherwise come into the community, such as philanthropic investment and grants, Federal loan guarantee programs, secondary market mechanisms, low-income housing tax credits, JTPA and numerous other programs. Because it knows the target market intimately, a development bank can choose the most appropriate tools and use them to reinforce each other and generate synergies.

Q.3.B. Why do you feel that the creation of a CDB was necessary to address the needs of your community?

A.3.B. In the older communities of Wayne County, we have inactive real estate markets that present few opportunities to conventional lenders. Although banks compete for attractive mortgage lending within the City of Detroit to meet their CRA obligations and participate in partnerships with non-profits to provide small business credit, the real estate markets remain an obstacle. Although significant amounts of public resources have been poured into these communities, the markets are failing to work.

We believe that a private sector-managed community development bank can be the mechanism to jumpstart the rebirth of our urban neighborhoods. The development bank will include a regulated commercial bank, a for-profit real-estate developer, and a non-profit providing small business support services and housing assistance. Through a careful targeting of resources, it can stabilize certain neighborhoods that are threatened by blight. The opportunities include attractive housing stock, affordable land values, and a strong home ownership base with block clubs and community organizations. A community development bank should be able to halt the spread of blight through the remaining pockets of strength in distressed neighborhoods throughout Wayne County.

Although an effective delivery system for philanthropic, private, and public resources, a CDB is not a panacea. It will rely on serving a cross-section of Wayne County's older communities to combine areas of extreme disinvestment and need with the working class/moderate-income neighborhoods necessary to support a bank. As a permanent, private institution with a long term development objective, however, we believe a community development bank can begin the process of rebuilding our neighborhoods one by one.

Q.3.C. How do CDBs fit within the spectrum of all community lending institutions?

A.3.C. If the spectrum of community lending institutions is described with conventional financial institutions at one end and non-profit loan funds at the other, CDBs are somewhere in between. CDBs are much more proactive than banks and S&Ls in the design and delivery of coordinated bank and non-bank products and services. CDBs are also better capitalized and have more comprehensive interventions than most non-regulated community lenders. By accepting deposits, a CDB can leverage the amount of capital invested by 8 to 12 times and convert deposits into development credit.

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There is a wide range of credit needs within disinvested communities. Different market niches are best filled by specialized institutions. A bank holding company can combine many of these specialized lenders within it (such as a bank and a non-profit, for example), however, a bank also requires higher capitalization and higher revenues to cover its operating costs. There are many markets where either the market is too small or the degree of blight and disinvestment is too high for a CDB to operate profitably. These markets are best served by specialized Community Development Finance Institutions, such as community development credit unions, community development loan funds, and microenterprise lenders who target a particular segment of the market and meet those credit needs.

Follow-up: Concerns About a Dual Banking System

As mentioned above, Wayne County is very aware of Government's limitations. A program creating CDB's as Government banks would be destined for failure. The success of existing development banks demonstrates that the most effective economic development institutions are market driven and accountable to the businesses and customers they serve. Development banks should continue to have exactly the same status and set of requirements as any other bank holding company and regulated financial institution. The standards of performance should remain high to ensure a business-like approach to development and to ensure prudent and sound lending and management practices. As Shorebank Corporation's financial results have demonstrated, it is possible to be a development institution and a profitable bank.

Question 4—missing.

Question 5—Impediments:

Why are there so few CDBs and what are the impediments to the formation of new institutions? Are there other community lending models that should be explored as part of a Federal community development banking initiative?

Answer 5:

As the oldest CDB, South Shore Bank has spent many years figuring out what works in distressed and underinvested communities. The Self-Help Credit Union and Southern Development BanCorporation have also adapted these methods to rural environments. The strategy was largely discounted until the 1980s when Shorebank began to achieve scale and momentum. As evidence began to mount that the approach was creating change in these neighborhoods, Shorebank received many inquiries from others seeking advice on replication and adaption. We were one of those parties.

The biggest impediments facing those who want to establish a development bank include recruiting capable management, raising patient capital that is willing to accept long term returns, and financing organizational and start-up costs. In addition, new development banks will need to finance technical assistance from exist-

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ing CDBs to avoid reinventing the wheel in the process of adapting the model to their local needs and opportunities.

Like any business, the most important element in a CDB's success is capable management. Although there are few "ready-made" development bankers available, we believe there are experienced non-bank lenders with the ability to build and manage an organization. Similarly, there may be bankers who would like to shift to a greater development focus. Regardless of the management team we identify, we hope to receive guidance and management training from existing CDBs.

Credit needs and market opportunities vary among communities. In those communities where the credit needs are narrower, in particular, there may be a stronger need for a specialized non-lender such as a community development credit union to provide local banking services, or a loan fund to finance housing institutions, each with a specialized role and market niche. Federal support for these organizations is important to filling the credit gaps in disinvested communities. However, Federal legislation should be focused on the particular support needs of each type of institution, rather than try to meet the needs of all community development institutions simultaneously. Such an approach usually results in finding the lowest common denominator, rather than developing effective and efficient legislation.

Question 6—Limits of CDBs:

Are CDBs a panacea for the ills facing disinvested communities? What are the limits? What factors or conditions must be present in a community for a CDB to be effective? What other initiatives should we be examining as part of a Federal community lending strategy?

Answer 6:

Community development banks can be a very effective model for urban and rural economic development, but they are not a panacea. CDBs are an effective means of delivering resources within a targeted, distressed community. While a CDB tries to build the capacity of local residents to access and use those resources, some communities require much greater investment of time. A CDB looks for market conditions to support both the bank and the non-bank affiliates, such as a real estate developer. The bank needs a strong working or moderate-income class population that can borrow from the bank. In contrast, the developer needs an area with sufficient blight that it can attract the subsidy required to undertake large, top down rehab projects. A possible list of target area selection might include:
—A sufficient level of distress;
—A mixed income population with some working class economic strength;
—Population and market opportunity sufficient to support a bank;
—Close to areas with healthy economic activity;
—Salvageable housing stock (if a housing driven strategy);
—Defensible boundaries (which allow targeted investment);
—Presence of other development actors.

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Other initiatives that would affect the development impact of CDBs include incentives and accountability under the Community Reinvestment Act. In addition, new ways of delivering portfolio-based guarantees to small business lenders would complement the SBA 7(a) lending program and reduce the usage costs for banks (such as the Capital Access Program run by the Michigan Department of Commerce).

Question 7—Safety and Soundness:

Do institutions dedicated to community lending pose safety and soundness problems or create significant risks to the bank insurance funds? How do existing community development banks compare to conventional lenders in financial performance? What role should the Federal regulatory agencies pay with respect to regulating institutions that might receive Federal assistance?

Answer 7:

I will address the first and third questions only, as the second is best addressed by the existing CDBs themselves.

First, if CDBs are regulated by the same regulatory authorities as are other banks and bank holding companies, the standard of safety and soundness should not differ from that of other institutions. Risk is mitigated through adequate capitalization, training and development of management, and effective internal control systems and procedures. The strong financial performance of Shorebank Corporation, the CDB with which I am most familiar, suggest that CDBs do not pose any inherently higher risks to the banking system.

The greatest risk in the establishment of CDBs lies in a too rapid pace of establishing these institutions. It is more prudent to take the time to design effective legislation and to identify the best candidates for any Federal support rather than aim to produce quantity at the expense of quality.

In response to the third question, I again emphasize that CDBs should not come under any special rules or either more or less stringent oversight than any other banks. There are many smaller commercial banks and savings and loans across this country that have engaged in community lending for many years and who have operated under the same regulatory guidelines. A CDB is different in how it combines that lending function with other, non-bank activities. These permitted non-bank activities are regulated by the Federal Reserve.

Federal assistance must be carefully designed to not alter the incentives and decision-making behavior of management. The standard for safety and soundness and prudent lending must remain high. Greater education of regulators about the strategy and its approach might make routine regulatory scrutinies less painful, but the performance expectation should be no different than for other financial institutions.

Additional Questions Concerning CRA:

A. To what extent should insured depository institutions receive credit toward fulfillment of their CRA requirements for contribu-

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tions to or investments in community development financial institutions (CDFIs)?

B. Should contribution to or investment in community development financial institutions be sufficient to fulfill an insured depository institution's CRA obligations?

C. Would it be appropriate to exempt institutions from CRA examinations and requirements if they contribute a sum equal to approximately .05 percent of their assets or 5 percent of their capital base to a CDFI?

Answers:

A. Insured depository institutions should receive some credit for investments or contributions to CDFIs, as these community-based organizations can often serve a niche market much more effectively than can a regulated bank. The extent of credit granted for such investments, however, should not relieve the lending institution of all of its CRA obligations. Banks are the primary vehicle for basic banking services, consumer credit, mortgage lending and other forms of credit. Non-profit and other CDFIs are designed to fill a market gap, but not to permanently replace a function that rightly belongs with the mainstream financial system.

B. No. If a depository is providing a wide range of support services to the CDFI and is providing a wide range of financial services (such as those provided by a bank) through it, then perhaps a higher percentage of CRA is warranted. There should be compliance with the spirit of CRA, not only the letter.

C. No. As mentioned above, CRA performance should be evaluated on outputs to the community. If a bank capitalizes or grants funds to a CDFI without the capacity to translate those funds into meaningful access to credit in the community, then there has not been a significant increase in credit outputs to the community. Banks have a specialized training and experience in lending and servicing loan portfolios. That responsibility cannot be passed on to CDFIs which lack the systems, infrastructure, and experienced staff to make prudent loans.

RESPONSE OF RONALD L. PHILLIPS TO WRITTEN QUESTIONS OF SENATOR RIEGLE

Question 1—CPA Enforcement:

Can the credit and revitalization needs of distressed neighborhoods be satisfied through better enforcement of CPA alone, instead of the creation of a network of CDBs or other community-based lenders?

Answer 1: In part. The credit and revitalization needs of distressed neighborhoods (and rural communities) must be addressed through continued and vigilant enforcement of CPA. CPA has helped to stimulate bank involvement in credit markets that otherwise may not occur.

However, the creation of CDBs or other community-based financial, housing and economic development institutions are a necessary complement to CPA because these institutions identify, package and present projects to mainline banks for financing that otherwise cannot be developed.

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Therefore, a CDB or bank affiliation with a community-based organization would represent a more proactive application of CPA.

How can we strengthen enforcement of CPA to better meet the needs of distressed communities?

Answer 2: Analysis of bank lending patterns continue to show discrimination to minority communities. In many instances, the bank lending officer is caught between two conflicting goals: loan safety, and community reinvestment. Loans to small businesses have been particularly affected by this contradiction. These disparities must be addressed by clearer CPA guidelines for both bank personnel and examiners.

But banks do not tend to understand or know how to reach underserved markets. A community development bank is a model for reaching underserved communities, and those who still suffer from discriminatory lending patterns. The community development bank concept must be broadened wherein CPA endorses (and rewards) a bank *affiliation* with a nonprofit community-based organization (or helps establish an organization if none exists) to develop the market for mortgages, commercial real estate, small business, consumer and other credit needs.

In Maine, banks and consortiums of banks have *affiliated* with Coastal Enterprises to extend credit targeted to certain rural populations, communities and industry sectors (e.g. value-added natural resource enterprises, small business manufacturing, microenterprises, child care centers, affordable housing subdivisions, women, AFDC recipients).

How are community-based financial institutions distinct from banks and how can we ensure that support for these institutions does not undermine the obligation of other insured depository institutions to address community lending needs?

Answer 3: Capital is a necessary but *insufficient* ingredient in community development. Community-based financial institutions are distinct from banks because they perform a variety of pre-credit functions essential to developing credit-worthy opportunities. In a nutshell, community-based organizations: are intimate with their communities and market region; are professionally staffed with people skilled in project development, and mobilizing federal, state and private resources; provide technical assistance to prospective individual and small business bank borrowers; develop the plans for and manage housing, health or dependent care facilities; and mobilize and provide development capital essential to securing bank participation.

If CRA encourages partnerships between community organizations and banks, the capacity of how to meet their obligations will be facilitated rather than undermined; and the lending needs of communities will be significantly enhanced.

Question 2—Community Development Needs:

What are the most significant development gaps inhibiting revitalization of distressed communities?

Answer 1: Among the more significant development gaps are the presence of viable, community-based institutions that demonstrate capacity, scale and permanence to develop their market region.

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Are there products or services that community-based institutions provide that banks do not, but could provide?

Answer 2: Yes. But if a bank formed a community development bank, then it would include the products or services that community-based institutions are concerned about, particularly the approach to community revitalization that is holistic and comprehensive, targeted and inclusive of a variety of nonprofit activities normally not associated with existing banks.

For example, the bank would have a relationship to: commercial real estate development; soft lending and technical assistance for businesses, including microloans; venture capital; use of special federal, state or private foundation programs for housing, community and business development.

Short of forming a community development bank, by affiliating with a community-based organization, or helping to establish one if none exists, a bank could ensure the products or services needed for the community are being developed.

Are there products or services that community-based institutions provide that banks cannot?

Answer 3: Yes. Community-based institutions have developed a culture of professionals dedicated to working in low-income neighborhoods, rural communities, and with populations normally cut off from the economic mainstream. This network includes community development corporations, which have developed 320,000 units of low-income housing, 17 million square feet of commercial real estate, and made 3,500 small business loans creating at least 90,000 jobs; community development credit unions; community loan funds; and microloan groups.

It is not clear that existing banks can, or should try, to completely integrate this kind of culture. As a first step, affiliation with the special capacities of the community-based institution may be desirable.

Question 3—Two-Tiered System:

Is this a legitimate concern? Why or why not?

Answer 1: It is a legitimate concern if community development banks are seen as a solution to the problems of distressed communities irrespective of the existing banking system or CRA.

If, however, community development banking is viewed in its broader sense, that is, as a way to enhance CRA through existing bank affiliations with community-based institutions, then you are getting the best of both worlds: the participation of existing banks, and the partnership with community organizations intimate with the market region.

In some communities, formation of a new community development bank as a special institution for certain market niches may be necessary and ought to be valued as part of a community revitalization strategy.

If we adopt a policy of assisting community lending institutions, how can we ensure that other institutions are not let off the hook of providing credit in distressed communities?

Answer 2: Again, CRA must be upheld as the primary inducement to meeting the credit needs of communities. Community de-

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velopment banking, and affiliation with community organizations, are extensions of CRA, not replacements.

Question 4—Community-Based Lenders:

How are your institutions different from CDBs? How are they similar to CDBs?

Answer 1: How do non-CDB groups differ? Our institutions, that is, community development corporations, community loan funds, and microloan organizations, are fulfilling community development needs that go well beyond the capacity of a bank to perform.

We are different because we are performing the nonprofit development functions independent of serving as a regulated, depository institution. Credit unions, however, are regulated, and are much more similar to a CDB in that regard.

We are also different because in many instances we *affiliate* with existing banks to gain their participation in our community development initiatives. For example, in CEI's case, we have leveraged $60 million in bank financing for primarily business and housing projects whose credit needs otherwise would not be met.

How are we similar? Commonalities include: targeting of resources of low-income communities; mobilizing other private and public funds for our projects (e.g. SBA 7(a) guarantee program, low-income housing tax credits, job training funds).

What is the justification for including these institutions in any new community banking initiative?

Answer 2: There are several sound reasons for broadening eligibility for a community banking initiative. First, the most obvious is the commonality of our goals, inclusion of mainline banks in the process, and overall expanded political base for the community revitalization field.

Second, by inference, this question suggests an either/or situation. But a program that supports a menu and diversity of approaches would be more strategic, and have a wider audience. Thus, in some cases, Federal funding to form or further develop a CDB or credit union may be appropriate (to include consideration of FDIC-troubled banks); in other cases, Federal funding to spur an affiliation between existing banks and community organizations (e.g. community development corporations, community loan funds, microloan funds) may be appropriate.

Third, the field of community development is much broader than CDBs. There are virtually only a *handful* of CDBs in the 25 years that South Shore Bank has been in existence. On the other hand, there are several thousand community development corporations, community development credit unions, community loan funds, and microloan funds. There are also EDA development districts, municipal and county development organizations, SBA 504 certified development companies, and SBA Small Business Investment Companies.

Anyone seriously interested in community revitalization would not bypass the tremendous accomplishments, skills and network that exist *outside of* community development banking experience.

Fourth, as a development model there are reasons for limited replication of CDBs. In part, this is due to the complexity of forming a bank and capitalizing it with significant *patient* deposits from

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outside individual and institutional depositors (such as churches and foundations), like South Shore has done.

Would this money flow in an accelerated federally-assisted program to form CDBs?

And fifth, another reason is that the community development field has witnessed a *continuum* of need such that *credit per se* is not the only issue in a distressed community. Rather, the capacity to develop business, real estate or housing projects, to provide technical assistance, training and education, and to offer flexible, "gap financing" sources of capital, are key ingredients in the community development process.

Only community organizations have this extensive experience. To eliminate them from a community banking initiative would be like shooting oneself in the foot.

Question 5—Market Discipline:

If nonprofit organizations are included in a Federal community banking initiative, how can we ensure that the projects developed and financed by non-profits will be financially strong and the Federal Government's interests are protected?

Answer 1: It is absolutely incorrect to assume that the CDB strength as an insured, depository institution imposes a market discipline on community development projects, and that projects are therefore financially feasible, or that nonprofits do not have the same pressure to balance bottom line profitability against community impact.

This argument is particularly specious when you realize that a CDB needs subsidy to ensure it can extend credit to a project to ensure its feasibility. For example, South Shore uses the SBA 7(a) guarantee program. It also uses soft deposits who do not demand a return (South Shore has never paid a dividend to a stockholder) to generate "development credits" which in turn are used to "subsidize" loans, technical assistance, or other activities.

Further, nonprofit management is no different than a bank's management and bottom-line requirements. In fact, banks, not nonprofits, have tended to be the ones making speculative, unsound investments. CDBs do not exist in any particular number to measure their performance, so there is no comparative reference.

At CEI, for example, we have highly qualified financial and technical staff, a board consisting of successful business, bank, financing and community representatives, and a portfolio of projects that have been through rigorous screening and due diligence. We have a strong asset base and net worth. It would be hard for any CDB advocate to suggest that we are not disciplined because we are not regulated. We are audited, and must comply with a variety of fiduciary, contractual and related requirements and standards.

Community development corporations have a 25-year legacy in community development. There have been failures. But today, many of these organizations can demonstrate track record; capacity; professionalism; diverse and qualified boards of directors; audit compliance; net worth and financial stability. CDBs alone have a developed a combined value of some $3–5 billion in housing, business and commercial real estate financing. Community develop-

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ment credit unions, loan funds and microloan funds also demonstrate growing degrees of capacity and skill.

The Federal Government can be assured that its interests are protected with nonprofits, non-CDBs because it can a) rely on the tremendous historic experience nonprofits have gained in project development and management of resources from HHS, HUD, DOL, SBA, FmHA, EDA, and other Federal programs; b) establish qualifying criteria where applicants must demonstrate there capacity, track record, and experience; and c) monitor and evaluate program performance.

Question 6—Impediments:

What are the most significant impediments to the formation of new or expansion of existing community-based lenders? What types of incentives would encourage their formation or expansion?

There are several levels of impediments that, given a creative Federal program, could be successfully addressed:

a) CAPACITY BUILDING. Community organizations need funds to plan for and develop strategies for community development; to hire qualified staff; to provide for core funding that does not unduly rely on assets (or deposits) for earnings.

b) TECHNICAL ASSISTANCE. Community groups require training and technical assistance in starting up, operating and expanding their organizations. At CEI, we receive 1–2 serious requests per week, perhaps 50–100 per year, from communities and groups who want to learn about CEI as a model, and replicate our approach either as a start-up or expansion.

c) GRANTS FOR EQUITY CAPITAL. Given a local plan and organizational capacity, the most serious obstacle to the start-up or expansion of community-based lenders is grants for their equity capital base. This capital is important because it (1) contributes to the net worth of the organization; (2) provides an earnings base for operations; and (3) serves as leverage to borrow other funds for project financing. While no data currently exists on the financial worth of community organizations, any group engaged in community financing ought to have a 1:1 debt equity ratio. Most community financing groups probably have a 10:1 ratio.

d) TAX INCENTIVES. Community groups could benefit by favorable IRS treatment of private sector tax deductible contributions. Currently, the IRS has reduced the deduction to something like 30 percent or less. This should be increased to a 100 percent deduction. The Low-Income Housing Tax Credit is being extended; a similar proposal has been offered for a Federal tax credit to stimulate capital investment in small businesses in affiliation with community organizations.

Question 7—Implementation:

What entity do you believe is best suited for administering a community development banking initiative, and why?

A community development banking initiative that included the menu of funding opportunities and support for the variety of community-based organizations described could be administered by any one of a number of existing Federal agencies. A major concern

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would be how rural communities are treated and what kind of experience the agency has with rural development issues.

Existing Federal agencies have strength and limitations. For example, while HUD has some grasp of housing and urban projects, it has very little understanding of the culture of commercial lending and financial institutions, let alone rural communities.

The Treasury has virtually no experience with community development. Federal financial regulatory agencies ought not to be considered because they need to preserve their regulatory status versus a program management and oversight status. The Federal Home Loan Banks have experience in community development, but this is mainly focused on housing.

A federally-chartered corporation may be the best route because it provides a fresh start and streamlined context for funding of a variety of initiatives. However, a memorandum of understanding with all the other Federal agencies noted, including Department of Commerce and SBA, and FmHA, should be developed in order to ensure complementary resources.

Additional Questions Concerning CRA:

To what extent should insured depository institutions receive credit toward fulfillment of their CRA requirements for contributions to or investment in community development financial institutions?

Answer 1: They should. I am not familiar with the options of incentives. But as a community development practitioner, the design and implementation of a project could be enhanced with expanded incentives.

For example, we are designing a targeted business and self-employment loan fund for economic and worker dislocation around defense department base closings. A consortium of banks is participating. We expect contributions to assist in development of the project, and to match a pool of capital for loans.

Should contribution to or investment in community development financial institutions be sufficient to fulfill an insured depository institution's CRA obligations?

Answer 1: No. But contribution or investment in a community-based financial organization should be given special treatment if the scale or impact of credit flowing to or in relation to the community organization's projects is significant.

Would it be appropriate to exempt institutions from CRA examinations and requirements if they contribute a sum equal to approximately .05 percent of their assets or 5 percent of their capital to a community development financial institution?

Answer 1: No, banks should not be exempt from CRA generally. But it is a very good idea to structure a funding relationship as a percentage of assets or capital. Another approach would be to have a bank contribute 5 percent of its earnings on an annual basis, rather than a "one-shot" contribution.

Such contributions could be significant, and banks ought to get some "special credit" from it as they would be going outside of their normal banking channels to more proactively affiliate with and endow a community organization through their financial structure.

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RESPONSE OF ROBERT JACKSON TO WRITTEN QUESTIONS OF SENATOR RIEGLE

Question 1—CRA Enforcement:

Can the credit and revitalization needs of distressed neighborhoods be satisfied through better enforcement of CRA alone, instead of the creation of a network of CRAs or other community-based lenders? How can we strengthen enforcement of CRA to better meet the needs of distressed communities? How are community-based financial institutions distinct from banks and how can we ensure that support for these institutions does not undermine the obligation of other insured depository institutions to address community lending needs?

Answer 1:

Enforcement of CRA and Federal support for community-based lending institutions are not contradictory or mutually exclusive goals; they should be considered two essential parts of a comprehensive effort to make capital available in low-income urban and rural communities.

CRA alone will not get the job done. After more than 15 years of CRA, it is dear that thousands of distressed communities remain cut off from capital. It is also clear that "grade inflation" remains a serious problem; many banks continue to be rate "outstanding" under CRA although their actual lending in poor communities is minimal. Also, in many areas, like the rural community where my credit union is located, there are only a few banks, so that even stringent CRA enforcement would not open floodgates of capital the way it might in an urban center.

The proliferation of community development credit unions throughout the United States in the last 15 years is, in and of itself, an indication of the limitations of CRA as a means of spurring community reinvestment. While conventional banks were withdrawing from low-income neighborhoods, many communities—including mine—decided to take matters into their own hands by starting locally-owned community development financial institutions CRA may be able to push some banks into reluctantly reinvesting, but this activity is no match for a team of enthusiastic local specialists who are in the banking business for the exclusive purpose of rebuilding the economy of a low-income community.

Even with CRA, I don't know of a single conventional bank in the Mississippi Delta that would make some of the housing loans to sharecroppers that my credit union makes all the time. The regular banks just wouldn't know how to do it—they wouldn't know the people, they wouldn't be willing or able to properly assess the risk, and they certainly wouldn't be willing to forego theirs usual level of profitability.

As you know, I am a member of the Board of Directors of the National Federation of Community Development Credit Unions, which supports efforts to strengthen CRA enforcement. In this regard, we wholeheartedly support the work of CRA advocacy groups like ACORN, the Center for Community Change, the National Neighborhood Coalition and the Center for Responsive Law. We have been in dialogue with these organizations, and have reached a com-

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mon position that support for community development financial institutions must not in any way lessen the obligation of other insured depository institutions to address community lending needs in keeping with CRA and other Federal laws.

Obviously, a bank that supports a community development credit union like mine should get some level of recognition under CRA, and indeed that is currently the case. But it would be a mistake to allow a community development banking initiative to allow banks a "buy-out" from CRA. For all the good work that we do, the Nation's 300 to 400 community development credit unions (CDCUs) are only a small drop in the bucket: our combined assets of about $500 million are less than the assets of a medium-sized conventional bank. The Nation needs a two-pronged approach that supports the very specialized, grass-roots work that we do, while using us as an example to the larger institutions of how far they need to go to make capital available in poor communities.

Question 2—Community Development Needs

What are the most significant development gaps inhibiting revitalization of distressed communities? Are there products or services that community-based institutions provide that banks do not, but could provide? Are these products or services that community-based institutions provide that banks cannot?

Answer 2:

While I do not have comprehensive knowledge of all the problems that prevent the revitalization of distressed communities, I do know that a lack of access to capital is a critical development gap that often blocks economic development. To put it simply, we are asking thousands of small businessmen and homeowner to make capitalism work without supplying the capital. Even very poor people tend to save some small amount regularly; this combined pool of funds is the deposit base that a CDCU draws upon to finance local development. But if those funds sit in a conventional bank, chances are that the money will be completely inaccessible to the same low- and moderate-income people who deposited the funds in the first place. So homes will go unrepaired, and small businesses will fail, and people will be unable to purchase homes and begin to build wealth. Credit unions close the capital gap left by banks.

Credit, of course, is the basic product offering that banks could provide in distressed communities. But there are a host of transaction services provided by CDCUs that banks probably could provide if they wanted to. Check cashing, for instance, is often needed in poor communities, but many banks either charge high fees or refuse to offer the service because they don't want a lot of poor people coming through the door. Certainly, the basic service of courteous treatment is one where banks have often come up short when it comes to poor people.

Mortgage lending is another area where banks have the means, but not the will, to provide services to people of low- and moderate-income. Banks have the capital and the administrative capacity to make mortgages, but they need to relax some of the iron-clad underwriting standards that tend to shut poor people out of the housing market.

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By the same token, CDCUs offer a range of services that most banks are simply unable to match. My credit union and others like it spend a groat deal of time explaining the basics of the financial system to poor people who have traditionally been simply turned away by banks. We also are able to provide unsecured loans based on the character of individuals. This ability comes from constantly being in direct contact with the residents of a community—something banks no longer seem to be able to do.

Our intimate knowledge of a particular community and the people who live in it constitutes a kind of "social capital" that can be used as collateral in communities where financial capital is in short supply.

Question 3—Two-Tiered System:

One concern raised about the creation of a national network of institutions dedicated to community lending is that it will create a two-tiered banking system. Is this a legitimate concern? Why or why not? If we adopt a policy of assisting community lending institutions, how can we ensure that other institutions are not let off of the hook of providing credit in distressed communities?

Answer 3:

I do not recommend that the Federal Government create or define an entire new tier of financial institutions. By relying on simple criteria, it is possible to identify which institutions are already acting as community development banks, credit unions or loan funds. If the institution has formally committed itself to make service to poor people its primary focus, then it's probably a community development financial institution.

However, we should not be afraid of making distinctions. The fact of the matter is that decades of underinvestment add disinvestment by conventional banks have created a market made up of hundreds if not thousands of large, capital-starved, underserved communities. Hundreds of community development credit unions have arisen to meet this need, along with dozens of community development loan funds, microenterprise funds and reservation-based lenders. These community development institutions specialize in dealing with neighborhoods that other financial institutions have ignored or written off. If this looks like segmentation within the financial services industry, so be it. More than 15 years of history has shown that, even with CRA, our current "one-tiered system" ends up leaving vast numbers of Americans without an adequate level of banking services.

As indicated in my response to Question 1, Federal assistance for community lending institutions should not in any way lessen the existing reinvestment requirements of banks. If a bank wishes to support a Federal community banking initiative, for example, it should get some level of favorable CRA recognition by its examiner. However, it could be stated publicly by bank regulators that all banks are expected to develop their own, in-house capacity to engage in lending that is similar to the kind being done by local community development financial institutions. The presence of a local community development credit union, for instance, should raise the

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standard of what acceptable lending is; local banks could then be asked to try to meet that higher standard.

Question 4—Community Based Lenders:

How are your institutions different from CDBs? How are they similar to CDBs? What is the justification for including these institutions in any new community banking initiative?

Answer 4:

CDCUs differ from CDBs in a few key respects.

OWNERSHIP. Unlike a bank, a credit union is organized as a non-profit cooperative, meaning that all control of the institutions rests in the hands of the people who are served by it. A bank must answer to two key constituencies—the bank's stock owners and its customers—whose interests occasionally diverge. Stockholders, for instance, are interested in maximizing dividends, while customers might prefer to use bank profits to lower the cost of various services.

A credit union, by contrast, is a cooperative that can concentrate exclusively on serving its member/owners. As non-profits, credit unions do not offer financial compensation to their elected boards of directors; they also rely heavily on community volunteers.

CAPITAL STRUCTURE. The capital structure of a CDCU is also different from that of a CDB. While a CDB accumulates net worth, or equity, by selling shares of common stock, a CDCU can only raise capital by setting aside a portion of the profits from its operations. A CDCU can also accept donations of equity to increase its net worth.

EDUCATION/EMPOWERMENT MISSION. Unlike a CDB, a CDCU has an explicit mission of teaching community residents how to manage the institution themselves. By serving on a credit union board or committee ordinary citizens learn about the workings of the financial system; that knowledge is then put to work on behalf of community development.

RANGE OF CONSUMER SERVICES. Unlike CDBs, which tend to focus exclusively on making credit available, CDCUs have a central mission of providing a place where citizens can be assured of fair prices on everyday cash transactions. In many neighborhoods, CDCUs are the only alternative to countless schemes—legal and illegal—that regularly cheat poor people. These include pawn shops, currency exchanges, check cashing outlets, home repair scams and loan sharks.

The similarities between CDCUs and CDBs easily overshadow the differences, Both kinds of institutions are dedicated to revitalizing low-income neighborhoods through the use of savings and credit. CDCUs and CDBs both rely heavily on "character" as a factor in making credit decisions. Both have acquired the business discipline that comes with being Government regulated.

Most importantly, CDCUs and CDBs both use a coordinated combination of financial institutions and non-profit assistance corporations in a comprehensive approach to development lending. South Shore Bank, for instance, is part of a bank holding company that includes a non-profit institution which helps turn housing developers and small-scale entrepreneurs into better bank customers.

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Without this assistance, many of the bank's successful development loans would be impossible.

Many CDCUs (including mine) have a similar arrangement. The Quitman County Development Organization acts as a non-profit "holding company" that created and currently supports the management of the CDCU. The non-profit offers training programs and other assistance to potential credit union borrowers.

Given the structural and functional similarities between this arrangement and the South Shore holding company model, I believe that CDCUs—especially those affiliated with a non-profit partner organization—should be included in any new community development banking initiative.

Question 5—Market Discipline:

How can we ensure that the projects developed and financed by non-profits will be financially strong and the Federal Government's interests are protected?

Answer 5:

Although CDCUs are non-profit organizations, virtually all are insured and/or regulated by the National Credit Union Administration, a Federal agency. In my experience, NCUA has never been lax about protecting the interests of the Federal Government; in fact, the more likely danger is that "safety and soundness" concerns may be carried so far as to weaken the level of development lending that CDCUs are capable of undertaking.

Question 6—Impediments:

What are the most significant impediments to the formation of new or expansion of existing community-based lenders? What types of incentives would encourage their formation or expansion?

Answer 6:

Until recently, the chief impediment to the formation of new CDCUs has been the NCUA's reluctance of NCUA to approve new charters. Since the fall of 1992, however, a new regulatory attitude has emerged; four new CDCUs have been chartered in the last five months in Denver, Los Angeles, Omaha, and New York.

Expansion, unfortunately, is a different story. All too often, Government regulators actively discourage CDCUs from making loans for micro-businesses and home purchases or repairs. These basic development activities are central to the CDCU mission, but they require levels of reserve capital that many CDCUs do not have. Without reserves that serve as a cushion against loan losses, many CDCUs end up looking financially fragile in the eyes of regulators. As a result, the regulators restrict CDCU lending activity, which in turn prevents them from growing.

Infusions of equity is the single most helpful way to encourage the expansion of CDCUs. With an additional $100,000 in reserves, for example, my credit union could underwrite at least $1 million worth of new loans for home repair and other purposes, We would also be able to reduce some of the regulators' fears about risk.

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Question 7—Implementation:

What entity is best suited to administer a program of assistance to CDBs or other institutions?

Answer 7:

Speaking as a board member of the National Federation of Community Development Credit Unions, my first preference would be the creation of a quasi-public National Neighborhood Finance Corporation, set up in a way similar to the Neighborhood Reinvestment Corporation. The National Federation has advanced this idea for years.

Answer to Additional Questions on CRA:

At present, banks receive credit toward the fulfillment CRA for making grants to, or deposits in, a CDCU. I view this as an appropriate recognition of the reinvestment work that CDCUs do. However, investing in a CDCU or other community financial institution should *never* be enough to exempt institutions from its CRA obligation or the requirement to submit to CRA examinations. The size of the contribution is irrelevant—the point is that banks are obligated to serve their entirely service area equally. To allow banks to purchase exemptions from this important law would send a dangerous signal about how serious the Federal Government is about enforcing fair levels of reinvestment.

Our understanding of the law is that it was never intended to allow banks to purchase an exemption; rather, it is supposed to be a *process* through which banks constantly reevaluate their core business and try to make it more responsive and relevant to the needs of all people in a given service area.

RESPONSE OF MICHAEL SWACK TO WRITTEN QUESTIONS FROM SENATOR RIEGLE

Q.1.a. Can the credit and revitalization needs of distressed neighborhoods be satisfied through better enforcement of CRA alone, instead of the creation of a network of CDBs or other community-based lenders?

A.1.a. Revitalization of distressed neighborhoods can be best achieved by both better enforcement of CRA and the creation of a network of CDBs. CRA will promote more lending in lower-income communities, but traditional intermediaries will never replace the specialized roles played by community development financial institutions (CDFI). Traditional intermediaries and CDFI usually are able to develop a complementary relationship. Traditional intermediaries are able to offer certain types of products and services—but they are quite different from CDFIs. Community development financial institutions must be able to offer a wider range of financing tools than traditional banks. These tools need to include the ability to provide equity, as well as a range of debt instruments. The present regulatory environment would make it difficult for commercial banks to address these financing needs. This regulatory environment limits the types of risks that the bank can take, and limits the range of financial tools available to a bank. Development banking is common in many developing countries. These in-

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stitutions provide financing in a manner that enhances the financial viability of the project or business seeking financing. The goal is a successful business or project, not necessarily a large return on investment.

Q.1.b. How can we strengthen enforcement of CPA to better meet the needs of distressed communities?

A.1.b. This is a very difficult question to answer. If you try to promote greater compliance through the threat of penalties (e.g. fines), you run the risk of encouraging regulators to enforce the provisions in a lax manners. That is, regulators will hesitate to give bad ratings because they don't want to take the step of imposing penalties. However, if you do not offer specific sanctions for poor performance (the current sanctions only "kick-in" if a bank seeks to expand or sell a branch), banks have no real incentive to comply with the law. One improvement that could be made within the current law would be to put more emphasis on the current regulation and provide better training to examiners responsible for CPA compliance. My experience suggests that most CPA examiners don't know what to look for, or what questions to ask. They simply don't understand the field of community development. Consequently, it is not uncommon to see banks that take compliance very seriously get only satisfactory ratings (or worse) while banks that do nothing, get the top rating. This is frustrating for banks as well as community development practitioners. Examiners need more and better training so they know what to look for and what to ask.

Q.1.c. How are community-based financial institutions distinct from banks and how can we ensure that support for these institutions does not undermine the obligation of other insured depository institutions to address community lending needs?

A.1.c. Again, community development financial institutions must be able to offer a wider range of financing tools than traditional banks (see answer 1.a.). Development banking is fundamentally different from commercial banking. The purpose of development banking is to promote self-sufficient and profitable business and housing ventures in poor urban and rural communities. Development banks do not attract profit motivated investors. The South Shore Bank is a commercial bank with a development focus. But even their core investors are social investors—investors who have never been paid a dividend, and whose stock is illiquid. CDFIs promote self-sufficiency, entrepreneurship, local ownership and control of economic resources. The "subsidy" to CDFIs (i.e. in the form of Government investment), is paid back many times. The South Shore Bank is but one example of this "repayment." In South Shore's case, the subsidy came from charitable foundations and religious organizations who were willing to sacrifice a return on their investment.

One of the primary purposes of a community development financial institution should be to leverage and develop partnerships with the private sector. For example, a community development financial institution such as a community development loan fund should be encouraged to enter agreements with traditional lenders so as to leverage its own investment with money from the broader capital markets. The development of secondary market mechanisms is

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critical for CDFIs. Current secondary market mechanisms have been unresponsive to CDFI loans even when the pool of loans being offered by the CDFI is of extremely low risk. A Federal initiative for CDFIs should target the development of secondary market mechanisms as a priority of the initiative and/or stimulate existing federally supported secondary markets to be more responsive to CDFIs.

CDFIs should be permitted to offer a wide-range of community economic development programs under one roof. They should be permitted to operate micro-loan revolving funds, venture capital funds, housing loan funds, and programs that encourage the acquisition by community based organizations of their community's resources, especially land. They should also be able, through direct investment or loans, to participate in specific infrastructure projects that allow a community to develop. For instance, on many Native American reservations, access to electricity, water and sewers makes economic development difficult. A CDFI should be permitted to become a partner, either through equity investments, or loans, with tribes seeking to develop these facilities.

Q.2.a. What are the most significant development gaps inhibiting revitalization of distressed communities?

A.2.a. Distressed communities definitely suffer from lack of capital. Many recent studies have documented this gap. Additionally lack of quality education and training for community residents impedes the development process. Capital alone is not the problem, but it is a significant problem.

Q.2.b. Are there products or services that community-based institutions provide that banks do not, but could provide?

A.2.b. Many CDFIs offer technical assistance to potential borrowers and specialized loan or equity products. Banks could provide some of this, but regulations would prohibit certain types of investments and the provision of technical assistance is expensive for banks to provide.

Q.2.c. Are there products or services that community-based institutions provide that banks cannot?

A.2.c. See A.2.b. above.

Q.3.a. Is this (concern of a two-tiered banking system) a legitimate concern? Why or why not?

A.3.a. No, this is not a legitimate concern. Development banking and commercial banking are two fundamentally different types of banking. I have addressed this in detail in A.1.c. above.

Q.3.b. If we adopt a policy of assisting community lending institutions, how can we ensure that other institutions are not let off of the hook of providing credit in distressed communities?

A.3.b. As mentioned above, better enforcement of CRA ought to be part of this initiative. There will always be credit needs for traditional intermediaries to address—CDFIs will not obviate the need for traditional intermediaries to provide a wide range of credit to communities and individuals.

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Q.4.a. How are your institutions different from CDBs? How are they similar to CDBs?

A.4.a. Community Development Loan Funds (CDLFs), Community Development Credit Unions (CDCUs), and microenterprise funds have some differences and many similarities to CDBs. CDLFs and microenterprise funds differ from CDBs in that they are non-insured institutions that typically don't service a consumer base. CDLFs and microenterprise funds typically provide credit directly to business, economic development and housing projects, but they do not provide consumer and depository services. CDLFs and microenterprise funds are similar to CDBs in that they accept loans from a variety of sources (and incur liabilities to those lenders), serve multiple borrowers, assess risk and underwrite loans carefully and systematically, set aside reserves and adopt appropriate portfolio management policies.

Q.4.b. What is the justification for including these institutions in any new community banking initiative?

A.4.b. Non-bank CDFIs have proven track records, skilled and experienced management and have built extensive relationships among both lender and borrower markets in their communities. These institutions should be supported to expand their activities because they know their markets and because they have proven that they can lend and invest successfully in low- and moderate-income communities. Successful CDFIs are rooted in the communities they serve. They draw significant amounts of capital from their areas and the boards of directors reflect the composition of their communities. This makes it possible for them to gain the requisite understanding of credit needs and borrower capacity to gauge their lending and investment properly. Institutions created without these strengths and operating with a mandate to lend quickly and in a safe and sound manner, will carry a heavy burden of unachievable expectations. In areas not presently served by CDFIs the Federal Government can help to foster the development of new institutions.

Q.5. If non-profit organizations are included in a Federal community banking initiative, how can we ensure that the projects developed and financed by non-profits will be financially strong and the Federal Government's interests are protected?

A.5. Non-profit CDFIs do have the same pressure to finance financially feasible projects as for-profit CDBs. As mentioned earlier, non-profit CDFIs incur financial liabilities just as for-profit entities do. Non-profit CDFIs who make bad decisions will go out of business—just as for-profit entities do. Non-profits are thus subject to the discipline of markets. In New Hampshire, it is interesting to note that in the past 18 months, 5 of the 7 largest banks went out of business because they had made too many bad loans. The two surviving banks survived only because they had substantial capital resources from out-of-state owners. However, the non-profit New Hampshire Community Loan Fund is still in business—with a strong balance sheet and a portfolio of performing loans to low-income borrowers. Institutions that make bad loans go out of business regardless of their legal structure for-profit or non-profit.

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Q.6. What are the most significant impediments to the formation of new or expansion of existing community-based lenders? What types of incentives would encourage their formation or expansion?

A.6. Existing community-based lenders need equity investment or grants to permanent capital. Equity is critical to the long-term viability of any financial institution. Equity allows intermediaries to take greater risk, price loans in a more flexible manner, attract additional investment, and generate earnings that contribute to self-sufficiency. Again, the South Shore Bank, which is held up as a model CDB, benefitted enormously from the large equity investment from religious and social investors. Without this investment, there would not be a South Shore Bank. Additionally, lack of access to long-term debt is a problem for many CDFIs.

Another impediment to the expansion of existing CDFIs is the lack of skilled loan officers, managers and directors with experience in community development lending and investment. CDFIs also need to provide technical assistance and training to borrowers. This assistance enhances the probability that loans will be repaid. A CDFI initiative should include funds for CDFI staff training as well as funds for technical assistance to borrowers. See answer 7 for additional ideas on incentives to encourage the expansion or formation of CDFIs.

Q.7. What entity do you believe is best suited for this task and why?

A.7. One of the key issues facing CDFIs is where they are placed in the Federal Government. I believe that one of the major challenges for CDFIs (and in some ways a defining issue for CDFIs) is to make sure that they are perceived as financial institutions. If CDFIs are perceived as financial institutions, it will be much easier to be gain access to some of the benefits that financial institutions enjoy and that CDFIs need, such as access to secondary markets. After looking at the range of "placement" options suggested for CDFIs, I believe that being placed within the Federal Home Loan Banks gives CDFIs more opportunities than other placements. Placement within the FHLB system would be desirable for a number of reasons:

1. The members of the FHLB system are banks—CDFIs would be seen as financial institutions not community development programs. I propose that CDFIs would become a new classification of member within the system. Membership within the system could give CDFIs access to member advances. Member advances allow banks to borrow from the FHLB at very favorable fixed-rates for long- or short-term. Although many technical details (e.g. capital requirements) would need to be addressed, the benefit of member advances would be a tremendous benefit to CDFIs. Currently, the FHLBs are owned by member banks who purchase stock in the system when they join. However, the FHLB of Boston recently created a precedent by allowing two public agencies to access funds as non-member borrowers (two state housing finance agencies). These institutions have full access to member advances. This would open the door to CDFIs. If there is enabling legislation for CDFIs, it could require the FHLB to establish a new category of membership and specify access to membership privileges such as advances.

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2. Allocation of funds and decision-making could be delegated to the 12 FHLB regions. Each region could have an advisory board comprised of local and regional community development lenders—and each region could develop lending and investment guidelines suitable to the specific region. The FHLBs already manage an affordable housing program with regional advisory boards—so they have some experience with this type of program. Regional decision-making would provide much greater flexibility than centralized (Washington) decision-making.

3. Operating within the FHLB structure would probably involve fewer bureaucratic problems than would operating within HUD. Additionally, the program could operate relatively inexpensively within the FHLB system. The program would be administratively inexpensive, non-bureaucratic and economically efficient. I estimate that the program could be run with a small Washington staff and as few as 2–3 people per region.

4. Operating within the FHLB structure could provide easier access to secondary market opportunities. FHLB members routinely deal with secondary market institutions such as Fannie Mae and Freddie Mac. Placement within the FHLB system could provide additional leverage for CDFIs as we try to push these institutions to develop products more suitable to its portfolios. I would also suggest that the enabling legislation for CDFIs should require the Government sponsored enterprises (GSE) to develop the products necessary to service CDFIs. The legislation might even specify that the GSEs must develop products for entities such as limited equity cooperatives and community land trusts (i.e. name products in the legislation), in consultation with CDFIs.

GOVERNANCE

Based on the regional model administered through the FHLB system, the following governance would apply.

1. The President would appoint the director of the program. This person would be based in Washington at the Federal Housing Finance Board. The director of the program would appoint regional directors, in consultation with the regional branches of the FHLB.

2. The regional directors would appoint a board comprised of regional community development lenders. This board would help design the policies and procedures governing the regional program (within the parameters of the enabling legislation). The board must approve the policies and procedures before the program is initiated. The board would be comprised of two representatives from each state in the region.

FUNDING

Allocation of funds through a regional FHLB system could work as follows:

1. Appropriations should be allocated to each of the twelve regions. Allocations should be based on a formula which considers both population and population of low- and moderate-income people.

2. Each region should be allocated at least 5 percent of the annual appropriation.

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3. Funding and investment decisions should be made by region with the instruction that attempts must be made to achieve geographic (funding) diversity both within the region and between urban and rural settings.

4. Within each region, funding for operating support may not exceed 20 percent of the regional allocation. Training programs and technical assistance may be funded at a level not to exceed 5 percent of annual allocation per region.

5. Regional programs may attract additional private investment by offering a tax credit to both corporations and individuals who invest in or contribute to approved CDFIs (need to define what this means). This would be administered through each regional program. Investments in for-profit intermediaries would be in the form of a tax credit of 25 percent of the amount invested in preferred stock (see explanation below of how investments in for-profits and non-profits will differ). Contributions to the capital of non-profit intermediaries would be eligible for a tax credit equal to 50 percent of the contribution. The amount of tax credits offered by each region would be capped at an amount no greater than twice the annual regional allocation. Administration of a tax credit program will be handled by region. (Note: The New Hampshire Community Development Finance Authority currently administers a state-wide program that grants state tax credits to corporations that contribute to the Authority. This has not been a difficult program to administer for either the Authority or the contributor.)

TYPE OF FUNDING

Primary funding of CDFIs should be in the form of equity capital investments in for-profit intermediaries, and grants of permanent capital for non-profit intermediaries as follows.

1. Investment in for-profit intermediaries should be in the form of 25 year preferred stock investments with a non-cumulative dividend of about 2 percent. Regulators should be instructed that these investments be counted as the equivalent of perpetual preferred stock (Tier 1) core capital until the final five years of the term. For the remaining term, the investments should be considered the equivalent of intermediate-term preferred stock (Tier 2) supplementary capital.

2. Investment in non-profit institutions (including CDLFs and CDCUs should be in the form of grants to permanent capital [capital grants]). This money cannot be used for operating funds, although the earnings on these funds could cover operating costs. There would be no obligation to repay these grants.

3. As mentioned earlier, funds should be specifically earmarked for operating support, technical assistance and training.

ADDITIONAL QUESTIONS CONCERNING CRA

Q. To what extent should insured depository institutions receive credit toward fulfillment of their CRA requirements for contributions to or investments in CDFIs? Should contribution to or investment in CDFIs be sufficient to fulfill an insured depository institution's CRA obligations? Would it be appropriate to exempt institutions from CRA examinations and requirements if they contribute a

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sum equal to approximately .05 percent of their assets or 5 percent of their capital to a CDFI?

A. Contributions or investments by insured depository institutions should be considered as partial fulfillment of CRA obligations, but it should not replace the requirement that these institutions assess community credit needs and meet those needs. As mentioned earlier, CDFIs meet a particular need but they do not meet the full credit needs of low-income communities. It is vitally important that insured depository institutions continue to meet the statutory requirements of CRA. Thus, contribution or investment in CDFIs should not be sufficient to meet CPA obligations and it would not be appropriate to exempt institutions from CPA examinations for contributing a portion of assets or capital.

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REVERSE REDLINING: PROBLEMS IN HOME EQUITY LENDING

WEDNESDAY, FEBRUARY 17, 1993

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:05 a.m., in room SD–G50 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

OPENING STATEMENT OF CHAIRMAN DONALD W. RIEGLE, JR.

The CHAIRMAN. The committee will come to order. Let me welcome all those in attendance this morning. We certainly have a large and very interested and enthusiastic gathering this morning.

Let me say, as we proceed this morning, we've got very serious matters to discuss and everyone here shares that feeling. Many have traveled a long distance because of the importance of these issues and how strongly people feel about it.

We have an opportunity today to build an important public record and I want to do that. There may be moments today when things are said or people have strong feelings and want to respond to something that someone has said. I want to ask everyone now, at the beginning, to maintain the order of the committee's work today. It is very important that we do that, because we've got a chance today to examine these issues carefully and fully and to get them out in the light of day.

So I am going to need everyone's cooperation to get that done. So I ask for that now. I don't want to have to gavel down anyone in the audience at any point. And there should be no need for that because we want to hear what everyone has to say and we want to be able to build this record fully and carefully.

Having said that at the outset, I again appreciate the fact that we have so many people here today. I think it underscores the very important requirement that we examine these issues and do so carefully and fully.

The committee today is meeting to conduct its second hearing in a series on the problem of people in our country getting access to capital in low-income and distressed communities. Just 2 weeks ago, we considered the issue of community development lending. Next Wednesday we are going to address the serious problem of mortgage discrimination, of which there is a very great problem in this country.

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We are proceeding systematically through an inquiry to get at these problems and get them out in the open so they can be dealt with and corrected.

Today then our subject is the discriminatory practice of targeting certain communities for credit on unfair terms. Typically the community involved is a low-income or minority neighborhood where housing prices often have appreciated. The residents in many cases are unsophisticated with respect to some of the financial transactions and the way they are presented, and in many cases are easily victimized by unscrupulous financial salespeople.

This committee has observed how unscrupulous check cashing outlets spring up in communities where banks and thrifts have deserted low-income neighborhoods, and in turn are charging exorbitant fees.

Our subject today is the lending side of the check cashing problem, namely the rise of what I would call shady home equity lenders offering promises of home improvements or credit consolidation. These lenders then often peddle high rate, high fee mortgages to cash poor homeowners. The borrower, who may not fully understand or not even receive disclosures from the lender about the terms of the loan in many cases ends up struggling to meet overwhelming mortgage payments. Too often, the borrower then ends up losing the house to foreclosure.

Now the answer to this problem is complex and it gets into the issue of how we regulate certain activities in this country. Some we do at the Federal level, some we do at the State level, and that issue comes into play here.

But clearly, better enforcement of laws that are already on the books can help in some instances. Much of the lending activity being complained of is presently legal and therefore is not on its face illegal activity. I want to get to that just a little bit later because we do write the laws of this country. And if they're not the way they should be, then they need to be rewritten.

Better disclosure to consumers may also be a solution here in some instances. But there may be instances in which the only solution is, as I say, new legislation. So today, I want to hear from our witnesses on these points. I want to establish a public record. I then hope to work closely with the Clinton administration to better identify the roots of the problem and then, in turn, to find better solutions to it.

We have two panels this morning. Our first panel will discuss the origins and extent of the problems in home equity lending and how we might address them. We have four witnesses on that panel. The first will be Scott Harshbarger, who is the Attorney General of the Commonwealth of Massachusetts. Mr. Harshbarger has conducted lengthy investigation of this issue in Massachusetts.

Filling out the first panel will be Kathleen Keest, who is a consumer credit specialist for the National Consumer Law Center, Terry Drent, housing coordinator for the Ann Arbor Community Development Department in my home State of Michigan, and John Hamill, who is president of Fleet Bank of Massachusetts. Fleet has had the misfortune to find itself closely associated with this issue in the press, but this problem is broader in scope than any one institution.

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We welcome Mr. Hamill here today for his testimony and to draw upon the experience and the insight that he can provide us.

The second panel will focus on the nature of the home equity loan problem. The witnesses will be Annie Diggs of Augusta, GA, and Eva Davis of San Francisco, CA, two home owners who say they've been victimized by second mortgage lenders. We will also hear from John Long, an Augusta, GA, attorney involved in related litigation, and Bruce Marks, who is the executive director of the Union Neighborhood Assistance Corp. Mr. Marks, I might say, has been a driving force in bringing the second mortgage problem to light and it is important that he testify today.

We have also received written testimony for this hearing from the Legal Aid Foundation of Los Angeles, the New York City Office of Consumer Affairs, including a study that they have given us that we will make a part of the record. The Legal Aid Foundation's Home Defense Center in Georgia, and the Legal Aid of Bilouxi, Mississippi, and any others that may wish to submit testimony or statements for the record. And we will keep the record open.

Let me note for the record that several of this morning's witnesses are involved in litigation related to the subject of our hearing today. It is of course not the function of this committee today to try to settle or in any way try to resolve these lawsuits. That just can't be done in this setting. Our purpose today is to try to determine what the laws should be.

I ask all of our witnesses if they would keep that in mind and help us in turn find the answers they need and lay a foundation in fact, so that we know where a new law may well serve us properly.

Finally, I want to stress again the relationship of this hearing to the larger and pervasive problem of an inadequate flow of credit to low-income communities on fair terms and without discrimination. This is a major problem in this country and it has to be dealt with directly.

As I say, this is one of several hearings in which we are doing it. But I am determined that we will face and solve that problem. Racial discrimination and the denial of credit to people who are creditworthy in this country, because they are being excluded from the system, either on racial grounds or geographic grounds, or because they are in certain neighborhoods, is absolutely un-American and it has got to come to an end. And I am determined to see that it comes to an end.

That is why four of our first six hearings in this Congress focused directly on this subject. I am very much committed to working with all the members of this committee and with the Clinton administration that feels very strongly as well on these issues to address these matters directly in a specific legislative package and as a top priority that's got to be dealt with now before more damage is done to our people and to our country.

So again, I want to thank all of our witnesses for coming this morning, many from long distances. And we look forward to your testimony.

Senator D'Amato.

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OPENING STATEMENT OF SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. Thank you very much, Mr. Chairman.

Mr. Chairman, today's hearing obviously focuses in on a situation that is evil, that is pernicious, that is unlawful, and that really is a stain on the financial community, as well as one that we share for having permitted this pernicious practice of discrimination and consumer abuse to take place.

When an elderly person is conned into taking a second mortgage—and I say "conned"—into taking a second mortgage to pay for some repairs, and within a matter of months cannot make those payments, than any decent credit analysis should demonstrate very clearly that he or she did not have the income to make the payments on this mortgage. It is intolerable to then have that elderly person's home foreclosed on, to put them out of the home that they have spent a lifetime of savings and scrimping only to receive nothing for it.

And that's exactly the kind of thing that is taking place in a number of our States, Mr. Chairman. State law in some cases is so permissive, without mentioning the individual States, that it often allows and encourages these kinds of practices.

For example, some States have no laws licensing mortgage brokers or setting limits on interest rates on second mortgages. We will hear today of other States, like Georgia, that have laws that actually authorize interest of up to 5 percent a month. That's 60 percent a year.

That's loan sharking clear and through and it should be made illegal.

[Applause.]

Mr. Chairman, too many Americans are losing their homes as a result of these fraudulent practices. Homeowners in credit starved areas are often pressured into taking out second mortgages, usually on usurious terms and conditions to pay for home repairs, to consolidate debts, or to obtain needed cash. Despite the illusion of big money on easy terms, the reality for these borrowers is often foreclosure and the total loss of their accumulated home equity.

Mr. Chairman, so-called reverse redlining is among the most pernicious forms of racial and ethnic discrimination and consumer fraud. The innocent and unsuspecting victims of these outrageous practices have worked hard to realize the American dream of home ownership and their dream of home ownership has been twisted into a living nightmare by the so-called "tin men" and loan sharks.

Mr. Chairman, these abusive practices must come to a halt. Unfortunately, current laws—the Real Estate Settlement and Procedure Act, known as RESPA, and Truth-In-Lending—do not provide adequate protection for consumers and borrowers in the second mortgage market. And the con artists exploit these gaps to the financial and emotional detriment of our constituents and our communities.

I have prepared legislation, Mr. Chairman, which I was going to introduce today, that will provide an important first step toward filling in the gaps in consumer protection. It is called the "Home Ownership and Equity Protection Act of 1993."

Now, I said that I was going to introduce it today. I am going to withhold it and circulate it so that hopefully we can make it a

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bipartisan act, an act that will give real and true disclosure, and provide consumers with an opportunity after the initial application is made for a person to reflect upon its terms. It will call for real disclosure and if, indeed, another 48 hours or so can bring forth suggestions from this committee and from staff to enhance and make it a better bill, as a first step toward a solution to the problems we will hear about this morning, this Senator would be pleased.

In short, the bill would provide a 3-day cooling off period between the time of the loan application and closing. We establish strict penalties for noncompliance with these enhanced disclosure and delivery requirements. And we mandate a comprehensive Federal study of the entire second mortgage market. I think that is important, so that we don't over-regulate. But by the same token, we get a comprehensive review. But this enhanced disclosure is something that I think is a first step that we should begin to move on quickly.

Under the bill, consumers will be warned in writing at least twice about the dangers of taking out a second mortgage. The 3-day waiting period, as well as the 3-day recision period already required by Truth-In-Lending, will give homeowners more time to consider and understand the responsibilities and risks associated with loans.

I believe that our financial institutions have a very real obligation themselves. They simply cannot hide behind the fact that there is some company out there doing this. That there are independent contractors making these deals. That's not good enough. You cannot do that; it's wrong.

[Applause.]

We have a credit-starved community. You have an obligation to see to it that if you make funds available, that the people really have the ability to pay back. No one wants to see unnecessary foreclosures. It's wrong. I have had it happen to someone in my family who should have known better; he didn't. It's wrong.

It is wrong for institutions that have a very special charter with America and the American people and the American Government not to act responsibly. It should not be necessary for us to pass this legislation. It obviously is.

So I hope, Mr. Chairman, that we can at least come forward with a basic bill that will provide more disclosure and begin to move us in the right direction. And I hope that the great financial institutions of our country begin to exercise a greater degree of care and concern in this area.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator D'Amato. With you and I both having stated our intentions today to introduce legislation of a comprehensive sort, I think we will be able to do that on a bipartisan basis and offer it in a way that can move it ahead. I think it would be very constructive. And I think today we will get a lot of valuable information as well that will help us in guiding the construction of that package.

Senator Campbell, let me start down in the order in which members have arrived for any brief opening comments they want to make.

Senator Campbell, we are pleased to call on you next.

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Senator CAMPBELL. Thank you, Mr. Chairman.

I have a complete written statement. With your permission, I would like to introduce it into the record.

The CHAIRMAN. Without objection, so ordered.

OPENING STATEMENT OF SENATOR BEN NIGHTHORSE CAMPBELL

Senator CAMPBELL. Just to tell you, I appreciate your doing this hearing and certainly intend to co-sponsor your legislation to correct some of the problems we have had with some of the predators who have given the lending institutions a bad name and taken advantage of people who are very often the people who have the most difficulty in our communities trying to make a living.

Very often, homeowners have nowhere to go for credit because mainstream institutions are reluctant to lend to low-income families; and these are the homeowners who are targeted by second mortgage lenders and charged very high rates of interest.

I am not well versed in the banking industry as you know, just coming on this committee recently. But I have always been interested and concerned about the disadvantaged and minority communities, particularly inner cities and Indian reservations, as you might know.

So I am interested in learning a little more about this. I have tried to collect all of the written material which I will go over in my office, since I do have a conflict this morning. But clearly we have an obligation, a moral and legal obligation, I think, to make sure that those people who have been predators on the disadvantaged in this country, to make sure that that's stopped.

We might not be able to go back in time and fix all of the mistakes that have been made and all of the unfair practices that have been made. Hopefully, courts will do that and find justice for those people who have been taken advantage of. But we can surely move forward and prevent it from happening again.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator Bennett.

OPENING STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you, Mr. Chairman.

I apologize in advance that I have a conflict that will not permit me to hear all of the testimony. But I want to make it clear that this is a matter that requires very careful study and something that members of the committee should pay very close attention to.

I am delighted, Mr. Chairman, in your comment, in your opening remarks, about the issue of whether this is a Federal jurisdiction or a State one. Because I think much of the problem may have arisen from the fact that States assume that there are Federal laws on the books that take care of this and therefore ignore it. And the Federal Government very often is the least effective agency for enforcing things of this kind. And it does require local administrators and local regulators who are closer to the situation and can say this is going on.

So I hope in the testimony that we address not only the question of the outrages, but the basic question of where the most intelligent

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enforcement should take place and what the Federal Government can do to facilitate activities on the part of State and local regulators. And I am delighted that we have some State regulators here to address that question.

I assure them that even though I do have a conflict that will require my leaving, that I will read their testimony very closely and pay close attention to the recommendations. Because this is an area that we need to pay very close attention to and see what we can do to alleviate the problem.

The CHAIRMAN. Thank you very much, Senator Bennett.

Senator Kerry, you may also want to make a comment about the fact that our first witness this morning will be your attorney general from your State.

Senator KERRY. Indeed, I would like to do that, Mr. Chairman.

The CHAIRMAN. A position with which you have some familiarity.

OPENING STATEMENT OF SENATOR JOHN F. KERRY

Senator KERRY. And with the gentleman himself.

Mr. Chairman, I think first of all I would like to join colleagues in reflecting my own appreciation for your leadership. And I am glad to hear Senator D'Amato withhold in an effort to try to put a bipartisan effort together. I am confident we can. I think it is very important we do.

I also want to underscore how important I think this hearing is and this effort is. It is larger than just the examination of the predatory practices that have caused considerable and appropriate outrage among a number of citizens.

But it really goes to the larger issue of a relationship between institutions, important institutions, financial institutions with great power, and people who do not share that power. It is an effort by this committee and others to try to transfer some of that economic power back to people who have been victimized by redlining and a series of other practices amounting to economic abuse of our urban areas.

I am particularly pleased that the leadoff witness is our attorney general from Massachusetts. He rightfully carries a well-earned reputation as a law enforcement officer, as a crime fighter, but also as a crime fighter who understands this other relationship I am talking about with respect to the non-street crime that you see every day.

It has been important for our State, and I think he is to be saluted for that. The work he did on this is groundbreaking and important. It is really the best of what attorneys general and district attorneys ought to do in protecting citizens. And I salute him for it.

I also want to welcome John Hamill here who has the difficult role of trying to articulate within an audience that is obviously suspicious of any corporate person representing an institution that is associated with the downside of some of these practices. In fairness, I think it is very important for people here to understand that John Hamill is an outstanding business leader in our community, somebody we have enormous respect for.

I know from my personal dealings with him and efforts to get minority lending increased and in our efforts to try to augment bank

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purchasing among minority businesses and other things, that his own sensitivity to this issue is real and that he does not condone these kinds of practices. And I think it is important to listen to whatever explanations are offered with that in mind.

Let me also say it is very clear that this committee has got to come up with some kind of response to what we understand to be an unconscionable relationship between disadvantaged people and institutions with the power that we have described. Not every person or institution who loaned money to poor people, incidentally, on second mortgages, committed improprieties. We understand that.

But on the whole, there really were substantial abuses within the industry which wound up causing people to lose their homes for no legitimate reason.

Over the past 2 years, my staff has interviewed a number of people from different parts of Massachusetts who met with these lending practices. And we have heard from over 70 people who received loans from Dime Bank in New York under circumstances that any person of common sense and decent conscience has to say are unacceptable.

We had instances where we had what was called a "no doc" lending process. No documentation. No normal documentation for folks who were supposedly a larger credit risk. The whole process of home buying was sped up. The less sophisticated borrower was lured. They were only required to put down 20 percent downpayment, but in many cases there was no documentation of their ability to do that, no income verification, no credit history.

These "no doc" loans made it easier for fraud to occur. Real estate transactions went unchecked. Incomes were inflated, downpayments were sometimes financed by the developers themselves as a second mortgage. Appraisals were falsely inflated. That institution, and another one that has subsequently been put out of business by the RTC were the only two who dealt this way in Massachusetts, I want to add. But they used techniques called negative amortization where they had a teaser interest rate with interest accruing from the moment and suddenly it would balloon to such a degree that people simply never had a prayer of being able to pay this. No one can accept that.

So, Mr. Chairman, I think it is important to build a record today to understand precisely how this occurred and what the implications are. I salute you for holding this hearing.

The CHAIRMAN. Very good, Senator Kerry.

Senator Domenici, did you have an opening comment?

Senator DOMENICI. Mr. Chairman, I have a few pages of remarks. Would you put those in the record?

The CHAIRMAN. Without objection, so ordered.

OPENING STATEMENT OF SENATOR PETE V. DOMENICI

Senator DOMENICI. Mr. Chairman, I think it is conclusive now that something is amiss with reference to inner cities and minorities, their ability to borrow money either for real improvements or for home building. For a long time, people said it wasn't so, but it is so. Frankly, we are quickly coming to the conclusion that you cannot fix inner cities with Government programs solely. Nothing works that way.

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That's why you have banks, that's why you have a secondary market which bundles up home mortgages and then permits banks to even lend more for homes. Frankly, what we are doing thus far seems to all be counter productive on the Government end, and I think we need some real answers. Why isn't FHA more active?

Before we go around criticizing others, we'd better find out what's wrong with our Federal programs. Something has to be amiss.

The CRA, which we take so much pride in and credit for, isn't even working in this area. It's being finagled in ways that it comes out that there's still no real help for the individuals that want to improve where they live.

We allowed tax deductions for home equity loans. I say to my friends here on the committee, which said you can borrow money and deduct that interest. That's working counter to the poor people in inner cities because what is happening is they're pooling their non-equity indebtedness and end up with a huge indebtedness on their house. And they are ending up losing their houses in the name of permitting them to deduct the interest payments.

Mr. Chairman, I don't have the answers, but I think it's pretty clear that we need many resources applied to the inner cities aside and apart from Federal programs. We need what every other part of America applies to the community, led by mortgages and loans for real home improvements and for housing. That is not happening.

The Banking Association of America has to face up to it. For years they said it didn't exist. Now if we've got to believe the Federal Reserve on this one, they looked at it carefully and they told us it does exist.

So I just don't think we ought to convene these hearings with the idea that we are looking for excuses. We are looking for answers. Maybe we have to change some things to help this occur. But it is happening, there is no doubt about it.

Mr. Chairman, and Ranking Member D'Amato, I laud you for the hearings. But more importantly, I really hope we can get together and find some ways to improve this situation. Without it, it's not going to work.

Putting in more community development block grants, I say to the members it's just going to be a little superficial thing. It's not going to fix the resources that ought to be flowing to individual family members who need that kind of help.

Thank you very much.

The CHAIRMAN. Thank you, Senator Domenici.

I want to note that Senator Murray was here and had to leave to attend to something. We will make her statement a part of the record.

The CHAIRMAN. Senator Shelby.

OPENING STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman.

I, too, am disturbed by the notion of the elderly and the less sophisticated among us being preyed upon by the over-zealous financial institutions. I believe, Mr. Chairman that this type of conduct is unconscionable at best. There's a lot of fraud in this type of lend-

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ing in America. Fraud must be stopped. I don't believe there is any place for fraud or predatory lending of this type in America.

[Applause.]

The recent settlement in my State of Alabama indicates that this has been and may continue to be a problem in Alabama. I am interested in learning more about the problem of reverse redlining. And I am very interested in what we can do to ensure that unwitting borrowers are not taken advantage of by predatory lenders.

Particularly troubling to me, Mr. Chairman, is the idea that a lot of borrowers are unaware that they are using their homes to secure a home equity loan on a second mortgage. These borrowers may get in over their heads and end up in a lot of cases losing their homes. Mr. Chairman, I believe no borrower in America should be unaware of what collateral he or she has used to secure a loan of any type.

However, Mr. Chairman, having said this, I think as these hearings go along, we have to be careful about interfering in the marketplace, interfere as little as we have to. We use the term "redlining" to describe a community that has been shut off from credit. The term "reverse redlining" suggests that a community has access to much too much credit, a notion that is not all bad if it were carried out right, if we had conscionable people making those loans.

Mr. Chairman, I have an additional statement I would ask to be made part of the record. And I, too, want to commend you as Chairman for bringing about the leadership in having these hearings and I want to commend Senator D'Amato for his foresight and leadership in the same area.

The CHAIRMAN. Thank you, Senator Shelby.

Senator Boxer.

OPENING STATEMENT OF SENATOR BARBARA BOXER

Senator BOXER. Thank you very much, Mr. Chairman. I will be brief.

I also want to echo the praise that has been heaped upon you and Mr. D'Amato this morning. I also want to say to the people who are here that I think it is absolutely terrific that you came out. What you've heard already should give you great heart and great hope.

I have been in this system for a long time and to hear the kind of commitment that you have heard from the majority and the minority today is, I think, a very good sign that something good is going to happen and that you—the public—have played a role by bringing these issues forward.

Mr. Chairman, many times, as you know, the people who are most hurt in these pernicious schemes are often the people without a voice. That is why it is so important for us to be their voice.

Twenty years ago I was a newspaper reporter, Mr. Chairman, and I wrote a story about an elderly woman who had this little dream house and this little dream picket fence and roses in the front, and she succumbed to one of these people who came and said, "gee, I can give you some more money and you can buy some gifts for your grandkids." But it was never explained to her that in just a few months, maybe a year or two, she would be hit with

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a balloon payment that would be more money than she ever hoped to get her hands on. So she lost the house.

We wrote the story and everyone was stunned and shocked and everyone thought this certainly would never happen again. But it's still happening, 20 years later. But I am sitting in this seat and I feel privileged to be able to do something now rather than just write about how to fix the problem.

I am going to work with you, Mr. Chairman. The bottom line is our home is our castle. And we can't let someone pretending to be a knight in shining armor take that castle away. That can no longer continue.

So I will work with you and do everything I can to make sure we fix this problem.

The CHAIRMAN. Thank you very much, Senator Boxer.

[Applause.]

I think what we have here today is a pretty good example of democracy in action. We have a lot of citizens here and I am very encouraged by that.

Mr. Harshbarger, you have been previously identified. We are going to start with you.

I am going to ask each of our witnesses on this first panel to try to keep your summary comments to about 5 minutes if you will so we've got time for questions. As you know, we have got a second panel coming behind you that will illustrate some of the very problems that you are going to talk about, but on individual terms. I want to make sure that we've got enough time this morning to get through all of that. So if we can try to adhere to that, that would be very helpful.

Mr. Harshbarger, we will start with you.

STATEMENT OF SCOTT HARSHBARGER, ATTORNEY GENERAL OF THE COMMONWEALTH OF MASSACHUSETTS

Mr. HARSHBARGER. Senator, thank you very much. I commend you as Chairman and the members for focusing on this issue and obviously, my colleague, and a leader on this issue, from Massachusetts, Senator Kerry. It is nice to be here.

I am Scott Harshbarger, the attorney general of Massachusetts. I thank you for this opportunity to outline the work of my task force, which investigated the home improvement and mortgage scams in Massachusetts. I would ask that my full testimony be entered in the record.

The CHAIRMAN. Without objection.

Mr. HARSHBARGER. I would also ask that the report of our task force, which contains in detail a number of our recommendations for you as well as for others in Massachusetts, also be entered into the record.

The good news. For the past 2 years, we have undertaken a comprehensive program of enforcement, regulatory and legislative action to remedy the harm done to vulnerable consumers in Massachusetts by unscrupulous lenders and home improvement mortgage contractors. The bad news. Our investigations documented and uncovered the worst kind of urban economic violence which blatantly victimized thousands of vulnerable homeowners.

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These vulnerable homeowners, elderly, people of color, and people in our inner cities, were targeted by certain brokers, lenders, and contractors to take out second mortgages with unconscionable terms and conditions. If the consumer had sufficient equity in his or her home to cover the loan in case of a default, irresponsible lenders motivated, as best we can tell, primarily by greed gave scant attention to whether consumers could repay their loans with their monthly income.

As a result, the consumers were burdened with unmanageable debt and, in numerous cases, lost their home through foreclosure.

The words of one victim best sum up the impact that these scams have on people. She said to me, "They did to me what a man with a gun in a dark alley couldn't do; they stole my house."

Following the complaints that we received—and many of the leaders of the community groups involved in this are here and will speak to you this morning—I mobilized the Home Improvement and Mortgage Task Force from the Office of the Attorney General to address, on a variety of fronts, this insidious form of urban economic violence.

To date, the Task Force has initiated thirteen enforcement actions. These actions have already produced more than $40 million in legally enforceable benefits to Massachusetts consumers, particularly consumers of low- and moderate-income. The targets and the participants in these actions were banks, home improvement contractors, and a variety of other mortgage company officials.

We also promulgated unprecedented and creative regulations to curb future abuses, and new mortgage licensing and home improvement laws have been enacted to legislate positive change. We recommend them for your consideration.

But the obvious question is, how and why did this happen.

First, many inner-city communities across Massachusetts and elsewhere in this country were entirely abandoned by mainstream lending institutions during the 1970's and 1980's. As a result of the vacuum that was created when the mainstream financial institutions left, the only credit available to inner-city consumers was from the then unregulated and unlicensed second mortgage companies.

This economic exploitation was aided by unethical brokers who extracted unconscionable fees from consumers, and who, in some instances, had undisclosed financial and corporate ties to lenders whose primary goal, apparently, was the acquisition of real estate in a then rising market.

I believe a second reason why these scams flourished is that for over a decade, there has been a wholesale abandonment of our cities in this country by many States, and by the Federal Government.

If these scams had in fact occurred or were occurring in middle class suburbs of this country, as we saw with the savings and loans scandals, the Federal "cavalry" would already have arrived on the heels of the scam artists.

But instead, the social fabric of many inner-city urban neighborhoods was allowed to be torn apart and communities destabilized. And these destabilized communities, as you know, and as Senator Kerry in particular knows from experience, are the breeding

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ground for further forms of economic violence and other types of violence.

Our Task Force uncovered and documented allegations of wrongdoing by home improvement contractors, lenders and brokers, against vulnerable consumers.

We have given examples in my prepared testimony and our report of what was documented.

I stress that only because this is a field where allegations are often made. Our investigation documented misrepresentations of the nature of the transaction to the consumer, illusory inducements, pressure and coercive tactics, failure to disclose key elements of the transactions, forgeries and falsification of documents, and unconscionable or unaffordable loan terms, many of which examples have been described by members of the committee here this morning.

Our attack therefore was multipronged. In addition to 13 actions that targeted banks, mortgage companies, home improvement companies, and individual home improvement salesmen and mortgage company executives, we did promulgate new consumer protection regulations to create a "level playing field" for all the lenders, particularly legitimate lenders who were playing by the rules and were protecting the consumers from these abuses.

We played a major role in working with the State Legislature to secure the passage of a new law, regulating home improvement contractors, registration, licensing and a guarantee fund to protect consumers.

And we initiated, and with the support of over 100 lenders in Massachusetts, a voluntary moratorium which was then followed by a legislatively-passed moratorium that precluded foreclosures during the period of our investigation.

Please allow me to mention just a few things in terms of recommendations.

We must look at the Community Reinvestment Act, and ensure that its requirements are absolutely enforced and that the Act mandates address issues that have been focused on here today. Let me give just some examples.

Given that the unscrupulous preyed upon the vulnerable and filled the vacuums that the mainstream financial institutions left, we must insist that more banks put branches in lower income communities. We must insist that they market credit products designed to meet the needs and resources of low-income consumers, and market them aggressively.

The banks must reach out actively to low- and moderate-income consumers, and become, if you will, more "user friendly," as they did in the middle 1980's for the "yuppie community." I apologize to those who may have been in that group.

[Applause.]

It is also clear that we need far more flexible and liberal lending criteria for mortgages in a number of areas. And, in addition, we must insist that long-term plans of banks include locating in urban communities.

We must also ask the banks to look at their financial relationships to other lenders. The fact is, in these situations, consciously or unconsciously, mainstream banks in Massachusetts did finance

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high rate equity lenders who made loans in areas where those banks were not participants.

We also must think about the education of consumers in some meaningful way, to ensure that they know how to protect themselves.

And I suggest we should adopt regulations similar to those that we adopted in Massachusetts, in terms of home improvement and mortgage abuses, as well as legislation relating to licensing.

This problem won't be eradicated overnight. There is no magic panacea or simple solution, but if together, the banks, the mainstream lenders, responsible brokers, responsible home improvement contractors, local community, Federal and State agencies, for once engage in a partnership, and not to compete with each other, but work together to try to address these problems, we can have a public private partnership that I believe will change the urban economic landscape from one of deprivation and disintegration to one of hope and opportunity.

And you, Mr. Chairman, are to be commended for your commitment to not simply hold hearings but to take action. And we stand ready and willing to assist in any way we can. Thank you very much.

The CHAIRMAN. Thank you very much. That's very valuable testimony. I appreciate also the submission of materials from your work and studies. That will be very helpful to us.

Next, Kathleen Keest, who is a consumer credit specialist with the National Consumer Law Center in Boston, and is also the author of the Center's study called "Second Mortgage Lending Abuses and Regulation."

We'd like to hear from you now, Ms. Keest.

STATEMENT OF KATHLEEN KEEST, NATIONAL CONSUMER LAW CENTER, BOSTON, MA

Ms. KEEST. Thank you for your invitation. Again, with everyone else, I'd like to thank you for focusing the attention on this.

As you noted, others today are going to be telling you in graphic terms what the human costs of this phenomenon are. I'm here to be your boring speaker today, and tell you why I think some of these things have happened, and what I think can be done about it.

One of the major contributors, we feel, has been deregulation. Usury rate ceilings have been around for thousands of years. They were around for a very good reason, that being that greed is unfortunately apparently an immutable human trait in human nature.

Similarly, because there is inherent unequal bargaining power in consumer transactions, particularly consumer credit transactions, the regulation of consumer lending has been around for at least the better part of a century.

But in the early part of the 1980's, when there was an anomalous mismatch between statutory rate caps and market rates, we threw the baby out with the bath water, and deregulated virtually everything, while, as Senator—I believe it was—D'Amato said, some States have nothing at all.

Congress contributed as well. Not all of what we call second mortgages are really second mortgages. Some are first mortgages

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which are also home equity loans. And Congress, in 1980, preempted State interest rate caps on those loans. That has contributed.

Congress, in 1982, preempted any State regulations on some of the other creative financing things. Tricks that have been mentioned here, like negative amortizing loans and balloon payments. Along with the Federal trend toward deregulation, many States gutted their laws as well. This deregulation then set the unscrupulous free to do what they will.

The second thing that happened was the appreciation of real estate values.

What happened was that there was an entire new pool of wealth created, and what we call the equity skimmers or equity thieves felt that it was there for them to, as Woody Allen put it, rob with a paper and pen.

This led to what is called asset-based lending, which is OK in commercial loans, at least some of them, but when you're talking about consumers who look to their regular daily income to pay their loans back, it doesn't make any sense to look at the value of the collateral unless the House is going to write the check every month.

It only makes sense if the homeowner is going to liquidate and if they have no intention of it, it doesn't make any sense to be making loans that these people cannot possibly afford with large balloons of large monthly payments. It just led to reckless underwriting because the lenders had nothing to lose while the borrowers had everything to lose.

The third thing that happened was the rise of the secondary mortgage market, which helped a lot in terms of increasing the pool of mortgage money available, but it also made these people, these second mortgage operators, it gave them a backend income stream from which they could continue to operate. And it encouraged their reckless underwriting, because they didn't have to deal with the consequences.

And the investors buying the paper felt that they didn't have to deal with the consequences because they could successfully or not. Ultimately, they felt that they could assert what is called the "holder in due course" doctrine to protect themselves, and separate themselves from any responsibility.

We've talked a lot already about who this happens to. I just want to point out that one of the things we found from our national perspective is that in the areas where there has been the most permissive legal environments, regulatory environments, is where it's been worst, along with the areas where the real estate values rose most, like Massachusetts, Florida, the southwest.

Then of course it happens most to the vulnerable populations, including the rural poor, as well as inner cities, rural Mississippi, rural Alabama, and of course, in addition, to the people who have no choices.

I just want to make a point that a lot of times these loans got justified by saying that these were high risk borrowers. In the paper that Senator Riegle alluded to, we take issue with that. I simply want to make reference to that, rather than go into it here, that it's not really true that that's the real reason.

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In terms of recommendations, there are a lot of recommendations that we've made in an appendix which is submitted with our written brief, which I'd ask to be made part of the record.

The CHAIRMAN. Without objection.

Ms. KEEST. Among the three most important are, one, reregulation. If you have a floating ceiling, that takes care of the problem of a mismatch, and it also concerns the problem that usury ceilings were around to serve for the last 3000 years. I would ask Congress not to preempt any States that want to do something even more protective.

Second is to eliminate the "holder in due course" doctrine for consumer loans.

And the third is to make improvident lending and equity skimming an unfair and deceptive or unconscionable act, and include a private means of enforcement. I see my time is up.

I haven't heard any suggestions that this is going to happen today, but I do want to urge caution people. I know there's a lot of talk about regulatory burden. And when I hear the bankers talk about it, all I hear them mention is the consumer protection laws. And to gut those in the name of relieving regulatory burden is not going to help matters at all.

There are a lot of other explanations, there are a lot of other reasons why there's a lot of paper work burden, and Truth-In-Lending is really not one of them. So I would urge you to not listen to that siren call.

I want to thank you again for having the opportunity to testify. Like Mr. Harshbarger, if there's anything we can do to help the committee in its considerations, we'd be more than happy to do it.

The CHAIRMAN. Thank you.

Let me just say that those consumer protection laws are not going to be gutted by this committee, not while I'm here as Chairman. I can assure you of that.

[Applause.]

Let me just say, that Mr. Terry Drent has given very important leadership in Ann Arbor, Michigan, for which I and others are appreciative. Further, he has actually assisted several homeowners with severe financial problems that have arisen because of these second mortgage abuses.

Mr. Drent, we're pleased to have you and we'd like to hear from you now.

STATEMENT OF TERRY DRENT, ANN ARBOR COMMUNITY DEVELOPMENT DEPARTMENT, ANN ARBOR, MI

Mr. DRENT. Good morning, Senator.

It's an honor to speak to this committee today, chaired by our distinguished Senator from Michigan.

I'm Terry Drent of the Community Development of the City of Ann Arbor.

Many people living on fixed incomes in Michigan and the rest of the country are facing a crisis. For many, the costs of medical care, housing, and basic sustenance is so high that people feel they have to supplement their incomes with debt just to survive.

Many of these people are being preyed upon by unscrupulous mortgage companies, with a practice that we know as reverse red-

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lining. These firms are targeting low-income families, claiming to be able to assist them in paying their bills. Many who avail themselves of these solutions find that they're worse off, and some are being actually forced out of their homes.

People living on fixed incomes are most susceptible to the abuse by mortgage companies because they see their expenses increase more than their incomes. You know that if someone's income is derived from Social Security or any other COLA based program, the most it's going to increase is the rate of inflation, which has been about 3.5 percent a year over each of the last 4 years. In that time, we've seen medical costs increase by as much as 15 to 20 percent. The cost of home repair is also very high.

Many people are also struggling to pay their property taxes on their homes, which have increased dramatically in recent years, as State and local governments continue to face budget imbalances, many due to Federal budget cuts.

So people are in situations where they have to choose between buying food or perhaps paying property taxes or paying for health care or paying property taxes, or fixing a furnace in winter time or paying property taxes. Like most of us, they choose to pay for the things that will keep them alive, and they don't pay the property taxes.

We've discovered that some mortgage companies study the delinquent tax rolls published by county treasurers, and these mortgage companies entice homeowners with loans to pay their back taxes and their medical costs.

Frequently, the interest rate is double market rate, and there are many high administrative fees and points.

One of the reasons these mortgage companies are successful in enticing people to accept these loans is that in Michigan and many States, if you are unable to pay the property taxes, the State will collect them by selling them at the delinquent tax sale.

So a tax purchaser, frequently a company, will step in, pay the taxes, get a lien on the property, and start the process to take the home.

Some of these companies also own mortgage companies. It's an embarrassment to me that Michigan is probably the worst State for this in the country. In Ann Arbor, we had an elderly widow with Alzheimer's disease who was unable to pay her property taxes, and subsequently they were purchased.

A mortgage company contacted her through the delinquent tax roll and put a lot of pressure on her to sign mortgage papers, saying she'd lose her home if she didn't. They offered her a $35,000 loan at 18 percent interest.

The CHAIRMAN. At 18 percent?

Mr. DRENT. Yes, sir. When she actually needed 13 percent to pay her taxes. Her income was $770 a month derived from Social Security. This mortgage payment would have cost her $680 a month. She'd still have to pay her property tax bill. Now, that would leave about $90 a month to live on.

So we worked with a local bank, Great Lakes Bancorp. And in consideration of the Community Reinvestment Act, they were able to extend her a loan for $15,000 at 9 percent interest. Her mortgage payment with her taxes is about $326 a month, and she's

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going to be able to stay in her home. But not everyone is that lucky.

There's another case in Southeastern Michigan where, again, an elderly widow with early onset of Alzheimer's disease couldn't afford her property taxes and medical bills. In 1989, she got a mortgage for $12,729 with a 3-year balloon payment. She defaulted. Her income was $520 a month derived from Social Security. Her mortgage payment was $350 a month. So she defaulted after 3 years. The bank refinanced. She defaulted again. They refinanced again. A third financial deal. In 18 months, her debt load increased from $12,729 to $39,500. Of this increase, this woman only saw $4,066. The rest of it went to points and administrative fees.

Right now, through a court agreement——

The CHAIRMAN. They're basically just stealing her equity through those inflated figures.

Mr. DRENT. Absolutely. It was clear that this woman could never pay this loan off.

Right now, in the court agreement, she has 8 months to refinance or she's going to lose her home before the year is out, and truly become a burden on the community. This is a house she paid off once. She paid off her mortgage.

There's another person in Ypsilanti, Michigan, who is mentally disabled. His mother left him her home so he'd always have a place to live. His State disability income equals $220 a month. A mortgage or a tax company bought his property taxes and exchanged the lien on his property for a mortgage at 25 percent interest. His payment is $250 a month, again, on an income of $220 a month. Right now, he's borrowing from friends and family to be able to live and pay this mortgage. He lives on about $25 a month after his payment. Soon, he will be one of our homeless mentally ill.

There are many abuses in the nonconforming mortgage market. What once were considered usurious mortgages are now the norm. Many lower income homeowners are being victimized.

The city of Ann Arbor isn't specifically against nonconforming mortgages. In fact, Mayor Brader of the city of Ann Arbor, and the City Council and the City Administrator are working with local banks to form a loan pool to help low-income people.

However, we feel that there are consumer protections that can be put in place to protect the low-income, the vulnerable and the disadvantaged from an under-checked and under-regulated segment of the banking industry.

We have some recommendations that I'd like to read into the record.

We'd like you to consider repealing the exemptions from State usury laws in the Federal Banking Statutes.

We'd like you to establish a Federal Usury Law, regulating interest rates as a specific percentage above prime rate and controlling the total financing charges imposed.

Strengthen and clarify the notice of foreclosure prevention services existing in current law.

Require personal notice of foreclosures to all significant interests in the property.

Require judicial foreclosures of all mortgages.

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And finally, amend the Older American's Act to require that low-income seniors facing a foreclosure be referred to social service agencies that can help them, literally get in contact with programs that can help them.

Now the problem is so severe in Ann Arbor and Southeastern Michigan, the Mayor and City Administrator set aside funds for a foreclosure prevention program. But we realized that we're putting a bandaid on an open wound, and regulatory action is needed.

The practice of reverse redlining is threatening the sanctity of part of the American dream; that's homeownership.

Right now, we feel that the rapacious dogs have been unchecked and under regulated, and are preying on our disadvantaged people. This activity is wrong, it's unfair, it's unAmerican, and it certainly needs to be stopped. And we hope that you take action to do so.

The CHAIRMAN. Thank you very much.

Thank you for your leadership in Ann Arbor and for coming today.

Mr. Hamill is President of Fleet Bank of Massachusetts and a senior executive for the Fleet Northstar Group. He is the spokesperson for Fleet on the second mortgage issue. Mr. Hamill, we appreciate having you here. We'd like to hear from you now.

STATEMENT OF JOHN HAMILL, PRESIDENT, FLEET BANK OF MASSACHUSETTS

Mr. HAMILL. Thank you, Mr. Chairman. I appreciate being here.

Senator D'Amato, I appreciate your comments and the legislation you are proposing. Senator Kerry, I appreciate your opening remarks. And Mr. Harshbarger, who I've worked with on a number of occasions. I'm pleased to be here.

Fleet is headquartered in Providence, Rhode Island. We're the fourteenth largest bank holding company with $47 billion in assets. We have 1,300 offices in 42 States, and we employ over 27,000 people in our company with 5 major non-bank companies and 7 banks.

Fleet Finance is in Atlanta, GA. That's the headquarters. It provides consumer finance services throughout Georgia and in 25 other States. It's one of the largest consumer finance companies in Georgia, but it's a smaller player in the national consumer finance industry.

I would like to turn your attention, if you will, to the consumer finance industry as a whole, because it provides credit I believe to millions of people who would not otherwise be able to get credit. These are people who have low- and moderate-incomes, and who cannot obtain credit from traditional sources, such as banks and credit unions because of their existing credit problems.

Fleet competes in this market with major national companies, such as Associates, AVCO Financial, Chrysler First Financial, Household International, Beneficial, Transamerica, G.E. Capital, the Money Store, Old Stone Credit, NationsBank, and many other companies.

This industry provides credit to a segment of our country that needs credit. I believe that the industry needs to be focused on for what it does right, as well as what it does wrong.

I would ask that we make sure that while we're looking at the question of access to credit, that we focus on the fact that people

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do deserve access to credit, notwithstanding the fact that they have had a poor credit history in the past. That I think from a public policy standpoint is very very important.

Senator DOMENICI. Would you state that again, please?

Mr. HAMILL. I think that people, as a public policy matter, have a right to access to credit, notwithstanding the fact that in the past, they have had credit problems.

I believe that that is what this industry has done and that certainly there have been abuses. But I want to make sure that we focus on the whole and not on the fringe.

Home equity loans are typically used by consumers to reduce their monthly expenses by consolidating debt and stretching payments out over a longer term, when used right. A longer term and lower interest rate reduces the borrower's monthly payment, it eases cash flow problems. In addition, home equity loans are used to finance home improvements, to acquire personal property, to pay educational, medical, or other expenses.

This is a new phenomenon, home equity loans. It is something in this country that we are dealing with, where we are bringing this to the consumer in a way that we've never done before. Congress allowed tax deductibility, as was pointed out.

The fact is that we did have a rise in the real estate values, and the fact is that many people looked for a way to be able to access that equity in order to be able to satisfy some of their needs.

I think that is a very important public policy decision that was made by this Congress, and I don't think it's something that we should retreat from because of the fact that we have problems at the fringe. We can take care of those problems.

I would like to also say that, although the subject is not to be a Fleet Finance hearing specifically, you do have another panel, and I've read their testimony. And I think it's instructive to be able to at least talk to the industry issues that have been raised by Ms. Keest and others in the testimony that you will see, in order to be able to look at those issues through at least the eyes of Fleet Finance, as one company that does business in this industry.

The first is that this industry makes loans at exorbitant interest rates. You might hear that. Also that excessive finance charges are part of this industry.

I'd remind you that the loans of Fleet Finance that are presently on its books, and have been amassed over the last 7 years when rates were higher, and now have come lower, so that you need to look out or back over the last 7 years.

Fleet Finance's Georgia loans, for example, have an average note rate of approximately 14.8 percent, and an APR of 15.9 percent. And I'm going to give you these statistics, and I will be happy to provide them to you with certifications and all of the documentation you need. Because I do not come before this committee lightly as a member of the Fleet Group, and give you statistics that I could not back up and prove to you. So I would mention that. Ninety-eight percent of Fleet Finance's loans in Georgia have interest rates below 21 percent.

The CHAIRMAN. I'm sorry. Would you repeat that again?

Mr. HAMILL. Ninety-eight percent of Fleet Finance's loans in Georgia have interest rates below 21 percent.

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The CHAIRMAN. Let's have order in the room.

Mr. HAMILL. We're talking about a portfolio of 20,000 loans, Senator, and I would like to make sure that we're looking at it through the eyes of the entire portfolio, in order to make sure that again you get the picture of this industry as a whole, not as a result of a piece of it.

Last, on that point, 41 percent of Fleet Finance's Georgia loans have zero lender points.

The CHAIRMAN. Say that again now.

Mr. HAMILL. Forty-one percent of Fleet Finance's Georgia loans have zero lender points, and 98 percent of Fleet Finance's Georgia loans had 10 or less lender points. I give you that because it is often alleged that there are lender points in the 20 and 30 point range in this category. I'll get back to that.

With respect to the allegation that this industry engages in home equity stripping, I'm sure that there are in fact some instances of that. We have heard those from Mr. Drent and others. But let me at least talk to that issue as it relates to the Fleet Finance portfolio in Georgia, because I think it's instructive.

Usually equity stripping means that you have a lot of equity in the house and the loan is a very small dollar percentage of that equity, in order to be able to get at that equity.

Eighty percent of the loans that Fleet Finance has made in Georgia have a loan to value in excess of 60 percent. That indicates that the loans that are being made are in fact substantial in relationship to the equity in that home, not low loans in relationship to the equity.

Fleet Finance lost in Georgia $5 million in foreclosures in 1991, $8 million in foreclosures in 1992, and nationwide, by the way, Fleet lost $24 million in foreclosures in 1992. And when it is often alleged that finance companies, such as Fleet, are in the business of making loans in order to foreclose on the loans in order to make money, I would be hard pressed to have that be a business that we would want to be in. In fact, at a loss of $24 million, it is quite to the contrary.

The CHAIRMAN. Let me just stop you there. I take it, and you correct me if I'm wrong, that the loss that you just cited is on those mortgages on which you foreclosed and which you collected, versus what you have loaned against them. That, I assume, does not take into account the rest of the mortgages where high rates were charged, and the loan terms were fulfilled and there was profit from those. Is that included as an offset or not?

Mr. HAMILL. These are the loans upon which a foreclosure took place, the loss on those foreclosures. And I'm addressing the equity stripping that says that you make the loan in order to be able to get the house and sell the house and make a profit.

The CHAIRMAN. I understand that. Wouldn't it be fairer to say, to really evaluate the profitability of that class of loans at the higher interest rates, and you've given us those numbers, that you have to take all of the loans, those that payout and upon which you earn the profits, and those that default, upon which you've cited the losses. Wouldn't you have to take both sets of loans to really give a full picture of the profitability or loss of that sector of activity?

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Mr. HAMILL. I think you obviously show that in the bottom line of the company, and what this addresses, and what your point, I think, goes to is the bottom line of the company. And yes, you can put those two together to see the bottom line of the company.

The CHAIRMAN. I'm not talking about the bottom line of the company. I'm talking about the bottom line of that classification of loans. Because, in a sense, you're taking a part of the loans that in fact default and where you take a writedown because you've loaned money, and you wash those loans through, and you've posted a loss on the figures that you cite.

I think what needs to be included at the same time is the profit on the other loans that are in that category of loan that are up at a very high level. To be fair about it, you have to do both. You have to talk about what the class of business yields in profitability or loss overall. Then if you want to take the part that has to do with the mortgage losses on those that don't pay out, I think that's appropriate to do. But you can't do one without the other, and give a fair picture.

Mr. HAMILL. Your assumption, I think, Senator, is that all of the foreclosures take place on loans that are taking place at the higher rate.

The CHAIRMAN. I'm not assuming that. I'm talking about these loans that go into these areas, where we think this problem exists.

Mr. HAMILL. I would suggest to you that the foreclosures take place, as Mr. Harshbarger knows in New England, we have had, because of the poor economic climate over the last 4 years, many many thousands of foreclosures in fact. It had nothing to do with where the loan is made, in fact, but rather has to do with the fact that somebody lost their job, and we unfortunately in New England have had a terrific downturn in our economy, and had many people who have lost their jobs.

It doesn't have anything to do with where they live. I think that is in fact part of the issue here, and not a question of the profitability of the piece of the business that is not foreclosed on.

The CHAIRMAN. Let me ask you one other thing while we're on this topic. I'm interested in knowing, and you've got the data there with you, as an example you were using Georgia data earlier, the average outstanding interest rate on that class of loans you cited was 15.9 percent.

Mr. HAMILL. That's the average of all loans in the portfolio.

The CHAIRMAN. And you also said, just to keep the numbers clear, as to what I think I heard you saying, there's obviously some dissenters in the room, but you indicated that 98 percent of the loans were below 21 percent.

Mr. HAMILL. Yes.

The CHAIRMAN. I don't know exactly what the practices are in Georgia. I'd have to tell you, I gag on the theory that there's even one loan in 21 percent or 19 percent or 18 percent. I understand you can take the averages across the board here.

[Applause.]

But correct me, if I'm wrong. If you get outside of Georgia——

Senator SHELBY. Mr. Chairman, can we have order in the hearing room? I think it's gotten out of control. We never have this in other hearings. We're all sympathetic to the people that are being

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preyed on who have been exploited, but we do need order in the hearing room.

The CHAIRMAN. Senator Shelby makes a good point. And it is important that we maintain order in the room. So I would ask that everyone respond to that.

What I'm wondering is this. Is Georgia a State, that because of its State laws, that shows us a profile, even within your lending radius, and other States in which you operate, that would be different than we would see in other States.

If, for example, we looked at your lending in Rhode Island, or we looked at your lending in Massachusetts, would we find average interest rates on this class of loans as high as the numbers you've cited in Georgia?

Mr. HAMILL. Interestingly enough, the interest rates in Georgia are not dissimilar to loans that are made in other parts of this country. And Fleet Finance does business in 26 States in the country.

So on the question of interest rates, you would see a difference, it was addressed by Ms. Keest and others, in the question of broker points and lender points. There would be more regulation in other States. Therefore you might see a difference there.

The CHAIRMAN. Let me just stop you.

So the 15.9 percent, if we were to take State by State in terms of the outstanding mortgages that Fleet has through the mortgage company that would be roughly comparable throughout all the States in which you operate?

Mr. HAMILL. Roughly comparable. There would be some States that would be a little higher; there would be some States that would be a little lower. But roughly comparable.

I looked back at the rate charts and the rate quotes that were used over the years by Fleet Finance in order to see what rates were, in fact, being quoted.

Senator D'AMATO. Mr. Hamill—if I might, Mr. Chairman I am not going to be able to stay throughout.

You have obviously reviewed this situation carefully as it relates, not specifically to one matter that's in litigation, but to the entire area. With the so-called "tin men" and others and people out there, the so-called independent contractors.

What conclusion have you come to if any as it relates to how you, Fleet, are going to conduct your business activities now and in the future? I mean, I recognize that there are some very real horrors and that your institution has been involved by at least being lax and not seeing to it that some guy is getting ten points for originating a loan that the borrower has no chance of ever paying back. You recognize that, right? Yes or no?

Mr. HAMILL. Senator, may I address the question?

Senator D'AMATO. You recognize that there have been these egregious examples?

Mr. HAMILL. We have recognized there have been problems, and we have taken steps. And I would like to address those if I might.

Senator D'AMATO. Good. I want to hear what you have done and what you are going to be doing and what you recommend to be done.

Mr. HAMILL. Let me take those in some order.

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First off, we think that limiting broker points by State law makes sense.

Senator D'AMATO. Shouldn't you be doing that?

Mr. HAMILL. We have.

Senator D'AMATO. Look, if you're paying some guy 10 points, he's going to be out there hustling like crazy. He's going to be selling these people—it's your responsibility. That's outrageous. How many points have you paid for a mortgage?

Mr. HAMILL. As I indicated, we have—if I can give you the statistics again on broker points, it is I think instructive in regard to the issue of broker points. We have 75 percent of Georgia loans had zero broker points. Ninety percent had 5 or less. I would suggest to you also that Florida law, for instance, allows a combination of 10 points, 5 broker and 5 lender points, by State law. So if we were doing business, as we do in Florida, that's accepted.

This is a question of State law. Each State has a different approach. We have taken the approach that notwithstanding the fact that 90 percent of our loans in Georgia—this is Georgia now—have 5 points or less, we will in fact adopt that as our policy. We will allow no broker to come to us with a loan who has charged more than 5 points.

And I would also suggest——

Senator D'AMATO. But that has not always been the policy?

Mr. HAMILL. No, it has not.

Senator D'AMATO. When did you change this policy?

Mr. HAMILL. We changed this at the beginning of 1992. But let me suggest to you, Senator D'Amato, that in fact in Georgia today there are plenty of lenders charging more than 5 points because in other States, by State law, you can charge more than 5 points. But we have taken the policy because, for the very reason that you suggest, even though we think that the problems that are here are the very edge, as I have tried to suggest, the very edge of some portfolios, we don't want to be subjected to the criticisms with respect to being at the edge of anything.

So we have instituted a change in the way we do business, even though many of our competitors do not adopt that change. We also have a rate structure that we think is competitive in today's environment as well.

The CHAIRMAN. Let me ask you this. Isn't it also an acknowledgement that you, in that category, you feel there has been an abuse? It isn't just to protect your good name, it's to protect your good name against a practice that I would assume you've decided in that area is abusive. If the costs get up to that point, it's a bad practice and it's one you don't want to continue; isn't that a fair conclusion?

Mr. HAMILL. No, I don't think it is. But it is one I can see you logically coming to because it sounds—but we are, again, a major banking company. We have spent, and I think Senator Kerry has alluded to this, Mr. Murphy who is our Government relations office, who spends much time in New York, has spent enormous time in the field of community reinvestment. Ron Walker, who is here with me from Fleet Bank of Massachusetts, and many of the people in this room know him. We have spent billions of dollars in trying

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to do what was just talked about, and that is to revivify some of these cities.

I happen to live in Boston, and we are doing an enormous amount. Mr. Murphy lives in New York City. Others live in other cities. We are spending too much to try to do what you're trying to do, and that is help the inner-city, to be at any point criticized for something like this.

So what we said is that our policy in effect will be 5 points, even though those points don't come to us. These are broker points that go to the broker. We are going to take the position that no broker that comes to us will be able to earn more than 5 percent, no matter where we do business, even though the State law allows more than that in other States.

Senator D'AMATO. Let me ask you this. Should the State law be changed?

Mr. HAMILL. I think that the issue of State law is, in my opinion——

Senator D'AMATO. Should there be a cap on brokers?

Mr. HAMILL. I would suggest at least on the basis of the policy we have taken that we would support a policy of a 5 percent cap on brokers.

Senator D'AMATO. Because isn't there something—if you start getting above that 5, isn't there something that's rather out of the ordinary?

Mr. HAMILL. It depends upon the size of the loan, Senator. It depends on the size of the loan. If it's a $100,000 loan, yes. If it is a $10,000 loan, a broker will tell you that he's trying to help somebody get a loan who might otherwise not get credit. Five percent is not an unreasonable amount, he thinks, for the time and effort that he has.

The CHAIRMAN. If I might——

Mr. HAMILL. You haven't allowed me all of my time.

The CHAIRMAN. I want you to conclude. Let us save the rest of our questions.

Senator KERRY. Mr. Chairman, if I may, I have an 11:30 I have to go to. Can the record remain open for submission of questions.

The CHAIRMAN. By all means. Let me just ask Mr. Hamill how long he has. I want him to finish and we've interrupted him before he's finished. You should be given the chance to finish and I want to do that now.

Senator Moseley-Braun wants to make a comment and others may as well. Mr. Hamill, why don't I give you—what do you need?

Mr. HAMILL. I am not sure how much time I took, Senator.

The Chairman. Why don't you take 2 or 3 minutes and then we'll go to questions.

Mr. HAMILL. I would appreciate it.

The CHAIRMAN. Senator Domenici, I will acknowledge you but I don't want to get into further discussion until he finishes.

Senator DOMENICI. Mr. Chairman, I have expressed my views on the seriousness of the problem and I can't stay. But I want to suggest that the heart of this problem is redlining. Because if we didn't have redlining, there would be more money available in ordinary ways and I would hope that we really get to the issue. While this is a major problem, it is a residual problem to the extent of

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I don't know what percent, 50, 60, 70 percent. Conventional bank loans don't have 20 points. If we can't get money into these areas, these kinds of problems are going to proliferate.

The CHAIRMAN. Let me say, Senator Domenici, we are having a hearing on precisely that subject next week, because all of these issues fit together.

Mr. Hamill, why don't you go ahead and conclude.

Mr. HAMILL. I finished on that last number, the 90 percent of the brokered loans that we do business with on Fleet Finance had 5 points or less. Let me go on to the issue of foreclosures in general.

It is often said that the consumer finance companies foreclose—and at least it has been said about Fleet Finance—on thousands and thousands of homes. The number is, in 1991 and 1992, Fleet Finance foreclosed in Georgia on approximately 530 loans in each year out of 20,000 loans in the portfolio.

The CHAIRMAN. 530 out of 20,000 in what quarter?

Mr. HAMILL. About 2 percent per annum. And we have compared the 2 percent to the national average, and it is right in line with the national average.

We have also looked at the race of the borrower upon which foreclosure has taken place, where we can tell that race of the borrower, because we don't always know what the race of the borrower is. But where we do know it, half of the foreclosures have been on people who are black and half have been on white.

The CHAIRMAN. Do you have numbers prior to 1991 and 1992?

Mr. HAMILL. They're smaller because the portfolio had been building up.

The CHAIRMAN. Did the percentage go down too?

Mr. HAMILL. It stays around 2 percent. But it is not enough to make a big difference because the denominator and the numerator both go up.

The next point I would make is that it is generally argued, and I agree with Ms. Keest, that if there is a loan made where the debt-to-income ratio of the borrower is out of line, we should never have made that loan. We have done some of those. They've gotten through. We buy some loans in bulk and we didn't do a good enough job.

But let me give you at least a sense of what we have. Generally the criteria is the debt-to-income ratio should not exceed 50 percent. But 62 percent of our borrowers had debt-to-income ratios of less than 40 percent, 62 percent. Seventy-eight percent had debt-to-income ratios of less than 45 percent, and 95 percent of the borrowers have debt-to-income ratios of less than 50 percent. If it is over 50 percent, there is either an explanation or an error. We have made errors; we are not perfect. I can give you the percentages going up.

But because we think very strongly that you have to be able to repay the loan, and as I mentioned the loan values here are not equity stripping, because we have made higher loaned values than has been alleged in the past.

I would say to you also that our debt-to-income ratios here are, I think, a critical policy issue for you to think about. Representative Kennedy in the hearings in the House suggested that maybe there should be a 40 percent debt-to-income ratio as it relates to

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the question of this issue. Mr. Harshbarger indicated that banks should have flexible lending guidelines.

I have worked with the Massachusetts Affordable Housing Alliance and others to try to come up with those flexible guidelines. There is a question on the table. That is, how flexible should one be, and is it right to have a loan made on debt-to-income ratios in the 40 to 50 percent range?

I say, yes, because as much of a tragedy as the foreclosure of anyone's house, and we hate it because not only is it a personal tragedy, but people lose money, I would say to you though that for the 98 percent of the people who could borrow that would not otherwise be able to borrow because of poor credit histories, who could not walk into a bank because of their prior credit history, it is most terribly important for them to have access to credit.

With respect to the issue of targeting minority neighborhoods, I have given you the foreclosure numbers. Half of our foreclosures are against whites, half of our foreclosures are against blacks. If we were targeting, that would not be the case.

We have stepped up to the plate, and I am going to finish by just saying what we have done. We have stepped up to the plate. I have said we do not want to be associated with any part of a fringe industry. We want to be in the mainstream. We have put on the table for those people who have been harmed in any way because of inadvertence, because we have missed some loans that are outside of our policy, that we have not done something that we should have done. We stepped up to the plate not because we have a legal admission of guilt but because we wanted to be good corporate citizens. And it has been thrown back in our face because we put a $38 million program on the table to help people that have had problems.

It is thrown back in our face by class action lawyers who say we cannot institute that program because they want to bring a class action. We have offered to give a release to anybody who comes forward under this program in order to be able to make sure that they are not losing any legal right under a class action and we have been told, no, we will not allow our clients to deal with you.

Now, before the class action lawyers got involved, we had been able to help 700 people who had been having a hard time making their payments and they have come to us and we have worked with them, and are willing to continue to work with them.

Finally, I would say, that in terms of the recommendations, I like Senator D'Amato's notion of being able to give even better disclosure. I like the licensing issue with respect to the brokers so that you limit the points brokers can charge. I like stricter licensing of home improvement contractors because I believe that many times the problems start here, as Mr. Harshbarger indicated, with the home improvement contractor. I don't think that the banks and the finance companies can estimate values and that's what winds up having to happen when the loan is made, if the value of the home improvement isn't what it was supposed to be, it is impossible for the bank to be involved.

Finally, I would say that as far as Ms. Keest indicated this, I think consumer education here and better disclosure is in fact, and I am not for doing away with Truth-In-Lending, in fact, the way

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in which we—this company discloses its loans under the Truth-In-Lending Act, we are all for it, we would like to see it enhanced, and we would hope with better education that will help. In fact, people who do not understand what it is that they are getting into.

The CHAIRMAN. As we start the question period, I am mindful of the fact that we are moving along in the morning and we've got another panel coming.

I am going to yield my question time initially to Senator Moseley-Braun who has not had a chance yet to make an opening comment. Let me just start with you and then we will go to Senator D'Amato, and we will go in the normal order.

OPENING COMMENTS OF SENATOR CAROL MOSELEY-BRAUN

Senator MOSELEY-BRAUN. Thank you very much, Mr. Chairman. I am going to ask that my opening statement—instead of reading it, I am going to ask that that be submitted for the record. Because, quite frankly, all the general things I was going to say in an opening statement have been overcome and overwhelmed by the testimony that we have heard.

The CHAIRMAN. Without objection, so ordered.

Senator MOSELEY-BRAUN. I am particularly taken by Mr. Hamill's testimony. That is most of what I have heard. And the apparent inability to understand how it is that what Fleet does and these other companies that we are looking at really has the effect of enforcing a tax on poor people. It is a tax that is all too often enforced on people who are black and brown.

I listened to your remark when you said "half of our foreclosures are black, another half are white." The fact is that the African-American population and the Hispanic population are, by definition, minorities. So you are talking about 50 percent of your foreclosures on 10 percent of the population, which is very different from 50 percent of 100 percent of the population. That has a disproportionate impact on people who are black and brown.

The second point to be made that should just be very evident, and this gets in part to what Senator Domenici was saying, is that your company steps in where the majority of companies will not lend. We have already seen the HMDA study, the study that reported that black and Hispanic mortgage applicants in the Boston area are roughly 60 percent more likely to be turned down for a mortgage loan than whites. That's geographic redlining.

But I want to submit that what we are looking at here is economic redlining as well, that it goes beyond just geography and that it really does go to people who literally have nowhere else to turn and they are preyed upon by companies that will make 21 percent because they can. That's what we are looking at is the situation in which people are subjected to lending practices because they have no options. There is something terribly wrong with that. And I would daresay, quite frankly, our failure to look at specific legislative solutions to this area which we have known about—I mean, this is not new news.

It is just worse now because of the economic downturn that we've just come through. These practices have been going on for quite a while now. They have been exacerbated by the recession that we have just come out of, but they are not new.

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Quite frankly, Mr. Chairman, I would very much like to hear from the other witnesses specific proposals for change, what we can do to fix this. Because 21 percent, you testified Mr. Hamill, that 98 percent of your loans were under 21 percent. It is terrifying to me what the other 2 percent might have been.

But even more to the point, that is no benchmark when mortgage rates have not been in the double digits for over a decade.

Second, I daresay without listening to your testimony you did not testify specifically in terms of your finance charges, your late fees, the time of turnover on these foreclosures, those kinds of things that are particularly hard for a family to deal with when someone loses their job, when there is a recession, or whatever.

All of this in my mind, Mr. Chairman, comes down to a poverty tax. It comes down to an anchor, a weight, that we have failed to lift if we haven't been responsible for putting it there in the first place. We have failed to lift it on people who really have nowhere else to go. Literally the boats that are stuck at the bottom are stuck there in large part because of practices like this.

I think we have an absolute moral obligation to move quickly on addressing specific recommendations for change and what we can do to make certain that this kind of activity ceases immediately.

Thank you.

The CHAIRMAN. Thank you.

Senator D'Amato.

Mr. HAMILL. Senator, I appreciate your comments, but if I might, just on a couple of points?

One is the rates that I was talking about, that 98 percent are below 21 percent, are as a result of a portfolio in Georgia that has been built up over the last 7 years. Yes, the interest rates today are much lower than they were. But as you look back over the period of the last 7 years, you will find that in fact interest rates have come down substantially. So it is part and parcel with that.

Today the interest rates are lower and, in fact, the rates that this company makes range from 9.9 percent up to, at this point in time, about 14 percent. It is a different rate environment.

I am giving you a picture of a portfolio, not at a point in time.

Senator MOSELEY-BRAUN. OK, Mr. Hamill. I was going to skip over asking all the questions that I had. But let's talk about that. You talked about an average interest rate of 14.8 percent. What is your high?

Mr. HAMILL. As I indicated, there are 2 percent of the loans over 21 percent. The highest rate that I can see in that portfolio is I think a loan of about 28 percent or 29 percent. Again, it never should have been made. But when I look at those loans and I look back and wonder why those were made, those were mistakes. And I have said—when you look at 98 percent or 99 percent of your portfolio being in what are, I think reasonable rate ranges, I am not here to say that we're perfect. But I am here to say, let's make sure we keep it in perspective.

The CHAIRMAN. Senator, if you will just yield for one minute, if I may say, because I don't want that to pass, I think an average—I heard two numbers, 15.9 percent and 14.8 percent.

Mr. HAMILL. 14.8 percent is a note rate, and 15.9 percent is an APR.

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The CHAIRMAN. The annual percentage rate average. I have to tell you, and I appreciate the fact that you have changed your practices and you mentioned that today, so you are not doing things the way they were done in the past and you have acknowledged that mistakes were made along the way. I think that's direct and forthcoming.

I've got to tell you that 15.9 percent on average as an APR bothers me. It bothers me and it ought to bother you, quite frankly.

Mr. HAMILL. Can we speak about that, because I think it's a very important issue.

The CHAIRMAN. We're talking averages right now. That means half of them are above that average.

Mr. HAMILL. What I am trying to do is put it in perspective with the 98 percent in order to not just give you an average. Because I understand that averages can be misleading. Therefore, I am giving you the 98 percent below.

In 1986, the rates of this company, not different from rates that were done by consumer finance companies—and this is not a fringe industry. The Household Finances and the Beneficials. These are companies that have been in business for 50 to 60 to 100 years. But the rates in 1986 ran from about 15 percent to 18 percent, depending upon the credit of the borrower.

Now, I would say to you that if a person has a credit problem and a credit history that makes him unable to go into a bank and borrow, unable to qualify for a credit card and is able to bring down their monthly payments to a level that is affordable to them, and needs the money to be able to pay for something, whatever it is that they want to pay for, that is the going rate.

I would say to you, I'd like to be able to lend to everybody at prime rate. But that is not the way the economic system works.

The CHAIRMAN. I understand exactly what you're saying. But I think there is a part of the story that has to be added to that that's critical here. And if you don't add it, then it's a lopsided story.

The fact of the matter is that traditional lending institutions have redlined certain areas of the community. We know this in the urban areas. The Federal Reserve has given us a study about discriminating against people based on race. And it is a very pronounced pattern.

When somebody can't go and get a loan who is creditworthy in the normal system and they are pushed out of the normal system into this secondary kind of a system where the mortgage lenders who have been around for a long time, as you say, 15 to 18 percent, they're being price gouged because they are being denied credit where they should be able to get it and I understand how that system works.

But I don't want to put a gloss of attractiveness on it or of acceptability on it, because it is very troubling to me and I think frankly it has hurt this country.

Now, you've got to take both halves of the problem. The fact that there were rates out there at this level, 15.9 percent, that's the average. So you got half the people on the APR that are above that level. Or I should say half the average is above that level.

Mr. HAMILL. Let me, if I might—these are second mortgages, these are not first mortgages. Although, as Ms. Keest said, some

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of them technically are first mortgages. But they are not purchase money mortgages. These are mortgages that are in the truest sense of the word second mortgages.

Second mortgages in banks, just as in finance companies, carry higher interest rates than they do with first mortgages. You cannot compare first and second mortgages.

I am very familiar with the question of the redlining issue. But here is an industry, in fact, that is not redlining and I don't think it's reverse redlining.

As we look at the statistics of this particular portfolio that happens to be Fleet Finance in Georgia, which has in Fulton and DeKalb counties a high percentage of people of color, I think it is usually viewed as a city that has done a great job with race relations by the way, and a model for many parts of the rest of the country.

The fact is that our portfolio reflects a split along the lines of the population mix in Fulton and DeKalb counties. Therefore, I would say to you that, one, there is no redlining going on in this company. Second, I would say to you that the people who are borrowing, even if the banks were doing business in some of the neighborhoods where some of the people who are borrowing might live, the credit history of the borrower who comes to a consumer finance company does not make that person qualified for a loan. And I have dealt with this on the bank side.

Let me put my bank hat on for a moment. We have struggled with this and Mr. Harshbarger knows that, Senator Kerry knows that. We have been pushed and I have tried to push to get Fannie Mae and others to take loans, and you have had hearings on this, that are beyond the traditional debt-to-income ratios that Fannie Mae would use or FHA uses and try to get them up if you will. They won't do that usually unless there is some kind of a subsidy that comes from the Federal Government.

My point here is simply that these are borrowers, whether they be white or black, who are not able to go into a bank and borrow because of their credit problems. And I think they still, from a public policy standpoint, they deserve credit. They should have access to credit. And I think that the rates that are charged are reflective of the cost of the credit, the borrowing, and the servicing costs.

The CHAIRMAN. If you will just withhold for a minute, Senator Moseley-Braun, do you have one other comment? Then I want to go to Senator D'Amato here because I've actually given you my time and I've interrupted you. Do you want to finish? Then I am going to go to Senator D'Amato.

Senator MOSELEY-BRAUN. Thank you, Mr. Chairman.

I am glad you asked the question about the high average. I wanted to specifically ask Mr. Hamill just on a small and very specific note, will you revisit that 28 percent mortgage and rewrite it for those people?

Mr. HAMILL. In fact, we have a program—I don't know if you were here when I mentioned it. We have in fact on the table a $38 million program, $25 million of which is intended to do just that. We have said to people who have rates that got through our screen, come in and we want to do just that.

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Senator MOSELEY-BRAUN. I don't mean them come in. If you know who those people are because that's in your portfolio, will you reach out to them and rewrite those mortgages?

Mr. HAMILL. In fact, we have tried to do that. We have been thwarted by the class action lawyers from continuing to do that.

I am more than pleased. We don't like the fact that that got through our screen. We're not perfect. We've said that we got 98 percent of our loans that we think at least have gotten through, but that's not acceptable, that 2 percent or 1 percent or whatever the number is that have gotten through the screen. We want to rectify that. So, yes we will. I would hope that I will be able to get through the legal entanglements in order to be able to do just that.

Senator MOSELEY-BRAUN. Your points and finance charges, do you aggregate those? What are they? Are they aggregated and become part of this foreclosure package?

Mr. HAMILL. As you know, the lender fees are part of the APR, so they are included in the APR.

Senator MOSELEY-BRAUN. That's the 15.9 percent?

Mr. HAMILL. That's the average, 15.8 percent. When I look at the portfolio——

Senator MOSELEY-BRAUN. I think you've got me where you got the Chairman a moment ago. It's 14.8 percent interest, 15.8 percent APR.

Mr. HAMILL. And that goes to the question of the calculations under the Truth-In-Lending, which is the way in which we disclosed to the borrower what is the cost of the loan. As I mentioned to you, 98 percent of the loans that we make have 10 points or less.

Senator MOSELEY-BRAUN. But what about your finance charges and your late fees?

Mr. HAMILL. Those are the finance charges the lender——

Senator MOSELEY-BRAUN. Do you have a separate category of late fees?

Mr. HAMILL. On late fees we do. If I could ask one of my colleagues, I don't have a specific on what the late fee is.

[Pause.]

It's usually 5 percent after 10 days, I'm told. I do not know that.

Senator MOSELEY-BRAUN. Five percent of what?

Mr. HAMILL. Of the payment due. If you owed that month $100 and you went 10 days, it would be 5 percent of the $100; it would be $5.

The CHAIRMAN. If I may, I think I've got to now yield to Senator D'Amato so we stay within the time constraints here.

Senator D'Amato.

Senator D'AMATO. First of all, I have to say, Mr. Hamill, I hope you can continue to reach out, as you've indicated before, and Senator Braun has indicated, to those people who have been victimized and who have gotten through the process and through the system. And their counsel would do well to permit that, and they can continue their suit. But they should not be so driven by their own interests that they disadvantage people that can and should be helped.

Second, it would seem to me that where you have built up tremendous costs at these kinds of interest rates, which are truly excessive, that there would be a forgiveness of those interest rates

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that have accumulated, a certain forgiveness, a recognition that 28 percent or 25 percent or 21 percent is absolutely out of line. And certainly, in the cases where it can be clearly demonstrated that people would never have the ability to make the payments given their income, that that recognition should be taken into consideration so that it is not just a matter of taking a situation and saying, well, you owe us $50,000 with the accumulated interest, et cetera. Now we will just stretch it out and give you a new and lower interest rate.

So I hope there is some kind of reasonable attempt to do that. Because I think that then demonstrates that you are on the cutting edge of doing the right kind of thing for the right reasons. And I certainly don't question your motivations as it relates to that.

I would like though, very much, because he has been a leader, to ask the attorney general, Mr. Chairman, Mr. Harshbarger—it's good to see him here—I didn't think that earlier I would be able to come back and see you again, Scott, in this capacity. So I am delighted that I am able to be here to ask you that question. Someone else wanted to do that.

What legislative remedies do you believe should be initiated on the Federal side? In our bill, we call for a Federal study, for example, of certain things such as should there be a cap on brokerage fees and commissions?

I don't know whether there should or shouldn't be or what the cap should be. I think we should get the regulators to give us that information.

But you have been a pioneer in this area along with Senator Kerry, your predecessor. So consequently, what would you suggest coming from the State side that you think the proper role of the Federal legislation should be in this area?

Mr. HARSHBARGER. We made a number of suggestions. Many of them are geared to State regulation. But the biggest thing that we heard from all of the industry at various times was the lack of uniformity and consistency, that things would vary from place to place, and therefore those who chose to be unscrupulous could always fall back upon. It was vague, it was technical, it was overlapping, it was duplicative, there's too much regulation. And those who tried to comply were having difficulties.

So one of the most interesting things for us about the regulations that we have the power in Massachusetts to issue under our consumer protection rates was we had long hearings with mortgage companies, with banks, with brokers, and the vast majority of the industry proposed most of the provisions that are contained in our regulations that have everything from fair and simple disclosure langauge, multilingual translation requirements, documents in other languages, interpreter services made available, assistance provided to people for mortgage transactions to issues such as how you do define APR, what points you can charge, what you cannot charge, what it should be.

We suggested a cap on the rates that would be some percentage in excess of the prime rate. The details of those regulations addressed many of the kinds of problems that people addressed. And I felt consistently, Senator, that it would have been very helpful to

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have had a Federal umbrella framework like Truth-In-Lending. We kept coming back to people saying, make it like Truth-In-Lending.

The only point I want to make is not in defense of Mr. Hamill, but was that we found that if we could have had the protections applicable to banks available to the victims, we would have had remedies. That was the biggest difference.

In this other world of consumer finance, the protections available under banking to banks were not available if you took your mortgages and loans from others. That was a very frustrating situation. A lot of our regulations and rulings were related to that. The second is your CRA looks that you're doing in terms of what is reasonable to expect of banks.

But I would urge you to include in mainstream financial institutions legitimate first and second mortgage companies as well. There is no particular reason I could see that they should be excluded from these areas of regulation and control.

Senator D'AMATO. Mr. Chairman, I want to thank you, and I certainly thank the attorney general for his comments and his work.

Mr. Hamill, we thank you for coming forward today and making yourself available. Obviously I think you go a long way when you do indicate that there are certain abuses that have taken place.

Now the question is how do we address and provide a remedy for those people who have been victimized, and what actions should we take to minimize future victims.

I think Senator Domenici and the Chairman made a point. This is going to take place as long as there is not sufficient capital that can and should be made available to creditworthy people.

I'll make one other aside.

I don't believe, Mr. Hamill, I don't believe, and this is the genesis and the core of my disagreement with the administration and others when I proposed caps on credit cards, that everybody should be encouraged to borrow.

I think it's wrong. I think it's absolutely wrong. When you get into this business and say, oh, well, look, people who are poor should be given credit. Let me tell you, if they don't have a possible chance of making the payments, you're going to enslave them, and it is wrong. Financial institutions should not do that.

And then what you do is, you play—and I'm not saying you, but I'm saying this is the argument—you mean you would deprive people of credit that otherwise—you're doggone right.

If a person is loaded up with bills, has got a family to support. Loan sharks do that. The guy's a gambler and he's desperate, and they say, OK, we'll loan you $1,000, and you've got to pay us x percent a day back. We're not helping people.

And I'm not coming down on you, but I just heard that doggone argument from the last administration, from the banks that came out and said, oh, no, credit card interest rates are wrong, because you'll deprive the very people who need it most. That's nonsense.

At some point in time, you've got to take a look and see, does a person, can they pay it back. And it's not wrong to say to them, we're not going to make it available to you. We'll work with you.

So I just have to say, Mr. Chairman, we too have a responsibility of being able to say that in certain areas, if you make credit avail-

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able to people that have no chance of ever paying it back, that is wrong.

And I'll tell you, Fannie Mae shouldn't back you up, and Ginnie Mae shouldn't back it up, and the Government shouldn't back it up, because then what you're going to do is, you're going to have the taxpayers paying for those defaults.

We've got to come to some kind of a reasonable balance in this.

I thank the Chair.

The CHAIRMAN. Thank you.

Senator Shelby?

Senator SHELBY. Thank you, Mr. Chairman.

I believe this helps make a case before the committee for something you've had hearings on, Mr. Chairman, on why we need community development banks around to help people that are the most vulnerable, in ways in which they won't be exploited.

I'm one Senator that's very interested in lifting the regulatory burden on banks in America in certain areas.

But a case like today doesn't help that much. Because none of us are interested in lifting the burden on regulation if lack of regulation in an area is going to help exploit the most vulnerable of our people.

A lot of these loans, a lot of these people that we've seen horror stories here and know about, a lot of people would be much better off if they had never taken a loan.

If I were a lender, Mr. Hamill, I would be very very careful of buying loans from people in the market. You know, most lenders do, especially where they're second mortgage loans on older people and poor people.

But there are horror stories here that we've read about where an elderly man 75, 76 years old has something done to his house. He has some remodeling done, with the money he receives from a loan and his payment exceeds his monthly income.

If I were buying the loan as a lender, I would look at the credit report of the borrower. And if the loan called for 27 percent interest, or 22 percent interest, I would look at the ability of the borrower to pay back. I also wonder if there was fraud involved here.

I don't want us to regulate lenders any more than they have to be regulated. But perhaps, if people are going to be exploited like this, this is an area that we're going to have to look into, nationally, and State by State.

I'd be interested in the documentation. If lenders, finance companies, home remodeling companies, are unscrupulous in the way they get borrowers to sign up, I would like to see how. Is it the documentation? Are the papers fraudulent? Do people know what they are signing? How do we police this?

How do you police it, if you were to buy these loans later? You assume that if you buy them on the market, that is what these borrowers assume, that everything is on the up and up. Many of these borrowers are desperate—perhaps they are elderly and in need of cash, perhaps they are simply uneducated and do not understand sophisticated loan documents. Some of our consumer protections are too sophisticated to actually protect consumers. We need to simplify the paperwork burden, both for lenders and for borrowers.

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I hate to see Government micromanagement. But to protect our most vulnerable, the Government may have to get involved.

Some lenders are obviously exploiting these people. I'm not saying whether you are or not. But why can't lenders police this problem in some way? If they can't, Government's going to step in.

Do these people need access to credit? Obviously, they need access to credit.

I would be interested to know, Mr. Hamill, since you are the spokesman and an officer, what is your profit margin in the area of second mortgage loans? How does it compare to credit cards?

You know, the Senate reacted to credit card interest rates. I know there's a lot of credit card losses, but rates have been unreasonably high. It's also a very lucrative business; we all use credit cards. I understand that. It would be better if each person paid his bill every month. Not everyone can pay his bill off each month. I would be very interested in seeing the profit margins of these businesses. Do you want to comment on that?

Mr. HAMILL. I want to be careful. Generally the rates on credit cards over the period we're talking about have generally been higher than the rates over this last 7 or 8 years. We're into a lower rate period. Many times during the period, rates would have been higher on many of the loans that were being made in this portfolio.

Yes, there are losses, but the credit card business has been a good business for banking over the years. It in fact has produced profits for banking. So I would say that in general, I would say that the credit card business has been more profitable for banks.

Senator SHELBY. Than second mortgage lending?

Mr. HAMILL. Than second mortgage lending.

Senator SHELBY. What is the loss ratio in your portfolio, just being generic on second mortgage loans?

Mr. HAMILL. The foreclosure rate, as I mentioned, in Georgia is around 2 percent.

Senator SHELBY. The foreclosure rate is not always indicative of a loss though, because you've got collateral. A home, a piece of property, and there's equity in that home and you're looking at that as part of your collateral, are you not?

Mr. HAMILL. Yes, we are.

Senator SHELBY. And you recapture that?

Mr. HAMILL. I'm saying, even after you go through the process of a foreclosure, nationally in this company, we lost $18 million, and in Georgia we lost $8 million.

Senator SHELBY. You lost $18 million out of the whole operation?

Mr. HAMILL. In the foreclosure process.

Senator SHELBY. As an offset of how much profit though?

Mr. HAMILL. Again, I think that the issue isn't profit. If you look at the company as a whole, it is a company that has generally provided about 10 or 11 percent of the Fleet Financial Group's earnings.

As you well know, a higher percentage in 1990 or 1991, as New England banks went through a terrible time, almost no profit this year in 1992.

Senator SHELBY. But a lot of your own testimony on Fleet Financial's offices are located in Atlanta, GA, and they do a lot of business in the South, where I am from too, don't they?

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Mr. HAMILL. In fact, we do business all over the country. We have, as I mentioned, the principal assets of the company, if you will, though, are the banks in New York and New England.

Just on an employee count basis, if you will, there are 27,000 people who work for Fleet Group throughout the United States. There are a thousand people who work for Fleet Finance throughout the United States. So 1/27th of the employee count of the whole Fleet Group of all companies is made up of the people in Fleet Finance.

Senator SHELBY. Let me ask you a question like this.

Assume you make a second mortgage loan to me, for example. And I have a home in Tuscaloosa, Alabama, which is my home. And whoever, if I'm dealing directly, you'd go out there and do at least a windshield appraisal of the house and the property for a second mortgage loan. You'd check to see if I have a first mortgage lien on the property, and how much it is. That's part of doing business in making a second mortgage loan, is it not?

Mr. HAMILL. Yes, it is.

Senator SHELBY. For example, if I had a piece of property that might be worth $100,000 on the market, then I owned say, $10,000 or $15,000 on an old mortgage that I was paying off on my home, which is typical, and you came in and loaned me $40,000 to fix up the house, so to speak, and give me some walking around money or whatever, you're looking at the equity in that home that you're protecting yourself by making that loan and putting up the mortgage on the equity. In other words, you'd be fairly well covered, wouldn't you?

Mr. HAMILL. I think the most important point, though——

Senator SHELBY. Isn't this important? You make a second mortgage loan because you believe that it is relatively safe; a loan on a person's home, when they have equity there, is relatively safe. Isn't that part of the criteria?

Mr. HAMILL. Senator——

Senator SHELBY. Answer my question. Isn't it part of the criteria?

Mr. HAMILL. It's part of the criteria. The first criteria, though, is whether or not you have a job and whether or not you have the income to afford the loan that you want.

Senator SHELBY. What about some of these horror stories where a man who is drawing Social Security and had equity in his home, but the loan payment exceeded his monthly income. It looks like a credit report would pick that out. And if you were a prudent lender, you wouldn't loan.

Mr. HAMILL. It shouldn't have been done. As I indicated, we are not—and, again, I go back to the statistics in this company with respect to the debt-to-income ratios that have been used in making the loans—62 percent of the borrowers in this company have debt-to-income ratios below 40 percent.

The general criterion is to not go over 50 percent. We've gone over that. Sometimes somebody has got some other assets. Sometimes it's a mistake. We buy loans in bulk.

Senator SHELBY. Let me ask you this. Let's assume that same scenario a minute ago. Let's say I or anybody, these people in here from Georgia, let's say they had a home that had $15,000 owed on

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it. The property you appraised was $100,000. They wanted to borrow $25,000. Do you take in the amount of equity in that house, the risk when you formulate the interest rate they are going to pay? Or do you have a standard interest rate for a second mortgage loan?

Mr. HAMILL. The better the credit of the borrower, you want to make sure, first off, what the credit of the borrower is. That person's going to get the best rate.

Senator SHELBY. And is part of the credit the collateral?

Mr. HAMILL. You're going to look at both the income of the borrower and the collateral.

Senator SHELBY. How important is the collateral?

Mr. HAMILL. It is of secondary importance. It is not of primary importance. It is clearly a piece of collateral that we don't want.

Senator SHELBY. Without the collateral, you wouldn't make the loan, would you?

Mr. HAMILL. The second mortgage business has grown up in this country, as I indicated, because of the fact that people wanted access to the equity in their homes to be able to borrow.

But the most important thing in our case is, every time we foreclose on a home, it is both a personal tragedy and it is a loss to us. We lose money through the process of foreclosure.

Senator SHELBY. You don't always lose money, because if the collateral is there, you don't lose money.

Mr. HAMILL. In other words, my point is, though, as I look at the entire number of foreclosures that have been done, there may be some that there is in fact enough equity to cover, but when I look at all of the foreclosures, we lose money.

The second thing is, the foreclosures that have taken place since I've gone back and looked at the records, the reasons the foreclosures have taken place has generally been because people have lost their jobs, because of the economic conditions.

Senator SHELBY. Why do people in the lending business—I know you've got great folks, and I assume you're one of them, I just assume that—but why do they gouge and exploit the most vulnerable people in America?

Mr. HAMILL. I would suggest, Senator, that they do not.

Senator SHELBY. But there is evidence that they do. I don't say the overwhelming majority of evidence. There is evidence here, sir, that there is overwhelming exploitation and gouging when you're charging 28 or 29 percent or 24 percent to the most vulnerable. There's a lot of fraud there.

I'm coming at you with an idea to deregulate, but you can't deregulate this kind of stuff.

Mr. HAMILL. I'm not suggesting that you deregulate Truth-In-Lending. I'm not here to say that.

Senator SHELBY. Truth-In-Lending sure didn't help these people, because a lot of them didn't understand that. Maybe it wasn't explained to them.

Mr. HAMILL. That goes to the question of education.

I'd make two points.

One is, I have not, and I'm sure you've seen a lot of different entities, whether it be businesses or other kinds of entities, I've found no entity that is perfect, but as I look at the portfolio of this com-

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pany, I am saying to you that we have a very small number of people where we missed it. We bought a package of loans and we didn't do the job, but it's a very small.

I would urge you, as we talk about this, that we have 98, 99 percent of the customers that are being well-served, and I want to make sure that 100 percent are. And we're taking all the steps we can. We've taken further steps to change the way in which we buy loans. We're dealing directly with the broker now, even though the business is generally done through correspondence.

Senator SHELBY. I know my time's expired, but shouldn't you bend over backward when you're dealing with the most vulnerable of our population, those that are under educated people, those that are desperate for money, not to exploit them?

Mr. HAMILL. Yes, I agree with that. Absolutely. We have, as a company, and as I indicated earlier, we're spending billions of dollars trying to help rebuild the cities of America. That I would suggest to you indicates that the ethical nature of this company is high.

Senator SHELBY. But you don't want to rebuild it on the big profit margins you make off of these people, do you?

Mr. HAMILL. Not at all. What we want to do is make sure that if there is an error, that we correct it. And we're taking those steps.

Second, I think we want to make sure that in the context of this business, that it is done without having to come to the Federal Government for subsidies in order to make it work.

And if it means that we cannot provide credit to people who are at the upper end of the debt-to-income ratio, then we will not. Those people, going to Senator D'Amato, and perhaps your comment also, maybe there are people who should not be borrowing here. We thought we were doing that by limiting the debt-to-income ratio in this company to 50 percent.

Maybe it should go down lower. We will do that if in fact that seems to be the way in which we can best get to the issues that you're talking about, because it is not worth our effort and time to be in a business where, even though it might be doing some good for an individual who would not otherwise be able to borrow, it's not worth it for us to be accused of trying to rip off people.

So we will move that down the scale, and make sure that we are in fact not going to be accused of that in the future.

The CHAIRMAN. Let me just say on that, Mr. Hamill, we're going to help you do this.

[Laughter.]

That comes to the point, too, where you've got to put your banking hat back on. Because we think the banking side of a lot of major entities in this country who enjoy Federal Deposit Insurance, and access to the Fed window and other certain Government granted assets and help, have to do a better job of coming in there through the normal lending institutions.

You're here in a dual capacity and you've explained that, and we understand that.

I think, if the normal banking system were doing a better job, I mean, the education problem here isn't just educating people in the inner cities, it's educating people that run a lot of these financial institutions, isn't it?

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Mr. HAMILL. I would say, Senator, that we've all, as we've spent more and more time in the inner-city—and I am one who has done a lot of that—understand that we have to try to go to great lengths in order to bring the resources of the financial institutions to the inner-city. And we have worked, as you have, with Fannie Mae and others to try to make that happen.

The CHAIRMAN. We're going to do more in that area.

Mr. HAMILL. The President of the Fed testified before Representative Kennedy. He said the balance here is the balance between access to credit and appropriate guidelines. We're all searching for that.

We do it in the banking business through ratios, debt-to-income. They're not perfect. We're not saying they're perfect. But they are proxies, the best proxies that we know.

We're trying to make sure that nobody tips over here, that nobody goes through. People do get through the safety net. We're here to try to help them if we can, and that's why we've put this program in place. And we're here to work with you in order to get that right balance.

The CHAIRMAN. You've acknowledged today that you've changed the practices within the institution. You've made changes in your practices.

Mr. HAMILL. We have, even though our competitors have not changed, to be able to be sure that we are at the leading edge of trying to make sure that people don't slip through, because they have.

You will hear testimony from Mrs. Diggs. That loan should never have been made. And we bought it in a package, and I'm sorry that it ever got through the package. But it's not representative of this portfolio.

The CHAIRMAN. We'll get to her very shortly.

Senator Boxer?

Senator BOXER. Thank you very much, Mr. Chairman.

Mr. Hamill, I really appreciate your trying to put the best light on some of the things you've done but some of your comments disturb me.

You said that maybe there are some people who don't deserve credit, you said this as a kind of veiled threat.

Mr. HAMILL. No.

Senator BOXER. Excuse me, sir.

You'll have a time to respond.

Not a direct threat at anyone, but sort of a veiled threat from the industry that if we don't lay off then no one will have any credit. That was what I heard.

Maybe you didn't mean it. I'm telling you that's what I heard when you said, I believe, "this isn't worth it."

Well, you're darn right it was worth it. You're talking about a portfolio that averages 15 percent and some loans as high as 28 percent. It was worth it for Fleet. You have a very small default so sure it was worth it.

And, you know, we're not perfect. I say that a lot. I'm not, you're not, no one is. But this is the business you're in so I don't accept the explanation that these high percentage loans got through your screening process.

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How could you let a 28 percent loan get through the screening process? What did you pay for that money that you're charging 28 percent? What did you pay? Nine percent, 8 percent? Do you have an answer? What did you pay for that?

Mr. HAMILL. If I might, the year in which that loan was made, I would estimate that the cost of money would have been in the 8 or 9 percent range.

Senator BOXER. Eight or 9 to 28 percent, and it got through the screening.

I'm not a person that likes to set caps on things, because I come from a free market economy. I was a stockbroker. I don't like to set limits. But I think what Mr. Shelby was getting at—and I know he doesn't like to do it either—is that in the face of such outrageous behavior it's almost impossible not to consider having the Government impose some limits.

Is there no shame here? Is there no conscience here? I have a lot of problems with the way Fleet conducts business.

Now how many homes did you actually take over that defaulted and then were sold?

Mr. HAMILL. Five hundred and thirty in Georgia in 1992 and 1991, on a base of 20,000 loans.

Senator BOXER. You took over 530 homes and on most of that, I assume, you made a profit?

Mr. HAMILL. No. As a matter of fact, the loss for 1992 was $8 million.

Senator BOXER. What about all the other homes that you took over and sold?

Mr. HAMILL. That's it. I'm talking about the losses on the 530 loans.

Senator BOXER. How does that compare to the profits you made on the other loans that did not default, which is something we're trying to get at here, and we haven't been able to succeed so far.

Mr. HAMILL. The issue, I think, is the bottom line of the company. And the company, I don't want to use 1992 because it was a bad year for the company, on average, it has made in the $30 million range bottom line on average.

I would be happy to provide you each of the years, and what that represents as a percentage of the total of the Fleet Finance Group's bottom line.

But let me address the veiled threat, because that was not my intention. I was trying to respond to Senator D'Amato's notion that there are some people who shouldn't be borrowing, and that the lending institutions should in fact take the initiative to be sure that they don't borrow because they get in over their heads, and they lose their homes.

Senator BOXER. No one should borrow at usurious rates. That's true.

Mr. HAMILL. If I might, though, these are not usurious rates.

Senator BOXER. That's debatable.

Mr. HAMILL. I would suggest to you that in this country today there are 15,000 companies that are in the second mortgage business. This is a highly competitive business. The rates are in fact set through competition, just like stockbroker rates are set, just like any other business' rates are set. We don't control this market.

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I would only urge you then to not think about them as usurious rates, but rather the rates of the industry.

Senator BOXER. Sir, I'm sorry. We're allowed to filibuster in the Senate. You know, you filibustered because that little light's going to turn red.

And I just want to make one more comment.

Mr. HAMILL. I apologize.

Senator BOXER. Unfortunately, I've waited 2 hours and I can't wait any longer, because I have to meet some young people who are meeting here. I'm sure you're very sad to know I'm leaving.

[Laughter.]

But on the next panel one of my constituents from California is going to tell a story that will make everyone just sick at heart. This is somebody who was preyed upon.

So I would urge you to tell your colleagues in this very competitive marketplace where it's all dog eat dog, not to send people out knocking on doors saying, gee, the step on your front porch is broken, and I can help you with that, and I can consolidate all your loans. All for the purpose, in effect, of destroying that person's life. There's got to be something that stops that from happening now.

What I'm suggesting is that there should be a new ethic. Maybe it's a new time that we need to be more responsible for everyone who's a part of our organization. Fleet needs to step up and accept responsibility. And you alluded to that. I would hope that you would take immediate steps voluntarily to change that. I know you're trying to do that. But, as Americans, we can't allow these practices to continue.

Mr. Chairman, you've been very patient. I thank you and I will work with you on this issue.

The CHAIRMAN. Thank you very much.

Senator Sarbanes.

OPENING STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman.

I apologize to the panel that I wasn't able to be here earlier to hear the testimony, but I had another hearing at which I had to be present.

First of all, Mr. Chairman, I want to commend you for holding this hearing. This is one in a series that the Banking Committee is holding this month on credit availability for borrowers in the low- and moderate-income areas in the country.

We held a hearing on February 3, 1993, on community-based lending institutions, such as community development banks, community development credit unions.

Next Wednesday, we have a hearing, as I understand it, on racial discrimination in mortgage lending.

I feel very strongly that this is a very important public service which the committee is rendering.

And I particularly want to go on the record in thanking you for your leadership in this regard.

I think there are a number of problems here.

My colleague, Senator Shelby, indicated that this underscored the need for the community development banks.

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I think it also underscores the fact that a lot of commercial banks are simply redlining out areas, and not making loans available, loans which, in many instances, ought to be made. And their refusal to do so, and the unavailability of credit gives an opportunity for others, often time less reputable lenders, to enter the market and take advantage of unsophisticated borrowers.

In some instances, you have mainline financial institutions who won't do it directly. But then they set up subsidiaries in order to do it, in order to be able to exploit that market.

This apparently is particularly true in the area of home equity lending, which for many low- and moderate-income people is their only source of personal wealth, is the equity they build up in their homes.

Then, to finance needed improvements or other needs, they borrow based on the value of their home equity. They encounter difficulty getting credit from conventional commercial banks. They turn to second mortgage lenders or finance companies.

Then they get loans at extraordinarily high rates of interest, and in many instances, it appears from the face of it on the record that the borrower is really going to be unable to service the debt. It's obvious on its face, when the loan is made.

I want to just put a couple of questions.

First of all, Mr. Hamill, you make money on the second mortgage lending, don't you?

Mr. HAMILL. Yes, sir.

Senator SARBANES. So the failure to make money was in reference to those instances in which you actually had to go to foreclosure. Is that correct?

Mr. HAMILL. Yes, Senator. It was in response to the question that was raised earlier about whether we were, as an industry or a company, strip mining the equity out of homes, trying to in effect make the loan knowing that the people could not pay back the loan, hoping to get the house and then make a lot of money on the sale of the house.

Senator SARBANES. But what you're doing to the others on whom you have not foreclosed is, you're absolutely pressing them to the wall.

Here's what happens. In some ways, this is a tremendous testimony to the responsibility to meet their obligations of low- and moderate-income people. That's one of the readings I take out of your testimony, because here's what happens.

They take these really high rate loans, exorbitant in the eyes of many, including my own, I assume. Then they're pressed, and they go to every possible effort to meet the loan payment.

Let me ask you this question. If I take that into account, let me accept your testimony now, the factual statement you've made, that on the actual houses on which you went to foreclosure, you lost money. And you said that was 2 percent of the houses.

Mr. HAMILL. The number of foreclosures that were effected in 1992 and 1991 represented about 2 percent of the total portfolio.

Senator SARBANES. So you have the other 98 percent of the portfolio made at these high interest rates. People doing everything they possibly can to meet those payments, which are really putting it to them. Now you made money out of that 98 percent, didn't you?

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Mr. HAMILL. Yes.

Senator SARBANES. You made so much money that it more than offset the losses, did it not?

Mr. HAMILL. Yes. The foreclosures are a part of the operations of the company and they're not synonymous with the profits of the 98 percent.

Senator SARBANES. Why are we looking only at the profit and loss on the foreclosed properties, and not looking at the profit and loss on the total picture?

Mr. HAMILL. I agree with you, Senator. I'm only trying to respond to the issue that keeps coming up, that there is, in effect, an underlying business inside of the entire business, and that the underlying business is one of trying to make money on foreclosures.

Senator SARBANES. Maybe you're making money on the threat of foreclosure. Maybe when you actually go to foreclosure, in that instance, you then don't make money. But the threat of foreclosure is absolutely pushing these people against the wall. And therefore not to lose their home, in order to hold onto their home, it's the only thing they have, the only thing they've worked all their lives to build up, and not to actually lose it, they're going to an extraordinary extent to produce the money to make these payments. Isn't that a reasonable hypothesis?

Mr. HAMILL. Senator, as I've indicated before you came in, in New England where I live, we've gone through an extraordinary economic downturn over the last 4 years.

We've had literally thousands of people who have lost their homes because of the fact that when the loan was originally made, the income of the individual in relationship to the debt they took on was reasonable, but they lost their job.

I would suggest to you that we have, as a matter of policy, had debt-to-income ratios, again 62 percent of the borrowers had debt-to-income of less than 40 percent. It's perfectly reasonable in terms of their ability to repay.

And if a change in circumstances takes place, it is going to put people into a position as it did with many of our friends and colleagues in New England.

Senator SARBANES. What's your return on the subsidiary?

Mr. HAMILL. In 1992, it was very poor because of a variety of one-time events, but in general, the return on equity is in the 17 percent range.

Senator SARBANES. And what's the return on your regular commercial bank?

Mr. HAMILL. Again, I don't want to use the last couple of years, because of the fact that there have been, in New England, enormous dislocations, but the Fleet Banking Group, if you will, in normalized times has been in the 17 to 18 percent rate of return range.

Senator SARBANES. You're including, now, the secondary mortgage—excluding that, your regular commercial operation. What is your return on that?

Mr. HAMILL. It's in the same category because this represents, on a normalized basis, again, taking out the bad year that this company had in 1992, and the bad year the banks had in 1990 and 1991, it represents about 10 percent of the total of Fleet Financial

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Group, so that the returns of Fleet Financial Group, excluding this, are about the same as the returns from this company.

Senator SARBANES. Let me ask the other members of the panel. Maybe I'll come to you, Ms. Keest, what do you think about this hypothesis of mine that it's the threat. It doesn't really get to the point to simply look at the actual foreclosures without looking at the threat of foreclosure.

And the company, in a sense, over lending on these houses, knowing that people are going to do everything they possibly can not to lose their house, they're going to be paying these very high rates of interest, they're going to go to extraordinary lengths not to do so.

So they've got something working here, I mean, they've got this threat of foreclosure and it serves as an incredible pressure.

In fact, if some people are not actually lost with these tragic stories, I don't know that the issue would have ever gotten the profile that it's now getting. And this practice then would have continued, but it never would have come so clearly to public attention. So what about those people?

I don't know where they're finding it. I guess they're taking it out of food and clothing and heat and everything else, in order to meet these payments.

Ms. KEEST. Or refinancing with other ones of these high-rate lenders. Absolutely.

I think originally when we started talking about this problem we did talk about equity skimming as trying to get the property. But as we began to see more of it, we began to think of it more broadly, which is that the ones who pay, that's a transfer of wealth from the equity to the lender and the ones who don't pay, it's a transfer of the property. Either way, the increased equity gets to the lender.

Even one of the worst of the examples in New England which I understand had about a 40 percent foreclosure rate, that was 60 percent of those people who paid.

I also want to make a point that to further complicate matters, when they talk about what the losses are, and I cannot speak to Fleet Finance's practices in this regard, but I know that in some of them in New England, if they talk about a loss on a foreclosure, they may be talking about saying we didn't get to recoup the principal that we expended. But a lot of these lenders, on top of charging 20-plus percent interest, were what we call loan padding, which is the note principal may say $20,000 and $15,000 was only their actual expenditure; $5,000 of it was smoke and mirrors.

So if they say they lost that $20,000 loan on foreclosure, they didn't really lose $20,000 because $5,000 of it was just another way of doing some equity skimming.

Senator SARBANES. The other thing, of course, is that you pay a high enough interest rate and the loan lasts for a while. The lender can recover through the interest. He is doing pretty good even if he loses on the principal when he finally goes to foreclosure. Isn't that correct?

Ms. KEEST. Absolutely. One of my favorite schemes in some of the New England ones was the ones where they would make loans where they were bound to go into default very early. Then the note called for a 42 percent default rate.

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The CHAIRMAN. Would you just yield to me?

I see another problem here we haven't really illuminated yet today. I want to leave Mr. Hamill out of it, so this isn't aimed at your company here. But it is aimed at companies that are holding companies where they have banks, traditional banks, then they've got these mortgage finance operations as separate entities under one corporate structure.

Let's take as an illustration the portfolio you spoke about in Georgia, where 98 percent of it was up to date, even though the interest rates were high and so forth. Only 2 percent were in foreclosure. The other 98 percent are functioning in the normal fashion.

Let's leave Fleet and just go to a bank with a holding company like that. If 98 percent of those loans are going to pay off and they are going to pay off at a high interest rate, you've got an opportunity because you can wear different hats. You can either be a traditional bank, you can go into the inner-city and you can make the loan to the inner-city borrower, let's say, at 7.5 percent. Or you can decide, no, you're not going to make the loan to that person at 7.5 percent. You'll go over here to another party or company and you'll make the same loan to that person at 15 percent.

And you obviously believe in anything like a 98 percent success ratio would let you believe that that borrower could afford to pay 15 percent.

If they could afford to pay 15 percent, don't you have even a more secure loan if they're only paying 7 percent, because you're not squeezing them to the wall like Senator Sarbanes has just talked about? I can see a very perverse incentive in a holding company here. I am not saying that's true in this instance. I don't know if it's true; I don't know if it is or isn't. But I can see why the economics if you've got a class of borrowers that are going to pay up 98 percent of the time, you can run them through the mortgage mill at 15 percent rather than 7.5 percent, why would you make a loan at 7.5 percent?

You just sort of take a look at it and say, well, that's a tough area and, you know, I'm not sure I really want to bother with that kind of lending, and so forth. We won't do it through this window; we'll go over here and do it through a different window. We will take off our banking hat and put on our mortgage banking hat and we'll go out and we'll find that same borrower is now suddenly and magically creditworthy at a 15 percent rate. And we are going to have a 98 percent payback. But that person who would find it easier to pay back if they were only paying 7.5 percent is not creditworthy.

Part of the problem here is I think we've had the financial system functioning in a way where we've had large parts of our society sort of ruled out of bounds for normal lending. The traditional banks, in many cases, have bailed out of the inner cities. In fact, in many cases you can't even cash a check. You've got to go into one of these high priced check cashing operations even to cash a Government check in a lot of inner-city locations. That's just not right.

But the fact of the matter is it seems to me that you've got a situation here where if you've got a holding company, there is a built

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in financial incentive, if you've got a good base of customers out there who are going to pay back 98 percent of the time and it is a highly profitable business, why would you go ahead and finance them at 7 percent if you can go ahead and finance them at 15 percent? Doesn't that logic hold together, Ms. Keest?

Ms. KEEST. Yes. I think it is called steering-the-sucker sales. You alluded earlier to a paper that I wrote and there is an appendix in there in which I had read a Law Review article that was conducted resulting from testing using paired testers of people shopping for new car loans. As I read that article, it really struck home to me on this whole issue of high-rate lending.

And what they speculated was—what they found was controlling for everything else, white women paid 48 percent bigger markups on new cars than white men. Black men made twice the markup, black women paid three times the markup. What they speculated the reason was is that not all the—that the profits from the sales were not spread evenly on all sales. So what they did, there were stereotypes operating as to who the salespeople thought would be the suckers that would pay full markup.

I would speculate that if I went into, for example, a finance company—this doesn't get to the holding company but it is the same sort of issue—and asked or was applying for a loan, they would not try to pad my loan. They do pad my clients' loans.

The CHAIRMAN. Wouldn't a holding company have exactly the incentive I talked about, Mr. Harshbarger?

Mr. HARSHBARGER. Yes. And I think in certain respects, a lot of our investigation documented that this was occurring, although the form in which it was occurring was through the second mortgage companies, like Resources Financial, which were selling packages to the banks. That was the original phenomenon that was being utilized most of the time, according to our investigation.

An investigation clearly documents almost every point that both you and Senator Sarbanes have made about this issue. One of our arguments about the flexible criteria had to do with the fact that most people were paying these rates. That was what was incredible to find. They were willing and able to try to meet these rates. Somehow, the criteria ought to meet that level of credit worthiness as opposed to something else.

The CHAIRMAN. And they would actually be a better credit risk if they were paying a lower rate of interest because they wouldn't be squeezed to death.

Senator Moseley-Braun.

Senator MOSELEY-BRAUN. Thank you very much, Mr. Chairman. I am going to be brief because we have a conference on the President's proposals coming up.

But I really want to reiterate and to thank you for calling this hearing. I have been on this committee now for the month that I have been in the Senate and we have had hearings now on credit availability, this hearing on reverse redlining, and these kinds of financial practices. You have really done a yeoman's job to bring and make the Banking Committee relevant to the concerns that the people have. I thank you for that.

I want also to say to Mr. Hamill I think part of the problem, and I don't know—the people in the audience really can't see Mr.

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Hamill's face. He looks so stricken. He looks like he really—his feelings are hurt. Well, you do.

I think part of the problem is that not only is he having to talk about Fleet's practices, but the practices of the rest of the industry. It is the industry that is the problem. It is the fact that we, the lawmakers, have not put the kind of regulation on this industry that it absolutely needs to have. That, in my opinion, is the problem.

The fact that people are being preyed upon, these horror stories someone sent me. I don't even know whose paperwork this is. But someone sent me some paperwork, Mr. Chairman. I was sitting here trying to calculate up the numbers and referring to your comment about loan padding, Ms. Keest.

I am looking at the numbers here. This individual received $10,000, had a note for $12,500, and paid about 20 percent in fees and charges, putting aside for a moment the 22 percent interest rate. I mean, it is nothing short of outrageous.

Mr. Chairman, I just wanted to say, and I don't know whose documents these are, but I want you to get them back. I kind of scribbled on them.

I just wanted to say I look forward to working with you as we approach some kind of a legislative response to try to take some of the corruption out of this industry because I think that, personalities notwithstanding, the corruption is inherent in the system. This system does prey on poor people and puts a tax on poor people that is an illegitimate tax and one that I think we have a moral obligation to repeal.

Thank you.

The CHAIRMAN. Let me thank this panel of witnesses. You have been very patient and you have been very helpful to the committee.

We have got other witnesses that we must hear. Let me excuse this panel.

Mr. HAMILL. Mr. Chairman, one final point.

The CHAIRMAN. If it's very important.

Mr. HAMILL. Just on the practices of steering you were suggesting, I would just for the record indicate to you that Fleet has banks only in New England and New York and does not engage in the practices of steering that were being talked about. And I know you weren't directing it at us, but I want to make sure that's on the record.

Thank you.

The CHAIRMAN. Thank you.

Let me thank this panel and excuse this panel.

Let me now call our next witnesses to the table. These witnesses are, and I will call them in this order, Eva Davis, who is a resident of San Francisco, CA. Her home is in foreclosure following her receiving a second mortgage loan.

Annie Diggs. Ms. Diggs is a resident of Augusta, GA. Like Ms. Davis, she has experienced problems after receiving a high rate second mortgage loan.

Mr. Jack Long is an attorney with Dye, Tucker, Everitt, Wheale and Long of Augusta, GA. He is presently bringing a class action suit against Fleet in Georgia on behalf of second mortgage borrow-

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ers, alleging reverse redlining and violations of the Georgia Fair Housing Act.

Finally, Mr. Bruce Marks, who is the executive director of the Union Neighborhood Assistance Corporation in Boston. As executive director of UNAC, he has been a leading community activist involved in the second mortgage issue.

Let me also say, as has been pointed out by Senator Moseley-Braun, in light of the President's State of the Union message tonight, we have been asked to attend a formal briefing on that issue here shortly. It will, in fact, start before long.

What I want to do with this panel is for each panelist to give us their story and statement. After we have done that, we will take the time we have for questions.

I am going to put the full statements in the record.

In some respects, this panel is more important than the first panel. I am not going to hurry our way through this. We want to take the time we need. Ms. Davis and Ms. Diggs, particularly we appreciate your being here.

Ms. Davis, we are going to start with you. We would like to hear your story now.

STATEMENT OF EVA DAVIS, RESIDENT OF SAN FRANCISCO, CA

Ms. DAVIS. My name is Eva Davis. I live in the Potrero district of San Francisco where I have lived for over 20 years. I am a widow and I live with my granddaughter and two grandchildren.

In October of 1989, the great earthquake hit Northern California. It frightened me and the members of my family. It also caused minor damage to my home. But what happened after the earthquake to me and to my family and to my home was more devastating than the big earthquake.

Nine months after the earthquake, two men came to my home. One visitor said he was a contractor. The other man said he worked for the Federal Emergency Agency, FEMA, where he said he processed loans for people like me whose homes had been damaged by the earthquake. The contractor told me that it would take about $6,000 to repair my front steps which had been damaged and tagged by the city of San Francisco as unsafe. It was this yellow tag stuck to the front of my home that had caught the eyes of the contractor as he drove by in July 1990.

I told the two men that I only had income of about $1,100 a month, that I could not pay for any repair to my home, and that I was not qualified for a loan because of my income level. At the time, I only owed $58,000 on my home and my home loan payment was only $619 a month. The only other debts that I had was about $700 to Montgomery Ward. I was current on that obligation.

The two men told me that I could qualify for a Government loan and see if they could arrange a short time loan until I got the FEMA loan. They told me the Government loan would pay off the shelter loan and I would not have to pay the FEMA loan until I sold my home. They told me I could have other repairs done to my home under this program. This sounded pretty good to me, since I had not planned to sell my home in the immediate future.

The contractor then called a person from the finance company in San Jose over 50 miles away. Within an hour, a loan officer ap-

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peared at my home in San Francisco. By the end of the day, I was talked into a loan that they said would pay off my three existing loans and would permit me to make major repairs to my home. I wasn't told how much the loan would be for or any other details of the loan. In fact, since I suffer from glaucoma, I had recently broken my glasses. I wasn't able to read the loan papers or sign any documents. The loan officer just told me to sign my name on a blank sheet of paper and he would take care of everything.

Within 2 weeks of meeting at my home, the loan contractor came to my home and told me that I had qualified for a loan of $150,000. I called Congress Mortgage and they told me that they had not paid off the first loan on my home as they had said they would. I learned that my monthly payment would increase from $619 to just under $2,000 a month. And I learned that Congress Mortgage was charging me $23,000 in loan fees.

Within 5 months, my home was put into foreclosure by Congress Mortgage because I was unable to make the loan payments of nearly $2,000 with my income of under $1,100 a month. There was other problems as well.

Congress Mortgage paid almost $700,000 to a contractor who quit work on my home and left my home in terrible condition. Over 2 years I have been fighting to save my home. I turned to Consumers Union for help and they found two attorneys who were willing to help me. They have told me that I may eventually lose my home, however they were able to stop the foreclosure sale of my home, which was supposed to take place at 10 o'clock this morning. I hope that members of Congress can do something to protect people like me whose only mistake was to trust people who sounded honest.

My home needed less than $6,000 in repairs but I was talked into a $100,000 loan. Now I may lose my home. Please don't let this happen to anyone else.

Thank you for letting me tell my story.

Senator SARBANES. Ms. Davis, that's a very powerful and moving story and I want to go to Ms. Diggs. But I just want to be real clear on one thing. Before all of this started, you were paying $619 a month on the house payments?

Ms. DAVIS. Yes.

Senator SARBANES. You had an income of just under $1,100?

Ms. DAVIS. Yes.

Senator SARBANES. By the time they got through with you, you still had the same income, but you were now going to be required to pay just under $2,000 a month?

Ms. DAVIS. Yes.

Senator SARBANES. How could anyone expect you to pay $2,000 a month when you had an income of $1,100 a month?

Ms. DAVIS. It's unbelievable to me.

Senator SARBANES. Ms. Diggs.

STATEMENT OF ANNIE DIGGS, RESIDENT OF AUGUSTA, GA

Ms. DIGGS. My name is Annie Diggs. I have lived in the same house at 1522 Blakley Street in Augusta, GA, since 1936. On January 17, I celebrated my 78th birthday. I was born in 1915 in Macon, GA, and was raised in a community known as Shady Dale, GA. My father was born in the West Indies, but he drowned 6

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months before I was born. My grandparents were born as slaves. My mother was forced to work for the fair, so she left me to be raised by a great aunt, who is my namesake, Annie Virginia Coleman.

The Colemans were originally farmers in Georgia, but had to give up farming after the boll weevils invaded their farms. We moved to Athens, GA, where my great uncle worked for a company that made axe handles and hammer handles. When I was 14 years old, I married Will Diggs, who worked as a fireman for the Georgia railroad. The railroad moved us to Augusta in 1932. We moved into my present home in 1936.

My husband and I was blessed to have 10 children, four of whom are still living. I became a widow in 1946. After my husband's death, I had numerous jobs, primarily of a domestic or clerical nature, such as a maid at University Hospital, a clerk at a grocery store, and I worked in a food processing plant known as Castleberry.

For the last 27 years of my working life, I was employed as a domestic at Elliott's Funeral Home in Augusta. I stopped working at Elliott's in 1979. Since that time, my only source of income is my late husband's railroad retirement, which is now $515 a month. Additionally, I receive food stamps worth $60 per month. Frequently, I have to go without food.

In 1987, my home needed major repairs, primarily due to a leaking roof. I went to a local bank. I had $343 balance on my existing mortgage. The local bank turned me down.

Later, I was contacted by a woman working for a local loan company. She looked at my house and contacted a remodeling company that agreed to do the repairs for $3,300. She said she could arrange a loan. Also the manager of the loan company told me I should pay off several other little bills so I wouldn't have nothing to pay but my loan and so I could get some extra money to buy a washer and dryer too. They never told me the rate or how long the loan would last.

When I went to sign the papers for my loan, I was asked to sign a stack of papers which I did not understand. Instead of the $3,300 which I originally needed, I ended up with a note to Tower Financial for $15,000 at an interest rate of 18.9 percent. My house is pledged as security. My monthly payments are $251.34 a month, almost half of my total monthly income.

I was charged $2,595 or 21½ percent of the loan in fees. My loan documents show that I received $4,328.48 at closing, but I didn't receive that. I don't know why they got me charged. I never had this money. I have never been told why I didn't receive the $1,900.

Additionally, if I were somehow able to pay this loan off by refinancing, I would have to pay a repayment of $900, 6 percent of the original note. The home repair work was very poor, the paint peeled off, and my roof continued to leak. After one payment, I learned that my loan had been sold to Fleet Finance. I complained to Fleet about the sorry repair work. They said that was my problem. All they was interested in was getting the monthly payment on time.

My ceiling finally fell in. For more than 5 years, I have lived in my house with the roof still leaking. All the while, I have paid

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Fleet. I have paid more than $13,000 on my loan since 1987, but Fleet Finance tells me I still owe more than $16,000 on my loan. How can that be? I cannot understand how I could owe $16,000 on a loan that was originally only $15,000, especially after I have paid over $13,000 in monthly payments.

I am scared of losing my home; I really am. I go to bed and get up in the morning looking for the mailman thinking I'm going to get a letter telling me to move.

I finally got the repair work done right, but only after I got a grant from the City of Augusta Community Development Housing Rehabilitation Program.

And I am thankful that you all give me this opportunity to come here today to tell my story. I am 78 years old. I ain't able to work. And every time I turn around, they badger me and badger me. I don't know. I just hope you all do something about this. They won't give you a chance. I didn't know Fleet. I never heard tell of Fleet until I got a letter. Then they're going to tell me I paid the first note to Tower. Fleet's going to tell me you've got to pay this note. We'll put it into your payment when you go to pay your last payment. You're going to pay this note because you were supposed to pay it to us.

Senator SARBANES. We thank you very much for coming to tell that story. It is a very powerful story. Actually, Mr. Chairman, it underscores the point I was trying to make earlier. You have been foreclosed on your home?

Ms. DIGGS. I am the lucky one.

Senator SARBANES. But you have been paying and you have been paying dearly all these years. So we're told that, well, they lose money on the foreclosures but they're making money on your loan.

Ms. DIGGS. If they take my home and sell it today, they can sell it for over what I got in here, $16,000, $17,000. Because it looks like a new house. The stuff they tore out of my house was piled up high, all rotten lumber, the top of the house. Everything was rotten in there. I just wish I could have taken a picture and brought it to show you the beginning and how they fixed it. I am just happy. When I think the work it needed, my heart bled so bad that they're going to come and take it.

Senator SARBANES. Mr. Long, we will be happy to hear from you.

STATEMENT OF JOHN LONG, ESQ., OF DYE, TUCKER, EVERITT, WHEALE AND LONG

Mr. LONG. Thank you very much, Senator.

My name is Jack Long. I am an attorney from Augusta, GA. I am not here to criticize any one financial institution, but I am here to try to encourage change to correct abuses in home lending, which I, along with other lawyers in my area, see every day.

We are not the traditional class action lawyers, because we represent a lot of traditional industries, insurance companies, and banks. However, we are morally outraged at what we have seen.

Thirty years ago in the South, we had a system of dual waiting rooms, dual water fountains, and the like. Congress reacted. Today, our Nation is better. However, we still have a dual system of lending in this Nation in which whites, in connection with home mortgage loans, more often than not receive the benefit of market rate

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home loans from traditional sources of financing. A substantial number of African-Americans only have one other source of lending on homes available; that is, loans at very high rates, very high prepayment penalties, very high points. The loans come from these non-bank banks that are completely unregulated by Congress.

The sad thing about what I am telling you and members of the Congress is that these people are not on some Government program. They are not trying to get grants. These are Americans who work hard their entire lives to earn the American dream, their homes. Now we are faced with a situation in which they are losing these homes at astonishing rates.

I noticed that previously we got a foreclosure statistic of 2.67 percent by Fleet. I don't want to criticize Fleet. I think that's probably for the finance company industry. That's way above the national foreclosure rate, which is one percent and less. You go back to 1980 with about half a percent or less. In 1991 according to the latest statistics, it was one percent.

If you apply that statistic over a 15-year loan that we're talking about, 40 percent of these 20,000 loans are going to be lost in foreclosure.

The examples of what I am about to describe to you are interest rates that make Master Card or Visa interest rates look reasonable. We all know that unsecured credit is the most risky credit. These loans I am about ready to describe to you are loans that have no relationship whatever to market rates.

The first example I am going to give you is a loan entered into by Ms. Lucille Williams. This is not a Fleet loan. In fact, Resolution Trust Corporation owns it.

This lady was charged 35 points; $6,300 of an $18,000 loan, that was charged on the day the loan was made. The loan documents say that was a "bonus" or points. That is unconscionable, is unreasonable, and is mind boggling. Out of $18,000, she only received 65 percent at an 18 percent interest rate—a rate higher than a Master Card.

The next example is the loan of Mr. and Mrs. Dukes. They were lucky! They were only charged points of 22.5 percent on a $16,200 loan at an interest rate of 18.5 percent. Both of these loans are secured by homes.

Let's take Ms. Diggs's loan. And I submit to you, Senator, it is not the exception; it's the rule. Fortunately, we were given the privilege to ride to Washington in a bus with a substantial number of Fleet victims. We saw these same types of loans. People were handing them to us and saying, "look at my loan."

This is not the exception; it is the rule. In this loan, 20 percent of the loan with the points, plus an interest rate of 18.9 percent. They can talk about this lady's credit, but look at who she's paying off. She's paying off Macy's, she paid off her Visa card, she had good credit. Credit had nothing to do with it. They took advantage of an elderly black lady. She was denied credit from traditional sources because the Community Reinvestment Act is a joke. It doesn't work. Traditional banks do not lend in minority neighborhoods, thus they create a void.

We talked about foreclosures. Mr. Willie Harris' loan is on a chart. We are handling a substantial number of Fleet loans. In

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every one of their loans, we found they did a workup on foreclosure. We may not have all the records, but of the records we've seen, we see they make a profit. They have these people going both ways, Senator.

Some of these prepayment penalties are up to 19 percent. So, you are charging points of, let's say, 20 to 25 points out in front. Then, on the date the loan is made, they're charging 18, 19 percent. They're charging a prepayment penalty of 19 percent. Customers are slaves to their loans. These companies make a profit if the customers pay, or if they default.

They are lending at loan-to-value. Forget about income-to-value. They are lending at loan-to-value of 40 percent or so. That's such a big equity. The companies are going to make a profit even if they foreclose.

I submit to you that what we see is wrong. As far as how to solve this problem, first of all, the Community Reinvestment Act needs to be strengthened. Banks are not lending in the minority neighborhoods. Congress needs to get tough just like you got tough with the South in the 1960's. We are better off as a people because of it.

What you need to do is to stop all the mergers, stop the acquisitions, stop them from buying failed banks and making profits off of it, if they are not lending in the minority communities.

Second of all, I think we need to have a nationwide cap. Now, in my part of the country, we talk of Government that is only supposed to defend the country and deliver the mail. We have to make exceptions to that philosophy when we see abuses. We need a cap, just like we have a minimum wage for income, you have to pay a certain minimum rate. We've got to stop these abuses.

We are destroying entire neighborhoods in our section of the country. In fact, we all know that minority individuals in Georgia, even though they comprise about 27 percent of the population, only own 17 percent of the housing units.

We found in our statistics and in our redlining cases and reverse redlining cases, that these loans are congregated. These high interest rates are congregated in the minority neighborhoods.

The result is that owner-occupied houses become rentals. Neighborhoods are destroyed. The crime rate goes up. These social problems are created and the taxpayers have to pay.

I'd like to end by saying this, Senator. The taxpayers had to spend billions of dollars bailing out the S&L's. I don't know of one savings bank or S&L that has gone broke from lending in the minority neighborhoods. They have gone broke because they lent money on some shopping center project, some condominium, vacation home, or something else. If they had complied with the Community Reinvestment Act in good faith, they probably wouldn't be in the position they're in today.

I ask Congress to adopt legislation in two areas. One, we need to strengthen the Community Reinvestment Act; and, two, put an interest rate cap nationwide on what these home equity lenders can charge.

Thank you.

The CHAIRMAN. Mr. Marks, we would be pleased to hear from you now.

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STATEMENT OF BRUCE MARKS, EXECUTIVE, UNION NEIGHBORHOOD ASSISTANCE CORPORATION OF BOSTON, MA

Mr. MARKS. Thank you very much.

What we are here really for today, with all the people here, it is a wakeup call to Congress. It is a wakeup call. It is the real state of the union. The real state of the union is that there is a sub-tier financial system. It is not fringe. It is where working class people cannot get access to credit and therefore these creditors come in and steal their homes, milk them of their money and steal their homes.

These are not people who are homeless. They are homeowners who are the foundations within our communities that no one has been paying attention to. And the state of the union is, we talk about drugs, we talk about violence, we talk about gangs, but these are the homeowners who are always the foundations, the stalwarts within their neighborhoods, who said to the craziness, the violence, and the gangs, stay out of my neighborhood.

So what has happened is that's the problem. That foundation has been wiped out because they are subject to a sub-tier, not a fringe, a sub-tier financial system. But it is worse than that. It is because that's where the money's at.

Fleet and some of the other corporations, ITT and Chrysler, but let's talk about Fleet because they have set the standard. They saw there was money to be made. They said this is a niche that we want to exploit. So what do you do? You want to reduce your risk and you want to maximize your profits. You reduce your risk by lending on people that have tremendous equity in their house, people that have been denied credit and have owned their homes for many, many years, often two or three generations.

So what do they do? That's the community they want to target. People are desperate for credit because that's their major asset. They want to improve their major asset.

So when someone comes knocking on the door and they say you're cash poor but you're property rich and we can put $20,000, $30,000, or $50,000 into your pocket, you tell me, Senator who would turn that down? When for generations you've been dying to have that opportunity. And when you have entities such as Fleet who has a national exposure saying, trust us, you can refinance. People are going to do that. It's not ignorance. It's what people do because that's what anybody would do.

Let's talk about just how profitable this is.

In 1991, 55 percent of the income of the Fleet Bank Holding Company was made by Fleet Finance. Fleet could not have purchased the Bank of New England if it was not for Fleet Finance. The fact of the matter is, that was blood money. That was money made off the backs of working men and women whose homes they've stolen.

Let's talk about just how that is.

When you look at that map, that's the Federal Reserve, that area where you see the dots. Those are the areas where the Federal Reserve says, in Boston banks don't lend. Well, where those dots are are every mortgage that the resource companies financed by Fleet has made.

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They're all within the minority community and now 82 percent of the people that purchased, that got a Fleet mortgage through the resource companies, have lost their homes. It's only a matter of time that when you have to pay up to 39 percent on a mortgage, you will lose your home. It's a matter of time because these are balloon mortgages with very high interest rates.

The CHAIRMAN. Let me understand again what you just said.

If I heard you right, you just said that within this zone that you've got on the map here, over some period of time, what percentage of the loans have now gone into default, and the people have lost their homes?

Mr. MARKS. I'm saying, when you look at the default rate, and the people who have lost their homes through fraud, it's now become 82 percent. The number there is 76 percent. That was done about 7 months ago, and that's gone up.

The CHAIRMAN. Again, I want to make sure we've got this straight for the record.

You're saying that this cluster of people who had these second mortgages through mortgage companies of this kind, 70 to 80 percent of them actually ended up losing their residences. That's been the experience in Massachusetts?

Mr. MARKS. Yes.

The CHAIRMAN. Over what time period is that? What does that cover?

Mr. MARKS. That will cover from 1985 to the period now.

The CHAIRMAN. You're saying, in almost every case, it's a matter of people actually losing their property in the end. It's not a matter of just paying exorbitant rates and they paying it off. But in fact, it's like running on a treadmill and they pay the money, and then when the money runs out, they lose the property anyway.

Mr. MARKS. That's right. Because if you look at the second mortgage industry, if it was legitimate, the high rates should only be for a period of time while people establish credit.

So if you get a balloon mortgage payment that is in 3 years, in theory, you're supposed to be able to make those high payments for a short period of time, reestablish credit, and then you can refinance at a lower rate, which you are able to afford in not an unconscionable way. The fact of the matter is, that doesn't work.

When you have a very high interest rate and you have a balloon mortgage, and you do not have access to refinancing of that, it's only a matter of time when you're going to lose your home.

The CHAIRMAN. How many mortgages would that have been in the time period that you just said, from 1985 forward? Would that be 500 or a thousand?

Mr. MARKS. We were talking, for this one company, which is called the Resource Companies. They have six different names but they are under one ownership. They were owned by a man named Burt Lambert. He was a college roommate of Terry Murray of Fleet. That one company made 330 mortgages within the Roxbury, Dorchester, Mattapan area within Boston.

The CHAIRMAN. You're saying then the total over that period of time was around 300. Of that number, 70 to 80 percent were foreclosed on and people lost their homes. Am I following you right?

Mr. MARKS. Yes. I just want to add one thing.

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Within Massachusetts, you have what's called a soldiers and sailors foreclosure process. And it's one of the oldest ones on the books in the country.

It stretches out the foreclosure process for at least 6 months. If someone is in the military, it's for 6 months that you cannot take their home. So what happens is, there's a deed in lieu of foreclosure. A lender goes and says, you haven't made your payments for 1 or 2 months. What we'll do is, if you sign over the deed, then we'll forgive that debt.

Now, in Georgia what happens is that they have a non-judicial foreclosure. What happens is the lender just has to put the notice in the newspaper for 3 weeks, and on the first Tuesday of every month on the courthouse steps, they do the foreclosure.

So you have two extremes. But Fleet gets around that one way or another. One way, they do the deed in lieu of foreclosure. On the other way, you will see foreclosures such as in Georgia.

The CHAIRMAN. Why don't you go ahead and finish.

Mr. MARKS. Sure.

Fleet said that they make only 2 percent of their mortgages that are over 20 percent. But they're not really being straight, because the fact of the matter is they're saying the ones that are in their portfolio.

The fact of the matter is, Fleet sells the majority of its mortgages. They are mortgage-backed securities. When you look at the SEC documents and you look at the prospectuses, you are talking about a far far greater number of the mortgages that are over 20 percent. We have the data, and we'd be glad to share the data with the committee here.

The facts are when you look at the interest rates, and you look at these charts and look at those interest rates, you see interest rates of 24, 28 percent. You see them 30 and 40 percent. You see virtually no interest rates less than 20 percent. That's true on all of those mortgages.

The CHAIRMAN. Let me be clear.

You are asserting here today, that these loans are continuing to be made. Are you talking about loans out of the past, or loans that are still being made that would be well above the 20 percent, because they are sold off to somebody else. They don't show up on the portfolio, so that we would have to look at both categories to really understand what the history was. Is that what you're saying?

Mr. MARKS. Right. What I'm saying is, the loans in the past, you've got to look at one, we're talking about the loans that were originated by brokers that were financed by Fleet.

So don't take the whole portfolio. You've got to look at those predatory loans. We're not saying the loans that they made directly. When you look at the loans that were made by what we call the seven dwarfs, the seven mortgage companies that were controlled by Fleet, those loans, the vast majority of them were over 20 percent. Many of those, the vast majority of those were sold.

So when Fleet says to you, of the loans we have in the portfolio, the fact of the matter is, they're not being straight. I think if this was a courtroom, the very proper recourse would be perjury. That's what's really going on. And if you look at what the first month of these mortgages are, the first month charges are, again, 15, 20, 30

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percent. They're not telling you the truth. They are dealing with the technicalities on those issues.

Let me go on to what we consider to be also a major issue. It's the safety and soundness issue.

When you look at Fleet, and we've been in touch with the regulators for the last 18 months, we said, even if you're not going to consider the social impact of what Fleet does, consider the safety and soundness issue.

You have approved Fleet's purchase of the Bank of New England because of Fleet Finance. But in reality, Fleet Finance is an albatross around Fleet's neck. So what is happening is, when we said to the Federal regulators, you have to scrutinize Fleet Finance, they knew nothing about it, because the Federal Reserve Bank does not regulate the finance companies or the bank holding companies. They have no basis on which to make an evaluation of it.

So what is happening now is that we have requested the Federal Reserve Bank do an analysis of Fleet Finance, and to prevent Fleet from expanding or acquiring any more institutions before they really understand what's really going on with Fleet Finance. Because how can you make a determination of the safety and soundness issue when the most profitable entity you have is in the business of predatory lending?

When the most profitable business you have is basically loan sharking? Because that's the reality. It's loan sharking. Anybody that charges 20 points up front over 30 percent interest rates and has the collection tactics that they have, I don't think there's another term for that.

That's why we have a meeting at 4:30 this afternoon with the Board of Governors of the Federal Reserve Board. What we are requesting them to do is, we are requesting them to put a halt to any acquisitions of Fleet, so they cannot prey on any more people.

There can be an effort to make a lot of these people here, who are Fleet victims, whole in the communities that they have devastated, to recompensate those communities. That's where we're at.

But we have another request. That request is that there are many many people here who are here who came overnight who are going back this evening. We are requesting that this committee, that you hold regional hearings, that you go to other communities, that you go out there and you listen to what's going on within our communities, because when you thought, and you heard about the environmental activism of the 1980's, you have not seen anything yet.

When you see the tens of thousands of homeowners who have been victimized by this type of predatory second lending around the country, who have always blamed themselves, who said it's my fault I lost my house. Who have taken that out on their families because there's no other recourse.

There is a recourse now, and that anger and that frustration will be directed at the financial institutions who have preyed upon them.

So what we request is that you start to hold those regional hearings so the thousands of people who couldn't come here, you can hear their stories, and you can get a better idea, because it is pervasive. It's the issue of the 1990's, and people are angry.

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These issues need to be addressed.
Thank you very much.
The CHAIRMAN. Let me say to you very directly that we're starting down this track, not just with today's hearing, but with the other hearings that we've cited before today, the ones that have already taken place, and the ones that will be taking place, including the one next week, when the Federal Reserve comes in, and we take a look at these discriminatory lending patterns.

I envision field hearings. So I appreciate the suggestion.

I would also appreciate suggestions from you and others as to where those might be held, so we don't have to have people journey a long distance to come to Washington, although I appreciate the fact that so many have today.

But, you know, to stay on that level of discussion for a moment, when we look around this country at why our urban centers and a lot of our rural centers are in such terrible difficulty, a large part of it is that proper flow of credit and community reinvestment has just been denied systematically over a long period of time.

There have been other factors at work, but we are choking a lot of these communities to death by practices such as were illuminated today.

I think the pillars of strength that are out there, either older people or other families that have had homes over the years and really provide the bedrock in a community, we're seeing these dynamics because of how badly the credit system is functioning, where practices spring up that actually destroy the rest of the strength that we have.

You know, there has been, I think it's fair to say, a turning away from the problems of our inner cities and our lower income communities over the last several years.

There was a big focus on foreign policy, everybody knows, particularly in the last 4 years, and not much attention being paid to problems in this country. That's changing.

I think the President tonight will be talking about the sense of the State of the Union as he sees it.

And part of that will be new strategies and new efforts and new resources directed at rebuilding our cities, and really turning our attention inward to try to figure out how we help our own country and our own people, which we haven't done very much of in recent years.

In many ways, I think the neglect and the indifference, if not the actual practice of hostile policies, has damaged our country. It's damaged it in many ways.

We've got two women sitting here right now who in effect have been damaged in the ways that they have described, but there are many others in this audience and many many more who can't be here today who, either through these problems and absence of credit, or an absence of credit on fair terms, because if somebody is creditworthy at 15 percent with 25 percentage points up front, they sure are creditworthy at a lower figure, especially if you've got a minuscule default rate, which is what we were hearing earlier.

The basic economics actually turn right upside down. Because if that's the case, if we can make these loans at very high rates and people can meet them, then obviously they're going to have an easi-

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er time of meeting them and your default rates will even be lower if the rates are lower.

But our banking system, our insured banking system, has a responsibility here, and frankly it hasn't been met. It hasn't been met either in terms of an adequate community reinvestment effort, nor has it been done with respect to fairness to credit.

The cold fact of the matter is, we've had patterns of discrimination in this country from the very beginning. Whether somebody tuned into the TV show last night, the Queen show that was on, talking about the problems facing black people over the history of this country, these discrimination problems are right here and now. They're pervasive and they're going on every single day in this country, and they're grinding down our people, and everybody suffers.

When that happens, the whole country is lesser for it. It's not right, it's not decent, it's not what the country should be about, and it's not what our laws should tolerate.

That's why we're here today to talk about this. This is just one part of the problem. The problem is much bigger than this. But we're meeting here not just to talk about it, we're meeting here to lay a foundation to do something about it.

And in order, by the way, I might say, to do something about it, you need two things. You need the facts, and you need a good legislative proposal, you've got to then craft it and take it through the Congress, but you've got to have a President who will sign it.

I think we've got both things in place now. We've got the ability to write a good legislative proposal, and to work it through the Congress, and I think we've got a President that will sign it, the sooner the better, in terms of the changes that need to be made.

Ms. DIGGS. May I say something?

The CHAIRMAN. Go ahead, Ms. Diggs.

Ms. DIGGS. I have a neighbor. She's connected with Fleet, but she's got some children that were sick, and she couldn't come here to speak for herself today.

Her name is Louise Darrian. She lives on my street. She's asked me to voice, she has a loan with Fleet. She's in the same boat as all of us here. They want to foreclose on her, but they haven't done it yet. We're the lucky ones, two of us in the same neighberhood. Her husband died, my husband died. She's with Fleet too. She's not working. I told her I would speak for her, as she couldn't come here today.

The CHAIRMAN. Thank you.

Does anyone want to say one other thing?

Mr. MARKS. If I could just mention two things. One is we would request that you work with us in terms of the Federal Reserve Board in terms of having them take seriously the issue of Fleet and having them take seriously the issue of the expansion of Fleet.

Second, we would suggest that when we talk about regional hearings, that you think about Atlanta, Charlotte, Jacksonville, as three of the places, because as Fleet's name in Massachusetts is synonymous with a loan shark, Fleet's name in Georgia is synonymous with a loan shark, soon Fleet's name in Florida will be synonymous with a loan shark.

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We think that it's important that you come forward and that the committee deals in those areas, including North Carolina, to do that.

If I can ask the people in the audience that came 16 hours, a lot of people to come up, they're going back this evening, if the people, so that you can get a sense. It's not me, it's not the people on the panel, it's all these people who have been victimized, who have either been foreclosed on, or are being pressured in terms of foreclosure to stand up. The people who all have a Fleet mortgage who came here today.

These are the people who have come forward. They're just the tip of the iceberg. And many many wanted to come. We didn't have the buses to bring them. And there are many many that just couldn't come.

Regional hearings we need that, please, to happen.

The CHAIRMAN. Let me acknowledge everyone who stood. And let me invite you to go ahead and sit back down, having taken note of those who stood.

This has been a very important hearing today, and this is not a courtroom and shouldn't be mistaken for one. I know there's a legal case pending. We can't try that case here and shouldn't try it here. And I don't want any misunderstanding on that issue.

You made a comment earlier about your judgment that the earlier testimony you thought, in your mind, was a form of perjury. That's your opinion. I don't want to give any official blessing to that kind of characterization here, either way. I think it's important that those issues be settled where they are presently lodged, and that is in a court of law. Let me just make that plain.

With respect to the issues involved here, though, in terms of the underlying problems facing the country, I think there is a need for a change in our practice and a change in our law. I think the States need to do more than they are now doing, because they have primary jurisdiction in this area, at least with respect to some of the practices we're talking about.

I think there needs to be a Federal response here, and we're going to design such a response.

I appreciate everybody that's testified here today.

These are difficult issues and they are issues that are having a big impact on our country. I'd just say that if we're going to lift this country up again, if we're going to get our cities and our communities and our urban populations and our rural populations that are under pressure back on their feet, and getting stronger for themselves and their families, and for this country, we've got to change a number of things.

We've heard about some of these things today that need to change. Getting this credit system to work, work properly, work fairly, work with fair prices, work in a fashion for all citizens of this country on an equal footing, is a critical need. We're not going to solve the problems any other way.

We talk about the private enterprise system, but if it's only for some and not for all, it isn't going to work.

So this committee intends to act on these matters. And I thank all of you for your appearance and statements today.

The committee stands in recess.

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[Whereupon, at 1:25 p.m., Wednesday, February 17, 1993, the committee was adjourned, subject to the call of the Chair.]

[Prepared statements of witnesses and additional material supplied for the record follow:]

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PREPARED STATEMENT OF SENATOR BEN NIGHTHORSE CAMPBELL

Thank you Mr. Chairman, for holding this hearing today on home equity lending. I am very interested in hearing from the panels concerning reverse redlining and to learn more about what can be done to change this trend.

As you know, reverse redlining occurs when second mortgage lenders victimize vulnerable homeowners by coaxing them into signing home equity or home improvement loans they cannot afford. Homeowners who have nowhere to go for credit because mainstream lenders are reluctant to lend to low-income families are targeted by second mortgage lenders and charged very high interest rates on loans. If this is taking place in the lending industry, which we are here to learn more about today, we need to take steps to do something to stop this unfair practice.

I have always been concerned about the disadvantaged and minority individuals in poor communities, especially in rural communities and on Indian reservations, and am very interested to hear what suggestions you have and what steps you think we should take to protect the disadvantaged in our society.

I look forward to hearing testimony from the consumer and housing groups, the Office of the Attorney General, the residents, the banks and community activists.

PREPARED STATEMENT OF SENATOR PETE V. DOMENICI

I am pleased we are having this series of hearings on the access to capital in low-income and distressed communities.

The practice of reverse redlining, that is to say targeting low income or minority communities for credit at exorbitant rates and unscrupulous terms is certainly something this committee should be concerned about

New Mexico is a state with a large Hispanic population. Thirty percent is Hispanic, another 10 percent is Indian. This is an issue that is very important to me.

A staff member of mine's mother was almost the victim of one of these home improvement scams. She is a widow, an immigrant to this country. She lives alone and she was so frightened when these people came door to door trying to sell home improvements at an inflated price, on very severe credit terms. She was afraid at first to go to the police. She was afraid the workmen would revisit her and beat her up.

I found the materials on this issue very interesting. I question whether our tax laws, in allowing a deduction for home equity loans are partially at fault. Prior to 1986, there were very few of these open ended home equity lines. Since the 1986 tax law, these types of loans have sky-rocketed.

It also appears that the Community Reinvestment Act may also be contributing to the problem since it does not distinguish between loans actually made by the financial institution and loans purchased by the financial institution.

We can address the tax law and the CRA shortcomings, but perhaps the greatest service can be done by investigative reporters who can widely publicize these scams. We need to better educate homeowners to these very sophisticated schemes and what the ramifications really are.

The best program for low-income borrowers is to have a vibrant economy. We want the recession to end, but we can't get from here to there without a strong real estate market.

While most people are focused on tonight's speech by the President, much can be done to help home buyers and the housing industry through the Banking Committee.

Nothing in our national experience captures the American dream more than home ownership. All Americans need to be part of this dream. While bankers for years have denied that mortgage discrimination exists, the recent Federal Reserve data proves that mortgage discrimination exists.

The decline in real estate values has sharply reduced the net worth of many American families since two-thirds of all American families' wealth is in the form of real estate. Reviewing these statistics, it is easy to understand that the decline in real estate values has contributed to consumers' lost confidence.

Federal Housing Administration (FHA)

I have a proposal to expand home ownership through the Federal Housing Administration (FHA) by helping first-time, low-income, and minority borrowers.

Since FHA is a 100 percent federal guarantee, it should be better targeted to those who are denied mortgage credit and provide a back up reassurance to reluctant lenders.

The fundamental impediment for first-time home buyers is the downpayment. Most private sector mortgages want at least 20 percent in a downpayment or pri-

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vate mortgage insurance. However, FHA borrowers can put up as little as 3 percent in a downpayment.

This bill requires FHA to develop new programs to improve its ability to better serve low-income, minority, and first-time home buyers. HUD will be required to report to Congress within one year on how it plans to implement new programs.

According to Census Bureau data, nearly 85 percent of all first-time home buyers are white, while 10 percent are black and 5 percent are other minorities. Nearly 90 percent of all homeowners are white.

According to Federal Reserve data, only about 15 percent of FHA's portfolio is serving low-income borrowers. An FHA guarantee is obtained based on home purchase price, not income of the home buyer. FHA needs to better target its resources to low-income borrowers and provide government guarantees to those who are being denied mortgage credit.

This bill stimulates the housing market by increasing the FHA mortgage amount of $125,000 for first-time home buyers in high cost areas. Nearly 33 percent of all first-time home buyers take advantage of a federal guarantee to obtain a mortgage. This bill allows borrowers in high-cost areas to take advantage of the FHA government guarantee.

Nothing in this bill changes the intent or the need for the FHA reforms. The reforms were needed to guarantee the fund operates in a financially sound manner. FHA can target the federal guarantee without threatening safety and soundness.

PREPARED STATEMENT OF SENATOR CAROL MOSELEY-BRAUN

I wish I could say I am pleased to be here this morning, Mr. Chairman, but I am sorry to have to be looking at lending practices that take unfair advantage of low-income American homeowners.

Home ownership is at the core of the American dream, and achieving home ownership is particularly tough for low-income Americans. Lending practices that prey on the vulnerabilities of low-income homeowners, therefore, are particularly troubling.

"Reverse Redlining" is a new term. It refers to lending practices that involve charging very high rates of interest and equally high up-front loan origination fees to borrowers that really cannot afford the loans. The results of "Reverse Redlining" range from less money for the basics like food, heat, and electricity for the low-income borrowers, to ever-increasing debt loads, to outright loss of the low-income borrower's most precious possession—his or her home.

We have recently held hearings in this committee on how to get more money into low- and moderate-income communities through a community banking initiative and by strengthening the Community Reinvestment Act. Today's hearing demonstrates clearly why those objectives must be priorities for the committee this year.

It is clear that we have to act to address the "Reverse Redlining" problem. I do not want to suggest, however, that mortgage brokerage and finance company activity is in and of itself a problem, or and purchases of loans by one financial institution from another, are not in most cases appropriate. Mortgage brokers and finance companies fill a real need in our finance system, and in the great majority of cases, loan purchases are entirely legitimate. And I do not want to suggest that mainstream financial institutions are engaging in behavior that hurts low-income homeowners as a standard business practice. I am sure that virtually every mainstream financial institution in this country joins me in condemning fraudulent lending practices.

What I hope we will focus on, therefore, is what should be done. What I want to know is how can we improve our laws and our law enforcement so that we can put an end to "Reverse Redlining." I congratulate you for calling this hearing, Mr. Chairman, and I look forward to working with you, with my colleagues on the committee, with our witnesses this morning, and with all interested parties in an effort to answer the legal and enforcement questions and take the actions necessary to solve this problem.

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SCOTT HARSHBARGER, ATTORNEY GENERAL
COMMONWEALTH OF MASSACHUSETTS

A SPECIAL REPORT ON THE ATTORNEY GENERAL'S RESPONSE TO THE HOME IMPROVEMENT AND MORTGAGE SCAMS IN MASSACHUSETTS: ENFORCEMENT, LEGISLATION AND REGULATION

OCTOBER 30, 1992

A LETTER FROM THE ATTORNEY GENERAL

To Whom It May Concern:

During the last 18 months, my office has undertaken a comprehensive program of enforcement, and regulatory and legislative action to address the consumer harm resulting from unscrupulous lenders and home improvement mortgage contractors. Investigations by my office showed that vulnerable homeowners—many of them elderly, minority and inner-city residents—were targeted by certain brokers, lenders and contractors, to take out second mortgages with unconscionable terms and conditions. The most decisive factor for these lenders was whether the consumer had sufficient equity in his or her home to cover the loan in case of default. In many cases, irresponsible lenders gave scant attention to whether consumers could repay their loans with their monthly income. As a result, these consumers were laden with unmanageable debt and, in numerous cases, lost their homes through foreclosures.

Following complaints received by my office, I mobilized a Home Improvement and Mortgage Task Force to take swift action on a variety of fronts to end this insidious form of urban *economic* violence, in this case blatant victimization of vulnerable homeowners.

This report describes the origins of the second mortgage lending scams, the nature of the illegal activities that took place, the actions my office took to remedy those problems and, most importantly, how to prevent these scandals from happening again.

Some of the major highlights, finding and recommendations of the Task Force are:

- The Home Improvement and Mortgage Task Force has initiated 13 enforcement actions in the last year. These actions have already produced more than $40 million in legally enforceable benefits to Massachusetts consumers, particularly consumers of low and moderate income. More than 1,000 families will be assisted by settlements already reached.
- Unprecedented and creative regulations have been promulgated to curb future abuses, and new mortgage licensing and home improvement laws have been enacted to legislate positive change.
- The widespread home improvement and mortgage scams apparently are primarily the by-product of greed and of the failure of numerous Massachusetts institutions.
- Large financial institutions failed to police their own industry; community organizations and educational institutions and agencies failed to regulate adequately abuse by home improvement contractors and lenders.
- Greater community access to the services of respected financial institutions is required.
- More diligent monitoring of financial abuses must be a priority for the mainstream financial institutions and for regulatory agencies.
- Extensive educational efforts to advance consumer understanding of financial transactions are also required.

I am proud of the success of the Task Force, which consisted of attorneys, investigators and support staff, whose commitment, skill and dedication made this all possible. The Task Force enforcement actions will provide relief for thousands of victims and hopefully prevent the tragedies which occurred from being repeated in the future.

I welcome your comments and suggestions on this report and important issue. It is only through working together in partnership that we will be able to protect those in society who need it the most and prevent victimization before it occurs.

Sincerely,

Scott Harshbarger

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I. Introduction

In recent years, across cities and towns in Massachusetts, a familiar sequence of events took place: inner-city and suburban homeowners, who were income poor, but had considerable equity in their homes, were targeted to enter into high interest rate mortgage loan transactions, often with unconscionable terms and conditions attached. The irresponsible lenders who preyed on these vulnerable consumers were interested primarily in the equity that these homeowners had built up in their homes, rather than whether consumers could repay the loans with their monthly income.

In hundreds of cases, when consumers could no longer repay these second mortgages, lenders foreclosed on the family home and entire families were evicted.

As homeowners are foreclosed upon, the social fabric of a community is torn apart and the community is destabilized. Destabilized communities are breeding grounds for further forms of economic and other types of urban violence.

Over the past 18 months, the Office of the Attorney General has been investigating and prosecuting unscrupulous lenders, brokers and contractors who engaged in home improvement or second mortgage schemes in an effort to steal the homes of consumers. This work has been largely undertaken by the Home Improvement and Mortgage Task Force which Attorney General Harshbarger created in July, 1991, by drawing upon the resources of numerous divisions within his office. Prior to taking any formal legal action, the Task Force issued dozens of subpoenas, interviewed hundreds of consumers and sought the advice of various banking and lending industry experts. The actions that were eventually taken by the Task Force were based on a careful assessment of the facts and the law that was part of the exhaustive investigation.

This report is intended to alert individuals, homeowners, community organizations, regulatory and law enforcement agencies and our major financial institutions to the various scams that the Office of the Attorney General investigated and brought to light and that can be so destructive to families and whole communities.

II. Background—Setting for the Problem

During the 1980's, the Massachusetts real estate market experienced unprecedented growth. Property values skyrocketed, and individuals who had purchased properties in the 1960's and 1970's saw the equity in their property increase dramatically.

During this period, scams emerged that were designed to persuade homeowners to transfer the built-up equity in their homes to lenders, brokers and home improvement salesmen under loan conditions that contained unconscionable terms, or under promises of home improvement repairs that were overpriced, faulty or never took place. Those hardest hit by these scams were the elderly, those already in financial distress, those unsophisticated in financial transactions, communities of color and others, who while income poor or on fixed incomes, had built-up significant equity in their homes.

These schemes flourished for a number of reasons. First, it appears that the only credit available to these consumers was from the then unregulated and unlicensed second mortgage companies and brokers. These lenders and brokers were not able to police themselves sufficiently to prevent economic exploitation by a certain few. This exploitation was aided by unethical brokers who extracted large, unconscionable fees from consumers and who, in some instances, had undisclosed financial and corporate ties to lenders whose primary goal apparently was the acquisition of real estate.

Second, the simple fact is that many inner-city communities across this state were abandoned by mainstream lending institutions during the 1970's and 1980's. Even during the economic boom years of the 1980's, little attention was paid to capturing inner-city markets, and creating loan products or providing access to banking services to these communities.

Given the void of credit options created by mainstream financial institutions, the unscrupulous contractor and high rate lender entered the picture and marketed their products to vulnerable homeowners. While there was a lack of access to traditional credit products for these consumers, mainstream financial institutions were funding high rate second mortgage lenders and unscrupulous contractors who were selling loans to these communities. Thus, in addition to the law enforcement attack directed toward specific second mortgage lenders and brokers, the Task Force also took a hard look at those mainstream financial institutions that provided lines of credit to or purchased mortgages from unscrupulous second mortgage lenders.

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III. Allegations—Apparent Scope of Problem

The Task Force uncovered wide-ranging allegations of wrongdoing falling into the categories listed below. Consumers, community organizations and law enforcement agencies should familiarize themselves with the listed scams and be on guard for them in their individual communities.

A. Misrepresenting the Nature of the Transaction

- Informing consumers that they are mortgaging their homes when they actually are deeding them away and merely retaining a right to repurchase the home;
- Misrepresenting the home improvement work to be performed, the price to be paid, the interest rate, the amount of the loan, the monthly payment or other term of the loan; and
- Misrepresenting that a broker is a lender when, in fact, the broker is merely arranging the loan for a fee rather than actually making the loan.

B. Illusory Inducements

- Promises by a home improvement contractor or lender that he will give the consumer a job to help pay off the loan;
- Promises that onerous loan terms will be rewritten in the future, if the consumer just agrees to pay those terms for a brief period;
- Charging a cash fee in return for a promise to find immediate refinancing for a consumer already facing imminent foreclosure when, in fact, nothing is done for the consumer other than taking the fee; and
- Giving consumers lump sum cash payments "to use as they see fit" as part of mortgage loan proceeds disbursements in order to induce consumers to agree to unaffordable loans.

C. Pressure and Coercive Tactics

- Consumers are rushed through the loan documents without an adequate time to read and understand them;
- Consumers are told that no lawyer is needed to assist them;
- Consumers are told that the contractor cannot get funds to begin home improvements until the bank releases funds and that the bank will not release such funds until the consumer signs a completion certificate indicating work is complete even though work has not even begun; and
- The consumer's ability to read loan documents is physically obstructed by the arms of the contractor across loan documents or because loan documents are rolled up, only revealing signature lines.

D. Failure to Disclose Key Elements of Transaction

- Asking consumers to sign incomplete documents missing such key elements as the interest rate, the finance charges and the number of payments;
- Failure to disclose that a mortgage is being taken on the consumer's property to secure the loan; and
- Failing to disclose that a consumer has inadequate income to repay the loan and that default is therefore likely.

E. Forgeries and Falsification

- Forging a consumer's signature to the certificate of completion credit application or other loan document; and
- Falsifying a consumer's income, by use of false or forged tax statements and rent receipts, in order to inflate the consumer's income and thereby arranging loans the consumer cannot afford.

F. Unconscionable or Unaffordable Loan Terms

- Balloon payment requiring consumers to make large payments of principal usually within a year or two of the loan closing;
- Excessively high loan fees, including broker fees, origination fees and late payment fees;
- Escrow and security fund accounts on which the consumer is charged interest but from which the consumer derives no tangible benefit; and
- Excessively high interest rates.

IV. Actions by the Task Force

Attorney General Harshbarger charged the Task Force with initiating a multipronged attack on the scams. This included initiating litigation, drafting and supporting legislation, and promulgating regulations.

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A. Litigation

The Task Force has initiated 13 actions relating to home improvement and mortgage scams in approximately the last year. These include actions targeting banks, mortgage companies, home improvement companies and individual home improvement salesmen and mortgage company executives. The actions include the following:

1. *Bank Settlements*

The Task Force has enterod into six separate settlement agreements with Boston area banks. These agreements were entered into following receipt by the banks of letters from the Attorney General indicating an intention to file suit, if settlements could not be reached. We were pleased that the banks involved, once they were aware of our commitment to seek effective remedies, chose to negotiate and settle their respective cases, rather than invest the cost and time involved in litigation. The bank settlements include:

a. BAYBANK SETTLEMENT

In February, 1992, the Attorney General reached agreement with BayBank regarding any liability it may have had in indirectly financing home improvement transactions. Under the terms of the settlement, BayBank agreed to establish a program to resolve consumer complaints regarding home improvements that BayBank financed indirectly through contractors between November, 1987 and February, 1992. BayBank, in effect, agreed to accept responsibility for any improper conduct by home improvement contractors where BayBank has indirectly financed the work. As part of the settlement, BayBank also agreed to make $5 million in below-market rate home improvement financing available to low income communities and $6 million available for the construction of affordable housing. The Lawyers' Committee for Civil Rights and the NAACP Legal Defense Fund, Inc. also assisted in the case and participated in the settlement.

b. SHAWMUT BANK SETTLEMENT

Attorney General Harshbarger reached a $7 million settlement with Shawmut Bank to resolve the Task Force investigation of Shawmut Bank's role in funding Resource Financial, a second mortgage company sued by the Attorney General. The settlement requires Shawmut to make $5 million in mortgage loans available to low income communities. These loans will have the following extraordinary features: (a) no downpayment required; (b) no closing costs; (c) an interest rate one point below Shawmut's regular rate. The settlement further requires Shawmut to make $2 million in below-market rate home improvement loans available in targeted low income communities. In addition, the agreement requires Shawmut to provide either a new loan or an average of $6,000 in cash to approximately 50 specific Resource borrowers whose loans were funded by Shawmut. The Union Neighborhood Assistance Corporation provided the Task Force with information regarding certain Resource borrowers who are aided by the settlement and others described below.

c. FLEET BANK SETTLEMENT

The Attorney General, in April of this year, reached a settlement with Fleet Bank to resolve its role in funding Resource Financial Group. This settlement requires Fleet to establish a $12 million mortgage program for low income communities. The program will have the same extraordinary features as in the Shawmut settlement. In addition, Fleet agreed to provide new loans or a $6,000 cash payment to each of the approximately 40 Resource borrowers whose loans were funded by Fleet.

d. QUINCY SAVINGS BANK

A settlement also was reached with Quincy Savings Bank to resolve claims against Lincoln Trust Company, which merged into Quincy Savings in early 1992 and which also had funded Resource Financial Group. Quincy Savings Bank agreed to provide either a new loan, on very favorable terms, or a $1,250 cash payment to 100 Resource borrowers. As part of the agreement, Quincy Savings also agreed to make $3 million in mortgage money available, again on terms extraordinarily favorable to consumers.

e. SOUTH SHORE BANK

In June, 1992, the Attorney General settled mortgage related claims with South Shore Bank, which also funded Resource Financial Group. South Shore agreed to provide relief to 367 Resource borrowers. Of this total, 278 Resource borrowers who have already paid off their Resource loans will receive a flat cash payment of $2,350. An additional 68 Resource borrowers whose loans are still outstanding will receive either the cash or a refinancing of their loan on very favorable terms. The remaining 21 Resource borrowers whose properties are currently held by Resource

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will either receive cash or a loan: to reacquire their homes. Finally, the agreement requires South Shore to donate $150,000 in cash to establish a legal assistance program for consumers facing foreclosure by lenders other than Resource.

f. USTrust Settlement

A sixth and final bank settlement was reached with USTrust to resolve claims regarding its role in indirectly financing home improvement transactions. USTrust agreed to establish an arbitration program for any consumer who has a complaint regarding home improvement loans funded by USTrust. Under the program, a consumer with a valid complaint can obtain up to $1,000 for Truth-in-Lending violations, can have his or her home improvement loans rewritten on favorable terms and can have shoddy home improvement work repaired at no cost, among other types of relief. Several hundred consumers could qualify for the arbitration program. USTrust also agreed to provide a $3 million mortgage program targeting low income communities. Finally, USTrust agreed to make $2 million in below-market rate loans available to minority owned businesses.

2. Mortgage Company Litigation

The Task Force also has initiated litigation directly against a number of mortgage lenders including Seacoast Industries, Resource Financial Group, Inc., the Money Tree, Inc., Rhodes Financial, Inc., and State Finance and Mortgage Company of Springfield. Each of these cases is in litigation, although several defendants have announced that they are going out of business in response to the suits.

3. Home Improvement Company Litigation

The Attorney General also has sued a number of home improvement companies, including Seacoast and Carefree Building Products, Pro-Tec-To Rolling Shutters of New England, Inc., and Rolling Shutter Systems of New England, Inc. These suits are pending.

4. Home Improvement Salesmen

The Attorney General also has initiated two separate consumer protection actions against four former salesmen for Vinyl Distributors of New England.

B. New Consumer Protection Regulations

In addition to litigation that will provide relief to consumers for past injuries, the Office of the Attorney General promulgated a comprehensive set of consumer protection regulations that are intended to create a level playing field for all lenders and to protect consumers from future abuses by unscrupulous lenders and brokers. The key features of these unprecedented regulations, which were promulgated following public hearings, include:

- Requiring that all brokers and many lenders provide borrowers with standardized copies of the Attorney General's Mortgage Broker and Lender Disclosure Forms. These forms identify in simple and clear language the essential features of a mortgage loan transaction as well as the cost and interest rate the borrower will have to pay;
- Requiring that lenders and brokers take reasonable steps to assure that borrowers understand the loan transaction. This is an effort to address the needs of non-English speaking borrowers. The regulations recommend the use of adult interpreters or translated disclosure forms, which will be provided by the Attorney General's office in several languages.
- Prohibiting unconscionable rates or other loan terms. As an example of unconscionability, the regulations indicate that factors to be considered include whether an interest rate is 10 percent above the Wall Street prime rate, or 20 percent.
- Prohibiting the advertisement of various inducements such as use of the words "immediate approval" of loan applications or "immediate closings;" the regulations also prohibit the advertisement of a "no points" mortgage loan when that is not the case.
- Severely restricting the use of certain other inducements such as "bad credit no problem" and "avoid foreclosure." Lenders and brokers cannot use these terms in advertisements unless they fully disclose all the restrictions that may apply to such loans. In addition, brokers and lenders who use such inducements must provide the following warning: "You may lose your home if you cannot make all of the payments or if you miss any of the payments on this loan."

A number of organizations assisted in the development of these regulations, including the Massachusetts Bankers Association and the Massachusetts Association of Mortgage Lenders and Brokers.

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C. Legislation to Regulate Home Improvement Contractors

The Attorney General played a major role in working with the Legislature to secure passage of the new law regulating home improvement contractors. The law enacted includes several important provisions which will:

- Prohibit home improvement contractors from also acting as mortgage brokers or lenders in connection with the home improvement contracts they enter into;
- Require contractors to register with the Commonwealth's Bureau of Building Regulations and Standards;
- Require a written contract between a contractor and a homeowner for any job over $1,000, detailing the work that needs to be completed and the terms of the agreement;
- Establish a Guaranty Fund to provide limited restitution to consumers who have been defrauded by a registered contractor but are unable to collect on the judgment; and
- Provide for criminal penalties for home improvement contractors who fail to obtain a certificate of registration.

D. Foreclosure Assistance

In response to the widespread incidence of foreclosures related to home improvement and mortgage schemes, the Attorney General, in June, 1991 called for and received extensive cooperation from over 100 lenders in a voluntary 120-day moratorium on foreclosures. After initiating this voluntary moratorium, the Attorney General's office supported the passage of a mandatory moratorium which was enacted by the Legislature. The Attorney General's office worked with private bar counsel and Registers across the state to enforce the moratorium.

In addition, the Task Force provided emergency assistance to individuals facing immediate foreclosure. As a result of this assistance, hundreds of foreclosures were delayed or cancelled. In those instances where it was not possible to stop a foreclosure, consumers were referred to appropriate social service agencies for assistance.

VI. CONCLUSIONS AND RECOMMENDATIONS

As a result of its 18 months of work in the home improvement and second mortgage arena, the Task Force has reached the following conclusions and makes the following recommendations:

A. Conclusions:

- The unregulated and unlicensed mortgage broker and lender industry was unable to police itself to restrain adequately unscrupulous lenders and brokers from unfair and deceptive practices in the provision of second mortgage lending services.
- Entire communities abandoned by mainstream financial institutions are attractive prey to high pressure and illegal tactics by unscrupulous lenders and brokers in the provision of second mortgage products.
- Vulnerable and unsophisticated consumers need to be educated to the dangers of urban economic violence that can accompany equity-based financing.

B. Recommendations:

- Lending associations should establish rules of conduct and codes of ethics for members and discipline those who breach such rules and codes.
- Consumers in low income neighborhoods need greater access to more branches in low income communities. Financial institutions need to create innovative credit products for these communities, and must aggressively market these and traditional products to low income consumers.
- In fulfilling their Community Reinvestment Act responsibilities, mainstream banks should actively reach out to low and moderate income, minority and non-English speaking consumers. There is a compelling need for banks to become more "user friendly" to low and moderate income communities all across Massachusetts.
- In particular, banks should develop mortgage loan programs that are maintained in their portfolios so that more liberal and more flexible lending criteria can be applied to low and moderate income applicants. Mainstream financial institutions should expand second mortgage and equity based lending programs, with appropriate safeguards, so that more such lending can be made available to low and moderate income consumers.
- Banks should formulate long-range plans to include branches, loan production centers and automated teller machines in low and moderate income neighborhoods. Access to banking services is an essential part of modern life, and it is as necessary as telephone, gas or electric utility services.

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- Mainstream banks should examine and scrutinize their financial relationships to other lenders that provide credit in low and moderate income and minority neighborhoods. Banks must look at the impact of the mortgage companies they finance on affordable housing and gentrification. Financial institutions must make sure that the mortgage companies which they finance are lending on terms that are fair and that such terms are not unconscionable. Mainstream banks must avoid financing high-rate equity-based lenders.
- Second-mortgage lenders' and brokers' associations should aggressively police themselves consistent with the Attorney General's consumer protection regulations and with the Commissioner of Banks licensing regulations.
- Public schools and community organizations must expand consumer education programs so that consumers fully understand the fundamental terms of basic financial transactions. At a minimum, each graduating student should understand the concept of interest and credit, and the basic elements of a mortgage transaction.
- Public institutions and agencies need to monitor newly-adopted regulations to insure that they are effective in curbing past home improvement and mortgage abuses. They likewise need to enforce aggressively compliance with the new mortgage licensing and home improvement statutes.

The problems that created the second mortgage scandals are complex and cannot be eradicated overnight. However, the recommendations outlined in this report, if adopted and carried out by mainstream banks, second mortgage lenders, brokers, communities and public agencies, are a necessary first step to changing the urban economic landscape from one of deprivation and disintegration to one of hope and opportunity. The equity-based lending that was carried out under unconscionable terms and conditions by irresponsible businesses is just one form of urban economic violence that we must seek to prevent. But, only by aggressive vigilance, and the availability and access to products to meet the needs of the consumers who were targeted can the remedial process begin. And it is the responsibility of all of us.

TESTIMONY OF THE NATIONAL CONSUMER LAW CENTER
(KATHLEEN KEEST, ROBERT HOBBS, MARGOT SAUNDERS, GARY KLEIN)

PREDATORY HOME EQUITY LENDING

FEBRUARY 17, 1993

PROBLEMS IN THE HOME EQUITY MARKET: PREDATORY LENDING[1]

Mr. Chairman and Members of the Committee, thank you for your invitation to testify today.

The National Consumer Law Center is an organization which acts in part as a national support center for legal services attorneys and pro bond attorneys representing low income consumers around the country. These attorneys routinely request us to help analyze credit transactions and determine what legal rights and remedies their clients might have. As a consequence, we have seen examples of predatory home equity loans from all over the country—the kind of lending which can devastate its victims.

Today you will hear from several other witnesses who can give you some vivid, real-life examples of overreaching lending practices which have contributed to record high foreclosure rates and the heartwrenching loss of homes to the auction block throughout the country. Rather than add to that litany, we will focus on what we believe has contributed to the increased incidence of predatory lending during the past decade, and on what reforms we believe may help curb the excesses.[2]

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[1] This statement may use the more common term "second mortgage" to refer to what are more precisely called "home equity" loans; that is, non-purchase money loans secured by residential real estate, irrespective of the priority of the lien.

[2] Some examples of the kinds of outrageous practices we have seen may be found in NCLC publications, such as: Hobbs, Keest, DeWaal, "Consumer Problems with Home Equity Scams, Second Mortgages, and Home Equity Lines of Credit," (AARP 1989) [hereafter "Consumer Problems"]; Keest, "Second Mortgage Lending: Abuses and Regulation," (NCLC, for Rockefeller Family Fund, 1991) [hereafter "Abuses and Regulation"]; "Nature Abhors a Vacuum: High-rate Lending in Redlined, Minority Neighborhoods in Boston," and "Principal Padding: The Prepaid Payment Pyramid," 9 NCLC REPORTS *Consumer Credit & Usury Ed.* (May/June 1991).

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THE CAUSES

Though home equity lending abuses are not new,[3] the 1980s witnessed a major upswing. "Equity-skimming," or "equity-theft" became a major threat to many homeowners—in particular to the most vulnerable.[4] A number of factors converged to contribute to the problem:

Deregulation: In tandem with the appreciation of real estate values, (see below), the deregulation of consumer lending in the 1980s left the door wide open for unscrupulous operators. Congress' contribution was to preempt both state usury ceilings on mortgage lending secured by first liens (whether purchase money or not),[5] as well as state limitations on risky "creative financing" options, such as negatively amortizing loans.[6]

Federal deregulation also set the stage for many states to remove rate caps and other limitations on other lending—including second mortgage lending. Whatever the overall merits of economic deregulation, it undeniably unleashed the greedy instincts of unscrupulous operators all over the country. In keeping with the conventional wisdom of free market theory, "the market" was supposed to take care of any problems. Unfortunately, there are market failures, and predatory home equity lending provides a good example of one. Even as the cost of funds has declined, these lenders have not lowered their rates, and for a number of reasons, competition and market forces don't operate according to theory in these loans.[7]

The Rise in Real Estate Values: The inflation in real estate values in the 1980s created much new wealth—the equity pool. Since real estate secured lending—particularly owner-occupied residential real estate—has historically been among the safest kind of lending, creditors of all stripes strove to develop or increase their portfolio of real-estate secured loans.[8] Legitimate lenders simply sought increasingly secure loans. The marginal lenders—the equity skimmers—looked to this new equity pool as something to enrich them.

In turn, the appreciated value of the property led to "asset-based lending"—that is, loans made based on the value of the security, rather than on the borrower's ability to repay. This has been common in commercial lending, but is unsuitable for consumer loans in a humane society. Most borrowers are simply wage-earners who look to their regular income to repay their debts. The amount of equity in the collateral is only relevant to the ability to repay a loan if the borrower intends to liquidate the collateral. In short, "asset-based lending" is a legitimate-sounding justification to ignore sound underwriting principles, and make unaffordable loans.

Equity skimmers may write loans with repayment terms which borrowers could not hope to meet over the long haul: monthly payments which are 70 percent or more of monthly income (or, in one case we've seen, monthly payments more than monthly income[9]); or large balloon payments which the borrower has no realistic hope of making. The loans are made because the lender can't lose: either they will be repaid at a high interest rate, or, too often, through the foreclosure process.[10]

The Rise in the Secondary Mortgage Market: Some high-rate mortgage lenders, particularly home improvement contractors, have historically operated by assigning installment contracts they write to other lenders, such as finance companies or banks. But the 1980s added a new wrinkle—bundling mortgage loans into large portfolios and selling them on the secondary mortgage market. This enabled mortgage companies specializing in home equity lending—unregulated in many states—to operate. Since there was a "back-end" income stream, they could operate with lit-

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[3] In fact, during the last cycle when serious abuses in this industry attracted public outcry and led to regulatory reforms, Congress created the Truth in Lending rescission right, 15 USC § 1635, now one of the most valuable tools available to attorneys representing second mortgage scam victims.

[4] See p. 5, *infra*.

[5] Depository Institutions Deregulation and Monetary Control Act of 1980, § 501 (DIDA), codified at 12 USC § 1735f–7a.

[6] The Alternative Mortgage Transaction Parity Act of 1982 (AMTPA). 12 USC § 3800, et seq.

[7] See, *e.g.*, pp. 7–10, *infra*.

[8] The portion of homeowners with home equity loans more than doubled between 1977 and 1988. In 1977, 5.4 percent of homeowners had such loans; in 1988, 11 percent (6.5 million families) had home equity loans. Canner & Luckett, "Home Equity Lending," 75 Fed. Reserve Bull. 333 (May, 1989).

[9] In this case, where default was absolutely predictable and inevitable as of the first payment on a 12-month balloon note, the contract provided for extremely high late charges plus a 42 percent default interest rate. Thus, at the end of the 12 month term, the lender could claim a lien on the property that was approximately $50,000 greater than than the original principal plus 22 percent interest provided for in the note.

[10] In fact, state laws on foreclosure almost universally allow foreclosing creditors to buy the property at a significant discount from fair market value and then to resell it at full value, pocketing the difference.

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tle capitalization base. They could obtain a line of credit from a major bank; originate predatory loans, taking out very high up-front fees; then dump the loans onto the secondary market.

It is a good deal for an equity-skimmer who originates the loans, because it can charge enormous up-front fees, be careless about underwriting, and then pass the consequences along. If the loan defaults, it is the new creditor's problem. Apparently the buyers on the secondary market thought it was a good deal: they'd save the expense of originating loans, and, if the borrower alleges the originator defrauded them, or engaged in usury or other violations of the law, they could hide behind a holder in due course defense.[11]

"Tax Reform:" The amendment of the tax laws which retained the deductibility of interest only for home-secured loans added to the massive increase in home-equity debt. Many consumers and taxpayers are not well-equipped to calculate how the tax savings would weigh against the extra interest to be paid. Yet that is a sales pitch given by many creditors, and many homeowners listen to that siren-call.

Cultural & Business Mores: Finally, these economic and legal changes happened in a context of shifting cultural attitudes. The business ethic was that "anything goes," and greed was no longer the subject of opprobrium, but rather viewed as an engine for growth. Unfortunately, home equity lending became one of the targets for the speculators.

THE VICTIMS

The problem of second mortgage scams and home improvement scams is not limited to certain regions; we have seen them from most parts of the country.[12] But there are certain factors which make it worse in some areas than in others:

—areas which had the greatest increase in real estate values tended to have more problems;

—the more permissive the legal environment (i.e. the less regulation), the greater the problem.

Most poignantly, the more vulnerable the population, the greater the problem. Thus the less educated and less sophisticated are particularly victimized by these lenders; as are the elderly (who often have a lot of equity in their homes); and those whose other borrowing options are blocked, or who perceive themselves as having no options.[13]

THE PERPETRATORS

When one looks at both the "sins of commission" and the "sins of omission," there is a great deal of culpability across the spectrum.

"Tin Men:" Fraudulent home-improvement contractors, particularly the door-to-door operators, have long been a major source of complaint about abusive home-secured loans. They have been with us always, and probably always will. But as to whether they are isolated actors, or are commonplace depends upon whether the ultimate sources of the financing—and the regulatory environment—encourage or discourage oppressive business practices.

In addition to needing a source of financing to run their business at the outset, these contractors must have an outlet for their credit sales, as they cannot afford to carry the credit accounts themselves. Thus they will either arrange for lenders to make direct loans, with the proceeds to pay off the sales; or will write financing contracts themselves, to be immediately assigned by prearrangement to a lender. In some instances, it may be the ultimate financier who drives the operation, in essence using the contractor as a "bird-dog" to drum up mortgage business for it.[14]

These ultimate lenders can be second mortgage companies (which may or may not be regulated by the state); often they are finance companies (which are regulated by the state); or banks (which are regulated by either the state or a federal agency,

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[11] The holder in due course doctrine generally gives assignees or other subsequent holders of negotiable instruments (such as promissory notes) immunity against legal claims and defenses that the borrower may have had against the original creditor. (See also p. 11, *infra.*) Some also bought the loans with a recourse arrangement, whereby they would return non-performing loans to the originator, giving them yet further protection against risk—at least until the originator went bankrupt.

[12] One exception is Texas, which has strict limitations on the kinds of home equity loans which can be written at all.

[13] This factor helps explain the disparate impact of predatory lending felt by minority borrowers and people living in minority neighborhoods. *See, e.g.* "Abuses and Regulation," note 2, *supra.*, Appx. B—"Race and Risk: High Rate Lenders for High Risk Borrowers—Myth or Fact?"

[14] This was the heart of the claim in *Baker v. Harper*, in which a mortgage company was ordered to pay $45 million to 5 families. See "Alabama Jury Orders Lender to Pay $45 Million in Fraudulent Lending Case," 57 BNA Banking Rept. 270 (Aug. 12, 1991).

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depending upon their charter). It is the cooperation of the ultimate financing sources which keep a contractor in business. Thus the lender is in a position to help assure that legitimate value be given for the money, or to help compound the problem by trying to disassociate themselves from any complaints the borrower may have about the contractor or his work.[15] Unfortunately, many ultimate lenders, despite their heavy involvement in facilitating the transaction, choose the latter course.[16]

Second mortgage companies: As was noted above, the 1980s witnessed the growth of second mortgage lending companies—many of which received notoriety: Landbank Equity; First American Mortgage Company; Freedlander. In many states, these companies were not (and still are not) regulated. The earlier discussion about the secondary mortgage market explains how these companies generally operated.

As with the "tin men," it is frequently regulated lenders—banks and thrifts—which provide the wherewithal for these companies to survive. Again, there are degrees of culpability among these "enablers." Some may actually know what kind of operation the second mortgage lenders are running; others simply choose to ignore the red flags in these transactions, and buy up the paper anyway.[17] The more "the legitimate" lenders opt to purchase these kinds of loans with an "ostrich" approach to their investment, the easier it is for the predatory lenders to flourish.

Finance companies:[18] Finance companies moved into home equity lending in a big way in the past 15 years. Some of the finance companies have been particularly bad at "loan-padding:"—inserting costly add-ons onto loans, making them much more expensive for borrowers.[19] Finance companies are regulated (with varying degrees of success) by the states, but some are subsidiaries of banks, which, in turn, are regulated by either the states or a federal agency, depending upon their charter.

The supporting cast: Mortgage brokers have played a major role in steering borrowers into bad loans. As their fees are a percentage of the loans, there is a "reverse competition" effect which encourages them to hook borrowers up with expensive, loan-padding lenders. Many of these brokers advertise as if they are market-rate lenders and de not disclose their true role—or their commissions—until loan closing. By that time many borrowers have lost their leverage to object or walk away. Loan brokers are not regulated in many states, and some regulation which does exist is token only.

Banks and thrifts: As the above discussion indicates, even if banks and thrifts are not directly engaging in predatory business practices, it often is their ultimate financial support which enables the predatory lenders to operate on the scale we have seen in recent years.

ALLOCATING RESPONSIBILITY

To anticipate one reaction we've heard too often in telling of these loans, I'd like to make a few other observations. That reaction: "Well why do people get themselves into these deals? Don't they have to take some responsibility for what they sign?"

There are a lot of reasons why that's not an appropriate response.

- Most obviously, it blames the victim, while relieving the business of any ethical obligation, as if the public policy is that a lender can do anything it can get away with. After all, we prosecute burglars even if the apartment window wasn't

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[15] *See, e.g.* "Spiking and Loan-Splitting in Home Improvement Contracts: Artful Dodges," 26 Clearinghouse Review 415 (Aug. 1992). Where the sale of home improvement goods and services is involved, the Federal Trade Commission's "holder rule" (16 CFR 433) provides that a related financier has vicarious liability for any claims or defenses the consumer has against the seller.

[16] More and more frequently, the same principals direct both sides of the business. But they try to disguise the connection, so as to try to claim the borrower's obligation to pay is distinct from the contractor's obligation to perform its part of the contract.

[17] Unlike the home improvement sales financing contracts, the FTC "holder" rule does not apply to straight loans, so these assignees can try to assert a holder-in-due course defense to claims the borrower may raise based on the originator's wrong-doing.

[18] Finance companies, such as Beneficial, ITT Financial, etc, are what used to be thought of as "small loan" companies, though in many states today they can make relatively large, mortgage secured consumer loans. It has been our experience that finance companies tend to keep the home equity loans they make (refinancing them frequently), rather than using the secondary market.

[19] "Insurance-packing" is one of the more common means of loan padding favored by finance companies. For a description of the practice, see National Consumer Law Center, Usury and Consumer Credit Regulation Chap. 7 (1987 and Supp.). For a good example of how it can distort the price of credit to a borrower, see *Besta v. Beneficial Loan Co. of Iowa*, 855 F.2d 532 (8th Cir. 1988). In that loan, insurance packing enabled the lender to skim an extra $3,000 from what was really a $1,400 loan. In one loan seen at the Center, the very same scheme was used to skim an extra $23,000 from a loan.

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locked. We prosecute muggers even if the victim didn't bother to learn martial arts for self-defense.

- Credit—especially given the credit fads of the late 1970s and 1980s—is enormously complex and hard for most people to understand. It is even more so for people with language barriers, educational barriers or any other of the multitude of barriers a lot of consumers face. A recent Consumer Federation of America consumer survey showed that though 70+ percent of respondents knew what the letters APR stood for, only half of them understood its significance as an indicator of the cost of credit. (Recent experiences with ARMs and consumer leases suggest that some credit products are so complex that even the employees of the financial institutions can't figure out what these contracts say.)
- Even aside from the issue of the products being too complex to be described in easily understood terms, disclosure laws like TIL aren't as much help as they should be. In fact, for residentially secured real estate, TIL actually *encourages* distortion in disclosing the cost of mortgage credit. Because of the special treatment given closing costs and brokers fees by TIL (in some cases exacerbated by FRB interpretations) in real estate secured loans,[20] unethical creditors are encouraged to pack a loan up with exorbitant costs that, on their face, are permitted by TIL to be excluded from the APR calculation.[21] For these kinds of loans, TIL has become part of the problem, not part of the solution. Moreover, TIL disclosures are often not finalized until the time of the closing on a loan, by which time the borrower may have foreclosed other options, and no longer have the choice of walking away.

Furthermore, contracts are not written in understandable language, and the sheer volume of paper is overwhelming. One transaction, for example, had at least 40 pieces of paper that the consumer would have had to wade through. (The vast majority of those 40 pages were not "government-mandated." Lenders wanting lopsided protections and verbose lawyers are the primary culprits for this excess paper.) The prose isn't exactly targeted for an 8th, grade reading level, and on some of these transactions, the numbers can take a lawyer a day or more to sort out.

- The dynamics of the sale must be understood as well. From our reports, some of these brokers solicit the customers, rather than being sought out by the customers. Like any good salesperson, they are well-schooled in retail seduction, and know how to gloss over their product's weak points.

That is problem enough when piled onto all the other factors mentioned here, but it also must be remembered that, at least for most of us, the tendency is to trust people. If it is hard to figure out what's going on, it seems the proper thing to do to trust the nice man or woman who seems like he or she is trying to help you. Many people don't operate from the assumption that all business people are out to

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[20] Many costs associated with these transactions would fall within the overall definition of a finance charge, except that they are specifically excluded from the finance charge because these transactions are secured by real-estate. 15 USC § 1605, 12 CFR 226.4(c)(7). To the extent the purpose of TIL was to disclose the full cost of credit to a consumer, there is absolutely no justification for some of the (c)(7) exclusions. (The ones that were justified would be justified in the purchase money mortgage context, but not in the second mortgage context. In a cash transaction real estate purchase, title fees and abstract fees would be incurred, so these fees would be imposed in a comparable cash transaction, and therefore wouldn't be a finance charge. In a straight second mortgage loan, there is no comparable cash transaction.) When TIL was passed, second mortgage lending was more rare, and closing costs were small in relation to the loan amount, so the degree of distortion was less significant to a consumer. *See generally* Rohner, The Law of Truth in Lending, § 3.03[1] (1984).

Additionally, the FRB interpretation as to brokers' fees is arguably wrong, at least in some factual circumstances, but until a court declares the interpretation "demonstrably irrational," creditors will exclude the fee from the finance charge. (15 USC § 1605(a)(3) declares a finders fee a finance charge, and nowhere in the statute is any exception to that authorized. Thus, where the broker acts as a finder for the lender, as many of these do, the fee should be a finance charge. But Official Staff Commentary § 226.4(a)(2)-3, while clearly in direct contradiction to § 1605(a)(3) and thus not legally entitled to deference, offers the creditors a convenient haven. Though at least two court cases have offered courts the opportunity to address this issue, neither of them choose to do so, and the issue remains an open one.)

So today, with the surge in home equity lending, the increased costs tacked on to these loans, exacerbated in the case of abusing lenders, the (c)(7) exclusions and broker's fee interpretation are beginning to be the exceptions that swallow the rule. This undermines the usefulness of TIL as an indicator of the cost and a tool for comparison shopping.

[21] Regulation Z, § 226.4(c)(7) does require that these charges be "bona fide and reasonable" in order to qualify for the exclusion, but that's of little help to a consumer at the outset. We grocery shop often enough to know what a bona fide and reasonable price for a loaf of bread is; most of us don't get mortgage loans often enough to know what a bona fide and reasonable price is for a brokers fee or an attorneys fee or a title search fee.

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rip them off until proven otherwise, and we as a society should think hard before we decide we want our economy to operate that way.[22]

- **And of course, one of the central questions raised by the distribution of these loans is to what extent, if any, the high-rate lenders' customers have alternatives. This public saga began with the allegation that predatory lending operated in a credit vacuum created when mainstream banks abandoned direct lending in minority neighborhoods. In response some creditors have asserted that these are high risk borrowers who could not get credit elsewhere, and that the high rates are justified by the high risks.**

Issues of redlining are for another proceeding, but there are some points we would like to make concerning the "high risk" allegations:

—Most important, many of these borrowers are not in fact any riskier than others.[23] There may be self-selection, with some people assuming they wouldn't qualify, or assuming that "regular" lenders don't want their business. Though some borrowers really may not have alternatives, many simply may believe they do not. (And in fact, the differences between market-rate lenders and high-rate lendors in their advertising campaigns and target markets may reinforce that belief.)

—Some consumers actually may present increased risk of default. But the way some of these loans are structured, these creditors seem to opt for writing a *more* risky loan, instead of one that might have a chance of working out, in order to suck more equity from the home. As discussed earlier (p. 3), the more than ample security given by the home eliminates the kind of financial risk which might otherwise justify such high rates.

—Finally, some of the consumers in fact could not get credit elsewhere—and perhaps should not. Whether the high-rate creditors are offering them a service or are simply making improvident loans to milk these people dry is yet another issue. Some of these loans are designed for failure—to simply suck out the last remaining equity in the consumer's home, leaving the consumer with nothing when the home is sold. High rates, loan packing, and unaffordable balloons all add to the notion that equity-stealing is too often the motivation.

RECOMMENDATIONS

The problem of predatory home equity lending has a multitude of sources, and the solutions will have to come on many fronts. NCLC has developed a catalogue of recommendations to address both the overall problem and individual pieces of the overall pattern. Following is a two-part appendix which contains full discussions of that catalogue, and for ease of reference, a summary thereof. While that list is comprehensive, it does not rank the suggested reforms in order of importance to consumers.

So to conclude our remarks today, we would like simply to highlight those reforms which we think would be of greatest value in combatting the overall problem of predatory lending practices.

- **Interest rate ceiling and limitations on other charges.**

As a result of an anomalous mismatch between statutory usury ceilings and market rates in the late 1970s, the entire concept of rate caps became anathema to lenders and regulators. Consequently, we threw the baby out with the bath water.

In 1827, the Virginia Supreme Court observed that "It has been a good deal the fashion of late, to decry the policy and justice of our laws regulating the rate of interest. . . . It may be permitted to observe, however, that if the experience of the ages, and the general opinion of mankind, deserve weight in legislation, their voice is in favor of usury laws. They have prevailed in all civilized countries, and in all time."[24]

The experience of the "deregulation decade" simply proves the point. The experience proves that rate caps are needed to protect the trusting, the unsophisticated, the unwary, and the necessitous consumer from "the oppression of usurers and monied men, who are eager to take advantage of the distress of others"[25] now no less than 150 years ago. The 1970s problem of a mismatch between statutory cap and market rate is easily resolved by the imposition of a statutory ceiling which can float with a specified market-related index.

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[22] Some courts have considered this "trust no one" approach and rejected it as untenable. *See, e.g. Northwestern Bank v. Roseman*, 344 S.E.2d 120 (N.C. Ct. App. 1986), *aff'd* 354 S.E.2d 238 (N.C. 1987).

[23] See "Race and Risk," note 2, *supra*.

[24] *Whitworth & Yancy v. Adams*, 5 Rand 333, 335, 26 Va. 333 (Va. 1827).

[25] *Id.*

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Furthermore, the usury ceiling should be combined with limitations on additional non-interest charges (points, brokers fees, closing costs, credit insurance, bogus escrows, etc.), which will curb loan-padding.

In the absence of a federal cap, the DIDA[26] should be amended to permit states to reintroduce rate caps on home equity loans should they choose.[27]

- **Eliminate holder-in-due course status for assignees and purchasers of home equity loans.**

This will force the industry to do more self-policing. If holders will clearly be liable for the claims the borrowers have against the originators, they should more carefully screen these with whom they do business. That, in turn, should help dry up the financial lifeline that has enabled the predatory second mortgage companies to operate.

There is already federal precedent for this: the Federal Trade Commission has eliminated the rule for the purchase of consumer goods or services. 16 C.F.R. § 433. (It thus already applies to home improvement credit sales, but does not apply to straight loans.) Congress also limited the holder rule somewhat for certain credit card purchases. 15 USC § 1666i. The limitation on the holder rule certainly has not dried up the legitimate auto financing market, so there is no reason to assume that extending it to home equity loans would dry up the legitimate home equity lending market.

- **Define improvident lending and overreaching home equity lending as an unconscionable practice or an unfair practice, and provide a private remedy.**

The 1974 model Uniform Consumer Credit Code § 5–108 contains a provision which provides consumers relief against unconscionable conduct or unconscionable terms. Ameng factors to be considered in determining unconscionability are:

—Belief by the seller, lessor, or lender at the time a transaction is entered into that there is no reasonable probability of payment in full of the obligation by the consumer or debtor.

—The fact that the seller, lessor, or lender has knowingly taken advantage of the inability of the consumer or debtor reasonably to protect his interests by reason of physical or mental infirmities, ignorance, illiteracy, inability to understand the language of the agreement, or similar factors.

It provides that courts may refuse to enforce an unconscionable agreement, or refuse to enforce any unconscionable term, or limit the application so as to avoid any unconscionable result. It authorizes injunction and actual damages. A similar provision in the model National Consumer Act provided for punitive damages as well. (NCA, §§ 5.107(4), 5.304).

As the attached appendix demonstrates, there is a wealth of steps—some major, some minor—that can be taken to address various aspects of this problem. But we feel that these are among the most useful to get to the heart of the matter.

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[26] Note 5, *supra*.

[27] See p. 3, *supra*. It will be also necessary to assure that a state's law is not further subject to preemption by a sister state with less inclination toward consumer protection through the "exportation" doctrine as a result of recent interpretations of § 521 of DIDA, 12 USC § 1831d. *Cf. Greenwood Trust v. Commonwealth of Massachusetts*, 971 F.2d 818 (1st Cir. 1992).

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APPENDIX
REGULATORY REFORM FOR PREDATORY HOME EQUITY LENDING

Summary

	Issue		Alternatives
1.	Federal encouragement of exorbitant rate HELs		Amend 12 U.S.C. Sec. 1735f-7a.
2.	Federal encouragement of HELs with balloon payments, etc.		Amend 12 U.S.C. Sec. 3800.
3.	Equity skimming	A.	Prohibit holder in due course status.
		B.	Establish claim that it is unfair to lend so that payments overburden the consumer's income.
		C.	Establish floating interest rate ceiling.
		D.	Require disclosures to investors.
4.	Unfair and deceptive practices by loan brokers	A.	Impose fiduciary duty on loan brokers.
		B.	Include fees in Truth-in Lending finance charges.
		C.	Enact maximum fee.
		D.	Require early disclosure of fees.
		E.	Require Truth-in-Lending disclosures by brokers.
		F.	Require brokers to advertise that they arrange loans but are not lenders.
5.	Balloon payments and demand notes	A.	Prohibit balloon payments generally.

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		B.	Alternatively, provide a right to refinance a balloon payment.
		C.	Amend Truth-in-Lending to require conspicuously disclosed demand clauses.
6.	Credit insurance	A.	Require credit insurance to be written on declining monthly balance basis.
		B.	Require creditors to take competitive bids on credit insurance.
		C.	Establish a 75 percent minimum loss ratio for credit insurance.
		D.	Establish maximum rates for credit insurance.
7.	Costly refinancing	A.	Prohibit mandatory loan consolidation.
		B.	Establish an unfair and deceptive practice claim for requiring imprudent refinancing.
		C.	Require lender disclosure of disadvantages of refinancing.
		D.	Require lenders to provide consumers a choice of a consolidation HEL, a HEL without refinancing, and unsecured credit.
8.	Closing costs on home equity loans		Amend Truth-in-Lending to include HEL loan closing costs in finance charge.
9.	Wraparound mortgages		Prohibit wraparound mortgages, or require the amount financed to include only actual advances for Truth-in Lending and usury purposes.
10.	Prepayment penalties		Limit to one month's interest.

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	Problem		Solution
11.	Punitive foreclosure laws	A.	Establish right to cure delinquency.
		B.	Amend Bankruptcy Act, 11 U.S.C. Sec. 1322(b)(5) to allow cure until a bona fide sale of home occurs, and to authorize cram-down.
		C.	Require private sale of foreclosed residence.
		D.	Require notice of redemption right.
		E.	Establish a mortgage assistance loan program.
		F.	Allow moratoria on payment of principal.
12.	Lender pockets property insurance proceeds.		Allow homeowner to decide whether to apply insurance proceeds to home or loan.
13.	Untimely disclosures.		Provide advance disclosures.

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ALTERNATIVES FOR HOME EQUITY LOANS (HELs) REGULATORY APPROACHES[1]

DISCUSSION

1. Issue: Federal Encouragement of Exorbitant-Rate HELs.

Problem: There has been a dramatic increase in predatory HEL lenders who encourage homeowners to take out large HELs at high annual percentage rates. Many of these mortgages are really first mortgages, particularly when the homeowners are elderly, because the homeowners' prior mortgages have been paid off. Under § 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA),[2] these HEL lenders were inadvertently set free to gouge consumers. DIDMCA was intended to repeal state usury laws which, because of high market interest rates, were impinging on home sales. However, it was written too broadly because it applied to any "first lien on residential real property," whether it was to be used for purchase or not. Unscrupulous HEL lenders use this loophole to target consumers with a lot of equity or to require homeowners to pay off existing low-rate, purchase money mortgages with high-rate HELs.

Alternative: Amend DIDMCA to limit it to first liens taken to secure a loan for the acquisition or construction of a residence or to first liens taken to refinance such loans if the annual percentage rate on the new loan is at least two percentage points lower than the interest rate associated with the original loan.

2. Issue: Federal Encouragement of Balloon Payments, Negative Amortization, Demand Clauses.

Problem: Another sweeping federal preemption of state consumer credit laws became effective on October 16, 1983 with the 1982 Depository Institutions Act. The primary preemption in that act is contained in the Alternative Mortgage Transaction Parity Act (AMTPA), 12 U.S.C. Sec. 3800. AMTPA does not affect interest ceilings on mortgage loans, but rather addresses the structure of mortgage loans by overriding state laws that restricted "creative financing," e.g., laws limiting variable interest rates, balloon payments or negative amortization. AMTPA, like DIDMCA, applies to HELs as well as mortgages to acquire a home, though the purpose of AMTPA, as well, was to encourage home construction and home purchases. In addition, AMTPA applies to any mortgage regardless of priority. Like DIDMCA, it has thus repealed traditional regulation by the individual states of the terms and conditions of consumer credit transactions that are secured by a family home. This preemption prevents states from taking such traditional steps as putting annual or lifetime caps on variable interest rates, limiting or prohibiting balloon payments (see Issue 5 below) or negative amortization[3] and limiting prepayment penalties (see Issue 10 below).

Alternative: Amend AMTPA to limit it to first and second liens primarily for the acquisition or construction of a residence, or to refinance first liens at an annual percentage rate that is at least two percentage points lower than the interest rate associated with the original liens.

3. Issue: Equity Skimming.

Problem: Equity skimming may come in several guises. It may involve writing a home equity loan that is likely to be unaffordable by the consumer: either the regular payments are too high for their income, or low regular payments lead to a final balloon payment that the consumer does not have the resources to pay. It also may be "padding" the loan with unnecessary and costly charges of no benefit to the borrower in order for the creditor to extract more of the home's equity, either through the borrower's repayment of the padded loan or through foreclosure in the event of default.

NCLC first started observing equity skimming loans in the late 1970s and early 1980s when many states began deregulating consumer credit laws. Some equity skimmers were most interested in obtaining a quick foreclosure sale of consumers' homes, which they could buy and then sell for a large profit. Others were engaged in what resembles a classic Ponzi scam. That is, they were in the business for the short-term, extending credit with large front-end charges and high interest rates, using underwriting criteria unlikely to prevent many defaults and foreclosures, and then selling the mortgages to investors attracted by the high interest rates. They

[1] This is adapted from Hobbs, Keest & DeWaal, "Consumer Problems with Home Equity Scams, Second Mortgages, and Home Equity Lines of Credit," (AARP, 1989).

[2] 12 USC § 1735f–7a.

[3] This occurs when the monthly payments are insufficient to meet the accruing interest on the loan. This results in an increasing loan balance even though installments are timely paid.

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would collect payments ("servicing") for the investor. (As with other Ponzi schemes, these sometimes collapsed into bankruptcy.) Finally, those who skim simply by loan-padding are trying to extract extra wealth from the vast real estate equity pool for themselves, without giving any real additional benefit to the borrower for the added cost.

Alternatives:

A. "Holder-in-due course" status prevents the investor/assignee from being subject to claims and defenses, e.g., fraud or usury claims, which the borrower might have against the original lender. Removing holder in due course status for home equity loans would put the burden on investors to make sure that they investigate the lender before they purchase the paper. With such investigation, financing for predatory lenders dries up. While it is not clear that equity skimmers' investors could technically prove they were holders in due course in a court proceeding, this is generally the investors' first line of defense when a consumer tries to protect the family home by suing for fraud or other claims.

The Federal Trade Commission's "Holder Rule," 16 C.F.R. Sec. 433, abolished holder in due course status for consumer credit *sales* in 1976. Because the FTC's rule was fashioned before the rise in HELs, the need to cover consumer *loans* was not considered. Legislation modeled on that rule, but applied to HELs, would help to dry up the sources of funds for home equity skimmers.

B. An additional approach is to make it an unfair practice to extend a home equity loan to a consumer if the payments on the HEL, together with the other debts which the consumer owes, are equal to or more than 40 percent of the consumer's net income, or otherwise prohibit "improvident lending." Most lenders would consider a 30 percent ratio of debt to income to be a dangerously high level of debt. This prohibition would give consumers a claim against the lender who pushed the consumer into insolvency. An individual's right of action, similar to that provided in the Truth-In-Lending Act, or model statutes such as the 1974 Uniform Consumer Credit Code would be necessary.

C. The *most effective* approach would be statutory interest rate ceilings, combined with prohibitions or restrictions on non-interest charges, e.g., points, brokers' fees, service charges, unearned interest, late charges. Effective yields on predatory HELs are presently in the range of 20 percent to 23 percent or higher, a rate well above legitimate lending. A floating statutory ceiling which gives a yield just above the level charged by legitimate lenders may be the most workable.

D. A fourth—though weak—approach would be to require the home equity lender to provide investors with a disclosure statement describing the investment, modeled after the requirements of the Securities and Exchange Act, which might include an independent appraisal of the property, the underwriting criteria applied by the lender, and how the consumer met those underwriting criteria. For this approach to have any effect, state or federal regulatory officials would have to regularly examine such lenders and statements.

4. Issue: Unfair and Deceptive Practices by Loan Brokers.

Problems: Loan brokers are people who offer to find credit for consumers who believe they cannot find it on their own. The business does not seem to take place at all in some states while it flourishes in others. Loan brokers charge a large fee, usually calculated as a percentage of the loan, often doing little or no work at all—at least not for the consumer's benefit. (They may do a lot of work for the creditor, acting as a "bird-dog" to flush out business for one or two lenders with whom they have pre-existing relationships.)

Creditors guard their underwriting criteria and do not make them generally available to the public. Consumers must apply for credit to determine whether they qualify. Theoretically, loan brokers match borrowers and lenders by knowing the details of lenders' underwriting criteria, but generally home equity brokers simply funnel consumers to their related lenders, who do the actual credit screening. For this they charge a fee of hundreds and sometimes thousands of dollars.

Since loan brokers' fees are often based on the amount of the loan to the consumer, the broker has an incentive to increase the loan size. Thus there is "reverse competition" operating, encouraging the broker to steer the borrower to lenders who engage in loan-padding. Also, he or she may encourage the consumer to refinance or consolidate debts that should not be refinanced because of prepayment penalties, partial rebates of unearned finance charges, or front-end charges. In some instances loan brokers have encouraged consumers to refinance low-rate debts with high-rate credit they arrange. Such refinancing may cost the homeowner thousands of dollars in additional finance charges, often with higher monthly payments.

Loan brokers are usually paid their fee directly by the lender out of the consumer's loan proceeds. This reduces the consumer's cash from the loan: it also makes

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the annual percentage rate lower because, under the Truth-in-Lending Regulation Z, a loan broker's fee is usually not counted as a part of the finance charge. Thus, brokered loans appear to have a lower APR than loans that are not brokered, which is deceptive. (Perhaps to take advantage of this, we have seen lenders pay "brokers's fees" where no broker was used by the consumer.) The broker's fee is a cost of credit to the consumer, and should be included in the finance charge.

Often, the consumer first realizes the size of the broker's fee only upon receipt of the Truth-in-Lending's itemization of the amount financed. The problem is worse if the person actually extending credit is a private investor who makes fewer than 6 real-estate secured loans a year, as no TIL disclosures are required at all then.

Some loan brokers advertise as if they were a lender and deal with the consumer in ways that hide their role. Consumers do not expect a "broker's commission," because they did not know they were dealing with a broker. And because many loan brokers operate their loan brokerage as a sideline to other business real estate, working for a lender, a law practice—further confusion is created about their role.

Alternatives:

A. Impose upon loan brokers a fiduciary duty to use reasonable efforts to obtain financing at the lowest available rate for the consumer and for an amount that is in the consumer's best interest. Through the fiduciary duty, prohibit a loan broker from encouraging a consumer to refinance credit when the refinancing is disadvantageous to the consumer's financial interest. Breach of fiduciary duty can give rise to a legal claim by the borrower.

B. Amend the Truth-in-Lending Act to require that loan broker fees be included in the finance charge.

C. Enact a maximum fee for loan broker charges.

D. Require that a loan broker disclose the method of determining, or the amount of, the broker fee before the consumer is obligated to use the loan broker's services. More preferable is to require written contracts between brokers and borrowers which set out the brokers fees and responsibilities in advance.

E. Require brokers who arrange home equity loans to provide Truth-in-Lending disclosures if the creditor is not required to make Truth-in-Lending disclosures.

F. Amend the Truth-in-Lending Act to require a loan broker's advertising to conspicuously state: "[name] is not a lender. This is an offer to arrange a loan."

5. Issue: Balloon Payments and Demand Notes.

Problem: Many predatory HELs include a balloon payment. A balloon payment is a payment substantially larger than the other installments—usually the final payment. It is not uncommon to see balloon payments in HELs that exceed the amount that the consumer actually borrowed because of other charges or negative amortization.[4]

A demand note contains a clause allowing the lender to demand payment of the full balance at some point prior to the scheduled maturity. For example, the contract may be set up as a 10-year note, but buried in the contract is a clause allowing the creditor to call the loan in 3 years.

Through the 1970s most states prohibited balloon payments and demand clauses in consumer credit transactions, either by requiring that all payments be in substantially equal installments or by expressly prohibiting balloon payments and demand clauses. AMTPA repealed those prohibitions of balloon payments and demand clauses for home equity loans. (See Issue 2, above.)

Most consumers plan to play their installment credit from future income and do not have sufficient savings to make a balloon payment or demand payment. A balloon payment or a demand for the balance by the lender puts the family in a position of either having to refinance their home equity loan (if they can find a willing lender) or losing the home. In many cases, predatory lenders use the threat of an unaffordable balloon to force refinancing at a higher rate or otherwise making it more costly with added penalties and costs. This subsequent loan just sinks the consumer deeper in unmanageable debt.

Alternatives:

A. The most restrictive approach would prohibit balloon payments and demand clauses on home equity loans. This could be done by federal or state law. Alternatively, they could be prohibited unless the balloon payment could be met from the consumer's reasonably anticipated future liquid assets or income.

B. If a HEL contains a balloon payment, the consumer should be given the right to refinance, without penalty, the amount of that payment before or at the time it is due. The terms of the refinancing must be no less favorable to the consumer than the terms of the original transaction. This is the general approach of the 1974 Uni-

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[4] See note 3, *supra.*

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form Consumer Credit Code, which has been enacted in some states, as proposed by the National Conference of Commissioners on Uniform State Laws.

C. Amend the Truth-in-Lending Act so that the effect of a demand clause is prominently displayed in or near the disclosure of the scheduled payments in a home equity loan, instead of being cryptic and buried, as is presently permitted.

6. Issue: Credit Insurance.

Problems: Selling high-priced insurance in connection with consumer credit transactions has been a problem for decades. "Reverse competition,"[5] profit to captive insurers[6] and greater interest on the insurance-padded principal all provide strong incentives for creditors to push insurance onto consumers. Credit insurance premiums—priced in most states unreasonably and unjustifiably high[7]—can amount to thousands of dollars when written in connection with a large, long-term home equity loan. We have seen home equity loans with $10,000 in insurance premiums. (See National Consumer Law Center, Usury and Consumer Credit Regulation Chap. 7 (1987 and Supp.) for more detailed explanation of credit insurance problems.)

Credit insurance premiums (including the commission portion) are usually considered part of the amount financed under TIL, so the presence of large insurance premiums can distort the APR, making the credit look cheaper than it is.

Alternatives:

A. While regulation of credit insurance rates has traditionally been a state function, Congress should legislate nationally on this issue. One step which might help is to require "net coverage," which would prohibit insuring unearned interest, as is common now.

B. Massachusetts formerly pioneered a free-enterprise approach of requiring state banks that offer credit life insurance to take competitive bids from insurance companies for underwriting their credit insurance. They were then required to accept the lowest-priced credit life insurance with acceptable coverage and underwriting for sale to their borrowers. This could be adopted by other states or Congress.

C. Credit insurance could be required to be written so that the loss ratio is no less than 75 percent. Many states have loss ratio requirements, though they are generally too low and even then are rarely enforced.

D. Provide for a genuinely reasonable maximum rate.

7. Issue: Costly Refinancing.

Problem: Most of the second mortgages extended by finance companies or second mortgage companies are what the industry would call "consolidation loans." That is, the consumer has used a substantial portion of the loan proceeds to pay off other creditors, in many cases contrary to the consumer's financial interests.

The refinancing of existing credit may be disadvantageous to the consumer in several ways. A low-rate loan may be paid off by a high-rate loan; the new payment maybe higher than the old payments combined. Front-end charges, prepayment penalties, failure to rebate unearned interest or use of the Rule of 78s make the actual remaining cost on an annualized basis of the existing credit less than the annual percentage on the new home equity loan. (This may be true with "same-creditor refinancing," as well as consolidation lending.)

Finally, in most instances, it is to the consumer's disadvantage to use a home equity loan to pay off debts that do not threaten the consumer's home, e.g., a medical debt or a car loan. If the consumer is unable to keep up with the payments on those transactions, the home would probably be protected by state homestead exemption laws or the federal bankruptcy code. However, a home equity loan would waive those protections (except in Texas), thereby putting the consumer's home at risk of a foreclosure and sale at a distress sale price.

Alternatives:

A. The most extensive protection would prohibit a home equity loan lender from requiring a consumer to pay off preexisting debts as a condition of extending credit unless the pre-existing debt is secured by the residence and has an interest rate higher than the annual percentage rate on the new home equity loan.

B. An alternative to A. would make it an unfair and deceptive practice, with a private right of action, for a HEL lender to require a consumer to pay off pre-existing debts where the pre-existing debt was not secured by the consumer's home, or

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[5] The commission to the creditor is greater from more expensive insurance, thus giving creditors incentive to sell consumers higher-priced insurance. Finance companies and other lenders may take 40–50 percent of the premium as commission.

[6] Many of the major finance companies now have affiliated insurance companies whose products they sell, thus keeping the considerable profits "all in the family."

[7] One recent study estimated that consumers were overcharged *$1 billion per year* just on credit life insurance alone.

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the annualized future cost of the pre-existing debt was less than the effective rate offered under the home equity loan, adjusted for any income tax savings.

C. Require a lender who refinances existing debts with a home equity loan to disclose to the consumer the disadvantages of refinancing the existing debt. This would involve a disclosure comparing the total finance charges, the amounts financed, the payment schedules, the total amount to be paid, and the collateral on the existing debt with those for the proposed new loan.

D. Where a lender requires or offers to refinance existing debts with a home equity loan, the lender should also be required to offer the consumer an additional alternative: an extension of credit that does not refinance existing debt.

8. Issue: Closing Costs on Home Equity Loans.

Problems: Regulation Z, 12 C.F.R. Sec. 226.4(c)(7), allows the exclusion of closing costs from the finance charges if they are bona fide and reasonable in amount. There has been almost no examination of the reasonableness of closing costs under this standard, and they are always added to the amount financed. This can distort the APR, which is what consumers are taught to look to as the "price tag" for the credit. A creditor who pads the closing costs thus might show a lower APR than one who doesn't, even though overall its loan is more expensive. This is not "truth" in lending.

Alternatives: Amend Regulation Z to require that closing costs for home equity loans are included in the finance charge.

9. Issue: Wraparound Mortgages.

Problem: A wraparound mortgage is a second mortgage which obligates borrowers to make the payments on the first mortgage through the second mortgage lender; the wraparound mortgage could be a third or lower mortgage requiring payments on all or some of the higher mortgages to be made through the wraparound mortgage. For Truth-in-Lending purposes (as well as usury purposes under many state laws), the amount financed for the wraparound mortgages is considered to be the sum of the amount actually lent by the wraparound mortgage lender plus the remaining balance on the first mortgage. This is permitted even though the wraparound mortgage lender does not advance any funds on the first mortgage. The usual Truth-in-Lending result is that the annual percentage rate considerably understates the actual cost of the wraparound mortgage to a consumer. In effect, the wraparound mortgage offers a way to avoid consumer comparison shopping and state usury limitations.

Alternative: Wraparound mortgages in consumer credit transactions could be prohibited by federal or state legislation. Alternatively, Truth-in-Lending and state usury laws should require that to calculate the annual percentage rate and interest rate, the amount financed be composed only of the amounts actually advanced.

10. Issue: Prepayment Penalties.

Problem: It is not unusual for home equity loans, particularly second mortgages, to require the consumer to pay a penalty for prepaying the home equity loan. This is a way that lenders, particularly high-rate lenders, try to create captive customers by making it too expensive for consumers to refinance elsewhere at market rates. (Particularly unscrupulous creditors may encourage unsophisticated borrowers to do an in-house refinance, and pad the loan balance by adding in the penalty.)

Alternative: Limit prepayment penalties to no more than the amount of interest that would accrue on the payment following the prepayment.

11. Issue: Punitive Foreclosure Laws.

Problem: Most states strictly enforce the acceleration clause in a mortgage that allows the lender to demand the balance of the debt for any default, which is generally defined as the failure to pay any single installment on time. It may also include allowing the collateral to depreciate or failing to abide by any other term of the mortgage.

When a mortgage lender forecloses, most states allow the property to be sold at a sheriff's sale, at which the lender generally buys the property for the balance of the outstanding mortgages. If it is a home equity loan, the foreclosing lender generally buys the home for the amount of first mortgage, thus paying off the first mortgage holder. The lender is then free in most states to resell the property in the private market for fair market value and pocket the profits.

Alternatives:

A. Homeowners should be given a right to cure (the right to bring their mortgage current and reinstate their right to pay it in installments). Many states already allow delinquencies on other consumer credit transactions to be cured by the

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consumer making up missed payments.[8] Federal regulations under DIDMCA also extend the right to cure to mobile home owners.

B. The federal Bankruptcy Code allows debtors to cure by repaying their debts through a Chapter 13 bankruptcy, 11 U.S.C. Sec. 1322(b)(3). The courts are divided on how soon a Chapter 13 bankruptcy must be filed in order for the consumers to forestall a foreclosure and cure a default on a mortgage. The bankruptcy code could be amended to provide for a cure up to the point that the residence is sold to a bona fide third party and state redemption rights have expired.

C. The Bankruptcy Code currently provides special protection from modification for all creditors "secured only by a security interest in real property that is the debtor's principal residence." 11 U.S.C. § 1322(b)(2). This provision has been invoked by home equity lenders with no legitimate right to protection ahead of other secured and unsecured creditors. The Bankruptcy Code should be amended to eliminate special protection for home mortgages other than purchase money mortgages and refinancings of purchase money mortgages made at least two percentage points lower than the original loan. Bankruptcy debtors would then be able to use their full panoply of Chapter 13 options to avoid foreclosure of HELs by payment in the bankruptcy process.

D. Adequate sale prices upon foreclosure would be encouraged if a foreclosure creditor is required to have the property listed for private sale with a realtor in the same fashion as any voluntary home sale. Some type of legal supervision of this sale would be necessary. Possibilities for supervision include a judge, a court-appointed receiver or an arbitrator. When a dispute arises (such as whether to accept an offer to purchase or wait for another offer), the judge, receiver or arbitrator would resolve the dispute.

E. Homeowners should be provided with a notice explaining that they have a redemption right, and that they can sell the redemption right to a buyer who can exercise that right. They should be informed that this is a way to recover their equity that would otherwise be lost in the foreclosure sale. The former homeowner could use these rights to get a fair value for the home rather than the foreclosure distress price.

F. The establishment of state mortgage payment assistance programs, such as those adopted by Pennsylvania and Maryland and considered several times in Congress in the past decade, is another solution to foreclosure problems. These are revolving loan programs that lend money to temporarily distressed households to pay part of their mortgage payments. The loan is usually for a limited time, e.g., three years in Pennsylvania. After that, the consumers are obligated to repay the mortgage assistance loan. This has been especially helpful to displaced workers and to other debtors who suffer temporary financial setbacks caused by illness, divorce, temporary disability, death of a wage earner, etc.

G. Moratoria laws, which were used a great deal in the Great Depression and by several states in the recession during the 1980s, allow homeowners to avoid foreclosure as long as they pay the current interest on their mortgages. The moratorium is on payment of principal. These laws may be triggered by a household's financial distress or, more commonly in modern times, by an economic emergency.

12. Issue: Lender Pockets Property Insurance Proceeds.

Problem: Mortgages generally require the homeowner to maintain casualty insurance on the property. The consumer is generally not required to purchase such property insurance through the lender, although it is usually required that any insurance procured elsewhere be acceptable to the mortgage lender. Requiring property insurance is generally felt to be prudent to prevent a loss if a catastrophe happens to the home. However, most mortgages, whether for purchase money or a home equity loan, also contain a clause requiring the lender to be named the insurance loss payee and allows the lender to apply the proceeds either to the balance of the debt or to the repair of the home. If the lender applies the insurance proceeds to the balance of the debt, there may still be a debt outstanding on a home that remains damaged. The consumer receives no insurance proceeds in that situation to make the necessary home repairs. When mortgage interest rates are low, there are very few complaints of mortgage lenders pocketing insurance proceeds to pay off mortgage debts. However, the last time mortgage interest rates were high, there were many complaints of mortgage lenders paying off older, low-rate mortgages with insurance proceeds because of the rising mortgage rates generally. Because of that, the home became uninsured against casualties.

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[8] These statutes may allow a creditor to charge a reasonable attorney fee if collection efforts were actually undertaken by an attorney.

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Alternative: Legislation could be enacted to permit future homeowners to choose whether to apply property insurance proceeds to repair the insured property or to the loan balance.

13. Issue: Untimely Disclosure.

Problem: The fundamental flaw in the Truth-in-Lending disclosure approach is that disclosures are made too late in individual credit extension: when consumers are too psychologically bound to the transaction to reject it, their shopping and negotiation costs have already been incurred, and the lure of the credit advance and fear of the lender's scorn are too immediate for most consumers to reject credit on the basis of a Truth-in-Lending disclosure statement. By regulating advertising and oral quotations of rates, Truth-in-Lending has improved the ability of consumers to shop and the market to compete on the basis of rates, but further improvements can be made to foster both consumer shopping and rate competition.

Alternatives:

A. Require the Federal Reserve Board to conduct surveys of lenders' annual percentage rates on HELs and make the resulting shoppers' guides available to consumers and to the press. A pilot project by the Federal Reserve Board indicated that such guides would save consumers millions of dollars by fostering lower credit rates through competition on some types of credit.

B. Require basic credit information, including the proposed APR, amount financed, finance charge, payment schedule, and total of payments, to be disclosed to the consumer at the time of application. Congress requires this approach for credit cards and home equity lines of credit.

TESTIMONY BY TERRY DRENT, HOUSING COORDINATOR, COMMUNITY DEVELOPMENT DEPARTMENT, CITY OF ANN ARBOR, MICHIGAN

FEBRUARY 17, 1993

Problem

Many people living on fixed incomes in Michigan and the rest of the country are facing a crisis. For many the cost of medical care, housing, and basic sustenance is so high that they have to supplement their incomes with debt in order to survive. In southeastern Michigan, we are seeing many low income families, senior citizens, and disabled people who live on fixed incomes being preyed upon by unscrupulous mortgage companies. These firms often target lower income families claiming to be able to assist them in paying for medical care, home repairs, and property taxes. The results, however, can lead to the misery and impoverishment of this population. Many of these victims are suffering great hardships because of the financial "solution" offered by mortgage companies, and it has increased the burden on limited community resources. Some people are actually being forced out of their homes.

Background

People living on fixed incomes are susceptible to abuse by mortgage companies because they have seen their expenses for vital items increase at a rate greater than their incomes. Social security has increased at an average rate of 3.5 percent a year over the last four years. Medical costs have increased by 15 percent to 20 percent in the same period. Senior citizens alone account for 40 percent of all hospital stays and have many needs not met by any insurance company. If you are a diabetic or have cancer, you need an expensive special diet. We have seen diabetics saving needles in a coffee saucer filled with rubbing alcohol because they can't afford to buy new needles.

When these fixed income individuals are homeowners, the burden is greater because of the need to make repairs on their home. If a furnace breaks it has to be fixed. Additional repairs or remodeling must be completed to accommodate a sick spouse or physical limitations of the homeowner. Increasing health problems can create home accessibility needs. Lowering bathroom fixtures and cupboards and building ramps and railings is a very expensive undertaking, though less so than hospitalization. An additional problem is the increase in property taxes over the last several years as localities and school districts continue to face budget imbalances, some due to cuts in Federal funds.

Lower income families have less and less disposable income and are being forced to make difficult choices. They must often choose between paying their medical bills or buying food, paying for a special need for themselves or an ailing spouse or paying property taxes, paying for home repairs or paying their property taxes. Like most of us they choose to pay for their basic needs, and the property tax bill is usually the one that goes unpaid.

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In Michigan and many other states, if you are unable to pay your property taxes, the state will collect them by selling them at the annual tax sale. Anyone can purchase these back taxes, from individuals to private companies. The tax purchaser will pay one year of the homeowner's taxes and get a lien on the property. After a redemption period they will get a deed to the house. As a result of these transactions, the homeowner loses everything, including all of the equity they have built in his or her home. The tax purchaser can then sell the home at its market value. ABC's Good Morning America did a program on this topic that aired on September 24, 1992.

A second means of conducting business is more complicated and insidious than the first. It starts with the tax purchasers, or tax lien buyer. Purchasing taxes is a big business and many companies as well as individuals are involved. The tax lien buyer will purchase the taxes and get a lien on an individual's home. They then contact the homeowner and inform him or her that unless the purchased taxes are paid in full, the home will be foreclosed upon. They then offer a deal—if the homeowner is unable to pay the full amount, the company will arrange a monthly payment plan that will allow the homeowner to stay in his or her house. Because the homeowner is desperate to remain in his or her home, the deal is agreed upon. The tax purchaser then refers the homeowner to a mortgage company, which the tax purchaser actually owns. The mortgage company will then exchange the tax lien for a mortgage. Again, the mortgage offered is generally double the market rate with very high administration and processing fees. The homeowner gets a mortgage he or she cannot afford to pay and over time the mortgage company forecloses.

This can be an acquisition strategy on the part of the tax purchasing companies. It is quicker and cheaper to foreclose on a mortgage than to perfect title with a tax deed through the courts. In Michigan, personal notice of a foreclosure is not required, and foreclosures are an administrative process, not a judicial proceeding. The notice is only published in the *Legal News*, which even few lawyers read, and the property is listed by its legal description, not by address. With the administrative foreclosure, the mortgage company can merely present an affidavit to the sheriff to have the homeowner evicted. In Ann Arbor, an elderly widow with Alzheimer's disease was confronted by a County Sheriff's Deputy with eviction papers of which she had no understanding. She was forced to move out of her home. A tax purchaser obtained her home for approximately $3,200 in back property taxes and later sold the home for $95,000. This women saw none of the proceeds from the sale of her home. She eventually ended up in a State Psychiatric Hospital that has since closed due to state budget cuts.

The City of Ann Arbor's Community Development Department had been working with another elderly widow with Alzheimer's disease. She was unable to pay her property taxes and subsequently they were purchased. Home Loan Financial Corp., a subsidiary of Birmingham Bancorp Mortgage Corp., obtained her name from the delinquent tax roll published by the County Treasurer's Office and offered her a loan to pay all of her back taxes. The mortgage company discovered that the Community Development Department of the City of Ann Arbor had a lien on the property for rehabilitation work completed several years earlier. The mortgage broker asked the city to subordinate to the new mortgage, which they were negotiating. The broker told the senior citizen and her daughter that they needed to act quickly or a tax purchaser would take the home. He put a good deal of pressure on these people to sign his note, calling them three or four times a day. He was also upset with the city staff for becoming involved and alleged we were obstructing his business. We discovered that although this homeowner needed approximately $13,000 to pay her delinquent taxes, the loan amount offered was for $35,000 at 18 percent interest. Her monthly income was $770 and was derived from Social Security. Her mortgage payment would have been $680 per month before taxes. She would have been left with $90 per month on which to live and still have to make property tax payments. This homeowner's case was presented to Great Lakes Bancorp, a local bank, and was approved under the Community Reinvestment Act. The homeowner was able to obtain a mortgage of $15,000 at 9 percent with monthly payments of $326 per month which included a property tax payment.

Community Development staff also assisted a disabled Vietnam veteran. His deceased mother left him her home, which had a mortgage payment of $348. He could not afford his increased property taxes and they became delinquent. He, too, was contacted by a representative of Birmingham Bancorp Mortgage Corporation, and agreed to a mortgage at 22.5 percent with a monthly payment of $980 dollars before property taxes. His disability income was $1,050 per month. He was facing foreclosure after 60 days of signing the note. Again, Great Lakes Bancorp, mindful of the Community Reinvestment Act, helped. He was approved for a 7.125 percent loan, and Great Lakes escrowed his property taxes to insure payment.

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There is also a case of a 77-year-old widow in Whitmore Lake, Michigan, who could not pay her medical bills and her property taxes. A mortgage company got her name from the delinquent tax role published by the Washtenaw County Treasurer's Office. In 1989 this woman received a $12,729.50 mortgage at over 25 percent interest. Her monthly mortgage payment without property taxes was $350 per month, and her monthly income was $520, derived solely from Social Security. The loan had a three year balloon payment, and eventually the woman defaulted. The mortgage company refinanced the loan with similar terms, and after she defaulted, they again refinanced. Her debt increased from the original $12,729.50 to $39,500 within eighteen months. The woman actually received only $4,066 from these two additional transactions, the rest going to pay points and administrative fees. This senior citizen could not read the mortgage documents she apparently signed because of poor eyesight, and she did not understand the mortgage process. She had neither a checking nor savings account. In the court agreement negotiated with the mortgage company, the woman has eight months to refinance the total debt so she does not lose her home of over forty years.

In Ypsilanti, Michigan, a 40-year-old mentally disabled man owned a home his mother left him "so he would always have a place to live." But his property taxes increased more than the disability income he received from the state, and he became delinquent in his property taxes. A property tax purchasing company bought the taxes and traded the lien on his property for a mortgage. His mortgage payment was $250 a month before property taxes; his monthly income was $220. The annual interest rate on the note he signed in March, 1992, when mortgages were available for 8.5 percent, is over 21 percent. He is currently borrowing from family and friends to make his mortgage payment, and he spends approximately $25 per month for food. This year his property taxes will increase over 10 percent. He is less than a step away from becoming one of the homeless mentally ill.

In Adrian, Michigan, an elderly person bought a home on a land contract subject to a mortgage to be paid by the land contract seller. The seller defaulted on the mortgage and the land contract purchaser was evicted. Without personal notice and a judicial foreclosure she had no knowledge of these proceedings until she was told to vacate the premises.

There are many abuses in the non-conforming mortgage market, and what was once considered usurious mortgages are now allowable under current law. Many lower income homeowners are being victimized. We are not against non-conforming mortgages, in fact, the Mayor and Administrator of Ann Arbor, along with City Council, are currently trying to develop a loan pool with local banks under the Ann Arbor Credit Enterprise initiative to write non-conforming mortgages to help low income individuals obtain housing. However, we feel that there are consumer protections than can be put in place to help protect the low income, vulnerable, and disadvantaged, from an unchecked and under-regulated segment of the banking industry. We recommend the following for your consideration.

Recommendations

- Repeal exemptions from state usury laws in the Federal Banking Statute.
- Establish a Federal Usuary Law, regulating interest rates as a specific percentage above prime rate and controlling the total financing charges imposed.
- Strengthen and clarify the notice of foreclosure prevention services existing in current law.
- Require personal notice of foreclosures to all significant interests in the property.
- Require judicial foreclosure of all mortgages.
- Amend the Older American's Act to require that low income senior citizens be referred to social service agencies before their property can be foreclosed.

Summary

The problem of reverse red-lining mortgages, along with the threat of tax foreclosures, is so severe in the City of Ann Arbor and the State of Michigan, that our Mayor, along with the City Administrator and City Council, has established a foreclosure fund to help our citizens with this terrible problem. But we have far too few dollars to meet the need, and many people are falling through the gaping holes in the small safety net that we can afford to throw out. As President Clinton is telling the nation today, these are austere times for Federal, State and Municipal government. We have less money to spend on the seemingly insurmountable problems facing our nation. Legislative action is needed to take care of this abusive mortgage system, which was largely created by the Depository Institutions Deregulation and Monetary Control Act of 1980. The practice of reverse red-lining mortgages is threatening the sanctity of part of the American dream, home ownership, for those

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who can least afford it. This activity is wrong, unfair, and unjust; it must be stopped.

STATEMENT OF JOHN P. HAMILL, PRESIDENT, FLEET BANK OF MASSACHUSETTS

Good afternoon, Mr. Chairman, and Members of the Committee. My name is John Hamill, President of Fleet Bank of Massachusetts, and with me from Fleet Finance, Inc. ("Fleet Finance") are R. Harold Owens—Chief Operating Officer, John B. Stanforth, Senior Vice President—Finance, and Therese G. Franzen, Senior Corporate Counsel. We are pleased to represent Fleet Financial Group, Inc. ("Fleet") and Fleet Finance today in discussing allegations that residents of communities that lack access to traditional sources of credit have been targeted by unscrupulous brokers, lenders and home improvement contractors for loans with abusive terms and conditions. We would also like to address the role of the consumer finance industry in providing credit to these borrowers and the recent controversy surrounding Fleet Finance and its business in Georgia.

1. Introduction of Fleet Financial Group and Fleet Finance.

a. *Fleet Financial Group*. Fleet, headquartered in Providence, Rhode Island, is the nation's 14th largest bank holding company with over $47 billion in assets. Fleet has 1,300 offices in 42 states, and employs over 27,000 people in its seven banks and five major nonbank financial services companies, including Fleet Finance, its consumer finance subsidiary. Fleet operates 7 banks in the Northeastern United States, with approximately 800 branches and $33 billion in deposits. Fleet banks serve their communities well, having consistently received "outstanding" or "satisfactory" ratings under the Community Reinvestment Act.[1] Fleet banks have provided over $1.6 billion in loans to low and moderate income neighborhoods in the communities in which they operate.

Fleet's other nonbank subsidiaries provide conventional first mortgage banking services (Fleet Mortgage, the second largest servicer of mortgage loans in the nation, made over $19 billion in mortgage loans in 1992); student loan processing (AFSA is the largest third-party student loan servicer in the United States, charged with collecting over $2 billion in guaranteed student loans); trust and investment services (Fleet Investment Services has over $44 billion under management or in custody); and leasing/asset-based finance (Fleet Credit is the largest bank-owned asset-based lender/leasing company in the United States, with over $2 billion in outstanding loans to small and mid-sized businesses).

b. *Fleet Finance*. Fleet Finance has a history of providing credit to those who cannot obtain credit from traditional sources, such as banks or credit unions. Fleet Finance began its business 57 years ago as "Southern Discount Company" during the great depression, as a small loan lender in rural Georgia. During the ensuing decades, the business expanded to provide small consumer loans in other southeastern states (Florida, North Carolina, South Carolina and Tennessee). In the 1960's and 70's, as the American consumers' appetite for larger personal loans increased, the consumer finance industry and Fleet Finance began to offer secured real estate loans. This type of loan provided more credit to the borrower, consistent with a lender's prudent credit standards. Many of Fleet Finance's early real estate secured loans resulted from Fleet Finance refinancing secured or unsecured small loans into real estate secured loans in order to provide additional credit to the related borrowers, usually at lower rates.

Due to geographic restrictions on Fleet's ability to expand its banking franchise prior to adoption of interstate banking in 1985, Fleet sought to expand its presence into other geographic markets through nonbank acquisitions. One of Fleet's first nonbank acquisitions was the acquisition of Fleet Finance in 1973.

Under Fleet's ownership, the operations of Fleet Finance continued to expand and, in 1983, Fleet acquired Credico Industries, a subsidiary of U.S. Industries, which gave Fleet Finance a Mid-Atlantic and Northeast presence. In 1985, the consumer finance operations of several affiliates of Fleet were merged into Fleet Finance, giving it a Midwest presence. Until the late 1980's, Fleet Finance and Fleet's banks did not operate in any common states (except to a very limited extent in Rhode Island). Today, Fleet Finance has a limited presence in the six states in which Fleet has bank subsidiaries.

[1] Additional information concerning Fleet's community reinvestment ratings and its associated lending activities are described on Exhibit 1.

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As the scope of Fleet Finance's operations widened during the 1980's, the company's secured real estate portfolio grew. This growth was a result of various factors, including increased consumer demand for secured real estate loans as compared to higher-rate unsecured credit, the Tax Reform Act of 1986 (which eliminated personal interest deductions other than interest paid on home mortgage loans), increased real estate values (which—provided borrowers more equity in their homes against which they could borrow) and the attractiveness of real estate loans from a lender's viewpoint, i.e., security with a more readily ascertainable value than loans secured by home furnishings or other items. Fleet Finance grew from a company with $413 million in outstanding real estate loans at December 31, 1985 to a company with $2.2 billion in outstanding (owned and serviced) real estate loans at December 31, 1992. Total loans grew from $863 million at December 31, 1985 to $2.6 billion at December 31, 1992.

Today, Fleet Finance, headquartered in Atlanta, provides consumer finance services throughout Georgia and in 25 other states. Fleet Finance is now one of the largest consumer finance companies in Georgia (based on its aggregate principal amount of outstanding loans in Georgia). Fleet Finance owns or services approximately 20,000 real estate secured loans in Georgia and another 60,000 throughout the country. In addition, it has approximately 100,000 consumer loans (non-real estate loans) outstanding across the country.

2. A General Overview of The Consumer Finance Industry.

To put in context the allegations which have been cited in the request for testimony and which have been leveled against Fleet Finance in the press and in various lawsuits filed against it, it is necessary to review the role played by the consumer finance industry in providing credit to deserving customers. The consumer finance industry, in which Fleet Finance is a participant, provides credit to millions of consumers across the nation, many of whom are low and moderate income borrowers who cannot obtain credit from traditional sources, such as banks or credit unions.

As Fleet Finance's real estate lending business has developed into the primary focus of its business, so too has real estate lending become the dominant focus of the consumer finance industry. The total principal amount outstanding nationwide for what are now called "home equity" loans (both floating rate products and fixed rate products) was approximately $270 billion at June 30, 1992, increased from $108 billion at December 31, 1985. The credit providers in this broad market include banks, nonbanks, consumer finance companies and others.[2] Fleet Finance competes in the consumer finance sector of this vast market with major national companies, such as Associates (a subsidiary of Ford Motor), AVCO Financial (a subsidiary of Textron), Chrysler First Financial (a subsidiary of Chrysler and scheduled to be acquired by NationsBank), Household International, Beneficial Corp., Transamerica, G.E. Capital, The Money Store and Old Stone Credit, the nonbank consumer finance subsidiaries of Bank of America, Norwest and NationsBank, and many other companies. This industry has grown tremendously over the last decade and currently has over 15,000 competitors.[3]

3. The Role of Home Equity Loans in Consumer Finance Transactions.

Home equity loans made by Fleet Finance and other companies are typically used by consumers to reduce their monthly expenses by consolidating debts and stretching payments over a longer term. Longer terms and lower interest rates reduce a borrower's monthly payment, easing cash flow problems. In addition, home equity loans are used to finance home improvements, to acquire personal property, to pay educational, medical or other expenses or for other purposes.

The growth of the consumer finance industry has been particularly beneficial for millions of low and moderate income borrowers. Many of these borrowers have credit problems that disqualify them for unsecured or secured bank credit, traditional credit cards or unsecured or secured small loans.[4] Banks have been unable to pro-

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[2] SMR Research Corporation reported as of June 30, 1992 home equity loan outstandings by type of company and by specific entity. See Exhibit 2. The first chart includes all loans outstanding for these entities, whether bank or non-bank. The second chart shows the outstandings by type of company, i.e., finance company, finance company affiliated with a bank holding company, etc.

[3] SMR Research Corporation, Second Mortgage Home Equity Loans, 1991 (the "SMR 1991 Report"), at p. 23. Also see Note 2 above. For a description of the growth in the consumer finance business, see pages 6 *et seq.* of the SMR 1991 Report.

[4] Fleet Finance's underwriting criteria (see Exhibit 3) reflect variances from the underwriting criteria used by traditional first mortgage lenders. Fleet Finance's criteria are similar to those used by other lenders in the consumer finance industry.

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vide credit to many of these types of borrowers due to regulatory restrictions resulting from concern over the funding of these riskier loans with insured deposits, regulatory accounting principles and the historic lack of a secondary market to provide liquidity for these loans. Consumer finance companies, however, because they are free in many respects from regulatory restrictions (because they do not fund their operations with deposits), traditionally have been able to employ more liberal underwriting criteria which enable them to lend to lower income borrowers and borrowers with credit problems.

An example of the potential benefit to low and moderate income borrowers of the typical consumer finance company's underwriting criteria is the use of so-called "front end" and "back end" ratios. For example, on an FHA mortgage loan, only 29 percent (the "front end" ratio) of the obligor's income is available for payments of principal and interest on the mortgage loan and taxes and insurance on the home and 41 percent (the "back end" ratio) is available for total installment debt payments (including those associated with the loan). If a borrower does not meet these ratios, the loan application is generally denied. A consumer finance company focuses only on the "back end" ratio, permitting up to a 45–50 percent debt-to-income ratio for all installment debt. This less restrictive guideline can provide a customer with the flexibility to enable him to obtain and carry more housing-related debt and more total debt for personal use.

The consumer finance industry provides a critical source of credit for low and moderate income borrowers through secured real estate lending, enabling these borrowers to overcome their credit problems and borrow money when they need it without having to comply with traditional, restrictive bank lending guidelines. Moreover, home equity loans as a source of credit reach far beyond restrictive conventional mortgage loan programs, which generally provide credit only for a purchase or refinance of real estate, rather than for cash for personal use.

4. Why Costs to Borrowers for Home Equity Loans Are Higher Than Costs for Conventional Mortgage Loans.

Consumer finance company interest rates on home equity loans are generally higher than interest rates on traditional first mortgage loans or bank quality second mortgage loans. These higher rates result generally from (1) higher delinquency rates and charge-offs associated with consumer finance company home equity loans, (2) higher costs of originating consumer finance company home equity loans, (3) higher costs of servicing consumer finance company home equity loans, and (4) higher funding costs associated with consumer finance companies.

Consumer finance company delinquencies are traditionally higher than first mortgage loans or "bankable" second mortgage loans.[5] These delinquencies are coupled with higher loan charge-offs. The industry charges higher interest rates to offset the effect of the higher charge-offs and delinquency rates associated with consumer finance home equity loans as opposed to traditional bank first mortgage loans and "bankable" second mortgage loans.

The costs of originating and servicing a home equity loan are much higher than those incurred in connection with traditional first mortgage loans because such first mortgage loans generally have much higher balances. There is no appreciable difference in the cost of originating a $100,000 first mortgage loan and a $20,000 home equity loan. Both loans require substantially the same documentation and analysis. However, an origination cost of 2 percent on the first mortgage loan ($2,000) becomes 10 percent on the $20,000 home equity loan.

Likewise, the monthly cost of servicing a home equity loan is higher than the monthly cost of servicing a first mortgage loan, relative to their respective balances. In addition to the standard servicing costs, the type of credit risk reflected in a consumer finance company's home equity loans is more costly to service than first mortgage loans or bankable second mortgage loans due to the more labor intensive work required to avoid delinquencies, to work with delinquent borrowers to avoid foreclosure, to collect delinquent loans and to restructure or modify loans as required by customer demands or needs. These additional costs not incurred with respect to traditional first mortgage loans or bankable second mortgage loans result in consumer finance company borrowers paying increased interest rates in order for the consumer finance company to earn a fair return.

The funding of a consumer finance company is more costly than the funding of a bank. Banks raise their funds through deposits at government guaranteed rates; Fleet Finance and other consumer finance companies raise funds at market rates dictated by their credit ratings, or from banks or insurance companies who lend to the consumer finance industry (and who charge rates in excess of deposit rates).

[5] See 1992 SMR Report p. 23 and Notes 12 and 13 below.

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Consumer finance companies also do not enjoy the leverage of banks; their required equity is more than double that of a bank, and thus, the funding cost in terms of the required returns on equity is much higher. Finally, the relative illiquidity of second mortgages compared to conventional first mortgages has caused consumer finance companies to maintain larger balance sheets, resulting in larger—equity requirements and greater sensitivity to asset/liability management risks due to prepayments and interest rate changes.

Fleet Finance and other similar companies, although slightly more profitable on a comparative basis (i.e. return on assets, return on equity) than a bank, are not "wildly" profitable as the press would like this panel to believe. The companies price their products commensurate with the risk inherent in their customer base, and a fair return is garnered.

The chart attached as Exhibit 6 compares Fleet Finance's interest rates to the rates of its Georgia competitors during 1992. These rates, which ranged from 9.99 percent to 17.50 percent throughout 1992, compare to credit card rates as high as 21 percent and to small loan rates as high as 30 percent. The interest rates charged on consumer finance home equity loans clearly are higher than those charged on first mortgage loans or bank quality second mortgage loans, but in the end provide a cheaper alternative to other unsecured debt, such as credit card or small loan debt.

5. Fleet Finance's Development of Business: Issues and Recent Changes.

As the consumer finance industry developed and changed its focus to secured real estate lending, Fleet Finance changed its focus to this type of lending along with it. During the 1980's Fleet Finance decided to expand its real estate lending business through the acquisition of loans which were originated by other correspondent lenders. In Georgia, as well as nationwide, it is a common and established practice for banks and finance companies to purchase loans originated by third parties.[6] Fleet Finance has acquired loans from over 300 correspondent lenders nationwide.

Fleet Finance purchased loans from correspondent lenders, generally on a loan-by-loan basis, often preapproving the loans prior to purchase. The correspondent lenders would submit to Fleet Finance a loan package consisting of a credit application, credit history, debt-to-income and other relevant ratios, and estimated property value. Fleet Finance would perform an analysis of this preliminary package, and make its basic underwriting decision. Unlike some other companies, Fleet Finance's policy required it to underwrite each loan purchased from its correspondents, not just a sample. Fleet Finance rejected substantial numbers of loans for various reasons. Approval rates for preapproved loans were as high as 65–70 percent for some lenders.[7] After establishing that the loan met its lending criteria, Fleet Finance would give conditional approval for the purchase of the loan. After closing and funding, and subject to the borrower and correspondent lender having complied with all conditions to approval, the loan would be purchased by Fleet Finance. Fleet Finance also acquires loans in bulk packages from correspondents and others (including the RTC and other large lenders). Underwriting procedures for a bulk purchase may vary and may consist of a loan-by-loan review or a review of a sample of the loans to be purchased.

In 1989, Fleet Finance tightened its lending requirements by discontinuing the origination or purchase of loans secured by undeveloped land and, discontinuing, in most cases, the purchase of loans made for the purpose of home improvements directly from the originator. Changes, such as discontinuing the purchase of home improvement loans, were made by Fleet Finance in response to changes in the economy as well as difficulties in policing the practices of home improvement companies. Because of federal and state laws regarding home improvement contracts, Fleet Finance was ultimately responsible for repairing incomplete or defective home improvements in connection with loans it had purchased.

In 1988, Fleet Finance was purchasing approximately 85–90 percent of its loans from correspondent lenders. For various reasons, but principally to reduce its dependence on these purchased loans, Fleet Finance made a strategic decision to more

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[6] Correspondent lender networks are the standard means of doing business in the first mortgage industry. For example, Fleet Mortgage acquires loans from over 800 correspondents. FNMA, GNMA, FHLMC and other mortgage conduits effectively acquire *all* of their production through a correspondent network. In this regard, the consumer finance industry is not much different, as many of the larger lenders acquire much of their production through such networks. See 1991 SMR Report (at p. 74), "The Rise of Wholesale Channels" regarding the growth of the wholesale market for second mortgages (attached as Exhibit 4).

[7] Of these pre-approved loans, only approximately one-third ultimately closed and were purchased by Fleet Finance due to fall-out foil various reasons, including failure to meet closing conditions or the customer obtaining credit from another source.

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rapidly develop its branch structure by upgrading personnel and systems to enable its branches to make and service more home equity loans. Branches achieved growth through direct marketing and referrals from various parties. From 1988 to 1992, the mix of loans originated/purchased changed from approximately 85–90 percent purchased/5–10 percent originated to approximately 50 percent purchased/50 percent originated. Beginning in 1990, the branch origination focus was enhanced by the consolidation of servicing of all purchased loans into regional service centers, which left branches with a greater capacity to originate and service their own loans.

Fleet Finance decided to entirely phase out the purchase of loans from correspondent lenders, effective December 31, 1992. The decision to eliminate the purchase of loans from third party lenders was made with the goal of providing direct contact between Fleet Finance and its borrowers prior to the loan being closed. The change was also made in response to criticisms concerning the allegedly excessive rates and fees charged on loans sold to it by third party lenders and for other alleged improper practices of these lenders. To eliminate this criticism, Fleet Finance decided to control each loan beginning width the application and proceeding through the negotiation of interest rates and the terms of the loan and the loan closing.

In addition, Fleet Finance decided in 1992 to discontinue making loans to higher risk borrowers (identified in the industry as Class 4 or Class D borrowers).

6. The Georgia Lawsuits, Alleged Activities of Fleet Finance in Georgia and Fleet Finance's 10-Point Initiative.

a. *Background.* Before discussing the specifics of the lawsuits against Fleet Finance in Georgia and the allegations in the press concerning Fleet Finance, it is necessary to describe the backdrop against which these lawsuits and allegations have taken place. In Georgia, unlike in the vast majority of states, third party loan brokers and lenders and home improvement contractors are completely unregulated, and interest rates and points are virtually unrestricted. In addition, Georgia has an aggressive plaintiffs' class-action bar, which welcomed the opportunity to bring lawsuits that they could couple with a media campaign to extract favorable settlements from Fleet.

Another reason Fleet has been the subject of attack is due to its high profile selection as the acquiror of Bank of New England ("BNE"). As a regulated bank holding company with obligations under the Community Reinvestment Act, Fleet was and is a particularly attractive target for community activists. A challenge against Fleet's' acquisition of BNE was made by the Union Neighborhood Assistance Corp. ("UNAC") and other community groups. Bruce Marks, in the presence of representatives of the Federal Reserve Bank of Boston, met with Fleet officials, but Fleet did not agree to his demand that $20 million be placed under UNAC's control for a housing fund. Fleet made other contributions to help solve the so-called "second mortgage scandal" in Boston, however it made its contributions through a broad array of community groups (and not UNAC). Since that time the volume of allegations made in the press have largely been the result of an orchestrated attack against Fleet by UNAC with the help of the plaintiffs' attorneys. This attack has been made without regard to the facts and is Mr. Marks' attempt to make good on his promise to have the story covered in the national press, whether or not it is based on the truth (a promise he had made in his meeting with Fleet).

b. *Georgia's Regulatory Framework.* Georgia enacted legislation in 1983 to remove its restrictive limitations on interest rate charges and adopted a free-market approach. Prior to the change, Georgia had capped mortgage rates making it impossible for Georgia residents, particularly low to moderate income borrowers, to obtain loans in the high interest rate environment of the early 1980's. To remedy this, legislation was passed which lifted the mortgage interest rate limitations, and credit immediately began to flow into the state.

The Georgia legislature, however, may not have given adequate consideration to the fact that Georgia, unlike most other states, does not regulate brokers and lenders.[8] In comparison, Fleet Finance makes real estate secured loans in 26 states, and is required to be licensed in 23 of these states. Many of these states regulate the amount of compensation which can be paid to a broker or lender, but Georgia does not. Georgia also does not regulate home improvement contractors.

c. *The Georgia Lawsuits.* Despite the fact that the alleged injuries complained of by the plaintiffs in the Georgia class action lawsuits pending against Fleet Finance were caused by the parties from whom Fleet Finance purchased the plaintiffs' loans or by home improvement contractors who contracted with the plaintiffs prior to Fleet Finance's purchase of the plaintiffs' loans, purported class action lawsuits

[8] Fleet supports the licensing and regulation of brokers and lenders. Such legislation is now pending in Georgia.

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have been brought against Fleet Finance, beginning in 1991, alleging violations of Georgia's criminal usury laws, as well as fraud, conspiracy, federal and state RICO claims and Truth-in-Lending violations.[9]

The usury charges against Fleet Finance and other companies in Georgia, which charges are, for the most part, the basis for these lawsuits, are premised upon a very radical interpretation of the Georgia criminal usury statute. The interpretation postures that points and other up-front fees charged on a loan should be allocated completely—to the first month to calculate whether Georgia's law prohibiting interest charges above 5 percent per month has been violated. This theory directly contradicts the concept of "spreading" the points over the term of the loan, which is the standard practice in Georgia (as set forth in a 1990 Georgia Supreme Court opinion), as well as the standard practice under Truth-in-Lending regulations, generally accepted accounting principles, regulatory accounting principles, the Internal Revenue Code and the law of all other states.

Oral arguments were heard on January 19, 1993 by the Georgia Supreme Court in the plaintiffs' lead case (a similar case was dismissed in federal court and the appeal is stayed pending the state court's decision). Fleet Finance's legal position with regard to the usury calculation is supported by the banking industry, and numerous lending institutions and trade associations have filed amicus briefs with the court supporting this position, including Trust Company of Georgia, NationsBank, Wachovia, Citizens Trust Bank (a minority-owned institution), AVCO, Transamerica, Norwest, the National Second Mortgage Association, FNMA, and the Georgia Bankers Association. A decision on the issue is expected in two to six months.

d. *Specific Allegations About Fleet Finance.* Various specific allegations have surfaced in the press regarding the consumer finance industry and Fleet Finance. While Fleet Finance cannot speak for the industry, it would like to address the following specific charges that have been made against it:

ALLEGATION: Fleet Finance has amassed a pool of home equity loans made at exorbitant interest rates and with excessive finance charges.

The facts are straightforward: Fleet Finance's rates range from lower rates for better credit borrowers to higher rates for borrowers with credit problems. While certain borrowers, due to their credit circumstances, are required to pay higher rates than others, very few Fleet Finance borrowers have loans of the type cited by the activists and the media. The facts are:

- Fleet Finance's portfolio of home equity loans in Georgia has a weighted average note rate of approximately 14.8 percent. Moreover, it has a weighted average annual percent age rate including all lender points and all other prepaid finance charges ("APR") of approximately 15.9 percent.
- Approximately 98 percent of the principal balance of Fleet Finance's Georgia loans have interest rates below 21 percent; 83 percent have interest rates below 18 percent.
- Approximately 89 percent of the principal balance of Fleet Finance's Georgia loans have an APR below 21 percent; 69 percent have an APR below 18 percent.
- Approximately 41 percent of the principal balance of Fleet Finance's Georgia loans by principal balance have 0 lender points; 63 percent have less than 5 lender points; 88 percent have less than 10 lender points; 98 percent have less than 11 lender points.
- Points charged were financed by the lender and repaid over the life of the loan (contrary to first mortgage loans where payment of points must be made at closing).
- Approximately 79 percent of the principal balance of Fleet Finance's Georgia loans had 0 broker points; 90 percent had 5 or less broker points; and 98 percent had 10 or less broker points.
- Fleet Finance competes with many other lenders. The competition would bring any lender into line with other lenders in the industry. In fact, rates on loans owned by Fleet Finance are comparable to those charged in Georgia[10] and throughout the country by other lenders.
- The effect of financed points during the term of a loan on the annual percentage rate is not as dramatic as one might expect.[11]

Despite the above facts, Fleet Finance has decided to eliminate any possibility of this charge reoccurring in the future by taking the extraordinary step of limiting brokers to a total of 5 points and placing an 18 percent interest rate cap on its loans

[9] A summary of the litigation is set forth as Exhibit 5.
[10] See Exhibit 6 for a comparison of rates charged by competitors in Georgia.
[11] See chart on Exhibit 7 for a comparison of effective annual percentage rates with various numbers of points.

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in Georgia and nationwide. Many states specifically permit higher levels of points (such as Florida which permits 10 points) but Fleet Finance chose this lower level to deflect the above criticisms, whether or not they have merit.

ALLEGATION: Fleet Finance engages in "home equity stripping"; Fleet Finance makes huge profits on the sale of foreclosed properties. Fleet has destabilized communities through its foreclosures.

This allegation is false. Fleet Finance loses money on foreclosures; eliminating foreclosures would make the company more profitable. The number of foreclosures in Georgia clearly establishes that Fleet Finance is not in this business, and could not be responsible for destabilizing neighborhoods. The facts are:

- In Georgia, Fleet Finance *lost* more than *$5.4 million* on foreclosures in 1991 and more than *$8 million* in 1992. Nationwide, Fleet Finance *lost $18.6 million* and *$24.6 million* on foreclosures in 1991 and 1992, respectively.
- The weighted average combined loan-to-value ratio of Fleet Finance's Georgia portfolio is approximately 70 percent. Fleet Finance's loan to value ratios are based on appraised values under the current market conditions.
- Approximately 79 percent of the principal balance of Fleet Finance's Georgia loans have combined loan-to-value ratios in excess of 60 percent; 25 percent have combined loan-to-value ratios above 80 percent; 50 percent have combined loan-to-value ratios between 60 percent and 80 percent.
- Fleet Finance foreclosed on approximately 530 loans in Georgia during each of 1991 and 1992.
- Because Georgia has been its headquarters for 57 years, Fleet Finance is the largest consumer finance company second mortgage lender in Georgia, therefore, gross numbers of foreclosures compared to other smaller companies are misleading.
- Fleet Finance's policy is to not commence foreclosure until a loan is at least 90 days delinquent. During the period of delinquency, Fleet Finance works with the borrower in an attempt to keep the borrower in their home.

ALLEGATION: Fleet Finance made loans without regard to whether the borrower had the ability to repay the loan.

Because Fleet Finance loses money on foreclosures, it would not be profitable for Fleet Finance to lend money to borrowers who lack the ability to repay their loans. The ability of the borrower to repay the loan is established by requiring sufficient cash flow. The facts are:

- Fleet Finance's underwriting criteria require (and have always required) a debt-to-income ratio of less than 50 percent, as well as verification of income and verification of employment.
- The weighted average debt-to-income ratio of Fleet Finance's borrowers in Georgia (calculated by including all debt at origination, including the Fleet Finance loan) was approximately 36 percent.
- Approximately 62 percent of Fleet Finance's Georgia borrowers had debt-to-income ratios of less than 40 percent; 78 percent had debt-to-income ratios of less than 45 percent and 90 percent had debt-to-income ratios under 50 percent.
- Fleet Finance's delinquency rates are comparable to those found generally in the industry,[12] and, while such rates are higher than first mortgage loans, they are not substantially higher.[13]

ALLEGATION: Fleet controls the correspondent lenders and brokers in a conspiracy to steal people's equity in their homes.

Fleet Finance did business with over *300* third-party lenders nationwide. A wholesale production network is common in the production of mortgage loads. This type of wholesale network has become the backbone of much of the consumer finance industry.[14] Fleet Finance qualified its lenders through an internal review and ap-

[12] See Exhibit 8 for Fleet Finance's delinquency statistics compared to other industry participants.

[13] On November 25, 1992, the Mortgage Bankers Association issued its report on nationwide first mortgage delinquencies and foreclosures at June 30, 1992. Residential first mortgage loans in foreclosure were 1.04 percent of total dollar amount of loans outstanding, while 90 day delinquencies on first mortgage loans were .78 percent of the outstanding balance. At June 30, 1992 and September 30, 1992, 1.98 percent and 2.04 percent, respectively, of the dollar amount outstanding of Fleet Finance's total portfolio of loans owned and serviced were in the 91 day or more delinquency category, which category includes loans in foreclosure (i.e., these figures compare to 1.82 percent of nationwide first mortgage delinquencies and foreclosures as of June 30, 1992).

[14] See note 6 above regarding the growth of the wholesale component of the consumer finance industry.

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proval process. More importantly, Fleet Finance's policy was to underwrite the loans it purchased, not to rely on the credit analysis of third parties. The facts are:

- Fleet Finance was independent of the correspondent lenders and brokers; it did not share employees, directors or officers.
- Fleet Finance preapproved loans, but this procedure is standard in a correspondent lender program. All transactions were conducted on an arms-length basis.
- Fleet Finance terminated lenders who did not meet Fleet Finance's standards.

Most of the allegations against Fleet Finance have centered on purchased loans. Fleet Finance decided to terminate all individual third-party loan purchases as of December 31, 1992 as part of its 10 Point Initiative. Fleet Finance believes the purchase of loans is still a legitimate method of doing business, but has decided to avoid any possible repetition of allegations concerning purchased loans.

ALLEGATION: Fleet and other bank holding companies engaged in a tactic of removing their banking operations from low and moderate income neighborhoods to allow their second mortgage companies to prey on borrowers in those neighborhoods.

This allegation against Fleet has no merit because Fleet is prohibited by law from owning a bank in Georgia. Fleet did not own a bank in Massachusetts until 1991 (when it purchased BNE). Thus, Fleet could not have been engaged in this alleged practice. Many other bank holding companies who operate nationwide would face the same sets of laws restricting their banking presence.

ALLEGATION: Fleet Finance, through third party lenders, targeted minority neighborhoods and charged higher rates to blacks than whites.

Fleet Finance does not generally know the race of a borrower prior to its commitment to acquire a loan. Fleet Finance set its rates based on credit statistics, not on race. In fact, for over 35 percent of Fleet Finance's loans, it is impossible to ascertain the race of the borrower from the files.

ALLEGATION: Fleet Finance is wildly profitable due to the above alleged practices and dominates Fleet's profitability.

This is simply not true. Fleet Finance's returns on equity and return on assets are higher than Fleet's banks, but not significantly higher. A consumer finance company has greater returns than a bank due to the risk inherent in a consumer finance company's portfolio; there is a greater risk that credit problems could significantly affect Fleet Finance's profits.

The contribution of Fleet Finance to the earnings of Fleet is historically 8–10 percent. The results cited by our critics for 1990 and 1991 fail to take into account the credit problems in Fleet's New England banks caused by the recession in the Northeast.[15] Fleet Finance does not dominate Fleet's earnings.

e. *Fleet Finance's 10 Point Initiative*. Fleet Finance believes that neither the above charges, nor other isolated charges made by the press, have merit. To illustrate its good faith, to address any perceived abuses and to benefit its customers, Fleet Finance adopted its 10 Point Initiative.[16] This initiative is intended to aid those customers whose loans are deemed burdensome without regard to the merits of the loan involved. It is not an admission of culpability by Fleet Finance as our critics might allege; it is an important customer relations program with the goal of reminding our customers of the fact that Fleet Finance is always ready to responsibly address their problems. This Initiative was a responsible act by a responsible company to address an issue in a responsible manner.

The initiative provides up to $38 million in various benefits to borrowers, including interest rate relief, a foreclosure moratorium, home improvement repairs, grants for revitalization of impacted neighborhoods, along with other benefits. The Initiative also confirmed Fleet Finance's policy to discontinue purchases of home improvement loans and loans from third party lenders generally. Fleet Finance also has made a total of $8 million available to impacted neighborhoods for reinvestment. Over 750 borrowers have already been approved for relief under the Initiative, and Fleet Finance expects to continue to provide the Initiative despite the efforts by the plaintiffs' lawyers who have sought to enjoin Fleet from pursuing the Initiative. The purpose behind such a move by the lawyers is not concern for the best interests of the borrowers, especially in light of the fact that no waiver of the borrowers' legal rights is required to obtain the relief. The 10 Point Initiative demonstrates Fleet

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[15] Exhibit 9 shows the earnings of Fleet Finance over the past 12 years, compared to those of Fleet. Gains on securitizations also increased Fleet Finance's 1990 and 1991 earnings, but represent the present value of future earnings which will not be earned in subsequent years.

[16] The 10-Point Initiative is attached as Exhibit 10.

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Finance's willingness to work with, and resolve any individual abuse or complaint, whether allegedly caused by Fleet Finance or otherwise.[17]

7. Recommendations of Fleet Finance.

There are a number of steps that could be taken at the state and local, and perhaps federal, levels to address those complaints, including:

a. *Regulation of Lenders, Brokers and Home Improvement Contractors.* The regulation of second mortgage market participants, including lenders, loan brokers and home improvement contractors, appears to be primarily a state matter. Fleet Finance welcomes reasonable regulation as a way to ensure the integrity of all participants in the industry. Fleet Finance is currently regulated in 23 states.

Current federal regulations include the Real Estate Settlement Procedures Act ("RESPA"), which prior to November 1992 covered only purchase money first mortgage loans and now covers all mortgage loans, and the Truth-in-Lending Act ("TILA") (as well as state consumer statutes) which covers home equity loans and provides a federal scheme for disclosure of their true interest rate to consumers.

Amendments to the TILA could be enacted requiring stronger home improvement contract disclosures, such as escrow requirements (including standard provisions) and disclosure of whether the contractor is an independent entity or related to the lender/broker or other party. Additional statements could be required to disclose the risks to the borrowers of failing to pay a secured home improvement loan (i.e., foreclosure). With respect to brokers, additional disclosure requirements could be fashioned under TILA for broker fees (lender fees are already included). Those fees could even be included in the calculation of prepaid finance charges as an additional cost of credit (despite the fact that the broker is working for the borrower).

b. *Role of Government Sponsored Entities ("GSEs") in Home Equity Lending.* The Federal National Mortgage Association ("FNMA"), Government National Mortgage Association ("GNMA"), Federal Home Loan Mortgage Corporation ("FHLMC") and other similar agencies could take a more active role in helping the private sector increase credit availability to finance company borrowers. Home equity lenders would benefit from additional liquidity for home equity loans. Securitization provides some relief, but only larger companies have the resources to engage in this activity. Increasing the liquidity of these loans should result in lower rates for borrowers.

The current GSE first mortgage program could be expanded to help guarantee payments on nonconforming loans and junior priority loans. This step would encourage more capital to enter the market, which should ultimately lead to better pricing (and less cost to borrowers). The resulting increase in liquidity would enable lenders to use their capital more efficiently to fund servicing and collection operations, in addition to making loans, thereby permitting more leveraging of a finite amount of capital.

In addition, completion certificates could be required from the home improvement contractors to the GSE and the lender, regarding the value of home improvement work and its completion (as opposed to the borrower certifying completion). The GSE and the lender would then be in a better position to exert pressure on the contractors if their work was not done properly.

c. *Consumer Education.* Another way to get the federal and state governments involved would be a nationwide education program. The lack of public education regarding consumer credit and the lack of awareness of credit-related issues on the part of consumers is problematic. In many cases consumers are said to have little knowledge about the available sources of credit and how consumer debt burdens can have an adverse impact on a person's credit rating and standard of living.

In particular, borrowers who enter into debt consolidation arrangements have created situations where they have a very difficult time meeting their restructured ob-

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[17] An example of how Fleet Finance's customers have been used by lawyers who purport to represent them can be seen in the case of Mr. James Hogan who recently testified at a House Subcommittee hearing. Mr. Hogan's attorneys (Legal Aid Society [Bill Brennan]) have refused to allow Mr. Hogan to participate in the Initiative. Mr. Hogan's home was foreclosed on when he could no longer make his payments, partially because he lost his job and was incarcerated. Fleet Finance has offered Mr. Hogan every chance to work out a solution, dating back to December 1991. Fleet Finance's efforts included working with his social service case worker after his release from jail. In addition, Fleet Finance offered Mr. Hogan, in October 1992, an opportunity to participate in the 10 Point Initiative, but Legal Aid refused to let him do so. Under the 10 Point Initiative he would not only have received his house back, but a loan at approximately 9 percent interest. We have made these circumstances known to Representative Kennedy and have submitted a written offer to his counsel to resolve this situation with a 9 percent loan for approximately $25,000 (his loan balance was approximately $32,000). Legal Aid has requested that Fleet Finance deed the house back to Mr. Hogan without consideration.

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ligations. Recent problems associated with persons selling debt consolidation fee-based services have been reported. Some states have already moved to license this activity, but helping educate consumers will give them the information necessary to reduce their borrowing costs.

d. *Rate Regulation.* Rate regulation which would specify a maximum cost of credit has been proposed in Georgia. Some other states already have such rate and point regulation. Federal or state regulation of maximum rates and points may result in credit allocation away from some credit needy persons and should be considered carefully.

Mr. Chairman and Members of the Committee, Fleet and Fleet Finance are proud of their long and distinguished record of providing a wide range of services to the American consumer. While Fleet Finance stands ready to discuss any individual borrower's complaint to reach an appropriate resolution, Fleet believes that your Committee can perform a useful and important service by focusing on the critical role that a well-run, and properly regulated consumer finance company can play in providing credit to low and moderate income consumers, by identifying those areas of the consumer finance industry where state or federal action may be needed to correct problems and by making recommendations regarding how the regulation of the products and services offered by the industry can be improved.

Thank you, and we look forward to answering any questions you and the Members of the Committee may have.

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EXHIBIT INDEX

Exhibit 1	Fleet's community reinvestment ratings, together with information concerning associated lending activities.
Exhibit 2(a)	SMR Research Corporation ("SMR"), The Top 25 Second Mortgage Lenders, 6/30/92.
(b)	SMR, The Second Mortgage Market By Institutional Type of Player, 6/30/92.
Exhibit 3	Fleet Underwriting Criteria.
Exhibit 4	Excerpt from SMR 1991 study, "The Rise of Wholesale Channels" at p. 74.
Exhibit 5	Summary of the Georgia litigation.
Exhibit 6	Chart comparing Fleet Finance's rates to competitors of Fleet Finance.
Exhibit 7	Chart showing effects of various levels of points on a 15-year loan.
Exhibit 8	Delinquency statistics.
Exhibit 9	Fleet Finance Earnings Comparison.
Exhibit 10	10-Point Initiative of Fleet Finance.

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EXHIBIT 1

FLEET FINANCIAL GROUP
LOW AND MODERATE INCOME COMMUNITY LENDING PROGRAMS

Fleet Financial Group (Fleet) has been very active in community lending and has had a comprehensive and effective Community Reinvestment (CRA) compliance program in place for a number of years.

In fact, Fleet's banks all received either "outstanding" or "satisfactory" CRA ratings in their most recent examinations.[1] However, in response to discouraging industry-wide statistics in 1991 and 1992[2] showing that racial disparities exist in mortgage application approval rates, Fleet has stepped up its efforts and is undertaking an aggressive effort to make its CRA and HMDA compliance programs more effective and incrsase mortgage loans to low to moderate income and minority borrowers.

Fleet established a corporate HMDA/CRA task force under the direction of Executive Vice President Jim Murphy. The task force's mission was to research and study the facts concerning the disparities in approval rates by race, resolve HMDA/CRA systems and reporting issues, and evaluate Fleet's products in meeting the needs of low to moderate income and minority communities. During the first half of 1992, Fleet compliance personnel, along with outside HMDA/CRA compliance consultants, assessed HMDA/fair lending programs at each Fleet bank and mortgage company.

Although the results of this unprecedented review did not reveal any discrimination against applicants, it did show that HMDA data collection and reporting systems needed improvement, fair lending compliance management processes needed strengthening, and increased training was needed overall in these areas. As a result, a new "Centrax" system (a computer-based data processing system) was purchased which will improve data processing and tracking and timely management reporting.

After discussions with local community groups to solicit their suggestions, Fleet took action to improve existing bank products to be more responsive to community needs, particularly in low income and minority urban areas. For instance, flexible first mortgage products for low to moderate income borrowers are now being aggressively marketed throughout all Fleet banks and mortgage companies.

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[1] See attached.

[2] Compiled and released by the Federal Reserve Board pursuant to the Home Mortgage Disclosure Act (HMDA).

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In addition, Fleet now has dozens of affordable housing programs in place throughout its system, and has improved its CRA efforts as well. Here is a summary of some of the major affordable housing and CRA programs in place at our banks and mortgage subsidiaries:

1. <u>Rhode Island</u>

- <u>Jump Start Program</u>: A innovative program called "Jump Start" was initiated on January 1, 1992 to provide home ownership to low to moderate income families. Fleet's Rhode Island bank joined with the Rhode Island Housing and Mortgage Finance Corporation (RIHMFC) and Commonwealth Mortgage Assurance Company to provide $10 million in low interest, no down payment financing for first time home buyers with income of no more than $23,000 per year. To date, over $4 million has been booked under this program (see attached press release).

- <u>Lease to Buy Program</u>: Another program, done in conjunction with RIHMFC provides financing to low to moderate income Rhode Islanders to purchase a first home through a unique two-year lease purchase agreement. Over $3 million has been committed to this program (see attached press release).

- <u>Line-of-Credit Program</u>: A program providing a $1 million restoring line-of-credit, priced at 2 percent over Fleet's passbook rate, was initiated to provide construction and renovation financing to non-profit companies to increase affordable housing stock. Over $1.7 million has been used to date.

2. <u>Massachusetts</u>

- <u>Community Investment Lending Program</u>

  On June 27, 1991, shortly after it acquired control over the banking subsidiaries of the former Bank of New England from the FDIC, Fleet initiated a $111 million community lending investment program for low and moderate income neighborhoods and communities in Massachusetts as part of a broader program designed to pump more than $500 million in new capital into the New England economy. This included an $11 million mortgage assistance program to help homeowners with burdensome mortgage loans (see attached press release).

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The plan, which has been very successful, will create over 1,750 affordable houses in Boston and across the state. It will also channel over $7 million to help minority-owned and other small businesses.

3. New York (New York City/Long Island)

- End Loan Financing

  Over the past five years, Fleet has made a concerted effort to become a leader in New York City in providing affordable housing and finance. Through Fleet Mortgage, it provided approximately $370 million in financing for the end loan financing of approximately 4,800 units of new 1-4 family housing in Brooklyn, Queens, the Bronx and Manhattan. This included end loan financing for 2,200 units of Nehemiah housing in Brooklyn by a coalition of churches and synagogues.

- Construction Lending Program

  Beginning in 1991, Fleet's New York City bank began developing an active construction lending program for affordable housing by working with the New York City Partnership, New York State and New York City housing agencies, and various for-profit and non-profit developers and sponsors. In 1992, $40 million in loans were booked, and as much as $100 million may be booked in 1993.

- New York Mortgage Coalition

  On January 29, 1993, a two-year commitment was given to the New York Mortgage Coalition for $50 thousand a year for administrative costs with the understanding that Fleet will make approximately $5 million in loans each year. The program also include "second look" loan restructuring and credit counseling.

- Micro Loan Program

  A pilot "micro" loan program was initiated in the minority communities of Hempstead and Glen Cove, Long Island, with an anticipated commitment of $150 million to each, plus administrative support.

- Other programs in 1992 include:

  $5 million in co-funding for the start-up of a small business development center at Pace University in

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Harlem; a $10 million grant for neighborhood housing services.

New York (Upstate)

- Portfolio Lending

  Fleet Bank of New York, in conjunction with the Neighborhood Housing Services, developed a new portfolio mortgage product targeted to low to moderate income populations living in distressed areas throughout Upstate New York. A partnership of 32 community organizations participate with the Bank to provide credit and homeownership counseling and assist in collecting potentially delinquent payments. A commitment of $12 million has been allocated.

- "Second Look" Program

  In February 1992, the Bank implemented a "second look" program to ensure that fair lending practices are consistently in place. The "second look" program entails a second review of minority HMDA related loans by a senior consumer officer before the credit is denied to a minority applicant. Under this initiative, the Bank considers all options or restructuring opportunities through the use of more flexible underwriting guidelines to facilitate mortgage applicants.

- Targeted Advertising/Community Diversification

  In 1991, Fleet Bank increased its emphasis on marketing which is targeted to minority communities. New ads, utilization of minority models, advertising in minority publications and the development of poster ads to reach our communities through branch and neighborhood networks have been initiated. Additionally, product brochures have been published in Spanish. Fleet Bank convened focus groups in Albany and Rochester in an effort to learn from minorities how best to serve minority consumers.

- Workforce Diversification/Outreach

  A full-time employee has been assigned to recruit and develop minority employees. During 1992, Fleet Bank contacted approximately 210 organizations to determine ongoing credit needs (with primary emphasis on affordable housing) through the Bank's Direct CRA Calling Program.

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4. Connecticut

- HART/Frog Hollow First Time Home Buyers Program

  In August 1990, Fleet became a pioneer participant in this Hartford program by making a $1,000,000 commitment. This program is aimed at low/moderate income buyers in Hartford.

- Southend Institutions Neighborhood Alliance

  This is a $1,000,000 commitment for home mortgages in Hartford.

- New Britain Neighborhood Preservation Program

  This program is designed to aid homeowners for home improvements with low interest loans in collaboration with the City of New Britain. Fleet Bank has been involved with this program for 19 years. The total current commitment of the banks is $600,000, with Fleet's share at $85,000.

- Fleet Banker's Pool with Neighborhood Housing Services of New Britain

  These funds are used for the acquisition and renovation of residential properties with low rates and flexible terms. There is a $1,500,000 total bank commitment with Fleet's share at $215,000.

- Thomas Valley Council for Community Action

  Through its Housing Advisory Committee, TVCCA is involved with housing projects in New London county. Childhood development, nutrition and neighborhood services are also areas of involvement. Fleet Bank is represented on the Finance Committee.

- Broad Park Development -- Hartford

  Fleet financed Jefferson-Seymour, an affordable housing project, in Hartford.

- Fairfield 2000 House Corporation (F2HC)

  Fleet Bank has committed to a Fairfield County project consisting of 16 homes which are currently owned by the U.S. Army and which will be sold to low/moderate income households. Fleet Bank is represented on the Board of Directors.

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- <u>The Affordable Housing Funds for Connecticut</u>

  This $5 million tax credit fund provides low/moderate income families with affordable housing throughout the state. It has developed 281 units of affordable housing and 7 retail stores in four years. Among its projects are Hartford's Sigourney Mews and Bridgeport's East Main. Fleet Bank is represented on the Board of Directors.

- <u>New Haven Infill Program</u>

  In collaboration with the City of New Haven, Fleet Bank has committed $1,000,000 to provide home buyers with mortgages for homes constructed on vacant lots in the City.

- Fleet Bank, with Legislative leaders, created the State Home Mortgage Task Force, made up of community leaders, public officials, mortgage lenders and banks. From this group came several home mortgage initiatives:

  A state law that permits interest in real estate escrow funds to be used for private mortgage insurance. The Connecticut Alliance of Homeownership Opportunities was then formed to purchase these loans. $16 million was committed for this purpose by Hartford insurance companies.

  A Review Committee has been created to monitor minority mortgage applications and analyze results on an ongoing basis.

  The State's Mortgage Down Payment Assistance Plan has been rejuvenated and the Department of Housing has taken a more aggressive approach to utilizing funds available.

  A centralized approach to First Time Home Buyers education programs is being developed.

  CHAMP (Connecticut Homebuyers Affordable Mortgage Program), a program of flexible credit standards and low down payments, was created. This program has commitments from banks statewide of over $75 million.

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5. <u>Maine</u>

- <u>Port-Lender Homeownership Project</u>

  Fleet Bank is among five Maine banks who have each pooled $250,000 for the Port-Lender Homeownership Project, a pilot homeowner/landlord program administered by the City of Portland's Community Development Office.

  The project represents a significant public/private partnership between the banks and the City. The program's goal is to improve the stability and livability of 1-4 unit properties in Portland's older neighborhoods by increasing owner-occupied properties and renovating local neighborhoods.

- <u>City/Bank Housing Rehabilitation Loan Program</u>

  The City of Portland annually receives a Community Development Block Grant under Title I of the Housing and Community Development Act of 1974. As part of their Community Development Program, the City assists low and moderate income property owners in the City of Portland.

  Fleet Bank's participation is to provide one-half of the amount of a housing rehabilitation loan, matched by a loan of a similar amount by the City, for eligible one-to-eight unit properties, containing a majority of households with low and moderate incomes. The aggregate amount the bank agrees to lend annually is $200.000. Presently Fleet bank has 22 loans totalling $95,000.00.

- <u>Bangor Hydro-Electric Company Residential Conservation Loan Program</u>

  The purpose of the program is to provide low cost funds to Bangor Hydro customers for rehabilitation for reducing electrical consumption/costs. Fleet has renewed its commitment to this program for 1992-93, and is the only participating lender underwriting these reduced rate low cost loans. Current volumes as of 9/13/92 are 21 loans at $72,000.00.

- <u>Western Maine Land Trust, Six Unit Low-Low Income Affordable Housing Project-Porter Hill Farmington</u>

  Fleet has committed to finance a $75,000 one year construction loan for three of the units, and subsequently finance the units (through FREF). MSHA

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Exhibit 2(b)

THE SECOND MORTGAGE MARKET BY INSTITUTIONAL TYPE OF PLAYER, 6/30/92
(Dollars in thousands)

	# OF LENDERS	OUTSTANDINGS, 6/92 OPEN-END HEL	CLOSED-END SECONDS	TOTAL
BANK HOLDING COMPANIES[1]	1,489	68,594,254	46,095,305	114,689,559
BANKS NOT PART OF ANY HOLDING CO.[2]	6,356	11,777,859	10,663,248	22,441,107
SUBTOTAL BANKS	7,845	80,372,113	56,758,553	137,130,666
% CH FROM 6/91	-2.5%	5.2%	-8.0%	-0.7%
THRIFTS[3] (HEL ONLY)	963	14,457,646	10,209,948	24,667,594
% CH FROM 6/91	-9.3%	-13.8%	-24.6%	-18.6%
CREDIT UNIONS[4]	5,962	11,811,205	8,767,324	20,578,529
% CH FROM 6/91	111.19%	3.06%	-5.2%	0.65%
SUBTOTAL OF ALL DEPOSITORY INSTITUTIONS	14,770	106,640,964	75,735,825	182,376,789
% CH FROM 6/91		1.9%	-18.4%	-3.58%
FINANCE COMPANIES[5]	1,600	11,900,000	42,420,000	54,320,000
% CH FROM 6/91	NM	19.0%	5.0%	7.0%
SECURITIES[6]	NM	5,984,966	7,010,486	12,995,452
% CH FROM 6/91		-23.6%	20.7%	-4.0%
FANNIE MAE[7]	1	0	1,700,000	1,700,000
% CH FROM 6/91		-100%	9.7%	-8.1%
MISCELLANEOUS LENDERS[8]	NA	0	19,824,000	19,824,000
% CH FROM 6/91		0	-5.6%	-5.6%
TOTAL		124,525,930	146,690,311	271,216,241
% CH FROM 6/91		-0.7%	-5.6%	-3.4%

Footnotes appear on next page.

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Exhibit 2(a)

THE TOP 25 SECOND MORTGAGE LENDERS, 6/30/92 (Measured by Outstandings)
(Dollars in Thousands; Securitized Loans ARE Included)

RANK	COMPANY	OUTSTANDINGS 6/92	OUTSTANDINGS 6/91	% CHANGE
1	BANKAMERICA	15,594,267	8,377,000	86.16
2	FORD MOTOR	8,739,658	7,888,900	10.82
3	HOUSEHOLD INTERNATIONAL	7,677,000	8,496,048	-9.64
4	BENEFICIAL CORP	6,251,506	5,210,337	19.98
5	WELLS FARGO	4,867,324	5,393,198	-9.75
6	CITICORP	4,506,000	4,810,000	-6.32
7	FLEET FINANCIAL GROUP	4,426,519	2,660,965	66.35
8	TRANSAMERICA[1]	3,596,762	3,330,000	8.01
9	NATIONSBANK	3,246,234	1,122,036	189.3
10	FIRST INTERSTATE BANCORP	3,158,905	3,395,837	-6.97
11	FIRST UNION CORP	2,880,002	2,676,787	7.59
12	AMERICAN GENERAL[1]	2,843,773	3,100,000	-8.27
13	FIRST FIDELITY BANCORP	2,638,794	2,460,829	7.23
14	PRIMERICA	2,600,000	2,650,000	-1.89
15	BANC ONE CORP	2,568,953	1,726,915	48.76
16	NORWEST CORP	2,564,700	2,276,300	12.67
17	PNC FINANCIAL CORP.	2,034,157	1,739,984	16.91
18	CHEMICAL BANKING	2,021,000	1,170,000	72.74
19	SHAWMUT NATIONAL CORP	1,823,689	2,038,763	-10.5
20	FANNIE MAE	1,700,000	1,850,000	-8.11
21	MERRILL LYNCH	1,596,425	1,314,269	21.32
22	UJB FINANCIAL CORP.	1,539,833	1,289,771	19.39
23	AVCO[2]	1,479,591	1,290,000	14.70
24	GENERAL ELECTRIC	1,415,080	NA	NA
25	MELLON BANK CORPORATION	1,343,065	1,085,629	23.71
	TOP 25 TOTAL...	93,[illegible]	[illegible],350,368	23.28

- Over $7 million in lines of credit, equity investments, and grants to agencies helping small businesses in minority and low- and moderate-income areas. These funds will be allocated to Massachusetts and City of Boston small business programs.
- Over $1 million to improve access to credit and the full range of banking products and services in the City's minority and low- and moderate-income neighborhoods. The funds will be used for opening a full-service branch office in Egleston Square, a bank loan production office in Grove Hall, and two ATMs in areas which would include Egleston Square and Grove Hall.
  In addition, funding will also be provided for active marketing and advertising to bring technical assistance and information about banking services to low- and moderate-income neighborhoods. This will help promote mortgage refinancing for any homeowner burdened by high-rate mortgage loans. Working with the community, the bank will also develop and implement programs dealing with home improvement contractors and financing, and as well as with small businesses in low- and moderate-income areas.
- Upon acquiring Bank of New England, Fleet will begin a program of continuous outreach statewide to community and government leaders in order to complete a comprehensive community investment plan by September 30, 1991. Charles J. O'Connell, executive vice president with 23 years of varied experience at Bank of New England, will be designated to manage the program. He will be assisted by Ronald L. Walker II, assistant vice president and CRA manager, who will work with O'Connell in managing the bank's CRA effort and serve as the principal contact for CRA-related issues.

Walker, a former Bank of New England credit analyst who will return to the Massachusetts bank from Fleet Bank of Rhode Island, directed the CRA program at the Rhode Island bank. That program recently received the highest possible rating, "Outstanding Record of Meeting Community Credit Needs," from the Office of the Comptroller of the Currency, as a result of the bank's CRA Performance Evaluation.

Mortgage Loan Assistance Plan

Fleet/Norstar's $11 million Mortgage Loan Assistance Plan is intended to address problems of low-income and minority homeowners who received burdensome mortgage loans from private mortgage companies which obtained financing from Fleet and Bank of New England.

The objectives of the plan are to allow eligible borrowers with burdensome mortgage loans to keep their homes, complete any repairs of home improvements bargained for but not completed; and provide financing on affordable and equitable terms.

The bank intends to establish immediately a panel consisting of two members of the City of Boston, a member of the Massachusetts Community Investment Coalition, a member of Massachusetts Banking Council, and a member from Fleet. The panel will decide which homeowners are eligible for financial assistance according to the plan.

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The bank is providing $1 million to write down mortgages to affordable levels and $10 million for below-market-rate mortgage assistance. The bank will also make available $100,000 for legal assistance to eligible borrowers, and will support comprehensive Massachusetts legislation to regulate home improvement contractors and private mortgage companies, and to curb burdensome mortgage lending.

Commenting on the company's program, Murray said, "As Fleet/Norstar prepares to enter Massachusetts markets in a major way, we have not forgotten the needs of low-income and minority neighborhoods, as evidenced by our commitment of $100 million to aid low- and moderate-income and minority consumers, and by our related efforts, amounting to an additional commitment of more than $11 million, on behalf of people who may have burdensome mortgage loans."

He said Fleet/Norstar's commitment extends beyond Massachusetts to all of New England and New York. "Our commitment also extends beyond special corporate citizenship programs to include the day-to-day business of banking. We intend to continue serving New England and New York as a major provider of business loans, first and second home mortgages, student loans, and the broad range of financial services necessary to help fuel a recovering economy."

Murray also commented on Fleet/Norstar's pending acquisition of Bank of New England, noting that "we are making excellent progress. The acquisition is solidly on target, and we expect to wrap it up by mid-summer, as planned."

Toward that end, Fleet/Norstar has raised more than $500 million in capital, "and our partner, Kohlberg Kravis Roberts, will bring another $280 million," Murray said. "All told, Fleet/Norstar's arrival in Massachusetts will bring half a billion dollars of new capital to the region's economy."

When it is fully deployed, a "capital infusion of this magnitude, coming at a time when the New England economy appears to be turning the corner, holds out a great deal of promise for employment in Massachusetts, for new small business development, for housing, and for many other ingredients necessary for the eventual economic revitalization of the Bay State," Murray said. He added that Fleet/Norstar through its acquisition of Bank of New England, expects to play a leading role in the New England economy's turnaround

Fleet/Norstar Financial Group is a diversified financial services company listed on the New York Stock Exchange (NYSE—FNC) Fleet/Norstar has approximately 1,000 offices nationwide, and manages the three Bank of New England bridge banks. Fleet/Norstar's lines of business include commercial and consumer banking, mortgage banking, consumer finance, asset-based lending, trust banking, student loan processing, and investment banking.

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Fleet/Norstar **NEWS**

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Fleet/Norstar Unveils $111 Million Massachusetts Community Investment Program; Includes Plan to Help Residents With Burdensome Mortgage Loans

BOSTON, June 27, 1991: After several months of planning and discussions with banking and community leaders throughout Massachusetts, Fleet/Norstar Financial Group today unveiled a $111 million community investment plan for low- and moderate-income neighborhoods and communities in Massachusetts as part of a broader program that will pump more than $500 million in new capital into the New England economy.

The company's program includes an $11 million financial assistance package for low- and moderate-income homeowners with burdensome mortgage loans.

Terrence Murray, Fleet/Norstar chairman and chief executive officer, said, "Our Massachusetts Community Investment Program goes well beyond simple compliance with the Community Reinvestment Act. It commits substantial human and capital resources of Fleet/Norstar to economically develop the communities we serve, as well as the individuals and families who live and work in those communities."

The first part of Fleet/Norstar's program is a $100 million "Fleet Community Reinvestment Plan" for Massachusetts, which will be effective upon Fleet/Norstar's acquisition of the Bank of New England

Fleet Community Reinvestment Plan

The plan will create over 1,750 affordable houses in Boston and statewide. It will also channel over $7 million to help minority-owned and other small businesses in Boston and other Massachusetts communities. And it will bring bank offices, ATMs, and banking services to Boston's minority neighborhoods, providing access to credit and information about financial assistance.

Highlights of the plan are:

- $91 million to increase production of new affordable housing, help rehabilitate properties for use as affordable housing, and provide low-interest mortgages to first-time homebuyers or homeowners who were hurt by high-cost mortgage lending practices in Boston. The majority of these funds would be channeled through existing public and private housing finance agencies such as the Massachusetts Housing Partnership

(more)

Fleet/Norstar Financial Group, Inc
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An Equal Opportunity Employer

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LOW INTEREST REVOLVING HOUSING FUND
FACT SHEET

I. Establishment of a low interest Revolving Housing Fund for use by Rhode Island based non-profit community groups in financing low to moderate income residential housing projects. Low to moderate income persons means members of households with incomes below 80% of median income for that household's size. This fund is intended to preserve existing housing and to create additional housing.

1. Total Fund: $1,000,000
2. Maximum dollar amount per project: $100,000
3. Rate: Fixed at 2% over the Fleet National Bank passbook savings rate.
4. First mortgage long term financing will not be included in this fund.

II. This fund will be administered utilizing the following general parameters:

1. Each non-profit organization must have a federal tax exempt status.
2. Each non-profit must have a Board of Directors
3. Each non-profit must have an accountant prepared annual audit or a Federal 990 report.
4. Each individual project must be approved by Fleet National Bank.
5. Standard bank criteria will be used in the approval process.
6. Financial data, plans, specifications, appraisals, etc. will be required on all proposed projects.
7. Projects will be restricted to one to four family residential units.
8. Project funding will be on a short term basis, normally not to exceed one year.
9. It is expected that repayment will be made through long term financing at prevailing rates.
10. The source of repayment must be defined at the inception of the project.
11. Projects will include:
    a. new construction, including land acquisition
    b. rehab
12. Condominiums and Cooperatives will be considered.
13. Contractors must be approved by the bank. Certain work must be done by certified craftsmen
14. Adequate fire and liability insurance must be provided from the inception of the project.
15. Disbursements will be made in accordance with Fleet's regular procedures, including incremental disbursements based on the percentage of completion of the project.
16. Requests for permanent long term financing will be considered by Fleet National Bank on an individual basis, for either an individual or a non-profit community group.
17. Ten percent of the total loan can be used for up front money.
18. Fleet National Bank will provide in-kind services. No fees will be charged with the exception of legal fees.

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Fleet National Bank **NEWS**

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RESIDENTIAL MORTGAGE

Fleet National Bank Introduces Low Interest Revolving Housing Fund

Providence, R.I., October 3, 1988: Fleet National Bank announced the introduction of a $1,000,000 low interest revolving housing fund for renovations or construction projects that will be made available to the state's non-profit organizations.

To support these community groups in financing low- to moderate-income residential housing projects, the fund offers a fixed rate at 3% over the Fleet National Bank passbook savings rate. The fund also is intended to preserve existing housing as well as create additional building opportunities.

Dennis M. Murphy, senior vice president of Fleet National Bank, in announcing this program said, "We recognize the need for affordable housing for low- and moderate-income families. We consider this fund a step in the right direction in meeting the credit needs of non-profit organizations."

Representatives of area community groups assisted in the development of the program.

Fleet National Bank is a subsidiary of Fleet/Norstar Financial Group (NYSE-FNG), a $25-billion diversified national financial services company listed on the New York Stock Exchange, with dual headquarters in Albany and Providence. Fleet/Norstar has about 1,000 offices in 40 states. Fleet/Norstar's lines of business include commercial and consumer banking, trust banking, mortgage banking and real estate lending, consumer finance, asset-based lending, student loan processing and investment banking.

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NEWS

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FLEET NATIONAL BANK AND RHODE ISLAND HOUSING ANNOUNCE NEW $11 MILLION LEASE-PURCHASE PARTNERSHIP TO PROMOTE AFFORDABLE HOUSING

Providence, R.I., March 6, 1990: Fleet National Bank and Rhode Island Housing and Mortgage Finance Corporation (Rhode Island Housing) have developed a new lease-purchase partnership designed to enable low- and moderate-income Rhode Islanders to purchase a first home, it was jointly announced today by Governor Edward D. DiPrete, Robert J. Higgins, president, Fleet National Bank, and Michael S. Van Leesten, chairman, Rhode Island Housing.

"This is a unique and innovative partnership developed to meet housing needs on a statewide basis," said Higgins. "Through the combined efforts of Fleet and Rhode Island Housing over the past several months, this program has been designed to enable households with yearly incomes ranging from the high teens up to the statewide median income to have the opportunity to own homes."

Governor DiPrete said, "The ultimate beneficiaries of this public/private partnership will be the Rhode Islanders who, for the first time, have a solid opportunity to own a home. In the face of a tough housing market, we continue to find successful formulas for helping families struggling to grasp homeownership, and this new lease-purchase program will continue our record of achievement. Moreover, the partnership of those making this new program possible clearly emphasizes the shared responsibility of public, private and nonprofit entities in providing decent, affordable homes for our residents."

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OBJECTIVE	- To Provide Home Ownership Opportunity to First Time Home Buyers Who Do Not Have the Funds for a Down Payment or Closing Costs
DESCRIPTION	- First Mortgage Financing to Purchase a 1 to 4 Family Residential Property Combined With a Second Mortgage Provided by NJHFC and an Unsecured Loan From Fleet Bank for Down Payment and Closing Costs.
ELIGIBILITY	- First Time Home Buyers Who Have Insufficient Assets to Cover the Down Payment and Closing Costs
SPECIAL FEATURES	- Unsecured Fleet loan at 5% for down payment and closing costs. - Must Be Owner Occupied - Second Mortgages Limited to 15% of the Property Purchase Price
PURCHASE PRICE LIMITS	- 1 Unit $121,365 - 2 Units $136,348 - 3 Units $165,394 - 4 Units $192,305 - New 1 Unit $130,218 - 2 to 4 Units Must Have Been Occupied as a Residence for the Past 5 Years
INCOME LIMITS	- $23,000 Maximum Family Income
MAXIMUM LOAN TO VALUE	- Maximum Combined LTV Secured Financing: 97.5%
FINANCING PARAMETERS	- Fleet Unsecured Loan Interest Rate is 8% for 15 Years With a 10 Year Call - 28/40% Ratios
TOTAL $ COMMITMENT	- $10,000,000

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Rhode Island Housing's Equity Rebate and Fleet's low-interest-rate loan may be used to cover your down payment and closing costs. The Equity Rebate is a grant equal to 2 percent of the purchase price up to $1,000. Fleet's loan is at an annual percentage rate of 5 percent interest with a 15-year payment schedule; however, Fleet reserves the right to require you to pay off the loan after 10 years.

All other Rhode Island Housing First Homes Program regulations and eligibility guidelines apply, including the following.

Recapture Fee - A federal IRS rule which would tax you only if: you sell your home within nine years of purchase, your income increases greatly during that time and you realize a big profit on the sale of your home. You would pay the Recapture Fee to the IRS at the time you sell your home. Check with your Realtor or Fleet for more information.

Affordability Mortgage: If you sell or transfer your home within 15 years, you must pay Rhode Island Housing an amount equal to 2 percent of the sale price or appraised value. However, if the sale price or appraised value is within Rhode Island Housing's Homeownership Affordability Index, or purchase price limits, at the time of sale or transfer, no payment will be required.

You must live in the home as long as you have your Rhode Island Housing mortgage.

How much can I borrow?

The amount you can borrow depends on your income. However, the purchase price limits are $124,875 for an existing single family house or condo, $130,286 for a new single family house or condo and $141,178 for an existing two-family house.

Properties with more than two units or those that include stores or offices are not eligible.

How do I apply?

Call Fleet at 431-7111 to obtain a registration number. The bank will accept just 75 applications, which will be taken on a first-come, first-served basis. You must have a signed purchase and sales agreement in order to obtain a registration number.

* The Annual Percentage Rate (APR) is based on no overpayment and payment of one point and mortgage insurance at closing. For each $1,000 borrowed, the first 24 payments would be [illegible] per month, the second 24 payments would be [illegible] per month, the third 24 payments would be [illegible] per month and the remaining payments would be [illegible] per month. In addition, under these terms you would pay monthly mortgage insurance and required escrows.

Rhode Island Housing

Fleet Bank

JUMP START

January 1, 1992

JUMP START- THE $0 DOWN PAYMENT PROGRAM

Jump Start is a pilot program designed to help Rhode Islanders to buy their first home. The program helps first-time homebuyers without enough cash to cover down payments and closing costs. In addition to a low-interest-rate first mortgage, buyers may combine an interest-free, deferred-payment second mortgage and a grant of up to $1,000 from Rhode Island Housing with a 5 percent annual percentage rate loan from Fleet Bank. Financing will be based on need. Buyers, who must apply through Fleet, will need at least $296 to pay for a credit report and appraisal.

Jump Start is offered through a partnership between Rhode Island Housing, Fleet and Commonwealth Mortgage Assurance Company (CMAC).

Am I eligible for a Jump Start mortgage?

You must be a first-time homebuyer. This is someone who has never owned a home or has not had an ownership interest in his or her primary residence for the past three years.

You must be unable to come up with enough money from savings, gifts or other sources to cover the downpayment and closing costs, based on a Rhode Island Housing assets/needs test.

You must not qualify for any other Rhode Island Housing program.

Your household income can be no more than $23,000.

How does Jump Start work?

Through Rhode Island Housing's First Homes Program, eligible buyers may qualify for a first mortgage with an interest rate beginning at 4.45 percent. This is a 30-year loan. For years 1-2, the interest rate will be 4.45 percent. For years 3-4, the rate will be 5.45 percent. For years 5-6, the rate will be 6.45 percent. For years 7-30, the rate will be 7.45 percent. Every loan will require private mortgage insurance through CMAC.

The Corporation's second mortgage program will be used to help keep the monthly mortgage payments affordable. The maximum loan amount is 15 percent of the purchase price. No payments are required on this interest-free, "silent" second mortgage during the life of the loan; however, the mortgage must be repaid when the house is sold or transferred.

Equal Housing Lender

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Fleet Financial Group

Current Bank Federal CRA Exam Results

Fleet Bank of New York	Outstanding	12/16/91
Fleet Bank	Outstanding	5/18/92
Fleet National Bank	Outstanding	10/29/90
Fleet Bank, N.A.	Satisfactory	9/18/92
Fleet Bank of Mass., NA	Satisfactory	2/28/92
Fleet Bank of Maine	Outstanding	7/16/90 8/12/91
Fleet Bank - N.H.	Satisfactory	4/22/91 4/13/92

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Footnotes from previous page:

[1] Federal Reserve Board Bank Holding Company reports (Y-9 Series)
[2] FDIC Call & Income Reports
[3] Thrift Quarterly Financial reports for revolving HEL amount; SMR computer estimation model for closed-end seconds
[4] Credit Union Semi-Annual Financial Reports
[5] Federal Reserve Bulletin, adjusted by SMR to remove estimated amounts that are not second mortgages; also SMR interviews and SEC documents; includes investment banks
[6] Public securities outstanding; Moody's Investors Service, Standard & Poor's, company reports
[7] SMR interview
[8] SMR estimates and Census Bureau Reports; category includes realty firms, builders, home improvement companies, and other lenders.
Note: Data do not include estimated amounts for loans held by individuals, where IRS data are too inspecific to allow estimates

Second Mortgage Outstandings, 1985 to 1992

(Dollars in Billions)

YEAR	CLOSED-END	OPEN-END	TOTAL	% CHANGE
1985	[illegible]	16	[illegible]	37%
1986	98	33	131	[illegible]
1987	116	63	179	37%
1988	139	81	220	23%
1989	142	96	238	8%
1990	149	115	264	11%
1991	151	125	276	5%
1992 (June 30)	147	125	272	-1%
Estimate for 12/31/92	150	129	279	1% (from 1991)

Sources: See Table "The Second Mortgage Market by Institutional Type of Player, 6/92."

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Home Equity Lines of Credit Outstanding, 1983-1992
(Dollars in Billions)

YEAR	OUTSTANDINGS	% CHANGE
1983	5	
1984	10	100%
1985	18	80%
1986	35	[illegible]
1987	65	91%
1988	81	24%
1989	96	19%
1990	115	20%
1991	125	9%
1992 (June 30)	125	0%
1992 (EST. 12/31)	129	3% (from 1991)

Sources: See Table "The Second Mortgage Market by Institutional Type of Player, 6/92."

Second Mortgage Originations, 1985-1992

(Dollars in Billions)

Year	Loans Originated
1985	49
1986	58
1987	81
1988	86
1989	73
1990	86
1991	97
1992 (EST.)	98

See the text prior to these tables for an explanation of the revised methodology used to make these calculations.

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Percent of Second Mortgage Dollar Volume Delinquent in the U.S., 1984-1991 (NA means Not Available: "Delinquency" Means All Loans 30 Days or More Delinquent)

YEAR	CLOSED-END	OPEN-END
1984	1.37	NA
1985	1.86	NA
1986	1.90	NA
1987	1.80	0.96
1988	1.42	1.15
1989	1.60	1.30
1990	1.59	1.55
1991	2.26	1.53

Sources: ABA, Consumer Credit Delinquency Bulletin, and Consumer Bankers Association, 1992 Home Equity Loan Study

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Exhibit 3

FLEET FINANCE UNDERWRITING GUIDELINES

CLASS A+

All creditors report I-1 (1 x 30).
No bankruptcy filings and no collections or judgements.
Owner occupied property only
Minimum 3 years home ownership except for purchase money first time buyers.
Minimum 3 years employment history, same line of work.
Maximum debt ratio of 40%.
Minimum property value of $60,000.
No condos, rental, or rural properties.
If self-employed must be in present business at least 4 years, decrease LTV by 5%.

CLASS A

0 x 60 on all mortgage ratings for last 12 months.
All installment creditors and major credit cards reporting I-1 and I-2 ratings for the past 36 months. Derogatory revolving credit at Fleet's discretion.
No bankruptcy filing during the past 5 years. All Chapter XIII's discharged minimum of 2 years.
No open collection or judgements exceeding $1000 in last 36 months. (Exclude medical, tax liens, and student loans).
Minimum 3 years home ownership except for purchase money first time buyers.
Minimum 3 years employment history, same line of work.
Maximum debt ratio 45% of gross income.
Rental, rural properties or properties under $40,000, reduce LTV by 10%.
Increase rate on rentals by 1%.
Self-employed must be in present business at least 2 years, decrease LTV by 5%, increase rate 1%.

CLASS B

0 x 6- on all mortgage ratings for last 12 months.
All installment creditors and major credit cards reporting I-1 or I-2 ratings for the past 24 months. Derogatory revolving credit at Fleet's discretion.
No bankruptcy filing during the past 4 years. All Chapter XIII's discharged minimum of 18 months.
No open collection or judgements exceeding $1000 during the past 3 years. (Exclude medical, tax liens and student loans).
Rentals, rural properties or properties under $40,000 reduce LTV by 10%.
Increase rate on rentals by 1%.
Maximum debt ratio 45% of gross income.
Self-employed must be in present business minimum of 2 years, reduce maximum LTV by 10%, increase rate by 1%.

REFER TO PRICING CRITERIA FOR YOUR STATE RATE

MAXIMUM INTEREST RATE = 18.00
(NOT TO EXCEED STATE USURY LAW)

MAXIMUM POINTS = 5
(INCLUDING ALL BROKER POINTS AND ALL PRE-PAID FINANCE CHARGES)

PRE-PAYMENT PENALTY IS 5, 4, 3, 2, 1
(NOT TO EXCEED STATE LAW)

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CLASS C

0 x 90 on all mortgage ratings for last 12 months with acceptable written explanation for mortgage delinquency.
Installment and revolving derogatory credit at Fleet's discretion.
No Bankruptcy filings in past 3 years.
Maximum debt ratio 45% of gross income.
Mortgages are no more than 2 payments due on day of closing and must be paid current plus
1 payment in advance from loan proceeds.
No condos, rental, rural properties or properties with FMV under $40,000.
Self-employed individuals must be in present business for a minimum of 2 years, reduce LTV by 10%, and
increase rate on self-employed by 1%.

NON-OWNER OCCUPIED PROPERTY

Minimum value $40,000.
Must prove positive cash flow, including taxes and insurance.
Maximum LTV 70%.

MISCELLANEOUS - ALL CLASS LOANS

Voluntary return/repo may be upgraded with acceptable verified documentation of circumstances.
Major deferred maintenance must be cured from loan proceeds. All escrows require written Escrow Agreement and
escrow funds must be held by Closing Attorney or Title Company.
Releases must be authorized by the original Appraiser and Fleet.
Modular and mobile homes:
- Maximum LTV 60%.
- Increase rate by 1%.
- Maximum term 120 months.
- Must be on a permanent foundation.

Debt ratios are based on gross income and all outstanding debts (including the new loan) with more than 6
monthly payments remaining.
All purchase money loans require the following:
- 1st mortgages must be underwritten in Home Office.
- One year paid-up fire insurance policy.
- Termite/pest control report.
- Copy of sales contract.
- Copy of survey or applicable title endorsement.
- Copy of the Notice of Completion (new construction or major renovations).
- Verification and source of down payments.
- LTV will be based on purchase price or appraisal, whichever is less.

All second mortgages:
- Senior lien cannot exceed $205,000.
- Second mortgage must be at least 20% of the size of the senior lien
- A copy of the note and mortgage is required if senior lien has a variable rate, has a negative amortization (negative amortized senior liens must be calculated at 125% of their original balance), or if it has a balloon.
- Any open-end senior lien must be changed to a closed-end transaction.

Condos increase rate by 1% - reduce maximum LTV by 10% unless otherwise specified. If not owner occupied,
reduce LTV by 20%.
Each loan is to be closed and funded by a Fleet approved closing agent.

NO EXCEPTIONS

If the debt ratio exceeds the maximum for loan class, the loan may still qualify if the applicant has $800 gross income
or more left over for the head of household and $100 for each dependent.
(Example: four person family would need $1100)
LTV's are based on the as is market value. Properties must be appraised by Fleet approved appraiser
Maximum loan $500,000.
Must see hard copy of appraisal for final approval on all loans
We will not approve any loans secured by properties presently in foreclosure.
No commercial properties.
No loans referred from a broker/lender for home improvement
No raw land deals.

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Exhibit 4

THE RISE OF WHOLESALE CHANNELS

FOR SECOND MORTGAGE PRODUCTION

Just a few years ago, second mortgage originations were almost all "retail." That is, almost all principal lenders got virtually all their production using their own employees to originate loans directly to borrowers.

Now, a "sea change" is occurring. A sizeable wholesale production business has developed in which lenders are getting new loans by means other than direct retail. They are getting loans from mortgage brokers, buying them from correspondents, or making bulk purchases of second mortgages. This is a parallel development to what happened several years ago in first mortgages.

The rise of wholesale production has all kinds of implications. It means, for instance, that a major second mortgage originator no longer must be a company with a huge chain of offices or bank branches.

The rise of wholesale also might change the economics of the business. In first mortgages, many companies that specialize in wholesale purchasing claim their costs to originate are much lower than those of retail players (the retailers, of course, often don't agree).

The rise of wholesale origination also carries with it potential implications for credit quality, since the initial customer contact and sometimes the underwriting on a loan is no longer under the control of the ultimate funding lender.

Why It is Happening:

The Growth of Mortgage Brokers and the Capital Regulations.

A host of new developments have conspired, in combination, to foster the growth of wholesale second mortgage lending. Three things stand out in terms of supply and demand:

Supply:

1. There has been a dramatic increase in the number of mortgage brokers in the U.S. Many thousands of these brokers specialize only in first mortgages, but some make both first and seconds, and some now specialize in seconds only. The brokers do not keep loans; they create a new supply of second mortgages that others may buy.

   A "broker," as most of our clients know well, is a self-employed person or independent firm that deals directly with the consumer but does not fund loans. He may represent several funding lenders (the wholesale buyers) and may offer a large number of their products from which the borrower may choose. The broker then typically makes the loan, taking the application directly on the paper of the selected funding lender, who in essence has "bought" it if the loan is

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approved.

2. **New risk-capital rules for banks and thrifts make it less attractive than in the past for depository institutions to keep the second mortgages they have originated.**

   This is not a new development, since risk-capital rules have been in effect now for a couple of years. But it is an escalating factor, because the risk-capital rules keep getting more stringent until they are fully implemented at year-end 1992.

   Under these rules, banks and thrifts must put 100% capital behind most second mortgages held in portfolio, whereas the required amount for most first mortgages is only 50%. At year-end 1992, the full risk-weighted capital amount is 8% of assets, meaning that the full 8% capital must be behind the seconds and only 4% behind the firsts.

   Banks and thrifts with capital adequacy concerns are thus increasingly incented to get second mortgages off their books. This creates more of a supply of loans for sale, and it naturally increases the development of a wholesale market where other lenders buy the loans on a contractual or bulk basis.

<u>Demand:</u>

3. **As has happened in the first mortgage business, many second mortgage lenders now see wholesale production as more <u>efficient</u> than retail.** Brokers, for instance, end up looking like an indirect sales force to some lenders, and the cost of this indirect sales force may be lower than the cost of a direct sales force.

   At the same time, with brokers and correspondents garnering so many retail customers, same lenders have come to believe that they cannot maintain their historic production levels without tapping this source.

In the net, the history of growth in wholesale production may be like the old unanswerable question about which came first, the chicken or the egg? In this case, which came first, the supply of second mortgages available for sale or the demand for them that enabled that supply to find a home? **The answer probably is unimportant. The salient point: Wholesale second mortgage lending has arrived.**

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The History of Second Mortgage Brokerage

Some second mortgage brokers have been around for a long time. But the vast growth of this business is recent. A whole series of events have brought about the creation of a meaningful second mortgage brokerage industry. Here's what happened:

Second mortgage originations by brokers started in the late 1970s, at least in the Northeast. They may have started even a little earlier in California. Certainly, there were very few brokers back them. Many were financial consultant types -- they would find people money. Barry Adelson, president of Rhode Island-based Century Mortgage, recalls that a friend persuaded him back then that he could double his income by becoming a broker instead of remaining a branch loan manager.

In the early days in the Northeast, there were only three major wholesalers buying from brokers: American Funding, Wells Fargo, and Colonial Commercial. Of these three, only American Funding is still doing so in the Northeast. Wells Fargo sold its program outside of California.

Second mortgage brokerage grew through the early and mid-1980s, but as a sort of "shadow" event. Direct retail lenders in those years held the limelight in this business, as banks and thrifts joined finance companies in embracing both closed-end seconds and revolving HELs. The loans looked good to make and to hold, and the retail lenders exploited their office and branch networks to get their loans the old-fashioned way: directly.

Effect of CLOs in Encouraging Realty Firms

But in the background, much was changing. In the early and mid-1980s, for example, early experiments were going on in computerized loan origination systems (CLOs). These were primarily first mortgage programs, such as First Boston's Shelternet, in which participating lenders put their first mortgage loan offerings on-line through computer terminals located right on the premises of realty firms.

In the Shelternet program, however, the realty firm could only participate if it had its own legal-entity mortgage banking or mortgage brokerage company in place. The concern was that without such a legal structure, the realty firm might violate strictures of the Real Estate Settlement Practices Act (RESPA), which arguably prohibited realty firms from being paid directly for recommending a mortgage lender.

In a fascinating turn of events, the actual effect of systems like Shelternet was to teach hundreds of realty firms how to enter the mortgage business as a sideline. In the end, many of these firms saw no need to keep the CLO, and to this date CLOs have been of questionable significance in mortgage production. But lots of realty firms did keep their mortgage units and went into the mortgage banking or mortgage brokerage business independently. Today, realty firm-owned mortgage operations comprise one segment of the new second mortgage brokerage community. Most of these operations still specialize in first mortgages, of course, yet some do offer seconds.

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Mortgage Power & Look-Alikes

Another change took place in the mid-1980s, and this one came mainly from a single lender: Citicorp. The big New York bank in those years rolled out its Mortgage Power program -- a membership organization for realty brokers and mortgage brokers. Like the CLOs, Mortgage Power was designed as a first mortgage program, yet it had a side effect on second mortgage production.

In this program, the members received a package of benefits from Citi. In exchange for recommending the Citicorp mortgage and (in some cases) for taking the application and doing related work, a member got some things in return. The bank offered fast loan approvals, liberal qualifying ratios, no required private mortgage insurance, and a variety of other terms that enhanced the likelihood that a loan would be approved in a way the brokers liked. Also, there was "room" for the realty or mortgage broker to charge a closing fee of his own to the borrower, although Citi itself never paid such a fee to the broker.

Soon after it was launched, Mortgage Power was attacked by the Mortgage Bankers Association of America (MBA) as being a thinly disguised kickback scheme. Citicorp vigorously denied that, and the government still is grappling with what to do about this.

But in the meantime, many other lenders launched Mortgage Power look-alike programs in order to remain competitive. The net result was to stimulate powerfully the growth of the mortgage brokerage industry. At first, Mortgage Power members were mostly realty firms. But soon afterwards, they were mostly mortgage brokers.

Again, Mortgage Power and its rivals were first mortgage programs. Yet, they fostered the emergence of a huge community of mortgage brokers -- independent businessmen who also could make second mortgages if they wanted to do so. All they had to do was find buyers, and many did.

The Layoffs of 1987-1989

Mortgage brokerage got yet another boost in an inadvertent way from events in the first mortgage business.

In 1986, the first mortgage business was booming and achieved its historic peak in originations. Mortgage bankers as well as banks and thrifts expanded their staffs of loan originators and their office networks to accommodate a flood of consumer demand the like of which had never been seen. In early 1987, that swell of demand continued apace.

Then, in the late spring of 1987, demand collapsed. Interest rates shot upward. The portion of demand that had been comprised of refinancings fell like a rock, and the pace of home sales also fell, drying up purchase money mortgage demand.

Mortgage bankers were impacted more than banks and thrifts, because, in a rising interest rate environment, adjustable rate mortgages became more

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popular than fixed-rate mortgages. Mortgage bankers typically don't like to make too many ARMs, whereas thrifts have grown to love those loans.

As a result of all this, lenders across the industry (but especially at mortgage banking companies) began laying off mortgage lending personnel. Many thousands lost their jobs, not only in 1987 but also in 1988 and 1989, when total mortgage volume continued to drop or else run at a low ebb. At the same time, the insolvency of so many savings and loans threw more mortgage lending executives out of work.

By the tens of thousands, mortgage loan officers had to make hard decisions about their careers. Few could be absorbed by established retail lenders still in a hiring mode. Many opted to set up their own mortgage brokerage companies -- often "mom and pop" shops -- or else to join small mortgage brokerage firms already established.

This change created the biggest single boom in the growth of mortgage brokerage. And, again, although the impetus for change came from the first mortgage industry, nevertheless, it had an effect on second mortgage brokerage. Once in business, a hungry mortgage broker often was eager to make any and all loans he could arrange with funding lenders. Some began to offer both firsts and seconds. Many stayed solely with first mortgages, but some opted to specialize in seconds, where growth seemed more predictable and steady.

The net effect of all these events has been the development of a huge network of mortgage brokerage companies and individuals. Today, they have their own fledgling national trade association -- the Phoenix-based National Association of Mortgage Brokers (NAMB). In a mid-1991 interview with SMR, NAMB estimated that there are about 40,000 full-time mortgage brokers in the U.S. working at perhaps 10,000 firms. More than one out of 10 of these firms appears to be based in California. As a group, the brokers today account for as much as half of all U.S. first mortgage originations.

Almost all these businesses are small, largely unregulated, and privately held, so little is really known about their characteristics. The number of mortgage brokers that offer at least some second mortgages -- and the number that offer second mortgages primarily -- are unknown, but probably are quite considerable. They do not account for nearly as high a percentage of second mortgages as they do first mortgages, yet the number is growing. Brokers today may account for 5% to 10% of second mortgage originations.

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Exhibit 5

FLEET FINANCE, INC.

Summary of Litigation

Fleet Finance, Inc. and its affiliates are defendants in four class action suits filed in federal and state courts in Georgia. The first Georgia class action lawsuit was filed by Johnnie J. Johnson, et al. on June 21, 1991 in the United States District Court for the Southern District of Georgia. Fleet Finance, Inc. and Fleet Finance, Inc. of Ga. are among the named defendants. Plaintiffs allege that defendants violated the Georgia criminal usury law, state and federal RICO laws and Federal Truth-in-Lending regulations. Plaintiffs are seeking forfeiture of all interest charged, treble damages, punitive damages and other penalties. Some plaintiffs are seeking rescission of their loans.

The main issue in the case is the interpretation of the Georgia criminal usury statute which states that no lender shall charge "any rate of interest greater than 5 percent per month". Plaintiffs argue that this statute should be construed such that any points and prepaid finance charges charged the borrower at the inception of the loan should be allocated, for purposes of the "per month" usury calculation, to the first month of the loan only, rather than spread over the life of the loan, as Fleet Finance argues.

By Order dated February 21, 1992, the District Court dismissed all claims against both Fleet Finance companies. The plaintiffs have appealed this dismissal of their case to the Eleventh Circuit Court of Appeals. Argument on this appeal has been temporarily post-poned; Fleet Finance believes that this case will not go forward until a decision has been made in the Jones case currently pending in the Georgia Supreme Court.

The Jones class action suit was filed in the Superior Court of Richmond County, Georgia in June 1992 by Elizabeth Jones, et al. against Fleet Finance, Inc. of Ga. and Fleet Finance, Inc. (R.I.). Relying on a theory substantially similar to that dismissed in the Johnson case, plaintiffs allege violations of criminal usury statutes and seek forfeiture of all interest charged, injunctive relief from further collections of interest and foreclosures by the defendants, cancellation of the related mortgages and other damages.

On September 4, 1992, the court granted plaintiff's motion for class certification, holding unconstitutional a Georgia statute which barred class actions where usury claims involve loans secured by real estate and denied defendants' motion to

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dismiss the usury claim. Defendants were granted immediate appellate review of all issues in the case (including the validity of the usury claims) by the Georgia Supreme Court and oral argument on this appeal took place on January 19, 1993. Fleet Finance believes that the Georgia Supreme Court may issue a decision on their appeal within the next several months.

In August 1992 Lillie Mae Starr, _et al_. filed a class action suit, naming Fleet Finance, Inc. (DE), Fleet Finance, Inc. (RI) and Fleet Finance, Inc. of Ga. as defendants, in the Superior Court of Cobb County, Georgia. This lawsuit also alleges violations of the Georgia criminal usury statutes as well as violations of the Georgia RICO statute. Plaintiffs seek forfeiture of all interest charged, injunctive relief, cancellation of the related mortgages, punitive and other damages. Plaintiff's motion for class certification has recently been granted. Fleet Finance has filed a motion for immediate appellate review based upon the same issues appealed in the _Jones_ case, but the ruling on this motion has not yet been made. A decision in the _Jones_ case could impact this lawsuit also.

Another Georgia class action filed by Keith Anthony Alexander, _et al._ on August 20, 1991 in the Superior Court of Richmond County, Georgia names Fleet Finance, Inc. of Ga. among the defendants. Plaintiffs allege that defendants engage in discriminatory housing practices which are unlawful under the Georgia Fair Housing Act; they seek refunds of excess interest and punitive damages. On October 2, 1992, the plaintiffs' motion for class certification was granted. The discovery process is currently underway in this lawsuit.

As a response to consumer complaints related to the issues in these lawsuits received by the Georgia Office of Consumer Affairs, in August 1992, the Attorney General for the State of Georgia announced that it is instituting an investigation of Fleet Finance, Inc. and its lending practices. The Attorney General has recently appointed a special investigator to conduct this investigation. Fleet Finance believes that the nature of the complaints and the lending practices which the special investigator will examine involve issues similar to those which arise in the lawsuits.

Fleet Finance, Inc. believes its practice have conformed to applicable law in all material respects. Fleet Finance, Inc. does not anticipate that any of these lawsuits, or all of these lawsuits in the aggregate, will have a material adverse effect on its business.

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Exhibit 6

January, 1992 - Georgia

	Rate	Total Points
Fleet	11.99 - 17.50	15
American Financial Corp.	11.50 - 18.50	17
First Family	12.00 - 14.75 (No Class 4)	15 - 17
Ford	12.99 - 16.50	17

October, 1992 - Georgia

	Rate	Total Points
Fleet	9.99 - 13.99	5
American Financial Corp.	10.50 - 15.75	17
American Industrial	11.99 - 14.99 (No Class 4)	10
Ford	12.49 - 16.25	10

Exhibit 7

15 YEAR LOAN - 15%

UP FRONT POINTS	PAY AT FULL TERM
1	15.21%
5	16.07%
10	17.23%
15	18.50%

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Exhibit 5

Mortgage Loan Delinquency Experience
All Loans Serviced By The Seller

(Dollar Amounts in Thousands)
(unaudited)

	At December 31,									
	1987		1988		1989		1990		1991 (4)	
	Number of Loans	Amount (1)	Number of Loans	Amount (1)	Number of Loans	Amount (1)	Number of Loans	Amount (1)	Number of Loans	Amount (1)
Total Portfolio	[illegible] $	945,372	[illegible] $	1,169,137	84,350 $	1,546,[illegible]	71,[illegible] $	1,[illegible]	70,[illegible] $	2,[illegible]
Delinquencies (2)										
31 - 60 Days	[illegible]	10,195	576	10,120	[illegible]	11,[illegible]	[illegible]	10,[illegible]	751	17,[illegible]
61 - 90 Days	420	9,211	420	7,[illegible]	563	12,129	[illegible]	12,[illegible]	373	10,[illegible]
91 Days or more	913	17,537	774	16,[illegible]	[illegible]	20,[illegible]	[illegible]	31,413	1,317	40,[illegible]
Total Delinquencies	[illegible]	[illegible]	1,770	[illegible]	2,0[illegible]	4[illegible]14	2,214	[illegible]	2,441	70,622
Delinquency Percentage (3)	3.91%	3.91%	3.12%	3.[illegible]%	3.10%	2.[illegible]%	3.11%	2.[illegible]%	3.37%	3.40%
Real Estate Owned	[illegible]	17,[illegible]	597	18,140	[illegible]	22,430	400	20,[illegible]	400	22,273

(1) Includes all amounts scheduled to be paid under Mortgage Loans, including unearned income.

(2) The period of delinquency is based on the number of days payments are contractually past due. Loans in foreclosure are included in the 91 day or more classification until the loan is charged-off or the real property is acquired.

(3) Total Delinquencies divided by Total Portfolio at period end.

(4) Includes mortgage loans serviced by the Sellers for third parties. Prior to 1990, the Sellers did not service mortgage loans owned by third parties.

FIXED AND FLOATING RATE HOME EQUITY DELINQUENCY HISTORY
Public Issuers of Home Equity Loan Asset Backed Securities

Issuer	30-Days + Delinquencies (1)						
	1992	1991	1990	1989	1988	1987	1986
Old Stone Credit Corporation (2)	4.35%	4.52%	3.59%	2.93%	2.51%	2.35%	—
Household Finance Corporation (3)	5.99%	5.43%	4.06%	2.24%	0.86%	0.79%	1.04%
The Money Store Inc. (4)	4.01%	5.15%	4.80%	4.72%	3.60%	—	—
Maryland National Bank	1.85%	1.52%	1.31%	0.20%	0.21%	0.10%	0.13%
Alliance Funding Company (5)	12.81%	13.06%	11.80%	11.10%	—	—	—
ADVANTA Mortgage Corp. USA (5)	7.32%	7.11%	6.63%	6.39%	9.22%	3.91%	—
Home Equity Loan Asset Backed Securities Corporation (5)	1.04%	1.23%	0.96%	—	—	—	—
Daiwa Mortgage Acceptance Corporation	—	3.75%	4.44%	4.49%	7.57%	3.36%	—
Shawmut Bank, N.A.	—	2.13%	1.51%	1.24%	0.26%	0.43%	—
Chevy Chase Savings Bank, F.S.B.	—	2.19%	2.33%	1.76%	1.40%	—	—
Fleet Finance, Inc. (5)(6)	—	3.56%	2.90%	2.96%	3.03%	3.91%	5.52%
GE Capital Mortgage Services (4)	—	5.31%	4.09%	3.63%	1.27%	—	—
Merrill Lynch Home Equity Acceptance, Inc. (7)	—	1.72%	1.31%	0.93%	0.43%	0.51%	0.92%
Beneficial California Inc. (7)	—	3.06%	2.50%	0.74%	0.64%	0.53%	0.92%
American Financial Corporation of Tampa (5)	—	8.40%	8.34%	6.01%	7.06%	—	—
Marine Midland Bank, N.A. (2)	—	2.10%	1.90%	1.60%	1.53%	0.93%	—
Security Pacific National Bank	—	1.67%	2.07%	1.23%	1.54%	—	—
Chrysler Financial Corporation (8)(9)	—	14.93%	10.60%	7.02%	5.86%	5.55%	6.02%
Security Pacific Financial Services Inc. (11)	—	—	5.84%	5.44%	5.41%	4.74%	5.20%
Transamerica Financial Services (10)(11)	—	—	3.73%	3.39%	4.09%	4.37%	—
First Interstate Bank of California (12)	—	—	0.30%	0.16%	0.40%	0.53%	—
First Security Bank of Utah/ Idaho, N.A. (11)	—	—	0.50%	0.69%	1.02%	1.15%	1.27%
Bank of the West (4)	—	—	0.40%	0.47%	0.53%	0.67%	—
Midlantic National Bank (2)	—	—	1.54%	1.05%	1.05%	0.60%	—
Goldome	—	—	—	5.64%	4.90%	5.82%	5.80%
Sears Consumer Financial Corporation (14)	—	—	—	1.41%	0.83%	0.61%	0.58%

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Notes:

(1) Unless otherwise footnoted, delinquency percentages are calculated by taking end of period dollar amount of delinquencies as a percent of end of period portfolio dollar amount outstanding not including unearned finance charges.

(2) Delinquency percentages include dollar amount currently in foreclosure and not yet charged off.

(3) Delinquency data for loans owned and loans serviced with limited recourse.

(4) Delinquency percentages are based on end of period number of accounts delinquent and end of period number of accounts outstanding and include accounts in foreclosure but not yet liquidated.

(5) Delinquency percentages include dollar amount of mortgage loans in foreclosure and real estate owned but not yet liquidated.

(6) Delinquencies in 1990 and 1991 include home equity loans serviced by the Seller for third parties. Prior to 1990, the Sellers did not service home equity loans owned by third parties.

(7) Delinquency percentages based on dollar amount of 60-day and over delinquencies, and end of period dollar amount outstanding.

(8) Includes delinquency experience for both fixed and floating rate mortgage loans.

(9) Includes unearned finance charges for precomputed loans in calculation of portfolio outstanding and dollar amount of delinquencies for delinquency percentage calculations. Delinquency percentages include dollar amount currently in bankruptcy or foreclosure.

(10) Delinquencies for 30-59 days for Transamerica Financial Services are not available. Transamerica Financial Services represents 88.30% of the total company portfolio in 1990, 88.19% in 1989, and 91.05% in 1988.

(11) Delinquency percentages include dollar amount of mortgage loans in foreclosure but not yet liquidated.

(12) Delinquency percentages for 1987 and 1988 are based upon end of period number of accounts delinquent and end of period number of accounts outstanding. For 1989 and 1990, the delinquency percentages on a dollar amount outstanding basis were .30% and .16%, as compared to .25% and .21%, respectively, on a number of loans basis.

(13) Includes unearned finance charges for simple interest loans in calculation of portfolio outstanding. Includes delinquencies for fixed rate home equity loans only.

(14) Delinquency percentages are based on monthly average number of accounts delinquent and average number of accounts outstanding during each month.

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Exhibit 9

Earnings Comparison of Fleet Finance, Inc. and Fleet Financial Group, Inc.

Year	Fleet Finance Earnings (million)	Fleet Financial Group, Inc. Earnings (millions)	Fleet Finance/ Fleet Financial
1980	$ 3	72	4.2%
1981	4	83	4.8
1982	6	105	5.7
1983	8	136	5.9
1984	19	173	11.0
1985	23	209	11.0
1986	26	253	10.3
1987	29	200	14.5
1988	38	336	11.3
1989	43	371	11.6
1990	55 [1/]	(74)	[2/]
1991	51 [3/]	98	52.0
1992	(8)	280	[2/]

1/ $8 million of the $55 million earned by Fleet Finance in 1990 was earnings from securitizations.

2/ Not determinable due to loss.

3/ $27 million of the $51 million earned by Fleet Finance in 1991 was earnings from securitizations.

4/ 24.5% excluding earnings from securitizations.

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Exhibit 10

Fleet Finance, Inc. NEWS

FOR IMMEDIATE RELEASE

For more information, contact:
Stacy Stout
404/936-2305

FLEET FINANCE ANNOUNCES $38 MILLION

10 POINT PROGRAM TO ASSIST ITS MORTGAGE CUSTOMERS

Fleet Includes $8 Million Commitment to Atlanta's Olympic Stadium Impacted Neighborhoods

ATLANTA, October 8, 1992 -- Fleet Finance, Inc. announced today a major 10 point program that amounts to $38 million to assist its customers with mortgage loans. As the largest second mortgage finance company in Georgia Fleet Finance believes this new program will improve its relationship with current and future customers.

In Atlanta, as part of its 10 point program, Fleet Finance will establish an $8 million Fund for Olympic Stadium Impacted Neighborhoods (FOSIN) to foster housing and community development in Summerhill, Mechanicsville and Peoplestown. The Atlanta inner-city neighborhoods program will consist of: $1,500,000 in grants for organizational, interim preservation and beautification purposes; $500,000 for a revolving property acquisition fund and $6 million in affordable housing tax credit investments.

"Our commitment to the Olympic Stadium Impacted Neighborhoods is only one part of our 10 point program, but an important part as it brings us closer to the communities within the city where we are headquartered. The changes announced in our new program, coupled with those Fleet began implementing over the past two years, will ensure Fleet Finance customers and communities receive the best possible service," said John R. Strickland, President and CEO of Fleet Finance, Inc.

-more-

Fleet Finance, Inc.
50 Perimeter Park Drive
Atlanta, Georgia 30341

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Fleet's 10 Point Program/Page 2

The Fleet Finance program addresses the following outreach initiatives:

1. Significantly reduce interest rates on mortgage loans with fees and points deemed burdensome, with no cost to the customer;
2. Place an immediate moratorium on all residential foreclosures for 60 days;
3. Personally contact all customers within 14 days whose foreclosures have been affected by the moratorium;
4. Complete unfinished home improvement work;
5. Continue the policy of not purchasing home improvement loans from other loan originators;
6. Complete program to eliminate purchases of individual loans from third-party lenders;
7. Significantly reduce interest rates and fees on new mortgage loans;
8. Create the $8 million Fund for Olympic Stadium Impacted Neighborhoods (FOSIN) and a consumer credit education program;
9. Establish an independent arbitration procedure for problems that cannot be resolved with the customer, and
10. Establish a nation-wide toll-free number, 800/972-1201, for customers' use in making inquiries about the program.

FOSIN will be overseen by a board, which will administer the funds, comprised of leaders from the three affected neighborhoods, Atlanta elected officials to be named later and Fleet Finance executives. Fleet Finance will also provide the strategic planning and financial counseling initiatives associated with this program.

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"These policy changes set the stage for Fleet Finance to market its products and services to borrowers more effectively," said Strickland, who also noted that all loans will be originated through Fleet Finance's existing branch network and through a business development network of Fleet Finance account executives.

The Fleet Finance program is not intended to compromise or settle any pending litigation, or otherwise affect any pending litigation in any way. All customers will retain all rights which they may have pursuant to any such litigation.

With $2.6 billion in assets owned and serviced, Fleet Finance is a major Georgia corporation with 80,000 mortgage customers served from 32 offices in the state and more than 130 offices in 23 states nationwide. Founded in 1936, Fleet Finance is wholly-owned subsidiary of Fleet Financial Group in Providence, R.I.

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TESTIMONY OF ANNIE DIGGS

FEBRUARY 17, 1993

My name is Annie Diggs. I have lived in the same house at 1522 Blakley Street in Augusta, Georgia since 1936. On January 17, I celebrated by 78th birthday.

I was born in 1915 in Macon, Georgia and was raised in a community known as Shady Dale, Georgia. My father was born in the West Indies, but he drowned six months before I was born. My grandparents were born as slaves. My mother was forced to work for the fair so she left me to be raised by a great aunt who was my namesake, Annie Virginia Coleman. The Colemans were originally farmers in Georgia, but had to give up farming after the boll weevil invaded their farm. We then moved to Athens, Georgia where my great uncle worked for a company that made axe handles and hammer handles.

When I was 14 years old, I married Will Diggs who worked as a fireman for the Georgia Railroad. The railroad moved us to Augusta in 1932. We moved into my present home in 1936.

My husband and I were blessed to have 10 children, four of whom are still living, before I became a widow in 1946. After my husband's death, I have had numerous jobs primarily of a domestic or clerical nature such as a maid at University Hospital, a clerk at a grocery store, and a worker at a food processing plant. For the last 27 years of my working life I was employed—as a domestic at Elliott's Funeral Home in Augusta. I stopped working at Elliott's in 1979. Since that time, my only source of income is my late husband's railroad retirement which is now only $515 per month. Additionally I receive food stamps worth about $60 per month. Frequently, I have to go without food.

In 1987 my home needed major repairs primarily due to a leaking roof. I went to a local bank where I had a $343 balance on my existing mortgage. The local bank turned me down.

Later, I was contacted by a woman working for a local loan company. She looked at my house and contacted a remodeling company that agreed to do the repairs for $3,300. She said she could arrange a loan, also. The manager of the loan company told me I should pay off several other little bills and that I could get some money to buy a washer and dryer, too. They never told me the rate or how long the loan would last.

When I went to sign the papers for my loan I was asked to sign a stack of papers which I did not understand. Instead of the $3,300 which I originally needed, I ended up with a note to Tower Financial for $15,000 at an interest rate of 18.9 percent. My house is pledged as security. My monthly payments are $251.34 almost half of my total monthly income. I was charged $2,595 or 21 percent of the loan amount in loan fees. My loan documents show that I received $4,328.48 at closing, but I only received $2,428.48. I have never been told why I did not receive the other $1,900. Additionally, if I were somehow able to pay off this loan by refinancing, I would have to pay a prepayment penalty of $900 or 6 percent of the original note.

The home repair work was very poor. The paint peeled and my roof continued to leak.

After one payment I learned my loan had been sold to Fleet Finance. I complained to Fleet about the sorry repair work. They said that was my problem. All they were interested in was getting the monthly payment on time. My ceiling finally fell in. For more than 5 years I have lived in my house with the roof still leaking. All the while I was paying Fleet.

I have paid more than $13,000 on my loan since 1987. But Fleet Finance tells me that I still owe more than $16,000 on the loan. I cannot understand how I could owe $16,000 on a loan that originally was only $15,000 especially after I have paid over $13,000 in monthly payments. I am scared of losing my home.

I finally got the repair work done right but only after I got a grant from the City of Augusta Community Development Housing Rehabilitation Program.

Something is very wrong when companies like Fleet can make these loans and take homes from people. I ask this committee to investigate these kinds of lending practices and to do something to put a stop to this.

STATEMENT OF EVA L. DAVIS

FEBRUARY 17, 1993

On July 20, 1990, three men came to my home in the Potrero Hill district of San Francisco. By the end of the day, events began that resulted in a $150,000 loan

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being placed on my home. My loan payments increased from $619 to $1,992 a month. However, my total monthly income still remained at $1,086.

Today, at the very moment that this committee begins its hearing on home equity loan abuses, my home was set for foreclosure sale. Fortunately, because of the assistance of Consumers Union and two attorneys, the trustee sale of my home was halted by the court in San Francisco. However, my attorneys warn me that I may very well lose my home through foreclosure.

While there is probably nothing that the U.S. Senate can do to save my home, I ask that you take steps to protect other homeowners like me from lending institutions and finance companies that abuse people's trust and take away their homes.

I never requested the $150,000. They found me. And what they told me seemed reasonable and believable because the company that provided the loan was called Congress Mortgage and one of the men who visited my home on July 20 said he worked for the Federal Emergency Management Agency (FEMA) which processed loans for people injured by natural disasters. Because what they said sounded believable and because I trusted them, I will probably lose the home where I have lived for 20 years.

As a result of the Loma Prieta earthquake in October of 1989, my home suffered damage to its front steps and interior walls. As a result of this damage, the City and County of San Francisco placed a tag on the front of my home to warn people about the faulty front steps. It was this yellow tag that the contractor saw when he drove by my house on July 20.

The contractor and "FEMA representative" knocked on my door and proceeded to explain to me that I could have my front steps repaired and have other repairs done to my home. When I told them that I could not possibly qualify for a loan due to my low income, they assured me that they could arrange a short-term loan that would pay for the repairs while I arranged a FEMA loan. They also told me that the government loan would pay off the short-term loan and that I would not have to repay the FEMA loan until I sold my home. Since I did not plan to sell my home in the near future, this sounded like a very good idea to me.

The contractor then made a phone call from my home and in less than an hour a person named Dion Brennan appeared at my home. He said he was a loan officer with Congress Mortgage. Mr. Brennan told me that his company would give me a loan that would pay off my existing three loans, which totaled $58,000. [There was a first loan of about $19,000 with loan payments of $185 a month; the second two loans, totaling $39,000, had been placed on my home because of medical bills that I had to pay as a result of my late husband's illness and my own illness.] I wasn't told how much the loan would be for or any other details of the loan at the July 20 meeting. I also was unable to read or sign the loan papers because I suffer from glaucoma and I had recently broken my glasses. The loan officer told me that this wasn't a problem and that I should just sign a blank piece of paper, which I did. My signature appears on all the loan papers, though I never signed a single loan document.

Within two weeks of the July 20 meeting, the contractor came to my home and informed me that my loan had been approved. I called Congress Mortgage, and they told me that they had decided not to pay off the first loan as they had said they would. I learned that my loan payments would now be just under $2,000. And I learned that they had charged $23,000 (or 15.33 points) in loan origination fees. [This is shown on the Mortgage Loan Disclosure Statement that is attached to this statement.]

The loan documents that I eventually received showed that I was to receive $15,299.40 from this loan. The only money that I received were two checks totaling $4,297.87 which they paid to me so that I would move out of the house while the contractor finished his work. [This also is shown on the attached Mortgage Loan Disclosure Statement.]

Within five months, my home was placed into foreclosure by Congress Mortgage since I was unable to make the loan payments of nearly $2,000 on my income of less than $1,100 a month. Also, during this period of time, the contractor, who had been paid nearly $70,000 by the finance company, quit work on my home and left my home in barely habitable condition.

Just before my home was to be sold at trustee sale in June of 1991, I was referred to an attorney who put me into bankruptcy, despite the fact that I was not behind in payments on my one account with Montgomery Ward. Also, because an arbitration provision had been placed into one of the loan documents (which I had never read and which was not explained to me), I was forced to go through arbitration without the help of an attorney, since the one I had retained withdrew from representing me before the hearing. Just two weeks ago, I learned that the arbitrator had denied my claims against Congress Mortgage. [The attached Consent and Com-

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pliance Agreement contains the arbitration provision which is hidden in the second and third paragraphs of this 14-paragraph form.]

At the arbitration proceeding I saw for the first time a copy of the loan application that had been filled out by the loan officer. It showed that I had monthly income of $4,294 a month which it claimed I received from renting the top floor of my home and that I would receive $800 in income from renting the lower half of my home after the remodeling was completed. This was completely false. I share one of the upstairs bedrooms with one of my grandchildren, and my daughter occupies another bedroom with her other child; when the loan officer visited my home, I was renting one upstairs bedroom to an elderly gentleman for $200 a month. The downstairs consists of a living room, dining room, kitchen and bathroom; there is nothing that could be rented for $800 a month, as the loan application stated.

The loan application, which I had never seen until December 16 of last year, also stated that I was receiving $767 in Social Security benefits and $627 in disability benefits; it also said that I would begin to receive $600 in benefits from my deceased husband's pension plan. What I had told the loan officer was that I was receiving $767 in disability (not Social Security) benefits and $119 from my late husband's pension plan; I also told him that I would begin to receive $627 in Social Security benefits on behalf of my late husband starting in October of 1990. The loan officer misstated my income on the loan application by $1,108 per month plus the $2,300 in rental income, which was also false. [A copy of the Residential Loan Application is attached to this statement.]

I have been through a terrible ordeal with Congress Mortgage. Before I ever met their loan officer, I was living very simply, but comfortably. I was able to pay my mortgage payments of $619 a month and my other living expenses out of my monthly income of $1,086. Now I am threatened with loss of my home through foreclosure. I will lose all the equity that I had in my home, and my daughter and two grandchildren will not have a place to live—all of this happening just because a contractor saw that my front steps needed repairing.

I hope that the United States Congress can do something to protect people like me whose only mistake was to trust people who sounded honest.

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MORTGAGE LOAN DISCLOSURE STATEMENT (BORROWER)

CONGRESS MORTGAGE CO 1662 THE ALAMEDA, SAN JOSE, CA 95126 (408) 295-1444

I. SUMMARY OF LOAN TERMS

A. PRINCIPAL AMOUNT $ 1[illegible] 000.—

B. ESTIMATED DEDUCTIONS FROM PRINCIPAL AMOUNT

1. Costs and Expenses (See Paragraph III-A) $ 1700.60

2. Loan Origination Fee (Finance charge) (See Paragraph III-B) $ 23 000.—

3. Amount to be Paid on Authorization of Borrower (See Paragraph III-C) $ 110 000.—

C. ESTIMATED CASH PAYABLE TO BORROWER (A LESS B) $ 15299.40

II. GENERAL INFORMATION ABOUT LOAN *Variable payment & interest rate. See Federal Truth-in-Lending Statement.

A. If this loan is made, borrower will be required to pay the principal and interest at 14.25 %* per year, payable as follows:

360 (x)monthly ( )quarterly ( )annual payments of $ 1807.03 * and a FINAL/BALLOON payment of $ — to pay off the loan in full.

NOTICE TO BORROWER: If you do not have the funds to pay the balloon payment when it comes due, you may have to obtain a new loan against your property to make the balloon payment. In that case, you may again have to pay finance charges, fees and expenses for the arranging of the loan. Keep this in mind in deciding upon the amount and terms of this loan (if applicable).

B. This loan will be evidenced by a promissory note and secured by a deed of trust on property identified as (street address or legal description):

C. Liens against the property and approximate amounts owing are:

Nature of Lien:	Present Liens	Proposed Liens
1ST MORTGAGE	$ 19 000.—	$ 19 000.—
2ND MORTGAGE	$ 28 000.—	$ 150 000.—
3RD MORTGAGE	$ 11 000.—	$ —
	$	$

NOTICE TO BORROWER: Be sure that you state the amount of all liens as accurately as possible. If you contract with the company to arrange this loan, but it cannot be arranged because you did not state these liens correctly, you may be liable to pay finance charges, fees and expenses even though you do not obtain the loan.

D. If borrower pays all or part of the loan principal before it is due, a PREPAYMENT PENALTY computed as follows may be charged (if applicable): Six (6) months interest on 80% of the unpaid balance (see Note for details).

E. The purchase of credit life or credit disability insurance by a borrower is not required as a condition of making this loan.

III. DEDUCTIONS FROM LOAN PROCEEDS

A. Estimated Costs and Expenses of Arranging the Loan to be Paid Out of Loan Principal

	PAYABLE TO Company	Other
1. Appraisal fee	$ 295.00	$ NONE
2. Processing fee	$ 375.00	$ NONE
3. Title insurance policy	$ NONE	$ 557.50
4. Notary fees	$ 20.00	$ NONE
5. Recording fees	$ NONE	$ 10.00
6. Credit investigation fees	$ 59.00	$ NONE
7. Other costs & expenses (SEE EXHIBIT A)	$ 374.00	$ NONE

TOTAL COSTS AND EXPENSES $ 1700.60

B. Loan Origination Fee (Finance Charge) $ 23 000.—

C. Estimated Payments to be Made out of Loan Principal on Authorization of Borrower

	PAYABLE TO Company	Other
1. Fire or other hazard insurance premiums	$	$
2. Credit life or disability insurance premiums (See Paragraph II-E)	$	$
3. Beneficiary statement fees	$	$
4. Reconvey. & similar fees	$	$
5. Discharge of existing liens against property (SEE EXHIBIT A)	$	$ 40 000.—
6. Other: (SEE EXHIBIT A) SEE NOTE ON EXHIBIT "A"	$	$ 70 000.—

TOTAL TO BE PAID ON AUTHORIZATION OF BORROWER $ 110 000.—

CONGRESS MORTGAGE CO (Company) A Consumer Finance Lender #605-1[illegible]72

DON BRENNAN Signature of Company Representative [signature]

NOTICE TO BORROWER: DO NOT SIGN THIS STATEMENT UNTIL YOU HAVE READ AND UNDERSTAND ALL OF THE INFORMATION IN IT. ALL PARTS OF THE FORM MUST BE COMPLETED BEFORE YOU SIGN.

Borrower hereby acknowledges the receipt of a copy of this statement. Date JULY 23, 1990

Eva L Davis
EVA DAVIS

RE881 6-87 (E3.1/4) (#ALL)(2360342) FOR INFORMATION CONTACT THE DEPARTMENT OF CORPORATIONS, STATE OF CALIFORNIA

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CONGRESS MORTGAGE CO [illegible] THE ALAMEDA, SAN JOSE, CA [illegible]

MORTGAGE LOAN DISCLOSURE STATEMENT (BORROWER)

EXHIBIT A

OTHER ESTIMATED COSTS AND EXPENSES OF ARRANGING THE LOAN, TO BE PAID OUT OF LOAN PRINCIPAL:

DESCRIPTION	COMPANY	OTHER
104 1 endorsement	175.00	
Tax Service	49.00	
No insurance info (NOTE--not an insurance coverage)	150.00	
TOTAL #1	374.00	00

DISCHARGE OF EXISTING LIENS AGAINST PROPERTY, ON AUTHORIZATION OF BORROWER:

DESCRIPTION	COMPANY	OTHER
2nd MORTGAGE		28,000.—
3rd MORTGAGE		11,000.—
PENALTIES		1,000.—
TOTAL #2		40,000.—

OTHER ESTIMATED PAYMENTS TO BE MADE OUT OF LOAN PRINCIPAL, ON AUTHORIZATION OF BORROWER:

DESCRIPTION	COMPANY	OTHER
REWIRE - ELECTRICAL		
NEW PLUMBING DOWNSTAIRS		
NEW ROOF + DOORS		
NEW WINDOWS (FRONT + REAR)		
NEW BATHROOM (DOWNSTAIRS)		
REMODEL BATH (UPSTAIRS)		
PAINT (INSIDE + OUT)		
NEW (CARPET + FLOOR IN KITCHEN)		
NEW STAIRCASE IN FRONT		
4 MOS PMTS WHILE WORK IS DONE		
TOTAL #3		70,000.—
GRAND TOTAL (1+2+3)	N/A	N/A

FL38/2 8-87 (E3.2/4) (#ALL)(258342)

NOTE: THESE FUNDS ARE TO BE HELD IN ESCROW AND [illegible] AS WORK IS COMPLETED

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CONGRESS MORTGAGE CO
1682 THE ALAMEDA, SAN JOSE, CA 95126
(408) 998-0444

CONSENT AND COMPLIANCE AGREEMENT

The undersigned borrowers have read and approved the Borrower Loan Instructions and consent to the employment of services by Ticor Insurance Co., Transamerica Title Insurance, Western Title Company, EQUITY HOLDERS SERVICING CO as servicing agent, and other companies appointed by CONGRESS MORTGAGE CO. hereinafter called CM, to perform services and being compensated for such services in accordance with Code of Civil Procedure Section 10248 and from others.

All disputes as to this agreement and accompanying loan documents or remedies for default herein shall be settled by arbitration in accordance with the rules of the American Arbitration Association, and shall be supervised by the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. Any costs of such proceedings shall be borne by the parties equally.

The disputes and differences arising out of this contract shall be settled and finally determined in the City of San Jose, County of Santa Clara, State of California, by arbitration in the foregoing manner.

CM further states its compliance with Federal Equal Opportunity Act which prohibits creditors from discriminating against credit applicants on the basis of sex or marital status. The federal agency which administers compliance with this law concerning this mortgage Company is the Federal Trade Commission located at 450 Golden Gate Avenue, San Francisco, California 94102.

CM further states its compliance with the Sate of California fair lending practices, which pertains to all applicants for a loan for the purchase, construction, rehabilitation, improvement or refinancing of one-to-four family residence.

Under the Housing Financial Discrimination Act of 1977, it is unlawful for a financial institution to refuse to make a loan or to offer less favorable terms than normal (such as a higher interest rate, larger down payment or shorter maturity) based on any of the following considerations:

1. Neighborhood characteristics (such as the average age of the homes or the income level in the neighborhood) except to a limited extent necessary to avoid an unsafe and unsound business practice.

2. Race, sex, color, religion, marital status, national origin or ancestry.

It is also unlawful to consider, in appraising a residence, the racial, ethnic, or religious composition of a particular neighborhood, whether or not such composition is undergoing change or is expected to undergo change.

If you wish to file a complaint, or if you have questions about your rights, contact:

Office of Fair Lending
Business & Transportation Agency
1120 N Street
Sacramento, CA 95814

Or call collect (916) 322-8661.

If you file a complaint, the law requires that you receive a decision within thirty (30) days.

Borrower(s) hereby acknowledge receipt of a copy of this notice.

______________________ Eva L Davis
EVA DAVIS

______________________ ______________________

CONGRESS MORTGAGE CO
BY [signature]
DION BRENNAN Loan Officer

DATED: JULY 23, 1990

FL37 7-88 (E3.4/4) (258342)

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CONGRESS M[illegible]RTGAGE COMPANY

1602 The Alameda, Suite 100, San [illegible] CA 95126 [illegible]

[illegible]sidential Loan Applicatio[illegible]

Amount: $150,000 — Interest Rate: 12.25 — No. of Months: 360 — Monthly Payment Principal & Interest: $1807.03

Prepayment Option

Property Street Address	City	County	State	Zip	No. Units
1119 Kansas St.	San Francisco	S.F.	CA.	94107	1

Legal Description (Attach description if necessary) — Year Built: 1949

Purpose of Loan: ☐ Purchase ☐ Construction-Permanent ☐ Construction ☐ Refinance ☐ Other (Explain)

Complete this line if Construction-Permanent or Construction Loan: Lot Value Data — Year Acquired — Original Cost $ — Present Value (a) $ — Cost of Imps. (b) $ — Total (a + b) $

Complete this line if a Refinance Loan: Year Acquired / Original Cost / Amt. Existing Liens / Purpose of Refinance / Describe Improvements [ ] made [ ] to be made

1971 — $36 K — $75 K — Major Remodel + Pay off 2nd + 3rd — Cost: $

Title Will Be Held In What Name(s): Eva L. Davis

Manner In Which Title Will Be Held: A Single Woman

Source of Down Payment and Settlement Charges

[illegible]

Borrower

Name: Eva L. Davis — Age: 52 — Yrs. School: 12

Present Address — No. Years: 15 — ☒ Own ☐ Rent

Street: 1115 Kansas St[illegible]

City/State/Zip: S.F. CA. 94107

Former address if less than 2 years at present address

Street

City/State/Zip

Years at former address ☐ Own ☐ Rent

Marital Status: ☐ Married ☐ Separated ☒ Unmarried (incl. single, divorced, widowed)

Name and Address of Employer: Property Mgmt., 1119 Kansas St, SF, CA. 94107

Years employed in this line of work or profession: 1 years — Years on this job — ☐ Self Employed*

Position/Title: Property Mgr — Type of Business: Landlord

Social Security Number: [illegible]60-54-8772 — Home Phone: (415) 891-7[illegible] — Business Phone

Co-Borrower

Name — Age — School Yrs

Present Address — No. Years — ☐ Own ☐ Rent

Street

City/State/Zip

Former address if less than 2 years at present address

Street

City/State/Zip

Years at former address ☐ Own ☐ Rent

Marital Status: ☐ Married ☐ Separated ☐ Unmarried (incl. single, divorced, widowed)

Name and Address of Employer

Years employed in this line of work or profession: years — Years on this job — ☐ Self Employed*

Position/Title — Type of Business

Social Security Number — Home Phone — Business Phone

Gross Monthly Income

Item	Borrower	Co-Borrower	Total
SS-Income	767	$	$
Disability	627		
[illegible]			
[illegible]			
[illegible]			
[illegible]			
Upstairs	1500		
Downstairs	800 (after remodel)		
[illegible]	600 (begins Oct-90)		
Total	$4294	$	$4294

Monthly Housing Expense**

	Present	Proposed
Rent	$	
First Mortgage (P&I)	185	$185
Other Financing (P&I)	434	1807
Hazard Insurance	45	45
Real Estate Taxes	20	20
Mortgage Insurance	[illegible]	—
Homeowner Assn. Dues		
Other: 3rd	165	—
Total Monthly Pmt.	$849	$2057
Utilities	150	150
Total	$999	$2207

Details of Purchase

Do Not Complete If Refinance

a. Purchase Price	$
b. Total Closing Costs (Est.)	
c. Prepaid Escrows (Est.)	
d. Total (a + b + c)	$
e. Amount This Mortgage	
f. Other Financing	
g. Other Equity	
h. Amount of Cash Deposit	
i. Closing Costs Paid by Seller	
j. Cash Reqd. For Closing (Est.)	$

Describe Other Income

NOTICE: † Alimony, child support, or separate maintenance income need not be revealed if the Borrower or Co-Borrower does not choose to have it considered as a basis for repaying this loan.

B–Borrower / C–Co-Borrower		Monthly Amount
	Rental income from Upstairs (currently being rec'vd)	$1500
	Rental income from Downstairs (unoccupied until after remodel)	800
	[illegible]	[illegible]

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[ ] Completed Jointly [ ] Not Completed Jointly

Assets | Liabilities and Pledged Assets

SAV.
BofA
24th & Bryant St
S.F. 94107
02345-4391

1427.—

SEE ATTACHED SCHEDULE

Creditors' Name, Address and Account Number	Acct. Name if Not Borrower's	Mo. Pmt. and Mos. Left to Pay	Unpaid Balance
(1) Bayview Fed S&L, 2121 So. El Camino, S.M. CA. 94403	280-59-13086-9		19,000.—
(2) 1st Alliance, 701 S. Parker # 500, Orange, CA. 92668	# 400577 L		28,000.—
(3) 1st Alliance, Same	# 401173		11,000

250,000

None

50,000.—

Schedule of Real Estate Owned

Address of Property	Type of Property	Present Market Value	Amount of Mortgages & Liens	Gross Rental Income	Mortgage Payments	Taxes, Ins. Maintenance and Misc.	Net Rental Income
1119 Kansas St.	SFR	$250,000	$75 K	$	$784	$65	$
TOTALS	$	$	$	$	$	$	$

List Previous Credit References

B - Borrower C - Co-Borrower	Creditor's Name and Address	Account Number	Purpose	Highest Balance	Date Paid
				$	

I/we fully understand that it is a Federal crime punishable by fine or imprisonment, or both, to knowingly make any false statements concerning any of the above facts as applicable under the provisions of Title 18, United States Code, Section 1014.

x Ellis L Davis [signature] Date

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CONGRESS MORTGAGE / [illegible] THE ALAMEDA, SAN JOSE, CA [illegible] [illegible]
A Broker acting as a Lender

FEDERAL TRUTH IN LENDING STATEMENT

Made in compliance with REGULATION Z of the FEDERAL TRUTH IN LENDING ACT

JULY 23, 19[illegible]

Borrower(s) Name: EVA DAVIS
Mailing Address: 1113 KANSAS STREET, SAN FRANCISCO, CA 94107

ANNUAL PERCENTAGE RATE The cost of your credit as a yearly rate, which is subject to change	FINANCE CHARGE The dollar amount the credit will cost you, which is subject to change.	AMOUNT FINANCED The amount of credit provided to you or on your behalf.	TOTAL OF PAYMENTS The amount you will have paid after you have made all payments as scheduled, based on the current annual percentage rate, which may change.
16.97 %	$ 523,531.03 This is an estimate	$ 127,000.–	$ 650,531.03 This is an estimate

You have the right to receive an itemization of the Amount Financed. [ ] I want an itemization. [X] I do not want an itemization.

Your payment schedule will be:

Number of Payments	Amount of Payments	When Payments are Due
36	1807.03	15th of ea. mo.
324	Varying, subject to adjustable mortgage terms	15th of ea. mo.

ADJUSTABLE NOTE AND LOAN CALL PROVISION: The annual percentage rate may increase during the term of this loan and the loan balance may be all called due and payable at the end of the 36th month or at the end of any subsequent 36 month period.

INSURANCE: Credit life insurance and credit disability insurance are not required to obtain credit and will not be provided unless you sign and agree to pay the additional cost.

Type	Premium	Term	
Credit Life	NONE		I want credit life insurance. Signature:
Limited Credit Life			I want limited credit life insurance. Signature:
Credit Disability	NONE		I want credit disability insurance. Signature:
Limited Credit Disability			I want limited credit disability. Signature:
Credit Life and Disability			I want credit life and disability insurance. Signature:

You may obtain property insurance from anyone you want that is acceptable to us. If you get the insurance through the company you will pay $________.

SECURITY: You are giving a security interest in your property (dwelling) located at:
1113 KANSAS STREET, SAN FRANCISCO, CA 94107

FILING FEES: $ NONE

LATE CHARGE: If a payment is late, you will be charged $ 108.42 / Ten (10) [illegible] % of the payment.

ELD PREPAYMENT: If you pay off early, you
~~[illegible]~~ will not have to pay a penalty.
[ ] may [X] will not be entitled to a refund of part of the finance charge.

See your contract documents for any additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment refunds and penalties.

I have received a copy of this statement.

Eva L Davis
EVA DAVIS

Date: JULY 23, 19[illegible]

[illegible] 10-87 ([illegible]) ([illegible]) (HALL) ([illegible])

NOTE

ADJUSTABLE RAT[illegible] [illegible]OTE WITH CALL PROVISIONS [illegible]CURED BY DEED OF TRUST

Loan Number 259342 SAN FRANCISCO, California JULY 23, 1990

$ 150 000 In installments as herein stated, for value received, I promise to pay to C[illegible]GRESS MORTGAGE CO (a Consumer Finance Lender) or order, at 1602 THE ALAMEDA, SAN JOSE, [illegible] 5126, or address designated by holder, the sum of

ONE HUNDRED FIFTY THOUSAND AND NO/100 DOLLARS

with interest from AUGUST 16, 1990, on the unpaid principal at

the rate of FOURTEEN & ONE QUARTER percent (14.25 %) per annum, principal and interest payable

in monthly installments of ONE THOUSAND EIGHT HUNDRED SEVEN AND 3/100 ($ 1807.03)

DOLLARS commencing SEPTEMBER 15, 1990 and continuing until AUGUST 15, 2020 on which date any unpaid balance of principal together with interest due thereon, shall be due and payable.

ADJUSTABLE RATE PROVISIONS On the 37th installment, and on each 36th installment thereafter, the interest rate of the Note will be adjusted to the 11th District Cost-of-Funds rate plus 875 basis points. The 11th District Cost-of-Funds rate used in the interest rate change calculation will be the figure most recently available one (1) month prior to the 37th installment, and on each 36th installment thereafter, of the Note. With each interest rate change, the payment will be adjusted to amortize the unpaid principal balance over the remaining term of the Note. Example: Mr. Smith takes out a loan on January 1, 1987, at 14.00% simple interest. On December 1, 1989, the 11th District Cost-of-Funds rate is 7.00%. Mr. Smith's loan on January 1, 1990, will now have an increased payment to correspond with his new interest rate of 15.75% (7.00% + 875 basis points). The next adjustment to the monthly payment and interest rate will be on each corresponding 36th month period.

LOAN CALL PROVISIONS The principal and interest of the loan will become all due and payable on the 37th month, and/or on each 36th subsequent month, if any of the following conditions have occurred during the previous 36th month:

1. All payments have not been timely received by us or nominee. ("Timely" is defined to mean that an installment payment must be paid within 10 days of the scheduled due date), or
2. All senior liens or real estate taxes on the property have not been timely paid, or
3. The subject property has not been reasonably maintained.

Example: Mr. Smith takes out a loan on January 1, 1987. The monthly loan payments are due the 10th day of each month. On February 22, 1988, Mr. Smith makes his February 10th, 1988 payment. This payment has not been made on a timely basis, because it was received more than 10 days after the due date. Mr. Smith's loan will be all due and payable on the 37th month of his loan.

OTHER TERMS

Borrower understands that said interest charged is also, on the prepaid finance charges, which are included in the principal sum of the Note. Principal and interest payable in lawful money of the United States. Each payment shall be credited first on interest then due, late payment charges, any and all advances made, fees and expenses, if any, and the remainder on principal; and interest shall thereupon cease upon the principal so credited.

All payments received on this Note secured by Deed of Trust shall be applied in pro rata proportions to the interest held by each Note Holder. Note Holders of [illegible] or more of the unpaid amount of this Note secured by Deed of Trust may determine and direct the actions to be taken on behalf of all Note Holders in [illegible]nt of default or with respect to any matters requiring the direction or approval of the Note Holders.

Should default be made in payment of any installment when due, or in the performance of any provision or condition contained in the Deed of Trust securing this Note, the whole sum of principal and interest shall become immediately due at the option of the holder of this Note. In event of sale, transfer, conveyance, or alienation of said property, or any part thereof, or any interest therein, whether voluntary or involuntary, Beneficiary shall have the right of acceleration, at his option, to declare this Note, irrespective of the maturity date expressed herein, and without demand or notice, immediately due and payable, including any prepayment charge provided for herein. No waiver of the right shall be effective unless in writing. Consent by the Beneficiary to one such transaction shall not constitute a waiver of the right to require such consent to succeeding transactions.

If any payment is NOT paid or tendered in full within 10 days of the scheduled due date, the maker(s) hereof agree(s) to pay a late charge of $5.00 or 10% of the payment then due, whichever is greater. For owner occupied property the following late charge shall apply: $5.00 or 6% of the payment of principal and interest, whichever is greater. Late charge to be paid only once on any late payment. Said late charges apply to past due payments and any maturity balance in final satisfaction thereof and at the option of the holder hereof, shall be due at the time of delinquency or at maturity thereof respectively. Maturity balance late charges are $250 from 10 to 30 days; $500 from 31 to 60 days after maturity and 6% of the unpaid balance thereafter.

If this Note is not paid when due I promise to pay in addition all costs of collection, including an action for judicial foreclosure, and reasonable attorney's fees incurred by the Beneficiary hereof on account of such collection, whether or not suit is filed hereon. I understand this Note is secured by a Deed of Trust on my property; I agree to perform and pay for all matters required of me by the Deed of Trust. I understand the usual Reconveyance fee and recording fee will be charged me and possibly a handling or forwarding fee when the obligations have been paid in full; that I may incur substantial costs and expenses if Default proceedings are commenced.

Should any additional funds be advanced to the undersigned on any Note secured by a Deed of Trust now of record, or should any change be made in the time or manner of paying such Note, or should any other action be taken by the undersigned with respect to such Note whereby the security herein provided for shall be impaired in any manner whatsoever, then the within Note shall, at the option of the Beneficiary, immediately become due and payable.

This Note is Secured by a Deed of Trust to EQUITY HOLDERS SERVICING CO. A California Corporation, as Trustee.

This Note is subject of Section 2966 of the Civil code, which provides that the holder of this Note shall give written notice to the trustor, or his successor in interest, of the prescribed information at least 90 and not more than 150 days before any balloon payment is due.

THIS NOTE INCLUDES DELINQUENCY CHARGES, RECONVEYANCE FEES, LOAN CALL PROVISIONS IN THE 37th MONTH AND EACH 36th MONTH THEREAFTER, AND AN ADJUSTABLE INTEREST RATE PROVISION. IT IS THE INTENT OF ALL PARTIES TO THIS NOTE TO ABIDE BY ALL OF THE CALIFORNIA BUSINESS AND PROFESSIONS CODE GOVERNING REAL PROPERTY LOANS AND ANY TERMS OF THIS NOTE INCONSISTENT WITH THAT LAW ARE HEREBY WAIVED BY THE BENEFICIARY.

Eva E. Davis
EVA DAVIS

DO NOT DESTROY THIS NOTE. When paid, this Note, with Deed of Trust securing same, must be surrendered to Trustee for cancellation before reconveyance will be made.

INSTALLMENT NOTE — INTEREST INCLUDED

FOR INFORMATION CONTACT THE DEPARTMENT OF CORPORATIONS OR THE DEPARTMENT OF REAL ESTATE, STATE OF CALIFORNIA

FL[illegible] 10-87 [illegible] (259342)

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WRITTEN TESTIMONY OF JOHN B. LONG AND THOMAS W. TUCKER OF THE LAW FIRM OF DYE, TUCKER, EVERITT, WHEALE & LONG AND DAVID E. HUDSON OF THE LAW FIRM OF HULL, TOWILL, NORMAN & BARRETT

SUMMARY OF TESTIMONY

During the past decade, thousands and thousands of American homeowners—primarily minorities—have been subjected to unregulated lending practices. We consider these lending practices to be not only illegal, but immoral. Unfortunately, the environment which spawned these lending practices has been the federal preemption of long-standing state usury statutes, the repeal of state usury statutes, redlining, and reverse redlining. Efforts by Congress to promote home ownership, to promote lending for the acquisition and maintenance of homes, and to promote fair lending have gone haywire. We now have in this country a type of lending that is concentrated primarily in minority neighborhoods, and which results in rates that are extremely unreasonable. Interest rates, points and other charges which are normally dependent upon risk are based primarily on sharp business practices, unscrupulous lending, and other practices which both Congress and the states have left completely void of regulation.

Free market concepts do work in certain types of lending, especially when the primary purpose of the loan is to acquire homes and competitive forces work to keep rates low. However, with the home equity loans, refinancing of existing homes in minority neighborhoods, and other types of lending practices in some segments of society, there is very little, if any, competition. This lack of competition has been brought about in part by redlining. Reverse redlining has followed. The amount of charges being assessed against certain segments of society are, in the words of the Eleventh Circuit Court of Appeals, "outrageous."[1]

Congress should act immediately to rectify these evils. Non-bank bank finance companies, some of which are owned by regulated bank holding companies, should immediately become regulated. Incentives should be offered for bank holding companies that do not engage in de facto redlining. Current statutory schemes should be strengthened, not repealed. Interest rate cap legislation, just like interest rate regulation of VA and credit union loans, should be imposed.[2] Rates should vary with the cost of funds and with the value of collateral, the capacity to repay and credit worthiness, not with the ability of unscrupulous lenders to take advantage of those who are unaware of loan terminology, points, discounts, hidden interest charges and high prepayment penalties. Congress should immediately request regulators to disprove mergers and acquisition of those who have failed to meet their Community Reinvestment Act requirements.

PRELIMINARY STATEMENT

My colleagues and I are lawyers from Augusta, Georgia, who are currently representing a substantial number of Georgians in claims against various consumer finance companies on claims of racial discrimination in lending and other lending practices which we consider to be unfair, illegal and immoral. We may not look like the typical consumer advocates, nor are we. In our law practices we often represent legitimate banking institutions and legitimate mortgage institutions, credit unions, insurance companies, public utilities, state and local governments, newspapers and other major corporations. One of us has been active in the Republican Party; and two have been active in the Democratic Party; and these comments are nonpartisan. Despite our political differences and, sometimes, differences in philosophy, we have seen over the past few years unregulated finance companies descend upon our state and prey upon a substantial number of citizens in Georgia. The individuals who have been the victims of what we consider as unfair, illegal and immoral lending practices have generally been minorities who have worked hard their entire lives to own their homes and build up equities in them. A substantial number of these individuals are upper middle aged and elderly. Because of past practices of segregation and the lack of educational opportunities for these individuals in their youth, they are not well versed in dealing with written contracts, mortgages, loans, interest

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[1] *Moore v. Comfed Savings Bank*, 908 F.2d 834 (11th Cir. 1990).

[2] Pursuant to the National Housing Act, housing loans insured by the Federal Housing Administration (FHA) or the Veterans' Administration (VA) have long been exempt from statute usury ceilings. The VA continues to set interest ceilings on loans guaranteed by it. 12 U.S.C. § 1709-1a, 38 U.S.C. § 1828. FHA loans currently have no rate cap. The National Credit Union Act allows federally chartered credit unions to assess interest up to 15 percent per annum or a higher temporary rate set by the National Credit Union Administration Board. 12 U.S.C. § 1757, 12 C.F.R. § 701.21(c)(7)(ii).

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rates, etc., even though, in their own professions and jobs, they have done very well, for they have in part achieved the American dream—to own ones home. We are here in part to address many of the problems that we see day-to-day in our communities.

In the past in some parts of this nation, we had segregated water fountains, lunch counters, waiting rooms, and the like. Those past policies of segregation, whether imposed by law or custom, were wrong. Today, we are faced with a dual type of lending, with minorities generally being pushed to the back of the bus economically and being charged higher interest charges than their white counterparts—for no acceptable reasons.

We will try to address the problems of high finance charges, redlining, reverse redlining, and other unfair lending practices, and will also try to give you some suggested changes to try to rectify a substantial number of these problems.

Problems

I. High Finance Charges.

Congress is partially responsible for certain segments of our society now paying some of the highest finance charges in history on home loans. During the late 1970's and early 1980's, we were faced with some of the highest interest rates on home mortgages in the history of this nation.[3]

As a result of these double digit interest rates, Congress reacted by generally overriding long-standing usury statutes in 1979 with the enactment of 12 U.S.C. § 1735f–7. In 1980, the Depository Institutions Deregulation and Monetary Control Act of 1980 was enacted, overriding state usury statutes governing mobile home and manufactured home interest rates. 12 U.S.C. § 1735f–7. Deregulation of rates continued in 1982 when the Alternative Mortgage Transaction Parity Act (AMTPA), 12 U.S.C. § 3801, *et seq.*, was enacted.

The same lobbyists who descended upon the Congress telling it that home mortgages would dry up unless long-standing state usury statutes were preempted then descended upon the state legislatures; and historic rate restrictions which were based on state statutes were repealed. In repealing these long-standing state consumer protection statutes, Congress and state legislatures failed to look at history. Historically, we have always had laws which govern what one man could charge another for the use of money. Aristotle condemned interest as unnatural. In the Bible, Jews were restricted from charging fellow Jews interest for the use of money. See, Leviticus 25:35–37; Exodus 22:25; Deuteronomy 23:19–20. In Roman times, the Twelve Tables forbade interest above 8.33 percent. *The Story of Civilization*, Part III, "Caesar and Christ," by Will Durant (Simon & Schuster, N.Y.), 1944, Chapter IV, p. 79. While mankind eventually came to the conclusion that to charge interest was not necessarily wrong, historically, laws have provided that a certain rate be the maximum. Usurers were historically condemned, with Dante placing usurers on the Seventh Level of Hell, whereas cardinal sinners were only placed on the Second Level. In Georgia, like most original states, we had the common law of England, which restricted what one man could charge another for the use of money. In fact, until the advent of federal intervention and deregulation, interest rates were always a prerogative of the states, except in VA and FHA guaranteed loans. Georgia, except for a two year period during the 1870's, had always restricted what one could charge another for the use of money.

Congress' actions in overriding a substantial number of state laws, however, was not all wrong. In connection with funds that were being advanced to purchase housing units, free market competitive forces worked and still work. In those situations, there is an anxious seller, an anxious buyer, and, in most cases, an anxious real estate agent, all of whom are working to try to make the sale work. Competitive forces therefore are at work from various angles to try to find the lowest interest rate financing. Legitimate banks and mortgage companies, being aware of these competitive forces, compete against one another, advertise, and therefore keep rates low. Home mortgage interest rates for loans used in purchasing real estate are a function of generally the cost of funds. Interest rate regulation is not necessarily needed in these types of loans. However, in other areas, Congress' override of long-standing state usury statutes or state action in repealing these, together with *de facto* redlining, has resulted in situations where free market concepts do not work to keep rates regulated, with devastating consequences.

[3] The 112th Statistical Abstract of the United States, 1992, Table 791, shows that the contract interest rates for all loans in was 12.3 percent in 1980, 14.5 percent in 1982, 12.1 percent in 1983, 11.9 percent in 1989, etc. The average prime rate charged by banks was 15.26 percent in 1980, 18.87 percent in 1981, 14.85 percent in 1982. See Table 806.

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In connection with minority neighborhoods, whether the legitimate banks want to admit it or not, money is not being made available. The Community Reinvestment Act is not being enforced the way it should be. *De facto* redlining exists, and regulated lending institutions are not making loans in the minority neighborhoods from which they receive deposits.

As a result of the existence of *de facto* redlining, a golden opportunity arose for certain non-bank banks (finance companies) which, to a large extent, are completely unregulated. This lack of regulation has been created by the preemption of state laws and the repeal of long-standing usury statutes. These nonbank banks generally take the position that "the sky is the limit" and that the only restriction in how much they can charge is "let the buyer beware." If, because of age, infirmity, lack of formal education, or other factors, the borrower is unaware, then the borrower is at the complete will or mercy of the potential lender.

Since Congress has deregulated long-standing state usury statutes, this new form of lender has developed an affinity with the South. This lender is not one who is engaged in lending for the acquisition of a home where competitive forces work to keep rates low. This new breed of lender engages primarily in second mortgage lending, refinancing of homes, loans made in connection with home improvements contracts, etc. Either by accident or design, it appears that the great majority of the recipients of these loans are African-Americans. In 1983, in the South, the new type of lenders began surfacing, under the names of Landbank Equity Corporation, Atlantic Mortgage Corporation, and Freedlander, The Mortgage People. All three of these entities have since gone out of business, but the loans they made are still outstanding and are held by so-called legitimate lenders and even the Federal National Mortgage Association. Some of the principals of these now defunct entities have been tried and convicted, not for bilking the consumers, but for bilking the investors or banks who backed them.[4]

So that this Committee will know exactly what we are talking about, let us give you some examples of these types of loans and lending practices. These documents that we are producing are documents which are from actual court records. In 1984, Lucille Williams went to Atlantic Mortgage Co., now defunct, to borrow $18,000. She was charged 35 points as an origination fee. In other words, out of an $18,000 first mortgage on her home, $6,300 went to origination fees. The promissory note clearly stated that this was a "bonus" earned on the date of the loan. The $18,000, which included the $6,300 in points, carried a simple interest rate of 18 percent. This loan was sold to Statesman Bank and the RTC currently holds this loan. See, Appendix "A" attached hereto. Needless to say, Mrs. Williams is Black.

Mr. and Mrs. Kirks had a similar bad experience. They entered into a loan with Freedlander, Inc., The Mortgage People, on May 19, 1986. They signed a note for $18,166. In connection with that loan, they were lucky. They were only charged points of 14.3 percent, or $2,265, on an amount financed of $15,750, plus interest. This loan is currently held by a subsidiary of NationsBank. Mr. and Mrs. Kirks are Black. See, Appendix "B" attached hereto.

Mr. and Mrs. Arthur Moore entered into a loan transaction with Landbank Equity Corporation on a first deed to secure debt on their home on March 22, 1984. The note amount was $10,800, of which they were charged a loan discount of $2,800 and a loan service charge of $140, or more than 27 points! The note rate was 18 percent and the annual percentage rate computed to 19.4 percent. See Appendix "C" attached hereto. Mr. and Mrs. Moore became the named plaintiffs in a case entitled *Moore v. Comfed Savings Bank*, 908 F.2d 834 (11th Cir. 1990) and *Moore v. Comfed Savings Bank*, 777 F. Supp. 960 (S.D. Ga. 1990). In *Moore, supra*, the Eleventh Circuit Court of Appeals referred to these types of charges as "outrageous."[5] Mr. and Mrs. Moore are Black.

Mr. and Mrs. Hosey Dukes were granted a first mortgage from Mortgage Lenders on August 25, 1989. The promissory note was in the original sum of $16,200. The

[4] There have been federal criminal prosecutions of the principals in Freedlander, Inc. *See*, "The Fall of the House of Freedlander," *Business Week*, March 4, 1991, at 26.; "Former Freedlander President is Indicted on Charges of Fraud," *The Wall Street Journal*, February 14, 1991, Sec. A, at 6; "Eric Freedlander convicted on 79 of 83 Charges," *The Richmond Times Dispatch*, June 23, 1991, p. 1; "Fraud Growing in Lending Risk on Home Equity," *The New York Times*, October 13, 1991, at 1. The Runnells of the Landbank Equity scheme were likewise convicted in federal court. However, the true victims of these frauds have not been the investors or banks who lent money to these sharks, but are the recipients of these loans, thousands of whom are in Georgia.

[5] The FDIC and the RTC ended up owning a large portfolio of Landbank Equity loans. Subsequent to the Eleventh Circuit Court of Appeals' ruling in *Moore, supra*, consumers in Georgia whose Landbank Equity loans were still held by the FDIC or RTC were given credit on principal for all payments made as required by Georgia law. O.C.G.A. § 7-4-18.

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amount financed was $12,548, and the balance consisted of prepaid finance charges or points of $3,652. These charges or points were earned on the date of the loan and were approximately 29 percent of the loan. Mr. and Mrs. Dukes are Black, and are currently involved in an appeal to the United States District Court for the Southern District of Georgia in the case of *Dukes v. Chemical Bank, N.A., Trustee for Goldome Credit Corporation Home Equity Trust*, CV192–195. See Appendix "D" attached hereto.

Mr. Raymend Bryant has lived at 103 Hillsdale Drive, Atlanta, Georgia, since April 26, 1973. In June of 1990, he entered into a loan contract with a master broker of Fleet, Tower Financial Services, Inc., in which he borrowed a stated amount of $15,000. At the closing, points or origination fees of $2,095 were charged. In addition, another loan broker took $1,500 in origination fees, that loan broker being First Southern. Therefore, the total amount of origination fees or points up front were $3,595, or 31.5 percent of his true principal amount. The note contained a yearly interest rate of 19.9 percent and, in addition, contained a 19 percent prepayment penalty. Not surprisingly, this individual was not able to pay the monthly payments created with these front-end fees and interest charges. In December of 1991, Fleet prepared its mortgage foreclosure approval worksheet which shows that it expected to make $11,000 in profits when Mr. Bryant's property was foreclosed upon. For the convenience of the Committee, a copy of the promissory note showing the 19.9 percent interest rate and prepayment penalty of 19 percent, a copy of the itemization of amount financed showing the $1,500 brokers fee to First Southern and prepaid finance charges of $2,095, and a copy of the mortgage foreclosure approval showing the estimated profit to Fleet, are included in Appendix "E" hereto. This example is a Fleet example, but is listed only because these are the types of documents that have been produced in discovery in another case pending before the courts. These examples of projected profits on mortgage foreclosures can be found in numerous lending scams where the loans are made at very low loan-to-value ratios, coupled with high front-end fees and points, high interest rates and high prepayment penalties.

This list could go on and on. These individuals and thousands of individuals like them had very little or no protection from any loan shark or loan broker. These loan sharks and loan brokers, upon making the loans, transferred or assigned these loans to seemingly legitimate lending institutions. The interest rates and points that these people pay are truly outrageous, are not based on free market concepts of supply and demand, and are not based on the three C's of lending—character, capacity or collateral. The charges and rates were primarily based on the fact that the consumers were easy prey, and there were no competitive forces from legitimate banks.

In addition to high points and rates, these types of lenders charge all sorts of "hidden" interest charges. Some of these are sold under the guise of "unemployment insurance," unipay accident insurance, auto club memberships, etc.[6] While these types of hidden finance charges may seem to be voluntary, the saturation rates shows just the opposite. Instead of truly being voluntary, the only way for a consumer not to pay these is be savvy enough to object.

II. Redlining and Reverse Redlining

Redlining, as we all know, is a situation in which banking institutions or financial institutions, in practice or in effect, draw redlines around certain minority areas of our communities and refuse to lend to these communities. Reverse redlining is just the opposite. In reverse redlining, financial institutions, by design or effect, target these same areas for high interest rate, high point loans.

Recently, the Federal Reserve Bank of Boston conducted a study which shows that black individuals were more inclined to be turned down for credit than their white counterparts.

In connection with redlining, when bankers have been questioned as to why there are not any more loans to minorities, answers are given that they can only make loans based on conservative banking practices and if the prospective borrower does not have the collateral, the capacity, or the character (good credit) for a loan, they cannot be held responsible.

In our experience, when we have tried to work with individuals who we know have good character, but may have one or two credit blemishes, more often than not we find the true reason. Credit reports cannot always be taken at face value. Some lending institutions have an incentive for their captive customers to remain their captive customers and not be captured by others; for example, with the indi-

[6] For examples of the many types of hidden interest charges, see *Usury and Consumer Credit Regulation*, 1992 Cumulative Supplement, by Kathleen E. Keest, National Consumer Law Center, Boston, Massachusetts, 1992, § 5.1, *et seq.*

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viduals we have described above. Once any creditor is able to obtain as a captive customer an individual who is paying substantially higher than the market rates, that creditor does not want to let that customer go. This is especially so when a real estate loan is at a loan-to-value ratio of 40 percent to 50 percent. Because late charges are high and because the interest clock keeps running until payments are actually received, the creditor is not upset if a borrower is a few days late, or even 30 days late in some cases. Adverse credit reports help ensure that the borrower will remain a customer of that company when the loan is renewed. Unfortunately, traditional mortgage bankers and lenders do not necessarily evaluate who reported slow credit. An adverse credit report turned in by an unscrupulous lender, though true on its face, can sometimes be explained. Unfortunately, until financial institutions increase their presence in the minority community by increasing the number of officers and branches and begin to understand exactly why they do not have a sufficient amount of loans in certain segments of our communities, the situation will not improve. The only other explanation that can be given to support the lack of figures would be that Blacks inherently have poor credit or worse credit than their White counterparts, a policy that we reject, and do not believe is true.

Reverse redlining is the practice in which certain lenders take advantage of the lack of lending in certain segments of the community and fill the void with a greater percentage of their loans to minorities at substantially higher rates than elsewhere exist. One example is a case which is currently pending in the Superior Court of Richmond County, Georgia, known as *Alexander, et al. v. Fleet Finance, Inc. of Georgia*, Case No. 91–RCCV–681, a case brought under the Georgia Fair Housing Act. Even though Fleet Finance is a defendant in this case, this Committee should not read anything into that fact. A careful analysis of the loans being made by other finance companies at extremely high rates and with extremely high front-end fees and points would reveal that similar claims could be made against these as well. We mention this to the Committee because we hope that these materials will not be perceived as complaints against one financial institution alone, but will be understood as complaints about problems that exist among many finance companies, problems which are created when the traditional sources of credit for housing loans engage in policies and practices which have the effect of denying loans to minority individuals at reasonable and fair rates, and thereby create voids which are quickly filled by those who charge "outrageous" charges.

Mr. and Mrs. Alexander had an existing first mortgage on their home which was being serviced by Fleet Real Estate Funding. This loan carried an interest rate of 8.5 percent simple, the type of loan which should be available to most Blacks and Whites. The Alexanders went through a series of loan brokers or master brokers for a second mortgage loan which they sought for $10,000. The loan was pre-approved for purchase by Fleet Finance, on March 14, 1991, at a note rate of 18 percent and a yield to Fleet of 17 percent. However, when the Alexanders came to the closing, they ended up refinancing an 8.5 percent first mortgage as part of the loan to obtain a $10,000 second mortgage. The new note was for $29,050 with monthly payments of almost $500 per month—high for a disabled serviceman with total income of less than $1,000 per month. The new first mortgage carried points of over 15 percent and a note rate of 19.5 percent.[7]

We know, from the 1990 Census, that 17 percent of all Georgians who own or are purchasing their own homes are Black. Therefore, if a lending institution was making loans across the board to homeowners in Georgia, that institution should have a portfolio which consists of loans made to Blacks of approximately 17 percent. However, from the initial review of loans, the Court was able to determine that 60 percent of the loans secured by real estate being made by Fleet Finance, Inc. of Georgia through its agreements with companies such as New South Financial Center, Inc. and Home Equity Center, Inc. were being made to Black individuals. See, order of the Superior Court of Richmond County, Georgia, dated October 2, 1992, in the case of *Alexander v. Kaye-Co, et al.*, Case No. 91–RCCV–681.[8] See Appendix "F" attached hereto.

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[7] Included in Appendix "E" is a copy of the loan approval from where Fleet approved a second mortgage for $10,000 at a note rate of 18 percent, a copy of the Alexander's truth-in-lending disclosure, a copy of the itemization of amount financed, and a copy of the note. No funds were disbursed to the Alexanders until Fleet purchased the loan. No explanation was ever given by Fleet as to why the note rate was increased or why the loan was changed from the second mortgage for $10,000 to a first mortgage for over $29,000.

[8] Since that order was entered, additional discovery has been conducted in this case and a total of approximately 6,963 loans have been reviewed that were purchased by Fleet from its existing master broker network in Georgia from July 1, 1990. The great majority of the loan files contain copies of the individuals' drivers licenses from which race could be determined. However, of all the loans reviewed 28 percent (1,950) are now classified as "unknown" and did

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It might be argued that statistics such as these show nothing, in that certain companies routinely charge both Blacks and Whites high interest rates. That is not the point. The point is, when the rates charged these groups are compared to rates charged across the board by all legitimate lending institutions, they go off the charts. For instance, in *Alexander* the Court found that according to the statistical Abstract of the United States for 1990, the average contract rate on loans secured by existing homes was 10.3 percent at this time, and the initial fees charged were 1.86 percent, compared to a 19.5 percent note rate, plus initial fees of over 15 percent for the Alexanders. The Eleventh Circuit Court of Appeals made a similar comparison in *Moore, supra*. The examples set forth herein should not necessarily be directed only toward Fleet Finance. The ease of preparing these statistics as to Fleet has been aided substantially by the fact that drivers licenses have been included in the great majority of loans files. Similar studies could be conducted using census tracts, together with courthouse records and locations of mortgages, statistical samples or the like. From our perspective as Georgia lawyers who know our communities and who see hundreds of consumers, we need no more studies. A number of nationwide finance companies who are completely unregulated by federal law and have few state laws that restrict their business have a disproportionately high number of Black customers who pay rates substantially higher than that charged by traditional mortgage companies, banks, etc., that lend predominately to Whites.

III. Issues

As we see the issues, the problems are caused in large part by the fact that there is no real competition in certain segments of lending. If, the Community Reinvestment Act is not strongly enforced and if regulated financial institutions do not offer credit at reasonable rates in minority neighborhoods, then voids are created which are quickly filled by the unscrupulous. Congress, in reacting to double-digit prime rates and double-digit home mortgage loans, acted quickly to make sure that funds would be available for mortgage lending. In its haste, it ignored the Doctrine of Federalism, and it overrode long-standing state statutes. Congress assumed that free market concepts would work across the board, in both White and minority communities, and that these free market concepts would be tempered with fair dealing and honesty. What has occurred is redlining by design or effect. Home mortgage loans are not being made available in the minority community at the same rates and on the same terms as in White communities. In deregulating interest rates, Congress gave unregulated non-bank banks the benefits, without any price. No federal agency was charged with policing the market place to keep unscrupulous and unconscionable lenders at bay. No one then assumed that fly-by-night mortgage companies would spring up and direct their attention to a market of homeowners who, despite their lack of formal education, had acquired their American dream—their homes. There has been no or very few restrictions on this new breed of lender, and the profits being made by them have been so great that other non-bank banks, primarily finance companies, who are completely unregulated, have continued to fill the breach and have continued to have as their customers a disproportionately high number of minorities.

One long-term effect of what is occurring is the destruction of communities, especially in Georgia. It does not take a genius to know that families who are trying to buy their homes or who own their homes are less likely to have their members commit crimes, are more likely to have their members complete their education, become more productive workers, and add fewer claims to our social welfare programs. If anything, Congress should be fostering policies that encourage home ownership and policies that encourage home mortgages at reasonable rates to all, both Black and White. Currently, the policies which exist result in the destruction of neighborhoods, in increased foreclosure rates, in the inability to pay outrageous charges and fees, and the siphoning of funds these families need for basic necessities.

IV. Recommendations

1. Conduct hearings throughout the nation and hear first hand from consumers about how the dual system of lending we have described is destroying the lives of many.

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not contain drivers licenses. Of those carrying drivers licenses, 2,740 were shown to be Black, and 2,273 where shown to be White. Of those individuals identified, over 55 percent are Black. Even if the unknowns were all to be White, which is highly unlikely, Black individuals who have these types of loans would far exceed the percent age of Black homeowners in Georgia—17 percent. Accepting all of the unknowns as being White would show that Blacks still comprise 39.35 percent of the loan portfolio. No explanation has been given as to why a disproportionate number of these Fleet loans with such outrageous rates were made to Blacks.

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2. Strengthen the Community Reinvestment Act and Home Mortgage Disclosure Act.

Non-bank banks which are often owned by regulated financial institutions need to be governed by the same rules and regulations as banks, as well as those finance companies who are owned by non-financial conglomerates. The regulators need to be told by Congress to increase their vigilance. All mergers or acquisitions of bank holding companies that have poor CRA grades should be disapproved until those banking corporations improve their lending practices in the minority communities. In connection with the sale of the assets of failed banking institutions, those institutions that have not demonstrated by their lending practices a commitment to home loans in minority communities should not be allowed to purchase the assets of failed institutions.

3. Imposition of lending rate caps and other restrictions on lending practices.

Prior to the late 1970's and early 1980's, states traditionally governed the amount of interest that could be charged on loans. The banking and finance companies came to Congress and asked Congress to override the state statutes, and Congress did so without looking at the historical reasons for such caps. If Congress is going to override state statutes, Congress should not leave a vacuum—a vacuum which has resulted in the wholesale lending abuses to date. Just as VA loans have a regulated cap, loans that come within the ambit of a federal preemption statute should be regulated. Caps should be placed on all charges, including origination fees, discounts, appraisal fees, interest rates and other charges. These caps can be tied to moving indicators or otherwise tied to the price of funds. In addition, restrictions should be placed on other charges, such as hidden interest charges which may be called unemployment insurance, which are pervasive in the finance industry.

V. CONCLUSION

Legitimate lending institutions have in the past asked Congress to do just the opposite of what we are asking here. Congress has accommodated these lenders. They came to Congress in the late 1970's and early 1980's and asked Congress to override long-standing usury statutes. The result has been devastating to unsophisticated and minority borrowers in this country. Now these same banking officials want you to further deregulate banking and interest charges, but remember who was responsible for the savings and loan association failures, for banks, lending hundreds of billions of dollars to shaky foreign governments, and for other policies which have placed in jeopardy the solvency of hundreds of banking institutions in this country. Scores upon scores of savings and loan associations and savings banks have gone under as a result of lending on shopping centers, condominium projects, and other types of speculative projects. *To our knowledge, no bank or financial institution has required the taxpayers to foot one dime as a result of losing money by lending in the minority community on loans where reasonable rates are charged and which are secured by an individual's primary residence.* We submit to Congress that those who may oppose what we are saying are the same people who have encouraged you to pass statutes which have led to the worse financial problems since the Depression. While we believe in free market concepts, we also believe that the free market concepts can be abused. Abuses in free market lending, when they appear, should be corrected by enacting a cap high enough so that market forces and other factors such as capacity, character and collateral, can be used in arriving at a rate within some type of bounds.

In closing, we would like to leave this Committee with a quote from President Theodore Roosevelt. In his autobiography at page 55, President Roosevelt explained in part his disillusion of the law, writing:

> But, doubtless chiefly through my own fault, some of the teaching of the law books and of the class room seemed to me to be against justice. The *caveat emptor* side of the law, like the *caveat emptor* side of business, seemed to me repellent; it did not make for social fair dealing. The 'let the buyer beware' maxim, when translated into actual practice, whether in law or business, tends to translate itself further into the seller making his profit at the expense of the buyer, instead of by a bargain which shall be to the profit of both. It did not seem to me that the law was framed to discourage as it should sharp practice, and all other bargains except those which are fair and of benefit to both sides. I was young; there was much in the judgment which I then formed on this matter which I should now revise; but, then as now, many of the big corporation lawyers, to whom the ordinary members of the bar then as now looked up, held certain standards which were difficult to recognize as compatible with the idealism I suppose every high-minded young man is apt to feel.

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We ask you add to the law books statutes which will discourage the sharp practices that we have described here as *caveat emptor* in lending leaves too many hard working American families at the mercy of the sharks.

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APPENDIX A

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT [illegible]

SETTLEMENT STATEMENT

B. TYPE OF LOAN: 1. ☐ FHA 2. ☐ FmHA 3. ☐ CONV. UNINS. 4. ☐ VA 5. ☐ CONV. INS.
6. File Number | 7. Loan Number
8. Mortgage Insurance Case Number

C. NOTE: [illegible]

D. NAME OF BORROWER: ...CILLE WILLIAMS

E. NAME OF SELLER:

F. NAME OF LENDER: ATLANTIC MORTGAGE CO., INC. 3601 Washington Rd, Suite 8 Augusta, GA 30907

G. PROPERTY LOCATION: Lot 3, Block "A", Section 2, East View Subdivision, Richmond County, Georgia a/k/a 605 Sea Isle Drive, Augusta, Georgia 30901

H. SETTLEMENT AGENT: BOUDREAUX & WARD

PLACE OF SETTLEMENT: 429 Walker Street Augusta, GA 30903

I. SETTLEMENT DATE: August 24, 1984

J. SUMMARY OF BORROWER'S TRANSACTION	
100. GROSS AMOUNT DUE FROM BORROWER:	
101. Contract sales price	
102. Personal property	
103. Settlement charges to borrower (line 1400)	
104.	
105.	
Adjustments for items paid by seller in advance	
106. City/town taxes to	
107. County taxes to	
108. Assessments to	
109.	
110.	
111.	
112.	
120. GROSS AMOUNT DUE FROM BORROWER	$18,000.00
200. AMOUNTS PAID BY OR IN BEHALF OF BORROWER:	
201. Deposit or earnest money	
202. Principal amount of new loan(s)	
203. Existing loan(s) taken subject to	
204.	
205.	
206.	
207.	
208.	
209.	
Adjustments for items unpaid by seller	
210. City/town taxes to	
211. County taxes to	
212. Assessments to	
213.	
214.	
215.	
216.	
217.	
218.	
219.	
220. TOTAL PAID BY/FOR BORROWER	9,477.14
300. CASH AT SETTLEMENT FROM/TO BORROWER	
301. Gross amount due from borrower (line 120)	18,000.00
302. Less amounts paid by/for borrower (line 220)	(9,477.14)
303. CASH (☐ FROM) (☐ TO) BORROWER	8,522.86

K. SUMMARY OF SELLER'S TRANSACTION	
400. GROSS AMOUNT DUE TO SELLER:	
401. Contract sales price	
402. Personal property	
403.	
404.	
405.	
Adjustments for items paid by seller in advance	
406. City/town taxes to	
407. County taxes to	
408. Assessments to	
409.	
410.	
411.	
412.	
420. GROSS AMOUNT DUE TO SELLER	
500. REDUCTIONS IN AMOUNT DUE TO SELLER:	
501. Excess deposit (see instructions)	
502. Settlement charges to seller (line 1400)	
503. Existing loan(s) taken subject to	
504. Payoff of first mortgage loan	
505. Payoff of second mortgage loan	
506.	
507.	
508.	
509.	
Adjustments for items unpaid by seller	
510. City/town taxes to	
511. County taxes to	
512. Assessments to	
513.	
514.	
515.	
516.	
517.	
518.	
519.	
520. TOTAL REDUCTION AMOUNT DUE SELLER	
600. CASH AT SETTLEMENT TO/FROM SELLER	
601. Gross amount due to seller (line 420)	
602. Less reductions in amount due seller (line 520)	( )
603. CASH (☐ TO) (☐ FROM) SELLER	

Mrs. Lucille Williams   8-24-84

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-2-

L. SETTLEMENT CHARGES

700. TOTAL SALES/BROKER'S COMMISSION based on price $ @ % =	PAID FROM BORROWER'S FUNDS AT SETTLEMENT	PAID FROM SELLER'S FUNDS AT SETTLEMENT
Division of Commission (line 700) as follows:		
701. $ to		
702. $ to		
703. Commission paid at Settlement		
704.		
800. ITEMS PAYABLE IN CONNECTION WITH LOAN		
801. Loan Origination Fee %	$1,300.00	
802. Loan Discount %		
803. Appraisal Fee to	175.00	
804. Credit Report to	16.95	
805. Lender's Inspection Fee		
806. Mortgage Insurance Application Fee to		
807. Assumption Fee		
808.		
809.		
810.		
811.		
900. ITEMS REQUIRED BY LENDER TO BE PAID IN ADVANCE		
901. Interest from 8-29-84 to 9-15-84 @ $ /day	150.90	
902. Mortgage Insurance Premium for months to		
903. Hazard Insurance Premium for years to		
904. years to		
905.		
1000. RESERVES DEPOSITED WITH LENDER		
1001. Hazard insurance months @ $ per month		
1002. Mortgage insurance months @ $ per month		
1003. City property taxes months @ $ per month		
1004. County property taxes months @ $ per month		
1005. Annual assessments months @ $ per month		
1006. months @ $ per month		
1007. months @ $ per month		
1008. months @ $ per month		
1100. TITLE CHARGES		
1101. Settlement or closing fee to BOUDREAUX AND WARD	275.00	
1102. Abstract or title search to		
1103. Title examination to BOUDREAUX AND WARD	275.00	
1104. Title insurance binder to BOUDREAUX AND WARD	10.00	
1105. Document preparation to		
1106. Notary fees to		
1107. Attorney's fees to		
(includes above items numbers:)		
1108. Title insurance to	45.00	
(includes above items numbers:)		
1109. Lender's coverage $		
1110. Owner's coverage $		
1111.		
1112.		
1113.		
1200. GOVERNMENT RECORDING AND TRANSFER CHARGES		
1201. Recording fees: Deed $; Mortgage $ 9.00 ; Releases $ 11.50	20.50	
1202. City/county tax/stamps: Deed $; Mortgage $		
1203. State tax/stamps: Deed $; Mortgage $		
1204. INTANGIBLE TAX	54.00	
1205.		
1300. ADDITIONAL SETTLEMENT CHARGES		
1301. Survey to		
1302. Pest inspection to		
1303. Collections Ltd.	169.25	
1304. Richmond Co. Delinquent Tax Dept.	1,830.27	
1305. Richmond Co. Tax Commissioner ('84 taxes)	147.27	
1400. TOTAL SETTLEMENT CHARGES (enter on lines 103, Section J and 502, Section K)	$9,477.14	

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ATLANTIC MORTGAGE CO., INC.

FEDERAL DISCLOSURE STATEMENT

Borrower: LUCILLE WILLIAMS — Account No.: — August 24, 1984

ANNUAL PERCENTAGE RATE	FINANCE CHARGE	AMOUNT FINANCED	TOTAL OF PAYMENTS
The cost of my credit as a yearly rate	The dollar amount the credit will cost me.	The amount of credit provided to me or on my behalf.	The amount I will have paid after I have made all payments as scheduled.
29.32%	$40,625.48	$11,549.10	$52,174.58

My payment schedule will be:

Number of Payments	Amount of Payments	When Payments Are Due
179	$289.88	15th of each month beginning October 15, 1984
1	$286.06	September 15, 1999

I may obtain property insurance from anyone I want that is acceptable to ATLANTIC MORTGAGE CO., INC.

Security: I am giving security interest in Lot 3, Block "A", Section 2, Part 2, East View Subdivision, Richmond County, Georgia a/k/a 605 Sea Isle Drive, Augusta, Georgia 30901.

Filing Fees: $20.50

Late Charge: If a payment is late, I will be charged 5% of the payment.

Prepayment: If I pay off early, I will not have to pay a penalty and not be entitled to a refund of part of the finance charge.

I may see my contract documents for any additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment refunds and penalties.

I acknowledge receipt of a completely filled in copy of this disclosure statement prior to signing my Note and Deed to Secure Debt.

Borrower(s): LUCILLE WILLIAMS — Date: August 24-84

Itemization of the Amount Financed of $ 11,549.10

$ 8,522.06	Amount given to me directly
$ N/A	Amount paid on my former loan account with ATLANTIC MORTGAGE CO., INC.

Amount paid to others on my behalf:

$ 54.00	to tax commissioner
$ 16.95	to credit reporting agencies
$ 175.00	to appraisers
$ 55.00	to insurance companies
$ 550.00	to Boudreaux and Ward, Attorneys at Law
$ 20.50	to Clerk of Superior Court
$ 169.25	to Collections Ltd.
$ 1,838.27	to Richmond Co. Delinquent Tax Dept.
$ 147.27	to Richmond Co. Tax Commissioner
$	to
$	to
$	to
$	to

Prepaid Finance Charge:

$ 150.90	Odd-days Interest
$ 6,300.00	Origination Fee of points
$ N/A	Charge for calculation of APR
$ 6,450.90	Total Prepaid Finance Charge

I acknowledge receipt of a completely filled in copy of this discl::ure statement prior to signing my Note and Mortgage.

Borrower(s): Mrs. Lucille Williams
LUCILLE WILLIAMS

Date: 8-24-84

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NOTE

Augusta, Georgia

U.S.$18,000.00
Initial Principal Amount

August 24, 1984
Date of This Note

Lot 3, Block "A", Section 2, Part 2, East View Subdivision, Richmond County, Georgia, a/k/a 605 Sea Isle Drive, Augusta, Georgia 30901, and more particularly described as:

ALL that lot or parcel of land with improvements thereon, situate, lying and being in Richmond County, Georgia, and being known and designated as Lot 3, Block "A", East View Subdivision, Section 2, Part 2, as shown on a plat recorded in the Office of the Clerk of Superior Court of Richmond County, Georgia in Realty Book 37-B, Pages 691-694; reference being made to said plat for a more accurate description of said lot.

1. CERTAIN DEFINITIONS USED IN THIS NOTE.

a. "Note" means document.

b. "I","me" and "my" mean and refer to each person who signs this Note. If more than one person signs this Note, each one of us personally is equally and fully responsible to make all of the payments called for in this Note and to keep all of the promises made in this Note.

c. "Atlantic Mortgage" means Atlantic Mortgage Co., Inc., a Georgia corporation.

d. "Note Holder" means Atlantic Mortgage or anyone who takes this Note by transfer and who is entitled to receive payments under this Note. I understand that Atlantic Mortgage may transfer this Note.

e. "Deed to Secure Debt" means the deed to secure debt document I am and/o[r] other persons are signing today. That deed creates a lien on the Property a[s] security for my promises in this Note.

f. "Property" is the real property at the address of the secured property a[s] listed above. The Property is more fully described in the Deed to Secure Debt.

g. "Principal" means the initial dollar amount of this Note and any part o[f] that amount which remains unpaid.

h. "Default" means not paying on time or keeping the promises which I o[r] others make in the Deed to Secure Debt. "Default" also means letting certain thin[gs] happen or doing certain things. These are described in this Note or in the Deed t[o] Secure Debt.

i. "Waive" means give up.

j. "Odd-Days Interest" means the interest I am paying in advance for t[he] period from the date interest begins to be charged until the 15th day of Septemb[er] 1984.

2. MY PROMISE TO PAY.

In return for the loan that I have received today, I promise to pay to the or[der] of Atlantic Mortgage Company, Inc., $18,000.00 plus interest at the yearly rate [of] eighteen percent (18%).

K. W

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3. INTEREST.

I will pay interest on that part of the Principal which has not been paid. Interest will be charged beginning on August 29, 1984, and continuing until the full amount of Principal has been paid. I will pay Odd-Days interest today.

4. PAYMENTS.

I will pay Principal and interest by making payments each month of $289.88. I will make those payments on the 15th day of each month, beginning on October 15, 1984. I will make these payments every month until I have paid all of the Principal and interest and all other charges described in the Note.

If I still owe any amounts under this note on September 15, 1999, I will pay in full on that date all amount of principal, interest and other amounts which I owe under this Note.

I will make all payments to FAM Mortgage Servicing Company, P. O. Box 73198, Baltimore, Maryland 21273, or at such other address as the Note Holder may designate in a notice to me.

5. FAILURE TO PAY ON TIME OR TO DO REQUIRED THINGS.

a. LATE CHARGE: I will pay on demand a "late charge" equal to five percen (5%) of any monthly payment due under this Note which is not received by the Not Holder by the end of the 7th calendar day after the date such payment is due. Th late charge is to cover the Note Holder's extra expense of handling, accounting fo and processing late payments.

b. DEFAULT: I will be in Default if for any reason any of the following thing happen :

(i) The Note Holder does not receive a monthly payment on this Note by th end of the 15th calendar day after the date that the payment was due.

(ii) I do not pay promptly when due all of the taxes, municipal and oth governmental charges and assessments and water charges which are or may become lie of the Property.

(iii) I do not pay promptly when due any sums which I am obligated to p on any prior or existing mortgage on the Property. This includes periodic monthly payments and any other payments (including full payment) that I may required to make under such prior mortgage.

(iv) I do not keep the Property in good condition and repair.

(v) I do not keep the Property insured to the satisfaction of the N Holder, or I do not pay promtly when due all premiums for that insurance.

(vi) I do not pay in full the entire Principal and all other amounts I under this Note before, or at the time that, I sell or transfer all or any part the Property or any interest in the Property. However, without making such f payment, I may create or allow security deeds which are subordinate to the Deed Secure Debt securing this Note. Also, I may grant leasehold interests of th years or less not containing an option to purchase without making such full payme

(vii) I do not do everything I have promised or agreed to do in this Note

(viii) I do not comply with all of the terms of the Deed to Secure Debt.

(ix) I do not keep all of the promises and agreements made in the Dee Secure Debt, or I do not make sure that all such promises and agreements are kep

I understand that I have made many promises and agreements in this Note and there are many promises and agreements in the Deed to Secure Debt. It is al Default under this Note if even one of those promises or agreements is not kept and performed on time.

c. NOTE DUE ON DEFAULT: If I am in Default, the Note Holder may require pay immediately the full amount of Principal and all interest, late charge ... which I owe under this Note.

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d. NO CURE AFTER DEMAND FOR FULL PAYMENT: If the Note Holder has mailed to me a notice that I am in Default and that I must pay all amounts which I owe under this Note, then:

(i) The Note Holder may keep any payments it receives after that time; and

(ii) No payment, whether it is kept by the Note Holder or not, will cure the Default or reinstate the loan; and

(iii) I will immediately pay the full amount I owe under this Note. Nothing which either I do or the Note Holder does will be considered a cure of the Default or will reinstate the loan unless the Note Holder so agrees with me in writing after the notice of Default was sent.

e. DELAY IN ENFORCEMENT: If I am in Default at any time, even if the Note Holder does not require me to pay immediately in full as described above, the Note Holder will still have the right to require me to make immediate full payment if I am in Default at any later time. This is true even if:

(i) The Note Holder had the right to send me a notice of Default but did not do so;

(ii) The same Default continues;

(iii) The same kind of Default occurs again;

(iv) Any other kind of Default occurs at any time.

The Note Holder does not waive any of its rights under this Note even if it delays enforcing all or any of its rights or fails to enforce all or any of them at any time.

f. PAYMENT OF NOTE HOLDER'S COST AND EXPENSES: If the Note Holder has required me to pay immediately in full all amounts which I owe under this Note, I also will pay the Note Holder on demand all of its costs and expenses in connection with collecting under this Note.

Such costs and expenses include, but are not limited to, the cost of foreclosing the security deed, reasonable attorney's fees of 15% and court cost.

6. PAYMENTS MADE BEFORE THEY ARE DUE.

I have the right to make payments at any time before they are due. Such : payment is known as a "prepayment". When I make a prepayment, I will tell the Not Holder in a letter that I am doing so.

A prepayment of all of the unpaid Principal, all interest and all other amount due under this Note is known as a "full prepayment". A prepayment of only a part o the unpaid Principal and interest is known as a "partial prepayment".

I may make full prepayment or partial prepayments at any time without paying ar penalty. Upon prepayment during the period in which Odd-Days Interest accrues, th Note Holder will refund to me any unearned Odd-Days Interest, if any.

If I make a partial prepayment, there will be no delay in the due date of, a no change in the amount of, any of my subsequent monthly payments. The due date a amount of subsequent monthly payments will change only if the Note Holder agrees writing to such changes at the time I make a partial prepayment.

7. HOW PAYMENTS ARE APPLIED.

When the Note Holder receives payments from me under this Note, the Note Hold will apply them to my obligations under this Note in the following order:

a. First, to any of the Note Holder's costs of collection as described above;

b. Second, to any late charges;

c. Third, to unpaid interest; and

d. Fourth, to the unpaid Principal of this Note.

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8. THE NOTE IS SECURED BY A DEED ON THE PROPERTY.

In addition to the protections given to the Note Holder under this Note, I and/or other persons executed the Deed to Secure Debt, which has the same date as this Note, which gives the Note Holder additional protection. These are additional promises and agreements in the Deed to Secure Debt. I must make sure that all of these promises and agreements are kept.

The Note Holder may foreclose the Deed to Secure Debt to protect itself from possible losses which may result if I am in Default or if I do not keep the promises and agreements which I make in this Note or which I or other persons make in this Note or which I or other persons make in the Deed to Secure Debt.

The Deed to Secure Debt describes certain additional circumstances under which the Note Holder may require me to make immediate payment in full of all amounts that I owe under this Note.

9. MY WAIVERS.

I waive my rights to require the Note Holder to do certain things. These things are: (A) to demand payment of amounts due (known as "presentment"); (B) to give notice that amounts due under this Note have not been paid (known as "notice of dishonor"); and (C) to obtain an official certification of nonpayment (known as "protest").

Anyone else who agrees to keep the promises made in this Note or who agrees to make payments to the Note Holder to keep my promises under this Note or who signs this Note to transfer it to someone else also waives these rights. These persons are known as "guarantors, sureties and endorsers".

10. RESPONSIBILITY OF PERSONS UNDER THIS NOTE.

If more than one person signs this Note, each of us is fully and personally obligated to pay the full amount owed and to keep all of the promises made in this Note. Any guarantor, surety, or endorser of this Note (as described in Section 9 above) also is obligated to do these things.

This Note Holder may enforce its rights under this Note against each of us individually or against all of us together. This means that any one of us may be required to pay all of the amounts owed under this Note.

Any person who takes over my rights or obligations under this Note will have all of my rights and must keep all of my promises made is this Note. If I die or become legally incompetent, then my estate, executor, administrator or other legal representatives must keep all of my promises made in this Note.

Any person who takes over the rights or obligation of a guarantor, surety o endorser of this Note (as described in Section 9 above) is also obligated to kee all of the promises made in this Note.

The terms of this Section 10 are for the protection of the Note Holder. If sell or transfer all or any part of the Property or any interest in the Property i any way which is a Default under Subsection 5b. (vi), I must pay in full the entir Principal and all other amounts I owe under this Note.

11. GIVING NOTICES.

The Note Holder will give all notices to me under this Note by delivering th or by mailing them by certified mail, return receipt requested and postage prepai addressed to me at the address of the Property given above. The Note Holder wi deliver or mail notices to me at a different address if I give the Note Holder notice of my different address.

I will give all notices to the Note Holder under this Note by mailing them the Note Holder by certified mail, return receipt requested and postage prepai addressed to the Note Holder at the address stated in Section 4 above. I will gi notices to the Note Holder at a different address if the Note Holder gives me notice of that different address.

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12. POINTS I HAVE PAID FOR THE LOAN.

I have agreed to pay ATLANTIC MORTGAGE CO., INC., $6,300.00 as a fee (sometimes called "points" or a "bonus") in addition to the Principal, interest and all other amounts which I have promised to pay in this Note.

I have paid those points to ATLANTIC MORTGAGE CO., INC. I agree that those points now are fully earned and are not subject to a rebate if I prepay this Note.

I understand and agree that the Points which I have paid do not reduce the payments which I have promised to make in this Note.

13. DOCUMENTS RECEIVED.

I have received completely filled-in copies of this Note, the Deed to Secure Debt, a federal Truth-in-Lending Disclosure Statement, and two copies (for each person who signs the Deed to Secure Debt) of a Notice of Right to Cancel.

14. I UNDERSTAND THIS NOTE.

I FULLY UNDERSTAND ALL OF THE PROMISES I HAVE MADE IN THIS NOTE AND ALL OF THE TERMS OF THIS NOTE. I UNDERSTAND THAT THE WORD "NOTE" MEANS THIS DOCUMENT. THIS "NOTE" CONSISTS OF FIVE(5) PAGES, AND THIS PARAGRAPH SHALL APPLY TO EACH PAGE INDIVIDUALLY AND ALL FIVE (5) PAGES COLLECTIVELY. I HAVE BEEN TOLD NOT TO SIGN THIS NOTE :

a. IF THERE ARE ANY BLANKS WHICH ARE NOT FILLED IN; OR

b. IF I DO NOT UNDERSTAND THIS NOTE COMPLETELY AND ENTIRELY.

Lucille Williams _______________ (SEAL)
LUCILLE WILLIAMS

_______________ (SEAL)

This Note is secured by a Deed to Secure Debt on the Property at the address · the secured property shown at the beginning of this Note.

(SIGN ORIGINAL ONLY)

If notices under this Note should be given to me at an address other than at t Property, I will fill in that other address here:

____

____

_______ my initials

_______ my initials

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APPENDIX B

LENDER	[illegible] The Mortgage People	ADDRESS	4236 [illegible] Drive Glen Allen, Virginia 23060
BORROWER(S)	Joseph Kirks and Willie Mae Kirks	ADDRESS	3407 Byron Road Augusta, Georgia 30906

Item			
Principal amount of loan			$ 18166.00
Recording fee and tax		$ 66.50	
Legal fees	Milton Martin, Attorney	$ 169.00	
Title search	Milton Martin, Attorney	$ 169.00	
Mortgage title insurance	American Title Insurance	$ 45.50	
Appraisal fee	Jack L. Minor, Appraiser	$ 200.00	
Credit life insurance		$ 0.00	
Accident and health insurance		$ 0.00	
Points		$ 2265.00	
Origination fee		$ 151.00	
Milton Martin, Attorney escrow account		$ 1500.00	
Freedlander Inc., The Mortgage People		$ 13013.36	
		$	
		$	
		$	
		$	
		$	
		$	
		$	
		$	
		$	
		$	
		$	
		$	
		$	
Net proceeds to Borrower(s)		$ 586.64	
Total above		$ 18166.00	$ 18166.00

Witness: ______________________

Borrower: [signature] JOSEPH KIRKS

Borrower: [signature] WILLIE MAE KIRKS

Loan # 254-78-8311

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APPENDIX C
AMOUNT FINANCED ITEMIZATION

LANDBANK EQUITY CORP.

1587 Phoenix Blvd., Suite 12
STREET NUMBER

College Park, Ga. 30349
CITY STATE ZIP

DATE: March 22 ,19

BORROWER(S): ARTHUR MOORE

MARY M. MOORE

ADDRESS: FIRST RAILROAD STREET(P. O. B

SCOTLAND, GA 31083

LOAN NUMBER:

ITEMIZATION OF THE AMOUNT FINANCED: $ 10,870.00

$ 2,855.06 AMOUNT GIVEN TO YOU DIRECTLY, UNLESS PAYO BECOME NECESSARY TO CLOSE THE LOAN.

$ AMOUNT PAID ON YOUR ACCOUNT.

AMOUNT PAID TO OTHERS ON YOUR BEHALF:

$ 275.00 TO PUBLIC OFFICIALS: S. Andrew Shuping, Jr., Atty-At-Law

$ 225.00 TO APPRAISERS:

$ N/A TO CREDIT BUREAU:

$ N/A TO CREDIT LIFE & DISABILITY INS:

$ 213.00 TO MORTGAGE GUARANTEE INSURANCE: LANDBANK EQUITY CORP.

$ 2,800.00 TO LOAN DISCOUNT POINTS:

$ 140.00 TO SERVICE CHARGES: LANDBANK EQUITY CORP.

$ 53.00 TO RECORDING COSTS:

$ 47.25 TO TITLE INSURANCE:

$ 1,075.59 TO Security State Bank #070074200012
528.24 Western Auto. #9201601077
$ 765.75 TO Security State Bank #070074200013
835.33 Mathews Furniture Co.
$ 1,056.78 TO Telfair Finance Co. #A4042

PREPAID FINANCE CHARGE: $3378.00

I/WE ACKNOWLEDGE RECEIPT OF AMOUNT FINANCED ITEMIZATION THIS 22nd OF March ,19 84 .

Arthur Moore
ARTHUR MOORE

Mary M. Moore
MARY M. MOORE

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SETTLEMENT STATEMENT

Name of Borrower: ARTHUR MOORE & MARY M. MOORE

Gross Amount		$10,870.00
Less:		
Discount	$ 2,800.00	
Service Charge	140.00	
Appraisal	225.00	
Attorney's Fee	275.00	
Recordation Fee	20.00	
Title Insurance	47.25	
Intangible Tax	33.00	
Mortgage Guarantee Ins.	213.00	
Security State Bank	1,075.50	
Security State Bank	765.75	
Telfair Finance Co.	1,056.78	
Mathews Furniture Co.	835.33	
Western Auto.	528.24	
Subtotal	8,014.94	
Net to Borrowers	2,855.06	
Total	10,870.00	

We/I have reviewed the above statement, find it correct and hereby agree to same.

Dated: March 22, 1984

Arthur Moore
ARTHUR MOORE

Mary M. Moore
MARY M. MOORE

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70-832 O - 93 - 14

Date: March 22 ,19

LANDBANK EQUITY CORPORATION
Company Name

1587 PHOENIX BLVD., SUITE 12
Street Address

COLLEGE PARK, GA. 30349
City State Zip

Borrower(s): ARTHUR MOORE

MARY M. MOORE

Address: FIRST RAILROAD STREET

P. O. BOX 26, SCOTLAND, GA 31083

ANNUAL PERCENTAGE RATE	FINANCE CHARGE	AMOUNT FINANCED	TOTAL OF PAYMENTS
The Cost of your credit as a yearly rate.	The dollar amount the credit will cost you.	The amount of credit provided to you or on your behalf.	The amount you will have paid after you have made all payments as scheduled.
29.4%	$ 16,515.64	$ 7,492.00	$ 24,007.64

You have the right to receive, at this time, an itemization of the Amount Financed.

[X] I want an itemization. [ ] I do not want an itemization.

Your payment schedule will be:

Number of Payments	Amount of Payments	When Payments are Due
124	$193.61	May 1, 1984 and continuing until debt is paid in full

INSURANCE: Credit life insurance and credit disability insurance are not required to obtain credit, and will not be provided unless you sign and agree to pay the additional cost.

Type	Premium	Term	Signature
Credit Life Insurance	$ N/A	N/A	I want to apply for credit life insurance ______ (Signature)
Credit Disability Insurance	$ N/A	N/A	I want to apply for credit disability insurance ______ (Signature)

SECURITY: You are giving a 2nd deed of trust security interest in the property being purchased.

RECORDING FEES: $ 53.00 TITLE INSURANCE: 47.25

LATE CHARGE: If payment is eight days late, you will be charged $9.68 /(5%) Percent of the payment.

PREPAYMENT: If you pay off early, you you will not have to pay a penalty.

SEE YOUR CONTRACT DOCUMENTS FOR ANY ADDITIONAL INFORMATION ABOUT NONPAYMENT, DEFAULT ANY REQUIRED REPAYMENT IN FULL BEFORE THE SCHEDULED DATE, AND PREPAYMENT REFUNDS AND PENALTIES.

I/We hereby acknowledge receipt of this disclosure.

Arthur Moore /this 22nd day of March ,19__
ARTHUR MOORE

Mary M. Moore /this 22nd day of March ,19__
MARY M. MOORE

______ /this ___ day of ______ ,19__

______ /this ___ day of ______ ,19__

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NOTE

March 22, 19 84 — College Park, Georgia
City

FIRST RAILROAD STREET (P. O. BOX 28) SCOTLAND, GEORGIA 31083
Property Address *City* *State* *Zip Code*

1. BORROWER'S PROMISE TO PAY

In return for a loan that I have received, I promise to pay U.S. $ 10,870.00 (this amount will be called "principal"), plus interest, to the order of the Lender. The Lender is Landbank Equity Corporation. I understand that the Lender may transfer this Note. The Lender or anyone who takes this Note by transfer and who is entitled to receive payments under this Note will be called the "Note Holder."

2. INTEREST

I will pay interest at a yearly rate of 18 %. The Annual Percentage Rate on this Loan is 22.48 %.

Interest will be charged on that part of principal which has not been paid. Interest will be charged beginning on the date of this Note and continuing until the full amount of principal has been paid.

3. PAYMENTS

I will pay principal and interest by making payments each month of U.S. $ 193.61

I will make my payments on the 1st day of each month beginning on May 1, 19 84. I will make these payments every month until I have paid all of the principal and interest and any other charges, described below that I may owe under this Note. If, on August 1, 1994, I still owe amounts under this Note, I will pay all those amounts, in full, on that date.

I will make my monthly payments at Landbank Equity Corporation, P. O. Box 3272, Virginia Beach, Virginia 23456 or at a different place if required by the Note Holder.

4. BORROWER'S FAILURE TO PAY AS REQUIRED

(A) Late Charge For Overdue Payments

If the Note Holder has not received the full amount of any of my monthly payments by the end of 8 (eight) calendar days after the date it is due, I will pay a late charge to the Note Holder. The amount of the charge will b 5 % of my overdue payment, but not less than U.S. $ 9.68 and not more than U.S $ 9.68. I will pay this late charge only once on any late payment.

(B) Notice From Note Holder

If I do not pay the full amount of each monthly payment on time, the Note Holder may send me a written notic telling me that if I do not pay the overdue amount by a certain date I will be in default. That date must be at least 10 day after the date on which the notice is mailed to me or, if it is not mailed, 10 days after the date on which it is delivered to me

(C) Default

If I do not pay the overdue amount by the date stated in the notice described in (B) above, I will be in default. If I a in default, the Note Holder may require me to pay immediately the full amount of principal which has not been paid an all the interest that I owe on that amount.

Even if, at a time when I am in default, the Note Holder does not require me to pay immediately in full as describe above, the Note Holder will still have the right to do so if I am in default at a later time.

(D) Payment of Note Holder's Costs and Expenses

If the Note Holder has required me to pay immediately in full as described above, the Note Holder will have the rig to be paid back for all of its costs and expenses to the extent not prohibited by applicable law. Those expenses include, f example, reasonable attorneys' fees.

5. THIS NOTE SECURED BY A DEED

In addition to the protections given to the Note Holder under this Note, a Security Deed, dated March 22, 19 84, protects the Note Holder from possible losses which might result if I do not keep t promises which I make in this Note.

6. BORROWER'S PAYMENTS BEFORE THEY ARE DUE

I have the right to make payments of principal at any time before they are due. A payment of principal only is kno as a "prepayment." When I make a prepayment, I will tell the Note Holder in a letter that I am doing so. A prepayment all the unpaid principal is known as a "full prepayment." A prepayment of only part of the unpaid principal is known a

0011701

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"partial prepayment."

I may make a full prepayment or a partial prepayment without paying any penalty. The Note Holder will use all of my prepayments to reduce the amount of principal that I owe under this Note. If I make a partial prepayment, there will be no delays in the due dates or changes in the amounts of monthly payments unless the Note Holder agrees in writing to those delays or changes. I may make a full prepayment at any time. If I choose to make a partial prepayment, the Note Holder may require me to make the prepayment on the same day that one of my monthly payments is due. The Note Holder may also require that the amount of my partial prepayment be equal to the amount of principal that would have been part of my next one or more monthly payments.

7. BORROWER'S WAIVERS

I waive my rights to require the Note Holder to do certain things. Those things are: (A) to demand payment of amounts due (known as "presentment"); (B) to give notice that amounts due have not been paid (known as "notice of dishonor"); (C) to obtain an official certification of nonpayment (known as a "protest"). Anyone else who agrees to keep the promises made in this Note, or who agrees to make payments to the Note Holder if I fail to keep my promises under this Note, or who signs this Note to transfer it to someone else also waives these rights. These persons are known as "guarantors, sureties and endorsers."

8. GIVING OF NOTICES

Any notice that must be given to me under this Note will be given by delivering it or by mailing it by certified mail addressed to me at the Property Address above. A notice will be delivered or mailed to me at a different address if I give the Note Holder a notice of my different address.

Any notice that must be given to the Note Holder under this Note will be given by mailing it by certified mail to the Note Holder at the address stated in Section 3 above. A notice will be mailed to the Note Holder at a different address if I am given a notice of that different address.

9. RESPONSIBILITY OF PERSONS UNDER THIS NOTE

If more than one person signs this Note, each of us is fully and personally obligated to pay the full amount owed and to keep all of the promises made in this Note. Any guarantor, surety, or endorser of this Note (as described in Section 7 above) is also obligated to do these things. The Note Holder may enforce its rights under this Note against each of us individually or against all of us together. This means that any one of us may be required to pay all of the amounts owed under this Note. Any person who takes over my rights or obligations under this Note will have all of my rights and must keep all of my promises made in this Note. Any person who takes over the rights or obligations of a guarantor, surety or endorser of this Note (as described in Section 7 above) is also obligated to keep all of the promises made in this Note.

WITNESS the hands and seals of the undersigned.

Gale A. Burgess
Notary Public

ARTHUR MOORE — Arthur Moore ......(Seal)
Borrower

MARY M. MOORE — Mary M. Moore ......(Seal)
Borrower

....(Seal)
Borrower
(Sign Original Only)

This is to certify that this is the Note described in and secured by Security Deed dated March 22, 1984 on property located in TELFAIR, COUNTY

Notary Public, Georgia, State at Large
My commission expires: My Commission Expires January 31, 1986

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ASSIGNMENT TO NOTE

Date 4-05-84

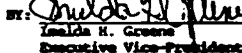
Landbank Equity Corporation hereby assigns the attached note of Moore, Arthur & Mary executed on 3/22/84 in the amount of $ 10,870.00.

For valuable consideration, the receipt of which is hereby acknowledged, Landbank Equity Corporation hereby assigns, sell, sets over and transfers any and all interest it may have in and to this note and all related security instruments, into:

Fidelity Federal Savings & Loan,
209 Orange Street, P.O. Box 1876,
New Haven, CT 06508,

with full recourse.

LANDBANK EQUITY CORPORATION



BY:
Imelda H. Greene
Executive Vice-President

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APPENDIX D

5709513

NOTE

AUGUST 25, 19 89 — AUGUSTA, Georgia
(City)

ROUTE 1, BOX 144-A — KEYSVILLE — GEORGIA
(Property Address — City — State — Zip Code)

1. BORROWER'S PROMISE TO PAY

In return for a loan that I have received, I promise to pay U.S. $ [illegible] (this amount will be called "principal"), plus interest, to the order of the Lender. The Lender is Mortgage Lenders, Inc. I understand that the Lender may transfer this Note. The Lender or anyone who takes this Note by transfer and who is entitled to receive payments under this Note will be called the "Note Holder."

2. INTEREST

I will pay interest at a yearly rate of [illegible] %.

Interest will be charged on that part of principal which has not been paid. Interest will be charged beginning on the date of this Note and continuing until the full amount of principal has been paid. In no event will the amount of interest paid or payable under this note exceed the maximum rate permitted by law.

3. PAYMENTS

I will pay principal and interest by making payments each month of U.S. $ [illegible]

I will make my payments on the 30TH day of each month beginning on SEPTEMBER 30, 19 89. I will make these payments every month until I have paid all of the principal and interest and any other charges, described below, that I may owe under this Note. If, on AUGUST 30, 2004 I still owe amounts under this Note, I will pay all those amounts, in full, on that date.

I will make my monthly payments at 1393 South Marietta Parkway, Bldg. 900, Suite 914 Marietta, GA 30067 or at a different place if required by the Note Holder.

4. BORROWER'S FAILURE TO PAY AS REQUIRED

(A) Late Charge For Overdue Payments

If the Note Holder has not received the full amount of any of my monthly payments by the end of 10 calendar days after the date it is due, I will pay a late charge to the Note Holder. The amount of the charge will be 10 % of my overdue payment, but not less than U.S. $ [illegible] and not more than U.S. $ [illegible]. I will pay this late charge only once on any late payment.

(B) Notice From Note Holder

If I do not pay the full amount of each monthly payment on time, the Note Holder may send me a written notice telling me that if I do not pay the overdue amount by a certain date I will be in default. That date must be at least 10 days after the date on which the notice is mailed to me or, if it is not mailed, 10 days after the date on which it is delivered to me.

(C) Default

If I do not pay the overdue amount by the date stated in the notice described in (B) above, I will be in default. If I am in default, the Note Holder may require me to pay immediately the full amount of principal which has not been paid and all the interest that I owe on that amount.

Even if, at a time when I am in default, the Note Holder does not require me to pay immediately in full as described above, the Note Holder will still have the right to do so if I am in default at a later time.

(D) Payment of Note Holder's Costs and Expenses

If the Note Holder has required me to pay immediately in full as described above, the Note Holder will have the right to be paid back for all of its costs and expenses to the extent not prohibited by applicable law. Those expenses include, for example, reasonable attorneys' fees.

5. THIS NOTE SECURED BY A DEED

In addition to the protections given to the Note Holder under this Note, a Security Deed, dated AUGUST 25, 19 89 protects the Note Holder from possible losses which might result if I do not keep the promises which I make in this Note.

6. BORROWER'S PAYMENTS BEFORE THEY ARE DUE

I have the right to make payments of principal at any time before they are due. A payment of principal only is known as a "prepayment." When I make a prepayment, I will tell the Note Holder in a letter that I am doing so. A prepayment of all of the unpaid principal is known as a "full prepayment." A prepayment of only part of the unpaid

[illegible] of the attached rider.

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"partial prepayment."
prepayment, there will be no delays in the due dates or changes in the amount of my monthly
te Holder agrees in writing to those delays or changes. I may make a full prepayment at any
ke a partial prepayment, the Note Holder may also require me to make the prepayment on the
y monthly payments is due. The Note Holder may also require that the amount of my partial
the amount of principal that would have been part of my next one or more monthly payments.
f any prepayment first to reduce any interest and charges owing at the time of such prepayment
amount of principal owed under this Note provided that such balance shall be applied to the
er of the payments maturity and shall not otherwise affect or delay the next payment due dates
ts.

AIVERS

to require the Note Holder to do certain things. Those things are: (A) to demand payment of
s "presentment"); (B) to give notice that amounts due have not been paid (known as "notice of
in an official certification of nonpayment (known as a "protest"). Anyone else who agrees to keep
his Note, or who agrees to make payments to the Note Holder if I fail to keep my promises under
s this Note to transfer it to someone else also waives these rights. These persons are known as
nd endorsers."

CES

ust be given to me under this Note will be given by delivering it or by mailing it by certified mail
Property Address above. A notice will be delivered or mailed to me at a different address if I give
ce of my different address.
ust be given to the Note Holder under this Note will be given by mailing it by certified mail to the
ress stated in Section 3 above. A notice will be mailed to the Note Holder at a different address if I
at different address.

S OF PERSONS UNDER THIS NOTE

person signs this Note, each of us is fully and personally obligated to pay the full amount owed
promises made in this Note. Any guarantor, surety, or endorser of this Note (as described in Sec-
bligated to do these things. The Note Holder may enforce its rights under this Note against each
gainst all of us together. This means that any one of us may be required to pay all of the amounts
. Any person who takes over my rights or obligations under this Note will have all of my rights and
promises made in this Note. Any person who takes over the rights or obligations of a guarantor,
this Note (as described in Section 7 above) is also obligated to keep all of the promises made in this

nds and seals of the undersigned.

(Seal)
Borrower

(Seal)
Borrower

(Seal)
Borrower
(Sign Original Only)

Please return to:
Richard G. Ward, P.C.
Post Office Box [illegible]
Augusta, Georgia [illegible]

TRANSFER AND ASSIGNMENT

FOR VALUABLE CONSIDERATION in hand paid, receipt whereof is hereby acknowledged, [illegible], INC. does hereby set over, transfer and assign unto:

Goldome Credit Corp.
2 Perimeter Park South
Birmingham, Alabama 35243

his/her/its heirs, executors, administrators or assigns, all of its right, title and interest to that certain Deed to Secure Debt, together with the Note it was given to secure, executed by

[illegible]

To: [illegible], INC. dated the 27th day of August 1989, and duly recorded in the Office of the Clerk of Superior Court of Burke County, State of Georgia, in Volume 171, page 239.

IN WITNESS WHEREOF, [illegible], INC. has hereunto caused its corporate hand and seal to be affixed hereto this the 30th day of August, 1989.

Signed, sealed and delivered in the presence of:

[signature]
Unofficial Witness

[signature]
NOTARY PUBLIC, State of Georgia
My Commission Expires: [illegible]

[illegible], INC.

BY: [signature]
Title: President

REAL ESTATE LOAN DISCLOSURE STATEMENT

(Made in compliance with Federal Law)

Creditor:

Mortgage Lenders, Inc
1393 S. Marietta Parkway
Suite 114
Marietta, Georgia 30067

Date of Loan: AUGUST 25, 1989

Borrower(s):

HOSEY DUKES

RUBY LEE W. DUKES

ANNUAL PERCENTAGE RATE	FINANCE CHARGE	AMOUNT FINANCED	TOTAL OF PAYMENTS
The cost of your credit as a yearly rate.	The dollar amount the credit will cost you.	The amount of credit provided to you or on your behalf.	The amount you will have paid after you have made all payments as scheduled.
24.87 %	$ 35,465.20	$ 12,548.00	$ 48,013.20

You will be furnished an itemization of the Amount Financed

Your payment schedule will be:

Number of Payments	Amount of Payments	When Payments Are Due
180	$ 266.74	BEGINNING SEPTEMBER 30, 1989
		LAST PAYMENT DUE AUGUST 30, 2004

Insurance:

You may obtain property insurance from anyone you want that is acceptable to Mortgage Lenders. Credit life insurance is not required to obtain credit, and will not be provided unless you sign and agree to pay the additional cost.

Insurance Disclosures	Signature
Credit life insurance for a term of ______ months is available for a premium of $______	I want credit life insurance. ______________

Security: You are giving a security interest in the real estate secured by a deed to secure debt on property located at:

ROUTE 1, BOX 144-A, KEYSVILLE, GEORGIA

Late Charge: If a payment is 10 days late, you will be charged 10% of the payment.

Prepayment: If you pay off early, you may have to pay a penalty.

(Check if applicable)

☐ **Assumption:** Someone buying your real estate cannot assume the remainder of the deed to secure debt on the original terms unless the Lender agrees in writing to such assumption.

See your loan documents for additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment penalties.

I HAVE RECEIVED A COPY OF THIS DISCLOSURE STATEMENT, THIS 25TH DAY OF AUGUST 19 89

[signature] Attorney for Mortgage Lenders

[signature: Hosey Dukes] Borrower HOSEY DUKES

[signature: Ruby Lee W. Dukes] Borrower RUBY LEE W. DUKES

"E" Represents an estimate of dollar amount.

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[illegible]
[illegible] OF AMOUNT FINANCED

LENDER:	BORROWER(S):
[illegible], INC.	[illegible]
[illegible]	[illegible]
[illegible]	[illegible]
[illegible], GEORGIA [illegible]	[illegible], GEORGIA

DATE OF LOAN: [illegible] 1997

(1) Amount given to you directly $[illegible]

(2) Amount paid to others on your behalf: $11,431.01

(a) $70.00 Appraisal

(b) $21.00

(c) $73.50 Recordation Fee

(d) $52.50 Title Insurance

(e) $400.00 Michael G. Ward Attorney's Fees

(f) $225.00 Michael G. Ward, Title Search

(g) $994.33 FIRST UNION

(h) $6,000.00 ESCROW FOR MORTGAGE PAYMENT

(i) $[illegible] S & S FINANCE

(j) $[illegible] FUTURE FINANCE

(k) $352.00 [illegible] & LEONARD, INC.

(l) $[illegible] JAMES L. LESTER

(m) $N/A

(n) $N/A

(o) $N/A

Total of (1) and (2) is Amount Financed $[illegible]

(3) Prepaid Finance Charge $[illegible]

(a) $[illegible] Mortgage Lenders, Inc.-Loan Origination Fee

(b) $100.00 Credit Investigation and Appraisal Review

(c) $75.00 Documentation Review

(d) $75.00 Application Fee

TOTAL OF (1), (2) and (3) is principal amount of your note.

$[illegible]

Hosey Dukes
Borrower HOSEY DUKES

Ruby Lee W. Dukes
Borrower RUBY LEE W. DUKES

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APPENDIX E

June 15, 1990 ______________ Atlanta ______________, GEORGIA

103 Hillsdale Drive Atlanta, Fulton County, Georgia 30315
Property Address City State Zip Code

1. BORROWER'S PROMISE TO PAY
In return for a loan that I have received, I promise to pay U.S. $ 15,000.00 (this amount will be called "principal"), plus interest, to the order of the Lender. The Lender is TOWER FINANCIAL SERVICES, INC. I understand that the Lender may transfer this Note. The Lender or anyone who takes this Note by transfer and who is entitled to receive payments under this Note will be called the "Note Holder."

2. INTEREST
I will pay interest at a yearly rate of 19.99% %. Interest will be charged on that part of the principal balance which has not been paid. Interest will be charged beginning on the date of this Note and continuing until the full amount of principal has been paid. In no event will the amount of interest paid or payable under this note exceed the maximum rate permitted by law.

3. PAYMENTS
I will pay principal and interest by making payments each month of U.S. $262.34. Payments will be applied first to interest accrued through the date of payment, then to the remaining principal balance.
I will make payments on the 20th day of each month beginning on July 20th, 1990. I will make these payments every month until I have paid all of the principal and interest and any other charges, described below, that I may owe under this note. If on 06/20/05 I still owe amounts under this Note, I will pay all those amounts, in full, on that date. I will make my monthly payments at 2970 PEACHTREE ROAD, N.W. SUITE 350, ATLANTA, GEORGIA or at a different place if required by the Note Holder.

4. BORROWER'S FAILURE TO PAY AS REQUIRED
(A) Late Charge for Overdue Payments
If the Note Holder has not received the full amount of any of my monthly payments by the end of five calendar days after the date it is due, I will pay a late charge to the Note Holder. The amount of the charge will be 10% of my payment.
(B) Notice from Note Holder
If I do not pay the full amount of each monthly payment on time, the Note Holder may send me a written notice telling me that if I do not pay the overdue amount by a certain date I will be in default.
(C) Default
If I do not pay the overdue amount, I will be in default. If I am in default, the Note Holder may require me to pay immediately the full amount of principal which has not been paid and all the interest that I owe on that amount.
Even if, at a time when I am in default, the Note Holder does not require me to pay immediately in full as described above, the Note Holder will still have the right to do so if I am in default at a later time.
(D) Payment of Note Holder's Costs and Expenses
If the Note Holder has required me to pay immediately in full as described above, the Note Holder will have the right to be paid back for all of its cost and expenses to the extent not prohibited by applicable law. Those expenses include, for example, reasonable attorney's fees.

5. THIS NOTE IS SECURED BY A DEED
In addition to the protections given to the Note Holder under this Note, a Security Deed dated June 15th, 1990 protects the Note Holder from possible losses which might result if I do not keep the promise which I make in this Note.

6. PREPAYMENTS
Borrower may not make partial prepayments of principal or interest. In the event Borrower shall prepay this loan in full by voluntary or involuntary (after default) payment the prepayment penalties shall be as follows:

If paid in full before 06/20/96 the penalty shall be 19% of the original principal balance.
If paid in full after 06/20/96 but before 06/20/98 the penalty shall be 16%.
If paid in full after 06/20/98 but before 06/20/00 the penalty shall be 12%.
If paid in full after 06/20/00 but before 06/20/02 the penalty shall be 9%.
If paid in full after 06/20/02 but before 06/20/04 the penalty shall be 7%.
If paid in full after 06/20/04 but before 12/20/06 the penalty shall be 4%.

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7. BORROWER'S WAIVERS
I waive my rights to require the Note Holder to do certain things. Those things are: (A) to demand payment of amounts due (known as "presentment"); (B) to give notice that amounts due have not been paid (known as "notice of dishonor"); (C) to obtain an official certification of nonpayment (known as "protest"). Anyone else who agrees to keep the promises made in this Note, or who agrees to make payment to the Note Holder if I fail to keep my promises under this Note or who signs this Note to transfer it to someone else also waives these rights. These persons are known as "guarantors, sureties and endorsers."

8. ADDITIONAL AGREEMENT

In the event that the rate of interest charged herein, including any penalties or other charges, shall be adjudicated or otherwise determined to be in excess of the legal limitation on interest at the time of the execution of this Note, or any future limitation, this Note shall not be deemed null and void. In such case borrower agrees to repay the indebtedness with interest (including any penalties) at the highest legal rate and hereby waives his right to demand a forfeiture of interest or to declare this Note null and void. Lender's sole obligation shall be the return of any excess interest previously paid.

9. GIVING OF NOTICES
Any notice that must be given to me under this Note will be given by delivering it or by mailing it by certified mail addressed to me at the Property Address above. A notice will be delivered or mailed to me at a different address if I give the Note Holder a notice of my different address.
Any notice that must be given to the Note Holder under this Note will be given by mailing it by certified mail to the Note Holder at the address stated in Section 3 above. A notice will be mailed to the Note Holder at a different address if I am given a notice of that different address.

10. RESPONSIBILITY OF PERSONS UNDER THIS NOTE
If more than one person signs this Note, each of us is fully and personally obligated to pay the full amount owed and to keep all of the promises made in this Note. Any guarantor, surety, or endorser of this Note (as described in Section 7 above) is also obligated to do these things. The Note Holder may enforce its rights under this Note against each of us individually or against all of us together. This means that any one of us may be required to pay all the amounts owed under this Note. Any person who takes over my rights or obligations under this Note will have all of my rights and must keep all of my promises made in this Note. Any person who takes over the rights or obligations of a guarantor, surety, or endorser of this Note (as described in Section 7 above) is also obligated to keep all of the promises made in this Note.

WITNESS the hands and seals of the undersigned.

Raymond Bryant (Seal)
Borrower RAYMOND BRYANT

_________________________ (Seal)
Borrower

_________________________ (Seal)
Borrower

_________________________ (Seal)
Borrower

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ITEMIZATION OF AMOUNT FINANCED

Creditor:

TOWER FINANCIAL SERVICES, INC.
2970 Peachtree Road N.W., Suite 350
Atlanta, Georgia 30305

Borrower(s):

RAYMOND BRYANT

Date of Loan 06/13/90

(1) Amount given to you directly $ 11,184.50

(2) Amount paid on your account $ N/A

(3) Amount paid to others on your behalf $ 1,720.50

(a) $ N/A to appraiser

(b) $ N/A to credit bureau

(c) $ 50.00 to public officials

(d) $ 37.50 to title insurance company

(e) $ N/A to property insurance company

(f) $ N/A to N/A, closing attorney

(g) $ 125.00 to PSLT, title search

(h) $ 1500.00 to FIRST SOUTHERN

(i) $ N/A to N/A

(j) $ N/A to N/A

(k) $ N/A to N/A

(l) $ N/A to N/A

(m) $ N/A to N/A

(n) $ N/A to N/A

Total of (1), (2) and (3) is Amount Financed $ 12,905.00

(4) Prepaid finance charge $ 2,095.00

(a) $ 1300.00 To Tower Financial Services, Inc. for discount points

(b) $ 395.00 to document preparation

(c) $ N/A to N/A

Total of (1), (2), (3), and (4) is principal amount of your note $ 15,000.00

Raymond Bryant
Borrower RAYMOND BRYANT

Borrower

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DISCLOSURE STATEMENT

Creditor:

Tower Financial Services, Inc.

2970 Peachtree Road N.W. Suite 330

Atlanta, Georgia 30305

Borrower(s):

RAYMOND BRYANT

103 Hillsdale Drive

Atlanta, Fulton, Ga. 30315

Date of Loan: 06/13/90

ANNUAL PERCENTAGE RATE	FINANCE CHARGE	Amount Financed	Total of Payments
The cost of your credit as a yearly rate.	The dollar amount the credit will cost you.	The amount of credit provided to you or on your behalf.	The amount you will have paid after you have made all payments as scheduled.
23.67 %	$ 34,316.20	$ 12,905.00	$ 47,221.20

You are being furnished with an itemization of the Amount Financed.

Your payment schedule will be:

Number of Payments	Amount of Payments	When Payments Are Due
180	$262.34	20TH
		Monthly beginning 07/20/90

Insurance: You may obtain property insurance from anyone you want that is acceptable to Tower Financial Services, Inc. If you get property insurance from Tower Financial Services, Inc. you will pay $ NA for a term of NA months.

Security: You are giving a security interest in the real property located at:

103 Hillsdale Drive

Atlanta, Georgia 30315

Fulton County

Late Charge: If a payment is late, you will be charged 10% of the payment.

Prepayment: If you pay off early, you may have to pay a penalty.

(Check if applicable:)

☐ Assumption: Someone buying your house cannot assume the remainder of this obligation on the original terms.

See your loan documents for additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment penalties.

I HAVE RECEIVED A COPY OF THIS DISCLOSURE STATEMENT, THIS 13th DAY OF June, 19 90.

Witness: [signature]

Borrower: [signature] RAYMOND BRYANT

Borrower:

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Tower Financial "Non-Sec" 12-13-91

MORTGAGE FORECLOSURE APPROVAL

Branch: ARSC — Account Number: 38171349

Name: Raymond Bryant

Address of Property Being Foreclosed: 103 Hillsdale Dr SE Atlanta, GA 30315

Original Loan Information: 6/20/90 — 180 — 262.34 — 19.90

Current Loan Information: 14961.23 — 10/30/91 — 289.00 — 60

Will owner give Deed in Lieu? ☐ Yes ☒ No

MORTGAGES — LIENS — JUDGMENTS — In Order of Priority
(List All, Including Fleet)

Will go atty gen

	Name	Balance	Payment	APR	Arrearage
1	Tucker Company	15996.38	229.40	8.25	2060.68
2	FFC	14961.23	262.34	19.90	655.40
3					
4					
5					

VALUE OF PROPERTY

	Appraised By		Appraised Date			Quick Sale Value	Fair Market Value
Original	Tower Drive By		6/15/90		✓		42,500
Current	FFC	Craig Butler	12/18/91		✓		50,000

Condition of property: ☒ Occupied — Roof worn, clean up

			Original	Current
1)	Quick Sale Appraisal / Fair Market Value	No escrow None at closing	42,500	50,000
2)	Less:			
a)	1st Mortgage Balance	Consolidation/Home improvement	15997	15997
b)	1st Mortgage Arrearage		2060	2062
c)	Estimated Payments on 1st Mtg.		832	832
d)	1st Mortgage Foreclosure Costs			
e)	Real Estate Taxes			
f)	Other Liens	10 day 12/20/91		
g)	Real Estate Commission @ 7%		3335	3500
h)	Appraisal Fee			
i)	Attorney Costs		1200	1200
j)	Fleet Costs and Foreclosure Costs			
k)	Property Insurance Premium			
l)	Cleaning and Repair Costs			
m)	Other Costs — Explain:			
	TOTAL		23423	23598
3)	Estimated Net Value (1 minus 2)		20077	26402
4)	Fleet Net Balance		14961	14961
5)	Estimated Net ☒ Profit ☐ Loss (3 minus 4)		9116	11441

Name, Address and Telephone Number of Fleet Attorney who will handle the Foreclosure: Tomlinson

Estimated date of Possession: — Estimated date of Final Sale:

Observations/Recommendations: 1st to F/C 1/92 no excuse - has ability. Wanted Refinance + additional $H.

Instructions to Branch:

Note: If "Deed of Trust" state, attach substitution of Trustee document

APPROVALS

Branch President: [signature] — Date: 12/18/91

Assistant Vice President: [signature] — Date: 12/19/91

Vice President: [signature] — Date: 12/19/91

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APPENDIX F

IN THE SUPERIOR COURT OF RICHMOND COUNTY

STATE OF GEORGIA

KEITH ANTHONY ALEXANDER, VERA ALEXANDER, and all other persons similarly situated,	)	
Plaintiffs,	)	CIVIL ACTION FILE
vs.	)	NO. 91-RCCV-681
KAYE-CO, NEW SOUTH FINANCIAL CENTER, INC., HOME EQUITY CENTERS, INC., AND FLEET FINANCE, INC. OF GEORGIA,	)	
Defendants	)	

ORDER

Presently before the Court is Plaintiffs' motion to certify the above-captioned case as a class action under Rule 23 of the Georgia Civil Practice Act. The Court conducted an evidentiary hearing December 31, 1992. After reviewing the evidence presented at said hearing, the evidence offered by way of depositions, subsequently offered evidence, and briefs submitted by the parties, the Court hereby GRANTS Plaintiffs' motion, based on the following findings of fact and conclusions of law.

FINDINGS OF FACT

1. In March, 1991 named Plaintiffs contacted Kaye-Co seeking a second mortgage of $10,000.00 on their home.

2. Kaye-Co contacted New South Financial Center, Inc. regarding named Plaintiffs' loan.

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3. New South Financial Center, Inc. normally obtained approval from Fleet Finance, Inc. of Georgia for Fleet Finance, Inc. of Georgia to purchase a loan prior to a loan being made.

4. There existed an agreement, prior to the time of the loan made to named Plaintiffs, between Home Equity Centers, Inc. and Fleet Finance, Inc. of Georgia concerning the sale of certain loan portfolios.

5. On March 14, 1991, Fleet Finance, Inc. of Georgia received a loan application by facsimile from New South Financial Center, Inc. for a loan to named Plaintiffs.

6. Fleet Finance, Inc. of Georgia preapproved the loan at a pricing whereby Fleet Finance, Inc. of Georgia would buy the loan and it would yield to it 17%.

7. Fleet Finance, Inc. of Georgia's preapproval was transmitted to New South Financial Center, Inc. through Home Equity Centers, Inc.

8. On March 26, 1991, named Plaintiffs entered into a loan agreement with New South Financial Center, Inc., secured by a first deed to secure debt on residential real estate.

9. Named Plaintiffs received a new first mortgage, instead of the second mortgage they originally requested.

10. Named Plaintiffs agreed to pay New South Financial Center, Inc. $29,050.00 over a 15-year period, at an interest rate of 19.5%.

11. Named Plaintiffs were charged initial fees in excess of 13%.

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12. According to the Statistical Abstract of the United States for 1990, the average contract rate on loans secured by existing homes was 10.3%, and the initial fees charged were 1.86%.

13. The loan files produced by Fleet Finance, Inc. of Georgia pursuant to discovery show 60% of the loans secured by real estate being made by Fleet Finance, Inc. of Georgia through its agreements with companies such as New South Financial Center, Inc. and Home Equity Centers, Inc., were made to Black individuals.

14. As of April 1, 1990, approximately 17.23% of the homeowners in Georgia were Black. Approximately 81.79% of the homeowners were Caucasian.

15. Of the loans produced by Fleet Finance, Inc. of Georgia, Black individuals paid front end fees of 11.06% as a percentage of amount financed. Caucasians paid 8.26% as a percentage of amount financed.

16. After named Plaintiffs' loan closed, New South Financial Center, Inc. assigned the security deed to Home Equity Centers, Inc.

17. Home Equity Centers, Inc. then assigned the security deed to Fleet Finance, Inc. of Georgia.

CONCLUSIONS OF LAW

The requirements for class certification are numerosity, commonality and adequacy of representation. O.C.G.A. 9-11-23. The courts also look to typicality and superiority of the class action. The class meets the requirements.

1. Numerosity. The class must be "so numerous as to make it

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impracticable to bring them all before the court." O.C.G.A. 9-11-23(a). Plaintiffs have shown at least 416 potential members of the class, satisfying this requirement.

2. Commonality. The class must present common questions of law and fact, and these questions must predominate over any individual questions affecting individual class members. Winfrey v. Southwest Community Hospital, Inc., 184 Ga. App. 383 (1987).

3. The common legal question is whether defendants have violated the Georgia Fair Housing Act, OCGA 8-3-200, et seq.

4. Defendants contend individual issues of fact regarding liability and damages predominate. This contention is without merit.

5. Common issues of fact regarding liability predominate. Defendants, working together, engaged in a common course of dealing with named Plaintiffs and members of the class.

6. Common issues of fact regarding damages also predominate. Defendants charged uniformly high interest rates and front-end fees.

7. The Court will not deny certification because of minor variations in damages. Sta-Power Industries v. Avant, 134 Ga. App. 952 (1975).

8. Adequacy of Class Representation. This requirement goes both to named Plaintiffs and their attorneys.

9. Plaintiffs' attorneys have experience in class action litigation and will adequately represent the class.

10. Named Plaintiffs have cooperated in the litigation thus

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far and indicated their willingness to represent the class. They understand their financial responsibilities to the class. Named Plaintiffs are adequate class representatives.

11. Typicality. Named Plaintiffs' claim must be typical of those of the class. The Alexanders fit within the class definition and have a typical claim.

12. Superiority of the Class Action. One of the primary purposes of the class action is to enhance the "efficacy of private actions by permitting citizens to combine their limited resources to achieve a more powerful litigation posture." Roper v. Consurve, Inc., 578 F.2d 1106, 1113 (5th Cir. 1978) (quoting Hawaii v. Standard Oil Co. of California, 92 S.Ct. 885, 893 (1972)).

13. Class certification will ensure that those economically disadvantaged class members who otherwise could not afford adjudication of their rights will be heard.

14. It is "well established that the discretion of the trial court in certifying or refusing to certify a class action is to be respected in all cases where not abused." Winfrey, 383.

Having determined the class meets all certification requirements, the Court concludes the following.

15. Named Plaintiffs bring this action pursuant to the Georgia Fair Housing Act, O.C.G.A. 8-3-200, et seq.

16. The Georgia Fair Housing Act is modeled after the Federal Fair Housing Act, 42 U.S.C. 3601, et seq.

17. The Court is unable to find, and the parties have not cited, any cases construing the Georgia Fair Housing Act.

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Therefore, the Court looks to the federal law for guidance.

18. Defendants argue Plaintiffs must show either intentional discrimination or that race was a consideration and played some role in Defendants' loan practices to have a meritorious claim under the Georgia Fair Housing Act.

19. Furthermore, Defendants argue they are not liable under the Georgia Fair Housing Act for loan practices which discriminate against Black individuals, absent evidence of discriminatory intent.

20. The Court rejects Defendants' arguments.

21. Named Plaintiffs need not show discriminatory intent to establish a valid claim under the Georgia Fair Housing Act.

22. Named Plaintiffs may establish a prima facie case of discrimination under the Georgia Fair Housing Act by showing Defendants' loan practices have a discriminatory effect. Huntington Branch, National Association for the Advancement of Colored People v. Town of Huntington, 844 F.2d 926 (2d Cir. 1988).

23. The Court recognizes Plaintiffs' need for intensive discovery to determine the extent, if any, of discrimination in defendants' loan dealings.

It is therefore ORDERED the claims of named Plaintiffs be certified as a class action. The class shall consist of individuals who meet the following criteria:

(a) Individuals who entered into loan contracts with one or more loan brokers or master brokers; and

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(b) Individuals whose promissory notes and deeds to secure debt have been subsequently assigned or transferred by one or more loan brokers or master brokers to the Defendant, Fleet Finance, Inc. of Georgia; a..d

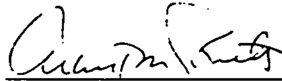
(c) Individuals who, in connection with their loans, have secured said loans by "residential real estate" as that term is used in O.C.G.A. 8-3-204; and

(d) Individuals who have entered into such loan transactions from July 1, 1990 to date; and

(e) Individuals who are Black.

In connection with the discovery motion currently pending before the Court, attorneys for Plaintiffs are hereby ORDERED to reassign the motion to compel for a hearing before the Court. The discovery deadline in this case is extended to and including April 1, 1993.

This 2nd day of October, 1992.



The Honorable Albert M. Pickett
Judge, Superior Court, Augusta
Judicial Circuit

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TESTIMONY OF BRUCE MARKS, EXECUTIVE DIRECTOR, UNION NEIGHBORHOOD ASSISTANCE CORPORATION

My name is Bruce Marks. I'm the Executive Director of the Union Neighborhood Assistance Corporation, a non-profit housing agency based in Boston with a new office in Atlanta and one opening soon in Jacksonville, Florida. I appreciate the opportunity to appear before the Committee and I commend Chairman Riegle and the Committee staff for tackling this very important issue.

For too long the national epidemic of reverse redlining has been tolerated by regulators and ignored by policymakers. What is reverse redlining?

It is the widespread practice of flooding working class communities with predatory financial goods and services.

It is the logical and predictable outcome of the systematic redlining practiced by the nation's financial institutions for generations.

It is a multi-billion dollar industry involving a multiplicity of financial products and some of the country's oldest and most respected financial firms.

It is a classic economic equation: The redliners create the pent-up demand for credit in working-class communities, and the reverse redliners step up to the plate with a basketful of predatory financial products and services. Quite often, the redliners and the reverse redliners are the same institutions, working both sides of the equation.

Let me be clear about who the victims are: They are creditworthy Americans of all races, religions and regions. They work for a living—some of them must hold two or three jobs just to make ends meet. They pay their taxes. They pay their debts. They are long-term residents of their respective communities, the bulwark against neighborhood decline, crime, drugs and gang violence.

They are the men and women in the audience today wearing the bright yellow T-shirts, homeowners from Georgia and Florida, New Jersey and Massachusetts and other states. And for every one of them here today, there are thousands of others who couldn't be here. Many of these homeowners boarded buses sixteen or seventeen hours ago and travelled through the night to deliver a simple message to the Committee and to Congress: STOP THE FLEET LOANSHARKS.

They are people who refuse to be nameless, faceless victims. If the word "Fleet" has become synonymous with the word "loanshark," it is because the people in this audience and the tens of thousands who couldn't be here are living, breathing witnesses to Fleet's monumental misdeeds.

Their presence here today is a tangible reminder of the real state of the union in working-class communities throughout the country: a state of chaos wrought by Fleet and its imitators.

We focus on Fleet not because it is the only financial institution that has figured out how to wring a hefty profit out of redlined communities, but because it was among the first of the country's major banks to do so, and because it is without a doubt the most efficient in its plundering. In a very real sense, Fleet set the standard in reverse redlining. Where Fleet first treads, its imitators—like Chrysler First (now NationsBank)—have followed.

Fleet is to reverse redlining what the Exxon Valdese was to oil spills and what AH Robbins was to toxic shock syndrome. That is why if this body is serious about taking steps to end reverse redlining it must condemn—and correct—the injustices perpetrated by Fleet.

Following this hearing, delegations of homeowners will be visiting Congressional leaders to educate them about those injustices and to request a simple thing: that banking regulators be enjoined from allowing Fleet to expand its franchise through acquisitions until the bank has stopped its predatory lending and all victims have been justly compensated.

When you listen to their stories, clear patterns will emerge. You will notice, for example, that many of the homeowners who have so far avoided foreclosure must pay upwards of two thirds of their family's monthly income to Fleet. You will see loan documents showing interest rates as high as 39 percent. Don't be surprised to learn that many of these loans carry points and upfront fees that are almost as high as the face amount of the loan. You will hear about Fleet's strong-arm collection practices and about the fly-by-night home improvement contractors who troll working class neighborhoods in search of fresh fodder for the Fleet foreclosure mill.

How widespread is Fleet's handiwork? You can go into any of the 28 states where Fleet Finance has offices, identify the neighborhoods that have been cut off from conventional credit, where median home prices have risen over the past decade but incomes have remained stable, and there you will find homeowners making unconscionably high monthly payments to Fleet. You will also find homes that have been foreclosed and bought at auction by Fleet.

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How could Fleet, the nation's second largest mortgage lender, devastate so many lives? That is a question people in this audience ask themselves every day. The inescapable answer is this: the regulators and the politicians who could have put an end to Fleet's illicit enterprise years ago did not do so.

Some nineteen months ago, UNAC tried to convince the Board of Governors of the Federal Reserve System to use its considerable powers to curb Fleet's abusive and criminal lending in working-class communities throughout the country. At the time, Fleet and its partner—the leverage buyout specialists Kohlburg, Kravis and Roberts—were attempting to purchase the failed Bank of New England. UNAC suggested that the Board delay its approval of the deal until it had thoroughly examined widespread allegations of Fleet's fraudulent and abusive second mortgage lending, particularly in the Southeastern states. The Board promised to conduct an investigation but approved the BNE merger before any investigation was undertaken.

We said then and we say again the Board's failure to use its power to delay the Bank of New England deal was a monumental mistake. In our view it was highly inappropriate for banking regulators charged with protecting the public interest to commit billions of taxpayer dollars to a deal that handed over control of the largest banking franchise in New England to an institution that unabashedly siphons millions of dollars a month out of working class communities through allegedly fraudulent and usurious home equity loans.

The Board's failure to protect the public from Fleet was a green light for other expanding banks—like NationsBank—to enter the highly lucrative predatory lending business. It also resulted in a flood of litigation as aggrieved homeowners were left with no other choice than to seek redress from the courts.

In approving the Fleet/KKR takeover of Bank of New England, the Board argued that it's primary responsibility was not to investigate charges of abusive lending but to protect the safety and soundness of the banking industry. Ironically, by allowing Fleet and KKR to expand their unholy enterprise, the Board actually increased the level of risk to the taxpayer-backed Bank Insurance Fund.

It is our belief that Fleet is an extremely unstable bank and that the source of that instability is, ironically enough, the bank's lucrative trade in fraudulent or usurious mortgages. Not only do the high-rate home equity loans result in lawsuits—and there are dozens of class action suits in the making throughout the country—they also erode confidence in the bank's more legitimate goods and services.

How many people sitting in the audience today would open up a checking account at Fleet if they had a choice?

If it is to survive, a banking institution needs the confidence not only of depositors and borrowers, but also of the investment community. How many public pension funds want to be associated with an institution known for preying on working people in 28 states?

For Fleet this is more than just a public relations problem. To an increasing number of working-class Americans, Fleet's familiar logo resembles not sails but shark fins. The bank may not want to admit it yet, but it is fighting for its very survival as a viable regional powerhouse. For regulators, particularly the Federal Reserve Board, this creates a classic dilemma: How do you save the bank from itself without precipitating a panic among investors and depositors?

If the Board had acted responsibly nineteen months ago it would not be in this precarious situation today. And there is some encouraging evidence that the Board is beginning to learn from its mistake. Until recently, our correspondence with the Board was a one-sided affair. But last week, we were informed that we could assemble a delegation of forty homeowners to meet with Board Vice Chairman John LaWare. That meeting will take place later this afternoon.

At long last homeowners will have an opportunity to provide Mr. LaWare with copies of loan documents the Board was unable to obtain from Fleet. And UNAC will also discuss with Mr. LaWare several safety and soundness issues we believe are raised by Fleet's legal and public relations dilemma.

Specifically, we will review with Mr. LaWare our contention that the Fleet scandal could lead to the bankruptcy of the Atlanta-based facility Fleet Finance, and that such an event could spread untold millions of dollars of risk throughout the banking system. Other financial institutions have been subjected to a Fleet "bankruptcy risk" through two processes: Fleet's securitization program, and its short and long term borrowings from other financial entities.

A majority of the home equity loans originated or acquired by Fleet Finance were transferred to three real estate mortgage investment conduits (REMICs). Through the REMIC structure, tens of thousands of allegedly fraudulent and usurious home equity loans became collateral for private mortgage backed securities that were sold to insurance companies; banks and pension funds. No private insurance was ob-

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tained by the Fleet REMIC Trusts to protect investors if the courts rule that the loans in question are indeed usurious.

Another way potential liabilities stemming from the Georgia lawsuits may have been spread throughout the financial system is through Fleet Finance's short and long term borrowing from other financial entities. Like most finance companies not regulated by federal banking agencies, Fleet Finance raises funds from FDIC-regulated banks as well as from state-regulated insurance companies. Between November 1990 and April 1991, Fleet Finance raised more than $900 million from banks and insurance companies. All of those credits were unsecured, meaning the banks and insurance companies are relying on the long term viability of Fleet Finance.

In closing, let me say that I hope the presence of hundreds of Fleet victims here today impresses upon you just what is at stake for tens of thousands of working families who are in similar straits.

By the time those homeowners have returned home to Georgia, Florida, Massachusetts or Maryland or New Jersey, the legions of lobbyists who work for Fleet and for it's silent partner—Kohlburg, Kravis and Roberts—will have already contacted many of your staffs to disseminate their notorious brand of misstatements and half-truths. Here's what they'll tell you:

Fleet, they'll say, is the victim of a witch-hunt. They'll cite misleading and unsubstantiated statistics to imply that Fleet's practices are in line with industry norms. They'll provide you with doctored weighted averages and bogus foreclosure rates.

In the final analysis, your view of these proceedings depends upon whom you believe, the hundreds of homeowners here before you, or the Italian suits and silk ties who are paid to speak for Fleet? And if you want to do more than scratch the surface of this issue, you need to have hearings in Los Angeles and Chicago, Detroit and Baltimore, Jacksonville, Philadelphia, Charlotte and Atlanta. That's where the rest of the witnesses are.

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LETTER TO SENATOR DONALD W. RIEGLE, JR. FROM JOHN P. HAMILL, EXECUTIVE PRESIDENT, FLEET BANK

March 1, 1993

Dear Mr. Chairman:

On behalf of Fleet Financial Group, Inc. ("Fleet") and Fleet Finance, Inc. ("Fleet Finance"), I would like to thank you for giving me the opportunity to testify before your Committee on February 17, 1993.

Let me reiterate that Fleet, and all of its bank and nonbank subsidiaries, are committed to the highest ethical standards, comply with all applicable federal and state laws, and do not engage in any form of discriminatory lending practices. I believe Fleet's excellent record of Community Reinvestment Act (CRA) compliance and involvement in the cities in which its banks do business, as well as the aggressive action already taken by Fleet Finance to address the criticisms levied against it, illustrate Fleet's and Fleet Finance's sincerity in making this statement.

In addition to the summary of the changes made by Fleet in certain of its business practices and a description of its community and minority lending programs which are discussed in Sections I and II below, Section III of this letter corrects several false and misleading statements made by certain witnesses who testified on the second panel at your hearing.

I. CHANGES MADE BY FLEET FINANCE

As I testified, Fleet Finance has attempted to act responsibly by taking quick and effective action to identify and rectify any customer complaints in Georgia and elsewhere. Despite its firm belief in its legal position and in an effort to put this issue behind it, Fleet Finance has taken the following actions: (i) it has stopped buying individual loans from third parties, thereby eliminating the charge that it sponsors the alleged illegal, immoral or improper activities of third parties, (ii) it has capped interest rates at 18 percent and brokers' fees at 5 percent (both, on a nationwide basis), (iii) it has determined that the loans which are the subject of complaints, whether meritorious or not, are limited to a small portion of its Georgia portfolio, and (iv) it has adopted its 10 Point Initiative to attempt to resolve each and every one of the cases which are brought to it.

To illustrate its good faith, to address any perceived abuses and to benefit its customers, Fleet Finance adopted its 10 Point Initiative in October 1992 (the "Initiative"). This Initiative is intended to aid those customers whose loans are deemed burdensome, without regard to the merits of the loan involved. It is not an admission of culpability by Fleet Finance, as our critics might allege, but an important customer relations program with the goal of reminding our customers that Fleet Finance is always ready to responsibly address their problems.

The Initiative provides up to $38 million in various benefits te borrowers, including interest rate relief, a foreclosure moratorium, home improvement repairs and grants for revitalization of impacted neighborhoods. It also confirmed Fleet Finance's policy to discontinue direct and indirect purchases of home improvement

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loans and loans from third-party lenders generally. Fleet Finance also has made a total of $8 million available to impacted neighborhoods for reinvestment.

Over 900 borrowers have already been approved for relief under the Initiative. Fleet Finance expects to continue to provide the Initiative, although it has been hindered from doing so by plaintiffs' lawyers involved in class action cases against Fleet Finance and a number of other lenders in Georgia. In fact, the plaintiffs' lawyers have obtained an injunction preventing Fleet Finance from pursuing the Initiative in Georgia, despite the fact that *no* waiver of the borrowers' legal rights is required to obtain relief through the Initiative. Fleet Finance is, however, actively advertising and implementing the Initiative in all states in which Fleet Finance does business other than Georgia. The 10 Point Initiative demonstrates Fleet Finance's willingness to work with, and resolve, any individual problem or complaint, whether allegedly caused by Fleet or otherwise.

II. Fleet's Commitment to CRA

Fleet's seven banks in the Northeastern United States, with approximately 800 branches and $33 billion in deposits, serve their communities well, consistently receiving "outstanding" or "satisfactory" CPA ratings. Fleet banks have provided millions of dollars in loans to low- and moderate-income neighborhoods in the communities in which they operate.

A detailed description of many programs which illustrate Fleet's commitment to increasing lending to low- and moderate-income and minority borrowers was attached to my written testimony for the hearing. Our Executive Vice President, James P. Murphy, submitted a separate statement regarding Fleet's mortgage lending and CRA programs for inclusion in the record of your February 24, 1993, hearing on "Redlining." The letter is attached as Exhibit A.

I would note for the record that Fleet operates banks only in New England and New York and that Fleet is prohibited by law from operating a bank in any southeastern state, including Georgia, and thus, cannot be charged with using its consumer finance company to make loans at higher rates in those areas. Fleet is proud of its long-standing and extensive commitment to meeting the needs of low-to-moderate income and minority borrowers, and I urge you to review the complete record of these hearings, especially Exhibit 1 of my written testimony and Mr. Murphy's letter, before you come to any conclusions about our efforts in this area.

III. Response to Specific Allegations

Since Mr. Marks' and Mr. Long's testimonies each contained misstatements and falsehoods too numerous to mention here, I have attached as Exhibit B a point-by-point rebuttal of each of those statements with which Fleet takes issue. However, I would specifically like to address the allegation made by Bruce Marks at the hearing that I committed perjury by citing statistics to the Committee that did not reflect Fleet Finance's securitized loans.

I take great offense at Mr. Marks' false allegation. The statistics which I cited included all outstanding loans made or purchased by Fleet Finance in Georgia, *including every loan sold in a securitiza-*

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tion. At your request, I will provide you with verification from Fleet Finance's accountants of all the numbers which I cited to you in my testimony.

I would also note that Mr. Marks' assertion that Fleet Finance is not regulated by federal banking agencies is clearly wrong. Fleet Finance, as a subsidiary of a bank holding company, is regulated by the Federal Reserve Board and subject to periodic examinations by that entity.

One other point, which I believe important enough to address specifically in the body of this letter, is the misconception that Fleet Finance is "wildly profitable." This is simply not the case. Every business hopes to be profitable, but Fleet Finance's profits are not significantly greater on a comparative basis (i.e., return on assets or "ROA," return on equity or "ROE") than profits earned at the Fleet banks. For example, in normal years, the ROE for Fleet Financial Group was between 17 percent and 18.5 percent—which is the same range as Fleet Finance's ROE.

In addition, Section 4 of my written testimony entitled "Why Costs to Borrowers for Home Equity Loans Are Higher Than Costs for Conventional Mortgage Loans" contains a full explanation of why Fleet Finance's interest rates are reasonable and why comparisons to conventional first mortgage loans made to individuals with bankable credit are inappropriate. Moreover, it is important to bear in mind that Fleet Finance's portfolio contains loans made over the past 10–15 years in higher interest rate environments. Fleet Finance's current interest rates run from 9.99 percent to 17.99 percent, with a cap of 18 percent. This is very reasonable when compared to alternative sources of credit. For instance, the current average credit card rate is 19.4 percent, and small loan rates can exceed 30 percent per annum.

In general, the consumer finance industry attempts to meet the credit needs of a whole range of borrowers, including many borrowers who cannot obtain credit from other sources, such as banks or credit unions. Some borrowers serviced by the industry have very good credit ratings, but others, who have substantial short-term debt, large high-rate credit card debt, are in arrears on other loans (including existing first mortgage loans) or have prior judgments against them for unpaid debts, have poorer credit histories. Because of these, and other pre-existing credit problems of many of these borrowers, consumer finance companies must expend more time and money to underwrite, negotiate and close these loans.

Further, servicing these loans once they close is much more time consuming and expensive than servicing conventional mortgage loans. In addition, delinquencies, bad debt charge-offs and losses on foreclosures are higher for second mortgages than for conventional first mortgage loans. In fact, Fleet Finance lost $18.6 million and $24.6 million on foreclosures nationwide in 1991 and 1992, respectively.

Mr. Chairman, Fleet fully supports efforts to ensure that the consumer finance industry makes credit available to all borrowers on a fair, impartial and nondiscriminatory basis. As I testified before your Committee, many of the problems that have been identified with the industry can, and should, be dealt with at the state level. In fact, we are in support of pending legislation in Georgia

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which calls for strong regulation and licensing of mortgage lenders and brokers. However, we are prepared to work with you and your Committee on all reasonable proposals at the federal level which will help achieve this objective.

Finally, I request that this letter, along with each of the attachments, be made part of the official record of your February 17, 1993, hearing.

LETTER TO SENATOR DONALD W. RIEGLE, JR. FROM JAMES P. MURPHY, EXECUTIVE VICE PRESIDENT, FLEET BANK

February 23, 1993

Dear Mr. Chairman:

During his testimony before your Committee on February 17, 1993, John Hamill, President of Fleet Bank of Massachusetts, mentioned that Fleet Financial Group has shown its commitment to increased lending, affordable housing and providing better products and services to low-to-moderate income and minority neighborhoods through a variety of programs initiated by its banks and mortgage subsidiaries.

I would like to take this opportunity to provide you and the Members of the Committee with a more detailed description of our major programs in this area, some of which include:

- Providing $370 million over the last five and one-half years in New York City to finance end loans for the acquisition of 4,800 one-to-four family homes for people with family incomes of between $22,000 and $40,000 per year.
- The "Jump Start Program" which was initiated on January 1, 1992 by our Rhode Island bank to provide home ownership to low-to-moderate income families through $10 million in low interest, no down payment financing for first time home buyers with incomes of no more than $23,000 per year.
- A $111 million community lending investment program for low- and moderate-income neighborhoods in Massachusetts, initiated in June 1991, which will create over 1,750 affordable houses in Boston and across the state, as well as channel over $7 million to help minority-owned and other small businesses.
- A construction lending program for affordable housing in conjunction with the New York City Partnership, New York State and New York City housing agencies which provided $40 million in loans in 1992 and will provide as much as $100 million in 1993.

A detailed description of these, and other major programs initiated by Fleet is contained in the attached memorandum. I request that this letter and attachments be made part of the official record for your February 24, 1993 hearing dealing with "Redlining".

We would be pleased to answer any questions you or your staff may have about this material, and to provide additional information that you feel would be helpful to the Committee.

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FLEET FINANCIAL GROUP

LOW AND MODERATE INCOME COMMUNITY LENDING PROGRAMS

Fleet Financial Group (Fleet) has been very active in community lending and has a comprehensive and effective Community Reinvestment Act (CRA) compliance program in place. A good example of our efforts is New York City where over the last five and one-half years we have provided approximately $370 million to finance end loans for the acquisition of one-to-four family homes for people with family incomes of between $22,000 and $40,000 per year. This program has created 4,800 units of new affordable housing, 90 percent of which are owner-occupied by minorities.

In fact, Fleet's banks all received either "outstanding" or "satisfactory" CRA ratings in their most recent examinations.[1] In addition, when the Federal Reserve Board (Fed) reported discouraging industry-wide statistics in 1991 and 1992,[2] as required by the Home Mortgage Disclosure Act (HMDA), showing that racial disparities exist in mortgage application approval rates, Fleet acted quickly to: (1) gather more data; (2) plan and implement an aggressive effort to make its CRA compliance programs more effective; and (3) increase mortgage loans to low-to-moderate income and minority borrowers.

In November 1991, Fleet established a corporate HMDA/CRA task force under the direction of Executive Vice President Jim Murphy. The task force's mission was to research and study the facts concerning the disparities in approval rates by race, resolve HMDA/CRA systems and reporting issues, and evaluate Fleet's products in meeting the needs of low-to-moderate income and minority communities. By the middle of 1992, the members of the task force, working with Fleet compliance personnel and outside HMDA/CRA compliance consultants, finished an assessment of the HMDA/fair lending programs at each Fleet bank and mortgage company.

Although the results of this self-assessment program did not reveal any discrimination against applicants, it did show that HMDA data collection and reporting systems needed improvement, fair lending compliance management processes needed strengthening, and increased training was needed overall in these areas. Fleet immediately took the following steps:

1. Purchased a new "Centrax" system (a computer-based data processing system) which will improve data processing and tracking and timely management reporting.
2. Held discussions with local community groups to solicit their suggestions, then took action to improve existing bank products by making them more responsive to community needs, particularly in low-income and minority urban areas. For instance, flexible first mortgage products for low-to-moderate income borrowers are now

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[1] See attached.

[2] HMDA statistics for 1990 (the first year for compiling such data), which included data on loan applications for new home purchases, mortgage refinancing and home improvements, were made public by the Fed in October 1991, and data on 1991 loan applications were reported in 1992.

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being aggressively marketed throughout all Fleet banks and mortgage companies, which include:

- More flexible underwriting guidelines that take into consideration timely payment of utility bills and rent as proof of financial responsibility, rather than just looking at a potential borrower's payment history on installment loans or bank credit.
- Instead of requiring a 5 percent downpayment on a loan to come directly from the borrower, the new guidelines allow 2.5 percent to come from a gift, grant or loan.
- A "second look" program whereby an application that has been declined will be looked at again by a senior manager.

3. Put in place dozens of affordable housing programs throughout its system, and improved CRA programs and products.

4. Began talks with representatives of Fannie Mae and others regarding the joint development of a new low-to-moderate income mortgage product.

Our goal is to help poor and minority neighborhoods stabilize their communities, to inject equity into those communities and provide a basis for home-ownership initiatives and promote small business activities. The attached memorandum summarizes some of the major affordable housing and CRA programs currently being implemented by our banks and mortgage subsidiaries.

Fleet does not condone or in any way tolerate discrimination against minorities or the practice of "redlining" certain communities. In fact, as indicated by the scope of the specialized programs we effer at all of our banks and subsidiaries, Fleet actively pursues opportunities to help previde more credit to disadvantaged areas and works closely with local government officials and community leaders to formulate and implement programs tailored to those communities.

The HMDA statistics reported by the Fed, although flawed because they do not provide an assessment of all the important criteria used in the mortgage approval process, are a wake up call to the industry to do a better job. Fleet has and will continue to be a leader in this important effort.

FLEET FINANCIAL GROUP

LOW AND MODERATE INCOME COMMUNITY LENDING PROGRAMS

(BY STATE)

1. Rhode Island

- *Jump Start Program:* A innovative program called "Jump Start" was initiated on January 1, 1992 to provide home ownership to low- to moderate-income families. Fleet's Rhode Island bank joined with the Rhode Island Housing and Mortgage Finance Corporation (RIHMFC) and Commonwealth Mortgage Assurance Company to provide $10 million in low interest, no down payment financing for first time home buyers with income of no more than $23,000 per year. To date, over $4 million has been booked under this program (see attached press release).
- *Lease to Buy Program:* Another program, done in conjunction with RIHMFC provides financing to low- to moderate-income

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Rhode Islanders to purchase a first home through a unique two-year lease purchase agreement. Over $3 million has been committed to this program (see attached press release).

- *Line-of-Credit Program:* **A program providing a $1 million restoring line-of-credit, priced at 2 percent over Fleet's passbook rate, was initiated to provide construction and renovation financing to non-profit companies to increase affordable housing stock. Over $1.7 million has been used to date.**

2. Massachusetts

- *Community Investment Lending Program*—On June 27, 1991, shortly after it acquired control over the banking subsidiaries of the former Bank of New England from the FDIC, Fleet initiated a $111 million community lending investment program for low- and moderate-income neighborhoods and communities in Massachusetts as part of a broader program designed to pump more than $500 million in new capital into the New England economy. This included an $11 million mortgage assistance program to help homeowners with burdensome mortgage loans (*see* attached press release).

  The plan, which has been very successful, will create over 1,750 affordable houses in Boston and across the state. It will also channel over $7 million to help minority-owned and other small businesses.

3–A. New York (New York City/Long Island)

- *End Loan Financing*—Over the past five years, Fleet has made a concerted effort to become a leader in New York City in providing affordable housing and finance. Through Fleet Mortgage, it provided approximately $370 million in financing for the end loan financing of approximately 4,800 units of new 1–4 family housing in Brooklyn, Queens, the Bronx and Manhattan. This included end loan financing for 2,200 units of Nehemiah housing in Brooklyn by a coalition of churches and synagogues.
- *Construction Lending Program*—Beginning in 1991, Fleet's New York City bank began developing an active construction lending program for affordable housing by working with the New York City Partnership, New York State and New York City housing agencies, and various for-profit and non-profit developers and sponsors. In 1992, $40 million in loans were booked, and as much as $100 million may be booked in 1993.
- *New York Mortgage Coalition*—On January 29, 1993, a two-year commitment was given to the New York Mortgage Coalition for $50 thousand a year for administrative costs with the understanding that Fleet will make approximately $5 million in loans each year. The program also include "second look" loan restructuring and credit counseling.
- *Micro Loan Program*—A pilot "micro" loan program was initiated in the minority communities of Hempstead and Glen Cove, Long Island, with an anticipated commitment of $150 million to each, plug administrative support.
- *Other Programs in 1992 Include*—$5 million in co-funding for the start-up of a small business development center at Pace Univer-

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sity in Harlem; a $10 million grant for neighborhood housing services.

3-B. New York (Upstate)

- ***Portfolio Lending*—Fleet Bank of New York, in conjunction with the Neighborhood Housing Services, developed a new portfolio mortgage product targeted to low- to moderate-income populations living in distressed areas throughout Upstate New York. A partnership of 32 community organizations participate with the Bank to provide credit and home-ownership counseling and assist in collecting potentially delinquent payments. A commitment of $12 million has been allocated.**
- ***"Second Look" Program*—In February 1992, the Bank implemented a "second look" program to ensure that fair lending practices are consistently in place. The "second look" program entails a second review of minority HMDA related loans by a senior consumer officer before the credit is denied to a minority applicant. Under this initiative, the Bank considers all options or restructuring opportunities through the use of more flexible underwriting guidelines to facilitate mortgage applicants.**
- *Targeted Advertising/Community Diversification*—In 1991, Fleet Bank increased its emphasis on marketing which is targeted to minority communities. New ads, utilization of minority models, advertising in minority publications and the development of poster ads to reach our communities through branch and neighborhood networks have been initiated. Additionally, product brochures have been published in Spanish. Fleet Bank convened focus groups in Albany and Rochester in an effort to learn from minorities how best to serve minority consumers.
- *Workforce Diversification/Outreach*—A full-time employee has been assigned to recruit and develop minority employees. During 1992, Fleet Bank contacted approximately 210 organizations to determine ongoing credit needs (with primary emphasis on affordable housing) through the Bank's Direct CRA Calling Program.

4. Connecticut

- *HART/Frog Hollow First Time Home Buyers Program*—In August 1990, Fleet became a pioneer participant in this Hartford program by making a $1,000,000 commitment. This program is aimed at low/moderate income buyers in Hartford.
- *Southend Institutions Neighborhood Alliance*—This is a $1,000,000 commitment for home mortgages in Hartford.
- *New Britain Neighborhood Preservation Program*—This program is designed to aid homeowners for home improvements with low-interest loans in collaboration with the City of New Britain. Fleet Bank has been involved with this program for 19 years. The total current commitment of the banks is $600,000, with Fleet's share at $85,000.
- *Fleet Banker's Pool with Neighborhood Housing Services of New Britain*—These funds are used for the acquisition and renovation of residential properties with low rates and flexible terms. There is a $1,500,000 total bank commitment with Fleet's share at $215,000.

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- *Thomas Valley Council for Community Action*—The Thomas Valley Council for Community Action (TVCCA), through its Housing Advisory Committee, is involved with housing projects in New London County. Childhood development, nutrition and neighborhood services are also areas of involvement. Fleet Bank is represented on the Finance Committee.
- *Broad Park Development—Hartford*—Fleet financed Jefferson-Seymour, an affordable housing project, in Hartford.
- *Fairfield 2000 House Corporation (F2HC)*—Fleet Bank has committed to a Fairfield County project consisting of 16 homes which are currently owned by the U.S. Army and which will be sold to low/moderate income households. Fleet Bank is represented on the Board of Directors.
- *The Affordable Housing Funds for Connecticut*—This $5 million tax credit fund provides low/moderate income families with affordable housing throughout the state. It has developed 281 units of affordable housing and 7 retail stores in four years. Among its projects are Hartford's Sigourney Mews and Bridgeport's East Main. Fleet Bank is represented on the Board of Directors.
- *New Haven Infill Program*—In collaboration with the City of New Haven, Fleet Bank has committed $1,000,000 to provide home buyers with mortgages for homes constructed on vacant lots in the City.
- Fleet Bank, with Legislative leaders, created the State Home Mortgage Task Force, made up of community leaders, public officials, mortgage lenders and banks. From this group came several home mortgage initiatives:

  A state law that permits interest in real estate escrow funds to be used for private mortgage insurance. The Connecticut Alliance of Homeownership Opportunities was then formed to purchase these loans. $16 million was committed for this purpose by Hartford insurance companies.

  A Review Committee has been created to monitor minority mortgage applications and analyze results on an ongoing basis.

  The State's Mortgage Down Payment Assistance Plan has been rejuvenated and the Department of Housing has taken a more aggressive approach to utilizing funds available.

  A centralized approach to First Time Home Buyers education programs is being developed.

  CHAMP (Connecticut Homebuyers Affordable Mortgage Program), a program of flexible credit standards and low down payments, was created. This program has commitments from banks statewide of over $75 million.

5. Maine

- *Port-Lender Homeownership Project*—Fleet Bank is among five Maine banks who have each pooled $250,000 for the Port-Lender Homeownership Project, a pilot homeowner/landlord program administered by the City of Portland's Community Development Office.

  The project represents a significant public/private partnership between the banks and the City. The program's goal is to improve the stability and livability of 1–4 unit properties in Port-

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land's older neighborhoods by increasing owner-occupied properties and renovating local neighborhoods.

- *City/Bank Housing Rehabilitation Loan Program*—The City of Portland annually receives a Community Development Block Grant under Title I of the Housing and Community Development Act of 1974. As part of their Community Development Program, the City assists low- and moderate-income property owners in the City of Portland.

  Fleet Bank's participation is to provide one-half of the amount of a housing rehabilitation loan, matched by a loan of a similar amount by the City, for eligible one-to-eight unit properties, containing a majority of households with low- and moderate-incomes. The aggregate amount the bank agrees to lend annually is $200.000. Presently Fleet bank has 22 loans totalling $95,000.00.
- *Bangor Hydro-Electric Company Residential Conservation Loan Program*—The purpose of the program is to provide low-cost funds to Bangor Hydro customers for rehabilitation for reducing electrical consumption/costs. Fleet has renewed its commitment to this program for 1992–93, and is the only participating lender underwriting these reduced rate low-cost loans. Current volumes as of 9/13/92 are 21 loans at $72,000.00.
- *Western Maine Land Trust, Six Unit Low-Low Income Affordable Housing Project-Porter Hill Farmington*—Fleet has committed to finance a $75,000 one year construction loan for three of the units, and subsequently finance the units (through FREF). MSHA also plans to finance three units. All six units will follow the MSHA Home Start Program specifications. This project will benefit six low-low income families in the Farmington area.
- *Lewiston Housing Opportunity Zone (HOZ) Program*—Fleet and several other local banks are working with the City's Community Development Director for the purpose of implementing a program similar to the Portland Port Lender's Project in Lewiston. Fleet has committed $250,000 to the project, which will benefit first time homeowners.

6. New Hampshire

- *Seacoast Affordable Housing Proiect*—Fleet is the lead participant in a $100 million commitment to the Seacoast Community Banking Council for a loan pool that supports affordable housing in that region of New Hampshire. So far, we have loaned over $179,000, which has financed 48 housing units.
- *Concord Community Investment Pool*—The bank is also a participant in a $500,000 commitment to the Concord Community Housing Investment Pool, which also provides affordable housing in the Concord area. To date, over $280,000 has been loaned to finance 34 housing units.
- *Neighborhood Housing Services*—It is also active in two Neighborhood Housing service groups in Manchester and Nashua, and participates in loan pools and in providing operating money.

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LETTER TO SENATOR DONALD W. RIEGLE, JR. FROM JEREMY EISLER, STAFF ATTORNEY SOUTH MISSISSIPPI LEGAL SERVICES CORPORATION

February 11, 1993

Dear Chairman Riegle:

I am writing you in connection with your hearings on Reverse Redlining.

In the more than ten years which I have now practiced poverty law in Southeast Mississippi, I can state that I have, with perhaps only one or two exceptions, never had a minority client who had been able to borrow money from a bank to purchase a home. Homeownership in our client community is usually the result of "heir property," that is, from an inheritance. Parodoxically, it seems as if it must have been easier for the last generation to purchase property than for the present generation. Whether or not this is the result of Reverse Redlining I cannot say.

I can, however, state with certainty and without exception that my clients' only avenue for home equity loans is through the numerous finance companies which cater to them. While there are numerous finance companies and pawn shops in the poorer areas of Biloxi, there are—literally—no bank branches.

In part because of physical availability, and in part due to the fact that they are unable to attain loans from conventional institutions, our clients are forced to go to these small loan companies. These companies for a small licensing fee are permitted to charge up to thirty-six percent interest in Mississippi at the present time.

These rates are exacerbated by the finance companies' collateral practice of selling credit life and disability insurance. The companies typically take a commission on the sale of this insurance, and it is priced far above what a comparable term policy would be if not sold in conjunction with the attaining of a loan.

I have attached a copy of a Complaint recently filed on behalf of Andrew and Floretta Wright, along with their loan documentation. The Wright's currently live on Ms. Wright's salary as an attendant in a pay laundry, doing laundry for others on a piece work basis, for which she averages a take home pay of less than minimum wage. While there is a dispute as to what the Wright's income was at the time this loan was taken out (Tower Loan contends that their income was $1480.00) under either figure, the Wright's were clearly unable to afford the exorbitant interest payments called for by this loan.

Given more time to go through old files, and obtain the client authorizations, I could show you many other similar examples, and some even more extreme. However, the lesson to be drawn from these examples would be the same. That is, as long as the banking community is allowed to avoid lending to certain areas and/or classes of persons on grounds that have little or no relevance to credit, these people will be forced to borrow at predatory interest rates. The consequence of this is not that they are not able to purchase homes, but that those homes such as the Wright's, which have been preserved in the family for one or more generations, will be lost.

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I would urge this committee to put some serious teeth into the Community Reinvestment Act. I would also urge it to consider requiring in addition to the mandated disclosure that the credit life insurance is optional, an additional requirement—disclosure that the lender will finance credit insurance purchased from another provider. This would go far to introduce competition into an area in which it is now conspicuously absent.

Thank you for your courtesy and consideration of this letter and attached material.

LETTER TO SENATOR DONALD W. RIEGLE, JR. FROM ELIZABETH RENUART, MANAGING ATTORNEY ST. AMBROSE LEGAL SERVICES

February 17, 1993

Dear Senator Riegle:

I am the managing attorney at St. Ambrose Legal Services. Our program was established in 1988 as a response to the fact that thousands of Marylanders have bean severely injured by unsolicited door-to-door sales of some home improvement companies and of loan companies who associate themselves with these contractors. We have served almost 1,200 citizens since that time.

Some lender practices we have observed include the following: requiring homeowners to refinance any and all existing mortgage loans as a part of making the new loan even if the homeowner is not behind, homeowners are not told that it is not to their advantage to refinance as the existing loans carry a much smaller interest rate and the lender becomes the first mortgage holder; where the lender is directly involved (as opposed to those where the contractor is the lender and then immediately sells the paper to a lender), settlement costs are extremely high with points ranging from 8 to 33 percent of the amount financed; while Maryland's usury rate is 24 percent, some lenders charge in excess of this due to the federal preemption under the Depository Institutions Deregulation and Monetary Control Act of 1980 which applies to nonpurchase money mortgages.

Some home improvement contractor practices include the following: taking a mortgage in the home with little regard as to whether the homeowner can actually afford the work, misrepresentations as to whether work is actually needed, the quality of work to be done, and what work will be done if the contract is signed; failing to disclose, and in some cases lying about, the fact that the homeowner is signing a mortgage, charging unconscionable prices, doing grossly inadequate work; and, falsely notarizing critical documents. Our clients are frequently targeted because they are often older, illiterate and economically marginal homeowners who own one thing in their lives: their $10,000 to $30,000 home.

An example is illustrative: A forty-six year old woman with a ninth grade education was able to buy a home in Baltimore in 1986 through a low-interest loan program for $7,800. In 1989, a home improvement company solicited her business. She purchased security doors and windows because she was concerned for her safety

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due to the fact that a number of robberies had occurred in her neighborhood.

The home improvement contractor told her that she would have to consolidate her mortgage loans in order to get a loan to finance the work. In order to finance the $11,000 contract (the work was only worth about $5,000), she paid closing costs of approximately $2,338.91 and points to the lender totalling $3,605.33. The amount of the loan was $19,000. She was charged a variable interest rate starting at 15 percent. The total interest projected was $21,529.71 over, a ten year term. The total of payments disclosed was $36,784.80. She had no contact with the lender until the day of settlement. She was taken there by the contractor and was given a gift from him after the papers were signed. There were problems with the work for which she was reimbursed after filing a complaint with the Maryland Home Improvement Commission.

Other examples abound: A disabled, 61 year-old homeowner who lives on a fixed income borrowed from a mortgage company. As a result, she found herself with a 15 year mortgage at an annual interest rate of over 24 percent with monthly payments of $411.66, over two-thirds of her monthly income. She was obligated to pay $74,098.80 in interest and principal.

An 84 year-old resident of Baltimore owns the house in which she lives. As a result of a transaction with a home improvement company and a lender, she unknowingly signed a mortgage which obligated her to pay $39,686.40 in principal and interest for the improper installation of two exterior doors and a sink, and refinancing of an $8,000 loan.

Unfortunately, the relatively unregulated loan market in Baltimore has allowed homeowners to be taken advantage of by those who are willing to make money at any cost to the innocent and trusting public.

Thank you for the opportunity to share this information with you.

LETTER TO SENATOR DONALD W. RIEGLE, JR. FROM WILLIAM E. MORRIS, DIRECTOR OF LITIGATION SOUTHERN ARIZONA LEGAL AID, INC.

February 18, 1993

Dear Senator Riegle:

We are advised that your Committee is now holding hearings on abuses in the mortgage brokerage industry and possible legislative remedies. We appreciate this opportunity to provide the Senate Banking Committee with further information on the subject and concrete suggestions for Congressional action.

In the early eighties, several private law firms joined our office as counsel for borrowers in a number of federal and state lawsuits, including a statewide, federal class action, against the five principal mortgage brokers then doing business in Arizona. The litigation and subsequent State investigations generally revealed the same patterns and practices among those companies:

1. The brokers advertised real estate-secured loans on "homeowner" or other enticing, but meaningless terms.

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2. The typical customer was an inexperienced borrower with little sophistication in financial matters. Most sought loans for outright necessities (e.g., medical care) or in an attempt to consolidate household debts. Two hundred fifty defense depositions in the class action revealed that a solid majority thought they were borrowing from brokers, on reasonable terms.

Brokerage staff had practiced methods of formally disclosing loan terms, while deflecting attention from their substance and significance. In addition, borrowers were given written representations calculated to allay foreseeable anxieties and commonplace concerns. All were materially misleading and in some instances, simply false.

3. Virtually all of the thousands of loans in litigation required short-term balloon payments, due as little as thirteen and never more than thirty-seven months after the closing dates. Relatively few borrowers could obtain loans from third parties to pay balloons as they came due—usually to the considerable consternation and genuine surprise of the average debtor. Practically none could meet balloon payments on their own. A majority either lost their homes after the balloons became delinquent or, more commonly, refinanced them through the same brokers, thus trapping themselves on the "financial treadmill" described by the California Supreme Court in the *Wyatt v. Union Mortgage* case.

4. Most loans contained or were subject to undisclosed charges, representing pure profit to the brokers (e.g., if one monthly payment was subject to a bonafide late charge, all subsequent ones were automatically treated as "late," with corresponding monthly penalties incurred at deregulated interest rates). Brokerage fees seldom fell below an average ten points on transactions typically financing more than $10,000. Exorbitant fees were charged for "brokering" loans funded by relatives of the firms' owners or by their own employees.

5. With that exception, most lenders were nearly as unsophisticated and, certainly, as deceived as a solid majority of borrowers. The SEC determined that in effectively inducing lenders to purchase deeds of trust on their borrowers' realty, the brokers engaged in the sale of securities on *per se* fraudulent terms, promoted through deceptive acts and practices.

6. The principals in some brokerage firms were indicted and convicted on related felony charges. Others declared bankruptcy, or simply vanished from the state. Several thousand lenders of comparatively modest means were left to protect their "investments" through direct—and often unsatisfactory—dealings with impoverished borrowers, hundreds of whom lost family homes.

We had hoped that this dismal experience would not be repeated. We have mounting evidence, however, that mortgage brokers in Tucson and Phoenix turned to similar business methods not long after the collapse of their major competitors.

Recent abuses simply appear somewhat more sophisticated and better concealed: Local mortgage brokers lately have acted as fronts for Fleet Financial and it appears, other national consumer finance companies, as well as for consortiums of individuals, trusts and partnerships regularly "investing" in second mortgage loans on terms the lenders invariably dictate. The fees, charges, balloon payments and other terms of these loans are at least as egregious as

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any we encountered a few years ago and, in some instances, more so.

We are convinced that federal regulation of the variety noted below is necessary—if not essential—for these reasons in particular:

a) There are over 1,100 licensed mortgage brokers in Arizona alone. We firmly believe that it has already become far too easy to obtain a license from the State Banking Department, which lacks the resources to scrutinize the backgrounds, prior business practices or substantive qualifications of most applicants. State law nonetheless contemplates that the average applicant will receive a license on meeting minimal requirements few fail to satisfy.

We therefore advocate:

i) Adoption of federal licensure standards specifying mandatory minimum qualifications and requiring adequate state scrutiny of all applicants.

ii) A moratorium on licensure of new applicants, pending full implementation of the federal licensure and other regulatory requirements suggested below.

iii) A specific requirement that additional licenses not issue thereafter, except on a sufficient showing that a genuine economic need exists for new brokers in the applicants' proposed service areas (the Uniform Small Loan Act has long conditioned approval of license applications from consumer lenders, seeking to enter new markets, on such a showing).

iv) Determination of whether brokers licensed under state law, as of the effective date of the federal enactment, subsequently brought themselves into compliance with federal licensure standards, after due notice and a reasonable opportunity to do so. If not, mandatory license revocation proceedings would commence.

b) In Arizona and, our colleagues advise, other jurisdictions, state regulation of the mortgage brokerage business ranges from decidedly limited to essentially nonexistent. Here and elsewhere, the regulatory hiatus is a function of both inadequate state resources and local legislation that could scarcely be more accommodating of brokers. We therefore advocate:

i) Adoption of federal provisions that would outlaw brokered balloon payment loans secured by owner-occupied dwellings; prescribe penalties for the imposition or exaction of undisclosed or concealed charges (e.g., forfeiture of all such amounts together with interest earned on them); mandate forfeiture of brokerage fees on insider loans (i.e., those funded by relatives or employees of the broker's owners); prohibit brokers from acting on behalf or at the direction of undisclosed principals, with forfeiture of all loan charges and interest mandatory in the event of a violation; and declare that brokers subject to the new Congressional enactment owe a fiduciary duty to borrowers and legitimate lenders alike.

ii) The foregoing provisions be enforceable in original actions against brokers, brought by both borrowers and lenders, as applicable.

iii) License revocation proceedings be made mandatory, in the event responsible state agencies acquire sufficient, pro-

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bative evidence that brokers have violated the aforementioned prohibitions on balloon payments, hidden charges, insider lending and/or representation of undisclosed principals.

iv) The FTC be directed to enforce provisions of the new legislation, on receipt of substantial complaints from consumers, requests from state authorities or in other appropriate circumstances.

We greatly appreciate your attention to this urgent matter and to our remarks.

LETTER TO SENATOR DONALD W. RIEGLE, JR. FROM ELIZABETH BRADFORD & MARLA TEPPER ASSISTANT ATTORNEYS GENERAL STATE OF NEW YORK, DEPARTMENT OF LAW

March 9, 1993

Dear Senator Riegle:

We are submitting this letter in connection with your recent hearings on predatory lending practices in the home mortgage area. This topic has been of concern to the New York State Attorney General's office since we began receiving, several years ago, complaints from homeowners who had been duped into signing away the equity in their homes, or, even unwittingly transferring title to their property. While these fraudulent financing arrangements vary, they all have at least two things in common—they tend to thrive in credit-starved neighborhoods and they cause massive hardship by threatening what is for most consumers the keystone of their financial and emotional security: their homes.

One type of fraudulent financing that has prompted both litigation and state legislative proposals by our office involves the use of the retail installment obligation to finance home improvements. Unlike a traditional home equity loan, a retail installment obligation ("RIO") purports to be a credit agreement directly between the homeowner/borrower and the provider of the good or services—in this case, the home improvement contractor. The RIO, along with the mortgage agreement that secures it, is actually routinely assigned to a bank or sales finance company once the job is completed and then frequently resold to other lending institutions; the contractors themselves are rarely in the business of extending credit, particularly for the 10 to 15 year periods frequently covered by the RIO's. The practice of assigning the RIO and mortgage agreements is so well established that these form financing documents are usually designed and printed by the bank or sales finance company, bearing its own logo, and are provided to the contractors for their use. Contractors are referred to as "dealers" by the finance company and are paid directly and in full by the finance company at the time the job is completed. The loan is reassigned by the finance company, usually to a bank, immediately after payout to the contractor.

The contractor uses his affiliation with the lending institution to help him sell his remodeling job, much as a car dealer offers to arrange financing so that he can quote the customer a monthly price for the vehicle that will fall within his budget. Typically, the con-

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tractor enters the customer's home armed with a packet of forms from one or more finance companies or banks and a "ratebook" which enables him to calculate monthly payment and total payment figures, based on the "going" interest rates or rates that are periodically communicated to the contractor by the bank or finance company. Once he has negotiated and executed the work contract with the homeowner, the contractor will take the homeowner's credit information and, at the same time, secure his signature on the RIO and the mortgage agreement and provide him with a notice of his right under the federal Truth In Lending Act ("TILA") to rescind the credit transaction within three business days.

Upon leaving the consumer's home, the contractor calls the credit information into the bank or sales finance company. A few days later, the contractor is notified that the consumer's loan has been approved or disapproved. However, the terms of the loan may be different from those originally offered to the homeowner by the contractor and stated on the RIO. While federal law requires the contractor to wait for the three-day recision period to expire before commencing work, it does not expressly require him to wait for loan approval in the event that such approval should take longer. Thus, it is possible for the homeowner to find himself in the position where he must either find the cash or alternative financing to pay for a remodeling job in progress, or be forced to accept more onerous credit terms than those that were initially represented to him. Moreover, since the finance company's initial approval is usually "subject to" proof of income and an up-to-date first mortgage at the time of payout, even a homeowner whose loan has been approved on the terms originally represented may later find himself with problems if these "subject to's" are not met.

At some later date, ostensibly upon completion of the home improvement job, the contractor secures the homeowner's signature on a completion certificate stating that the work has been done to the homeowner's satisfaction. The contractor provides the completed finance documents to the bank or sales finance company, which then conducts a tape recorded telephone conversation with the homeowner to verify that the work is finished and the contractor can be paid. These telephone conversations generally fail to fully disclose the terms of the loan and are frequently designed to pressure the homeowner into agreeing to the payment although the work is not complete. In addition, many of the finance documents presented by the contractors to the sales finance company contain incomplete or incorrect TILA disclosures. While those inadequacies are generally "rectified" before the paper is accepted, they are rectified at a time when the work is complete and the homeowner no longer has a meaningful opportunity to change his mind.

The most significant feature of this form of home improvement financing transaction, from a consumer protection standpoint, is that the contractor, and not the homeowner, controls the flow of credit information between the homeowner and the lending institutions. In many cases, the homeowner has no direct contact with the bank or finance company until he receives the phone call to verify completion—that is, after the work is done and the credit agreement and mortgage have become binding. The typical "closing," such as it is, takes place at the consumer's kitchen table at the

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same time that the work contract is negotiated and signed and the consumer's credit information is taken.

This type of financing arrangement presents many opportunities for fraud. The setting lacks the formality that most consumers associate with taking out a mortgage. In this setting, the unscrupulous contractor can therefore easily dupe the homeowner into signing a stack of blank financing documents under which the mortgage agreement has been artfully concealed. Moreover, most consumers expect that they will receive a response to their credit application before being bound to any credit agreement. That they could be obligated to accept a credit arrangement that has not, in reality, yet been offered to them, defies common sense.

We became aware of this deceptive form of financing, when we began to receive complaints against a sales finance company called The Dartmouth Plan, which was based on Long Island but did business in 30 states. As an "originator" of home improvement loans, Dartmouth was in the business of marketing retail installment obligations as a means of financing home improvements, relying on an extensive network of contractor/dealers to carry Dartmouth paperwork with them into the customer's home.

The availability of Dartmouth financing provided its contractors with enormous leverage, particularly in low-income neighborhoods. A $40,000 addition, which could not be sold as such to a family of limited means, living in a neighborhood largely deprived of traditional sources of credit, could be marketed as a $185-a-month job for which financing could be "arranged."

The contractors frequently failed to leave copies of the finance documents and/or had them signed in blank, filling in the credit terms after leaving the consumer's home. As a result, the homeowners remained unaware of basic terms of their financing including the actual interest rate they would be paying, the length of time over which they would be paying and, of course the total amount they would pay over time. Most common of all, however, were complaints from consumers who discovered, sometimes years after the fact, that Dartmouth had liens on their property due to mortgage agreements they had no recollection of ever having signed. To add insult to injury, many of the home improvement jobs proved to be defective or incomplete, forcing homeowners to incur additional expenses even as they sought to cope with the burden of a debt that had been improperly disclosed. Dartmouth did virtually nothing to monitor the activities of its contractors and virtually never terminated a contractor, regardless of the volume or gravity of the customer complaints against him.

In addition to the marketing power that they derived from this arrangement, and the opportunities to defraud their customers, the contractors benefited in a number of other ways—most of them at the homeowner's expense. Contractors who were able to impose a higher interest rate on the consumer than the lending institution required were permitted to keep some portion of the difference, which provided the contractor with a powerful incentive to defraud homeowners. Contractors who could not coerce or deceive the customer into accepting an interest rate high enough to satisfy the lending institution were paid less by the lending institution than 100 percent of the work contract price—but were taught how to re-

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coup this loss by inflating the contract price charged to the customer.

The victims of Dartmouth's predatory lending tactics homeowners run the gamut from homeowners who were deceived into bypassing the other credit options they undoubtedly could have pursued, to low income homeowners who could not afford the grossly overpriced improvements for which they were charged and would not have received credit, but for the substantial equity they had in their homes. Low income and minority neighborhoods are disproportionately represented in the customer base of companies like The Dartmouth Plan.

These consumers suffered extensive injuries. They suffered a dramatic reduction in their ability to borrow funds by virtue of mortgages to which they never consented. They paid exorbitant interest rates of which they were unaware at the time of financing. They received adverse credit ratings, suffered the humiliation of being dunned and the anguish of being sued, all because of their inability to meet obligations which were never properly disclose. They lost their homes through foreclosures of mortgages they never knew they had.

The Attorney General's office sued The Dartmouth Plan in late 1990, along with the company's owners and several of the banks that bought the loans and mortgages from Dartmouth. Predictably, the banks have asserted that they should bear no liability for the allegedly fraudulent conduct of Dartmouth and its dealers notwithstanding the considerable profits they have made merely by holding these obligations. The suit is presently pending in the Federal District Court in Brooklyn.

In addition to the suit against Dartmouth, the Attorney General's office has proposed state legislation that would reduce the potential for abuse in the area of home improvement RIO financing. The bill would require that finance companies communicate directly with homeowners concerning the terms of their financing whenever a mortgage is taken as security for a home improvement retail installment contract or obligation. The bill would also make it clear that home improvement financing documents cannot be executed in advance of credit approval by the finance company, and that the home improvement contract is contingent on credit approval and on the homeowner's acceptance of the proffered credit terms.

Notwithstanding our state proposals, it is apparent that solutions to these predatory practices must be national in scope. It has become increasingly obvious, as major scandals involving predatory lending and home improvements erupt in various parts of the country, that the problem is not confined to one or even a few localities. Many of the sales finance companies and most of the banks that originate home improvement loans operate in several states and would benefit from uniformity in regulation. In enacting TILA, Congress recognized that closed-end credit should be regulated at the federal level. Accordingly, TILA provides a useful, existing framework for addressing some of these problems. TILA should be strengthened and clarified to acknowledge that the home improvement contract and the dealer-arranged financing are part of a single transaction, to improve disclosure, and to enhance accountabil-

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ity to the consumer of the various lending institutions that stand—or in many cases hide—behind the home improvement contractors in their dealings with the public.

At a minimum, such legislative changes should expressly require that clear and conspicuous disclosure of the mortgage agreement, in language specifically mandated by statute, be made in any RIO secured by a lien on residential property. They should also clearly mandate that a copy of the mortgage agreement be left with the homeowner at the time he signs it. Currently, TILA does not specifically require that the customer receive a copy of the mortgage agreement. Many lending institutions rely on the absence of specific language imposing this requirement and omit a customer copy of the mortgage agreement from the form financing packet with which they supply their dealers. This practice is contrary to the intent of TILA and conflicts with some state court decisions, but underscores the need to clarify the law.

In addition, the legislation should provide that, in any case in which the contractor/dealer offers to arrange financing:

- the RIO may not be signed nor the three-day right to rescind permitted to commence until final, non-contingent loan approval has been communicated by the lender to the customer;
- the work contract will be deemed contingent on consummation of a final and binding loan agreement and the contractor/dealer expressly required to delay his performance pending such consummation;
- any and all financial arrangements between the contractor/dealer and the lender that are directly or indirectly applicable to the loan in question must be separately disclosed to the customer at or before the time that the retail installment obligation is signed—including any incentives, bonuses or discounts to be paid by or to the dealer.

In addition to victimization by companies such as Dartmouth, homeowners who are financially distressed—particularly those who are elderly, poor, uneducated and financially unsophisticated—are increasingly the victims of fraud, deception and unfair dealing by agents who solicit homeowners and who represent that they will help homeowners to avoid foreclosure or the indebtedness leading to foreclosure. These agents, broadly called "mortgage foreclosure consultants," may seek to provide financial advice or loans to homeowners for a fee.

More often, however, the consultant engages in a variety of tactics that seldom assist the homeowner and that result in title to the home vesting in the foreclosure consultant. For example, complaints from homeowners and from legal services organizations allege that foreclosure consultants have induced homeowners to sign over to such consultants the deeds to their homes while promising that the homeowners can lease their homes with later options to repurchase. This practice is commonly called a sale and leaseback arrangement. Many homeowners cannot afford the lease payments and subsequently face eviction.

One of the cruel ironies of such a situation is the fact that the homeowner, relying on the foreclosure consultant's promise of help, often is diverted from taking other action or from turning to legitimate businesses which could render beneficial or more productive

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services. Consultants often scour court records to obtain the names of homeowners facing foreclosure and frighten such homeowners into believing they have no other option but to rely on the consultant.

The tactics engaged in by Swiss Conservative Group ("SCG"), a Connecticut based company that preyed on financially distressed New York homeowners, are illustrative of the fraudulent practices of mortgage foreclosure consultants. SCG advertised that it could help consumers who were facing foreclosure save their homes. SCG sought consumers with small mortgages and substantial equity in their homes. Many of the consumers who turned to SCG were in desperate positions due to illness or unemployment, or were dependent upon fixed incomes due to disability or retirement.

When consumers met with SCG's agents, they assured the consumer that SCG could assist them with refinancing their original mortgage. SCG further represented that the consumer's home would be saved, there would not be any payments for two years and the new payments would be lower than the current mortgage payments. More importantly, consumers were told that they would receive a large amount of cash from the transaction, enabling them to pay off outstanding debts.

Consumers were told that their house would have to be "transferred" to either the wife, using her maiden name, or to a third party who was either a relative or "straw man" provided by SCG. SCG had documents for the purported sale of the house, and had mortgage applications, usually prepared from mainstream banks, prepared with false information. A large mortgage was then taken out on the property the wife or third party was allegedly "buying."

Consumers were told that they had to use an attorney provided by SCG at the closing, where consumers had no idea what was taking place. Sometimes, the consumers were directed to sign blank documents, and at other times, consumers were not allowed to read or review the documents before signing them. SCG assured consumers that the transaction was legal.

Most consumers left the closing without receiving any money from the mortgage proceeds. It was only after the closing, that those consumers who received any documents at all realized that SCG had taken a substantial fee. Within a few months of the closing, consumers received notices for mortgage payments from the bank. This was shocking to them, because they were led to believe that payments would not begin for two years, and, more importantly, the new payments were often double the amount of the previous payments which they were having trouble making.

Additionally, consumers were told that after the closing, title would be transferred back to them, but that never occurred. In fact, foreclosure proceedings were commenced either by SCG or the banks. Consequently, many of the consumers once again face the imminent loss of their homes, the equity they had in the property no longer exists, and they are precluded from seeking legitimate refinancing since they are no longer the owner of record.

The Attorney General brought suit against SCG and its principals in 1992. The case is currently pending in Supreme Court, New York County.

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The Attorney General has also introduced state legislation which would regulate the activities of mortgage foreclosure consultants. Our proposed legislation would lessen the potential for fraud and abuse engaged in by foreclosure consultants by prohibiting consultants from entering into contracts with homeowners for a sale and leaseback with an option to repurchase and from facilitating sales of the homeowner's property to third parties involving the sale and leaseback technique. The proposed legislation further prohibits representations that tend to mislead; requires foreclosure consultant contracts to be in writing and permits rescission of such contracts.

The proposed legislation would further require all notices of default and letters, written notifications or warnings related to potential default on a mortgage obligation to have appended thereto a notice expressly advising homeowners of their rights and options if they face foreclosure. This section would alert the mortgagor to various sources of legal assistance that might be helpful and to possible alternatives to foreclosure. In addition, the notice would highlight that in the event of a foreclosure sale, the mortgagor might be entitled to surplus revenues from the sale if the indebtedness is satisfied, but would remain obligated for the debt that remains unsatisfied. Significantly, the notice cautions the homeowner from the outset to be wary of solicitations by individuals or entities purporting to offer assistance.

As with the abuses in the home improvement loan origination business, tackling the fraud perpetrated by mortgage foreclosure consultants requires increased federal regulation. In many instances, mortgage foreclosure consultants are thriving simply because mainstream banks and lending institutions will not directly extend needed financing to distressed homeowners. The loans or financing obtained by mortgage foreclosure consultants are, however, from these same legitimate lenders. Thus, legitimate lenders may be benefitting from the scurrilous practices of mortgage foreclosure consultants. Congressional scrutiny of the mainstream lenders' practices is therefore necessary to determine the extent of their awareness of the practices from which they are benefitting and their culpability. Increased regulatory measures, including mandatory disclosures and heightened review of the practices of intermediaries (such as mortgage foreclosure consultants) by the lenders, may be warranted.

Through continued state enforcement and legislative initiatives we hope to limit the practices of predatory lenders in New York State. Congressional action is necessary, however, to eradicate this problem and to ensure that low-to-moderate income homeowners are able to retain their homes.

LETTER TO SENATOR DONALD W. RIEGLE, JR. FROM TROY B. SMITH, HOMEOWNERS OUTREACH CENTER LEGAL AID FOUNDATION OF LOS ANGELES

February 7, 1993

My name is Troy B. Smith and I am the Directing Attorney of the Greater Watts Justice Center and the Homeowners Outreach Center, which are both affiliated with Legal Aid Foundation of Los

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Angeles. The Greater Watts Justice Center and the Homeowners Outreach Center have been in existence since the late 1960's. Our office primarily provides, at no cost, legal services to poverty, low- and moderate-income residents of the city of Los Angeles. Legal Aid Foundation of Los Angeles has several offices which serves a majority of poverty and low-income residents of Los Angeles County.

Our office's major focus is in the area of home equity fraud and home improvement loan fraud due to its proliferation during the last ten years in the poor and minority communities across the country. As I am sure will be illuminated by the testimony before this body, home equity and home loan fraud has spread and is spreading like a disease which is out of control.

One of the major reasons why entities and individuals perpetrating home equity and home loan fraud are allowed to flourish in poor and minority communities of Los Angeles and across the country is that major banks are not providing any measurable access to home equity or home improvement loans to those communities.

What is significantly absent is a loan program developed to satisfy the specific credit needs of poor and minority communities. Often, individuals only need loans of $500, $1,000 or $2,000 to satisfy an urgent and immediate need and are capable of repaying the loan. A home owner is often persuaded by a representative of a loan company or a construction company to take out a home equity or home improvement loan for an amount far exceeding the amount that the homeowner can afford or needs. The homeowners' equity is substantially diminished by unnecessary and exorbitant loan amounts which pay for broker commissions exceeding 20 percent of the loan amount as well as many loan fees for services never rendered. Interest rates exceeding 25 percent are commonplace.

The major banks need to establish a serious, long range, comprehensive and sustained commitment to offer home and home equity loans and other consumer loan programs for the poor and minority communities. This effort includes advertising in all local minority owned newspapers and radio stations, and other nontraditional communication avenues (i.e. flyers and posters).

An example of an actual case of home equity problems involves a 51 year old African-American male who is a South-Central Los Angeles resident, and was forced to borrow $10,000 from a hard money lender. A hard money lender is an entity or individual who loans a certain amount of money to someone who has had a "hard" time in getting a loan and the hard money lenders' rates far exceeds that of mainstream banks and savings and loans. Additionally, most hard money lenders offer very onerous terms which are ultimately accepted by a borrower because they are desperate.

This individual has an income of approximately $24,000 per year, and owns a home with substantial equity value.

This gentleman initially approached a Bank of America branch for a loan, but due to the numerous documents requested and the extended period of processing time taken by Bank of America, he accepted a loan offer from a hard money lender.

This lender had made several calls to the borrower's home and had sent him several letters. This gentleman borrowed the money and diligently made his monthly payments for three years. At the

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end of the three years, he discovered that he still owed $10,000 which was due as a balloon payment.

This man was an obviously credit-worthy individual making interest-only payments on a bad loan when he should have received a loan from a bank at more reasonable rates.

Another example involves Ms. Inza Bradley, an 81 year old African American homeowner who bought her house with her husband in Los Angeles, California in 1937. The Bradleys fully paid off their loan on the house in 1950. They raised their children in this home, and have been upstanding community members.

Because of the need for home improvement and other needs, the Bradleys had taken out four loans on their home.[1] In May 1990, Mr. and Mrs. Bradley, ages 81 and 79 respectively, sought out the loan broker named Bonded Home Loans, to consolidate their existing four loans. Their decision to consolidate these loans was primarily based on their desire to make one payment instead of four, and possibly, to make a smaller monthly payment.

Although Bonded gave the Bradleys the impression that they would consolidate all four loans, the ultimate outcome is that only loans #2 and #3 were refinanced. Loans #2 and #3 were amortized loans, with a payoff of $70,000, and $1,020.73 per month in payments. The new loan brokered by Bonded was for a $88,150 loan, with $11,900 in commission to Bonded, and interest only (no payments affecting the principal), payments of $1,128.32 per month, for 35 months culminating in one balloon payment of $86,450.17. Bonded's documents show that they estimated $4,015 cash would be paid to the Bradleys as part of the deal, but Ms. Bradley alleges that she never received such monies. In essence, the Bradleys gave up two amortized loans at lower monthly payments, for one interest only, balloon payment loan at a higher monthly payment. It is quite evident that there was absolutely no logical reason for the Bradleys to enter into a financial transaction which was far worse than their preexisting obligation to their prior lenders.[2] Thus, simply from the paper work reflecting the loan transaction between the Bradleys and Bonded, it seems highly probable that the Bradleys were taken advantage of by their loan broker.

In September of 1992, Mr. Bradley committed suicide at the age of 83. At that point, the Bradleys were in foreclosure for their home, and Ms. Bradley was in failing health. Ms. Bradley is convinced that the realization that the balloon payment was due in a few months, which potentially threatened to render the Bradleys homeless, significantly contributed to her husband's depression, and ultimately, his death.

During the foreclosure period, Bonded promised to redo the loan several times at more favorable terms, but canceled every meeting with the Bradleys immediately prior to the date scheduled for the Bradleys to sign the new loan. Such tactics effectively kept the Bradleys from seeking other means of refinancing or selling the

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[1] Mr. and Ms. Bradley had four loans prior to their present status: Loan #1: $20,260, $256.35 per month w / Bank of America; Loan #2: $37,490, $595.51 per month w / Home Budget Loans; Loan #3: $25,000, $425.22 per month w / Home Budget Loans; Loan #4: $12,350, $259.57 per month w / Home Budget Loans—Total monthly payment of $1,536.65.

[2] Today Ms. Bradley's loans come out to: Loan #1: $20,26'0, $256.35 per month w / Bank of America; Loan #2: $12,350, $259.57 per month w / Home Budget Loans; Loan #3: $88,150, $1,128.32 per month w / Bonded Home Loan.

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property, and kept them in foreclosure. Since the death of her husband, Ms. Bradley's sole income is $324.00 per month from Social Security.

Presently, Ms. Bradley, has fallen behind on the loan from Bonded, the balloon payment is presently due, and Bonded is foreclosing on the property. Ms. Bradley has filed Chapter 7 Bankruptcy, and the trustee sale, the process in which the property is sold to the highest bidder at a public auction, has been stayed by the Bankruptcy Court.

The Los Angeles Times wrote an article in its Sunday edition of February 7, 1993 concerning con artists and the most common tactics used to access the equity of homeowners. Most of the victims discussed in the article are clients of the Greater Watts Justice and Homeowner Outreach Center, including Arlene Parkinson, and have a horror story to tell. Attached is a copy of the article printed in the Real Estate section of the Los Angeles Times Sunday edition.

Recommendations for addressing the problems associated with home equity and home improvement loan fraud are as follows:

(a) Propose legislation to require that no home equity or home improvement may be consummated until the homeowner has an independent individual, i.e., attorney review the loan documents and submits a letter to that effect;

(b) Take an aggressive, and pro-active approach to reach prospective borrowers and inform them of their rights and how to avoid being a victim;

(c) Eliminate balloon payments for residential properties;

(d) Create and assist new and existing institutions with the specific focus on making loans to individuals for consumer or home loans and for small businesses in the poor and minority communities;

(e) Limit the number of points that can be charged on loans for residential property;

(f) Place a cap on the interest rate that can be charged for loans secured by residential property;

(g) Federal criminal prosecution of perpetrators of home equity and home loan improvement fraud.

THE POOR PAY MORE . . . FOR LESS
PREDATORY HOME IMPROVEMENT LENDING

A REPORT BY THE CITY OF NEW YORK, DEPARTMENT OF CONSUMER AFFAIRS, MARK GREEN, COMMISSIONER

I. Summary: Predatory Lending Hits New York

Working hand-in-glove with finance companies, a swarm of home improvement contractors have fleeced thousands of lower-income and minority New York City homeowners in recent years by tricking them into approving mortgages to finance remodeling; the homeowner often does not realize they even have a mortgage and the renovations are sometimes done so poorly they have to be ripped out. In other instances, the homeowner knows about the mortgage but has no leverage to demand the contractor return to make repairs because the finance company has already paid him.

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And in still other cases, homeowners who understand they do have a mortgage and who have no complaint about the home improvement work are being exploited through mortgage interest rates twice what they would pay if they borrowed directly from a bank, which redlining of their neighborhood has made unlikely.

The established banking community, including several of New York City's major banks, have been financing these practices by purchasing such inner-city home improvement-related mortgages from the finance companies.

On February 15, 1991, the Department of Consumer Affairs (DCA) announced revocation of the home improvement contractor license of Harbor Crest, Inc. Harbor Crest tricked retired housekeeper Mattie Hill into signing a home improvement mortgage for $120,000 when she was told all it would cost was $3,700 to fix her porches, doors and windows. Hers and similar cases, and the fact that DCA receives more complaints against home improvement contractors than against any other kind of business, prompted this comprehensive investigation of predatory lending, involving equity fraud or shoddy workmanship, or both.

Our review of Department records, an extensive examination of mortgage records in the offices of the New York City Register, inspection of Harbor Crests' own case files, and interviews with experienced home improvement contractors and community activists, produced the following findings:

- **The working poor and homeowners eking by on Social Security are the most common victims of predatory lending.** Home improvement contractors solicited as contractor/dealers by finance companies talk homeowners into agreeing to over-priced remodeling work. They then cajole or trick them into signing mortgage documents they carry with them on their sales rounds. Financing is invariably for project's entire selling price with no money down.
- **The work these contractor-dealers complete is often done poorly or with low-quality materials.** In some cases, the workmanship is so poor it reduces the value of the home and the affected rooms are made unlivable. But the contractor is often paid the entire contract amount by the finance company before the work is ostensibly complete and, occasionally, even before workmen arrive. The homeowner is left with no leverage to force the work to be completed or redone.

  It is also common for the contractors, through the financer, to lend more money than is required for the remodeling work, with the extra funds to be used to pay off debts. In such situations, the homeowner is hesitant to complain about the quality of the work, for fear that the contractor and financer will not give them the extra money.
- **Through home improvement contractors, finance companies have written at least 32,000 mortgages in lower-income and/or minority New York City neighborhoods since 1985.** The biggest financers have included Sterling Resources of Garden City; the now-defunct Dartmouth Plan of Garden City; Capital Resources Corp. of Clifton, New Jersey and Oxford Resources/Oxford Credit Corp. of Woodbury, New York.

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To a lesser extent, the following companies have also worked with contractors in the same lower-income neighborhoods: General Home Services, Inc. of Woodbridge, NJ; Radcliffe Resources of Commack, NY; Madison Resources of Security Pacific Realty Corp., a unit of Security Pacific National Bank; Bencharge Credit Services of New York, Inc., a subsidiary of Beneficial Finance; Avco Financial Services of New York, Inc., a subsidiary of Textron, Inc.; Ford Consumer Finance Co., and Chrysler First Financial Services, both owned by the auto makers.

We estimate that Sterling Resources Ltd. alone wrote a minimum of 4,000 New York City mortgages since 1985, virtually all in lower-income or predominantly minority neighborhoods, averaging $12,500 each and together worth at least $65 million. The company was also active on Long Island: from 1988 to 1990, Sterling wrote more than $45 million worth of mortgages on properties in predominantly African-American and Latino Long Island communities such as Freeport, Hempstead, Roosevelt and Wyandanch.

Oxford Resources Ltd./Oxford Credit Corp. entered into more than 12,000 mortgages in New York City. Oxford Credit was sued by the Connecticut Attorney General in 1990 for deceiving homeowners in minority neighborhoods into signing its mortgages for remodeling work. A similar action was brought against The Dartmouth Plan in 1991 by the New York State Attorney General; we have determined that Dartmouth wrote at least 4,200 New York City mortgages in the 1980's. And Capital Resources Corp. wrote nearly 7,000 New York City mortgages, virtually all in lower-income neighborhoods, since 1985.

We have not concluded that all—or even most—of the mortgages these companies wrote were fraudulent or were to pay for shoddy work or renovations that were never completed. However, since the financers did concentrate on homeowners in lower-income neighborhoods who were especially vulnerable to fraud, abuse and manipulation, and since many of the contractors who procured these mortgages were the subjects of numerous consumer complaints filed with DCA, and approximately half of the contractors we have identified have had their DCA contractor licenses revoked, it is likely that at least several thousand of the mortgages were, indeed, procured under questionable circumstances or financed shoddy and incomplete work. At the least, these homeowners paid very high interest rates for their home improvements compared to rates available directly from a bank.

- **Interest rates on these mortgages ranged from 14 percent to an extraordinary 21.6 percent.** Why so high? Because high-interest rate lenders such as Sterling Resources and Oxford Resources have been practically the only financers of home improvement work in lower-income communities, and the contractors they work with have made it so easy to get credit. (See Appendix D, a copy of a typical contractor's flyer, which announces availability of 100 percent financing, even for "poor credit risks.")

Homeowners in middle-income neighborhoods are generally able to get banks to finance their remodeling work. They can comparison shop for reputable home improvement contractors,

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since plenty of contractors are willing to work in middle-income communities. In contrast, in lower-income communities, less reputable contractors/financers seek out the homeowners, with potentially very expensive or tragic consequences. Interest rates more typical of credit cards are typical, instead of more competitive mortgage rates of 8 percent to 12 percent available elsewhere.

- **Immediately after or simultaneously with originating mortgages for home improvement work in lower-income communities, finance companies usually sell the obligations to banks.** Banks and other financial entities which have purchased such obligations from financers which have backed equity fraud or who worked with contractors which otherwise gypped lower-income homeowners include: Gateway Bank, Provident Savings Bank, First Tennessee Bank, Bank Atlantic, National State Bank, Bank of Baltimore, Security Pacific Financial Services, Skopbank (of Helsinki), Associates Consumer Discount Co., Whitestone Savings, F.A., Fidelcor, Chrysler First Financial Services and Landmark Financial Services. One reason why out-of-state banks are used so often is that bank officials will probably not recognize property addresses as being in low-income areas.

But several New York City banks have also purchased thousands of the approximately 32,000 home improvement-related mortgages written in lower-income, minority communities since 1984 by the biggest financers. Citibank and European American Bank took Dartmouth Plan mortgages, and Chemical Bank, Empire of America, Home Federal Savings Bank, National Westminster Bank, and First American Bank, purchased hundreds of mortgages from Oxford Resources, Ltd./Oxford Credit Corp. Radcliffe Resources assigned mortgages to Dime Savings Bank and Long Island Savings Bank.

Indeed, Citibank and Chemical, among others, were so deeply involved in this lending that, starting in about 1988, mortgages were simultaneously recorded by both Oxford Resources and the banks. Radcliffe Resources mortgages were simultaneously recorded by Dime Savings Bank. In effect, banks used Oxford and Radcliffe to produce high-interest rate mortgages for work by contractors of sometimes questionable reputations in communities they otherwise largely ignored—communities where Chemical Bank and Citibank engaged in widespread branch closures in the 1980's.

Succumbing to the temptation of high mortgage interest rates, and believing there was probably sufficient equity left to cover the loan in case of foreclosure, the banks purchasing home improvement-related mortgages failed to examine carefully who originated the loans, how they were procured, or the actual ability of borrowers to keep current on their payments.

- **In effect, a dual home improvement lending system has been created in New York City—one for white and middle-class neighborhoods, the other for lower-income and/or minority neighborhoods.** Chemical Bank, for example, directly originated home improvement loans in middle-class New York City communities in the late 1980's at interest rates of from 10

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percent to 12 percent. But in lower-income and minority communities, Chemical purchased home improvement-related mortgages from Oxford on which the interest rates *started* at 13 percent and could be as much as 21.6 percent. At the same time that Citibank was purchasing 16 percent mortgages from finance companies doing business in poor or predominantly minority neighborhoods, they were charging only 10 percent to 11 percent for mortgages in middle-class neighborhoods.

- **Many of the contractors whose work the finance companies financed have been the subject of numerous DCA consumer complaints and/or fines, restitution orders and license revocations. Among them are:** Aall States Chimney & Fireplaces, Brooklyn; Belair Construction Corp, Glendale; Home Improvements by Zany, Inc, Queens; E & R Contracting/ Britcor/ JJ&L Building Materials, Franklin Square; GML Construction, Brooklyn; Harbor Crest/Hallmark Home Design, Cold Spring Harbor; Harris Home Designs, Inc., Merrick; Peerless Enterprises, Elmont; Target Windows, Garfield NJ; United States Alteration Construction Corp., Lynbrook.

Appendix A lists 80 local contractors which we have identified as having worked with the major financers discussed in this report. Of the 80, DCA has since 1989 revoked the home improvement contractor some 39, while another 21 appear to never have been licensed at all. Some of these companies owe consumers tens of thousands of dollars in DCA-ordered restitution for damage they inflicted and/or they have been fined thousands of dollars by DCA.

- **We reviewed several boxes of internal case files of Harbor Crest, one of the more active contractors. From these files, we estimate that in 1989 and 1990 alone Harbor Crest entered into more than 1,200 home improvement contracts,** virtually all with homeowners in lower-income or minority neighborhoods, usually financed by Sterling Resources, Ltd. Harbor Crest's overcharging and resulting profits were immense: since only approximately one-third of the cost of each contract went to labor and materials, $10,000 of a typical $15,000 contract was pure profit. We therefore estimate that, just in 1989 and 1990, Harbor Crest realized profits of more than $10 million off of approximately $18 million worth of home improvement contracts—having actually spent only $5–$7 million on labor and materials. In addition to consumers' interest payments or to compensation when the loans were sold, sterling also received an immediate "discount" or fee of at least 10 percent of the value of each loan at the time it was, written.

Equity theft victims complained to DCA that they had no idea of what they were signing when they put their signatures on home improvement contracts and mortgages, and that blank lines such as where the interest rate was to be written were filled in by the contractor later on. We witnessed direct evidence of this in several Harbor Crest files, where we saw unused home improvement contracts and retail installment obligations signed by the homeowner but with blank lines for loan amount and interest rate.

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- **New York City neighborhoods that have most suffered from equity fraud are:** Morrisania/East Tremont and Morris Park in the Bronx; Bushwick, Crown Heights, Bedford-Stuyvesant, Flatbush, East Flatbush, East New York and Kensington in Brooklyn; and Hollis, St. Albans, Jamaica, Laurelton, South Ozone Park, Springfield Gardens, Jackson Heights and Richmond Hill in Queens. The problem has been negligible in Manhattan and Staten Island.
- **Often, the assignees reassign the obligations to still other financial entities.** In some cases, where the assignment terms permitted it, the mortgages have been reassigned back to the initial lender once the assignee started experiencing payment problems with them. Or they were reassigned, sometimes several times. Such shifting of mortgagee makes it extremely difficult for a victimized homeowner to sue the responsible parties to remove house liens.
- **There appears to have been a significant fall-off in equity fraud in 1992.** This development is mostly attributable to the increasing hesitation of the banking community, stung by losses from bad real estate loans in the 1980's, to invest in more of these mortgage-backed obligations. The money has dried up. In addition, the sharp decline in real estate values has left less equity to "steal." And law enforcement actions, such as the one against The Dartmouth Plan, a major financer, has sent a welcome chill through the entire industry.

But hundreds of New York City homeowners who were victimized by equity thieves and who still live in their homes are now struggling to make their monthly payments and forestall foreclosure. They are still trying to get liens removed from their properties—still trying to get a reputable contractor to clean up the damage.

And new equity frauds are being committed every day. New financers are coming on the scene.

What has caused equity theft?

- **Surging home prices in the 1980's.** The extraordinary real estate boom of the 1980's benefitted all homeowners, including owners of homes in lower-income communities, and created a large pot of equity ready for the taking by con artists.
- **Bank redlining results in "reverse redlining."** Many victims might have afforded modest home improvement loans at competitive interest rates. Their often valiant attempts to make the sometimes enormous monthly payments demanded by the equity thieves indicates that many of the victims would have been good credit risks with smaller loans to finance work by reputable contractors. Nonetheless, the banking industry has largely avoided household lending in lower-income or minority communities. They have done this in large part by making themselves scarce there. The 1980's saw wide-scale bank branch closures, which took place disproportionately in these neighborhoods.

Homeowners are susceptible to fraud when, figuring that banks will probably reject a loan application if they file one, someone knocks on their door and offers to fix their home and finance it at seemingly attractive terms. They are made even more vulnerable when, as is common, the contractor offers to

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lend extra money to pay off other debts or to spend; homeowners in such a situation are less likely to complain about the quality of the work when they are depending on the contractor/financer to give them the extra money.

- **A dearth of reputable home improvement contractors in poor neighborhoods.** Many of the more reputable contractors refuse to work in poorer neighborhoods. According to recently retired DCA inspector Fred Miller, an expert in the home improvement business, "There are only four or five fairly decent contractors doing work in poorer neighborhoods of New York City." This absence makes homeowners who are anxious to make repairs much more susceptible to the less reputable contractors' solicitations.

Home equity theft is a national phenomena. Boston seems to have been hit especially hard. A *Boston Globe* series last May on home improvement contractors found that unregulated finance companies were charging interest rates of up to 24 percent a year and concluded that hundreds of equity thefts had taken place in the Boston area.[1] Last year, the *Wall Street Journal* reported that federal regulators were reviewing Fleet/Norstar Financial Group's "relationship with mortgage lenders that may be making profits through high-pressure tactics and foreclosures on inner-city [Boston] homeowners."[2] And, in May 1991, a Boston City Council resolution was approved calling for a six-month moratorium on foreclosures to allow officials to investigate whether as many as 4,000 residents of the city's mostly black Roxbury, Mattapan and Dorchester neighborhoods have been victims of equity fraud.

The front page of the *New York Times* on October 13, 1991 reported on the growth in home equity fraud in Alabama, Los Angeles, Florida and Arizona, concluding that at least 100,000 people in 20 states have been defrauded. In Los Angeles and Atlanta, the *Los Angeles Times* recently reported, there have been dozens of reports of elderly black homeowners being unfairly lured into taking out expensive home equity loans. This February, the *New York Times* reported on how desperate consumers—no mention of New York City residents—are falling victim to quick-cash schemes, including advance-fee mortgages that do not materialize or debt consolidation loans tied to window replacements, in which the home owner finds out too late that they really signed a second mortgage.

So far, existing laws are having little impact on equity theft in New York. Possession of a home improvement contractors' license from the Department of Consumer Affairs is no assurance of contractor good behavior. A New York State law requiring home improvement contractors to place consumers' money in escrow ac-

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[1] The House Banking Committee held hearings in Boston on the problem. During the hearings, it was revealed that one lender had loans on 312 homes in just one neighborhood and that 76 percent were foreclosed on.

[2] "Regulators Reviewing Fleet/Norstar's Relationship With Mortgage Lenders," *Wall Street Journal*, June 3, 1991, p. A7A. Fleet was reported to have acknowledged extending $7.5 million in credit to a finance company that activists claimed was engaging in equity theft schemes in Boston. And a headline over an Associated Press article in the Connecticut Post on January 31, 1993 read, "Fleet, other finance companies facing scrutiny." The article reported that Fleet Financial Group of Providence, RI has "found itself increasingly on the defensive with other, similar cases. It vigorously has denied charges in several class-action lawsuits in Georgia that it broke fair lending laws by conspiring with unscrupulous mortgage brokers to target low-income, black neighborhoods with expensive loans."

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counts and to receive reasonable progress payments is routinely ignored. Banking Department licensing requirements for mortgage brokers are circumvented because the contractors are usually the originators of the mortgages and merely assign the mortgage, albeit immediately, to the finance company when the finance company approves the homeowner's credit application.

DCA has acted aggressively against equity fraud—considering that its jurisdiction is limited to regulating contractors and does not extend to finance companies. [This Department brought 1,100 legal actions, citations and cases against contractors in the last three years, a ten-fold increase over the last 20 years combined. CHK] But dishonest contractors who have had their licenses revoked get around the system by having a friend or relative with a clean record get a new license for them.

DCA has also tried to ameliorate the misery caused by home equity theft through its Home Improvement Contractor Business Restitution Fund, financed by fees paid by licensed home improvement contractors. The $87,312 in restitution checks distributed to homeowners defrauded by licensed contractors in 1989 was increased to $120,221 in 1990 and to $780,243 in 1991.

But new laws designed specifically to address equity theft are needed to help DCA and other law enforcement agencies to more effectively attack this epidemic:

- **It should be illegal for contractors to present financer's mortgage documents to homeowners when they are selling home improvement work.** They might still recommend a financer, but the homeowner would have to contact the financer and obtain a credit application herself. Mortgage documents in the hands of the wrong people can wreak incalculable hardship on susceptible homeowners.
- **Finance companies should be required to actually sign the home improvement contracts they finance** and to personally inspect and sign-off on completed work before money is released to a contractor. This should be done by an inspector working for the finance company making a personal visit to the job site.
- **The holder in due course rule should be revised in New York State for investor/assignees in home improvement contractor/home mortgage situations** so that where the finance company *should* have known that an obligation was overdue, dishonored or that defenses existed against the contractor it cannot claim to be a holder in due course. A holder in due course is generally someone who takes an obligation for value, in good faith and without notice of defenses and is therefore free of all claims or defenses that anyone—such as a homeowner—may raise.
- **It should be an unfair trade practice for a finance company to extend a mortgage or home equity loan to a consumer if the lender has knowledge that payments together with other debts will be more than 50 percent of net income** (usually 30 percent is considered the maximum advisable). Such a provision would give a homeowner a defense against a lender who then tries to foreclose on her home.

Several high-profile criminal prosecutions of the principals of the contracting firms in these schemes would broadcast the message

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that government takes victimization of the vulnerable through equity theft seriously. It might put the worst culprits either in jail or out of commission and provide real deterrence for others. For many victims, it was a worse experience to lose a home because of fraud than to lose a wallet to a street robbery.

As for the Department of Consumer Affairs:

- **DCA will implement increased scrutiny of HIC license applications** through additional computer cross-referencing of principals' current and past business addresses and license revocations.
- **The Department is working with New York's legal community to obtain *pro bono*** legal assistance for home equity theft victims faced with foreclosure. DCA is also cooperating closely with paid lawyers preparing consumer lawsuits against contractors, financers and their assignees.
- **The Department will start administering a written test to all HIC license applicants.** The test will measure applicants' knowledge of pertinent laws and business principles.
- To provide immediate help to equity fraud victims, **DCA will write to the banks which bought home improvement-related mortgage obligations from the major financers to urge** them to investigate carefully the circumstances of the origination of each and every mortgage originated by a mortgage finance company involving home remodeling work before they send dunning notices. Was the promised remodeling work actually completed? Was it even begun? Did the homeowner know they had approved a mortgage? While we realize that such investigations could lead to immediate write-offs of many loans, it would indeed be a tragedy to kick equity fraud victims out of their homes when the loan was fraudulently procured or the agreed upon remodeling work was not done. The banks bought this paper. Now it should be their responsibility to conduct these investigations and, where feasible, to sue the contractors for monies paid to them on the false premise that work was properly performed.

  DCA will also ask banks to help undo the damage they paid for by providing restitution for affected homeowners in the form of cash or new loans on very favorable terms. Banks will also be asked to pay for consumer financial education programs through community-based organizations in the affected communities.

This report is the first comprehensive examination of home equity fraud in New York City. Who have been the major operators? What are their schemes? Who has been financing it? Now that the problem seems to be temporarily subsiding, what can be done to stamp it out altogether and make sure this epidemic does not reappear? We hope that this report leads to effective new measures to stop this most pernicious of consumer scams once and for all.

II. Equity Fraud: Where, Who, How and How Often

A. The Affected Neighborhoods: Only Minorities and the Poor Need Apply

Consumer Affairs case files show that the most common New York City neighborhoods for home equity fraud have been:

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Queens: Jamaica, St. Albans, So. Ozone Park, Jackson Heights, Cambria Heights, Laurelton, Springfield Gardens, Richmond Hill, Fresh Meadows, Hollis, Far Rockaway (Beach 100th St, east), South Ozone Park.

Bronx: Highbridge, Morrisania, Morris Park, East Tremont.

Brooklyn: Crown Heights, Bushwick, East Flatbush, Flatbush, Bedford-Stuyvesant, Kensington, East New York.

With few exceptions, all of these neighborhoods are predominantly populated by racial minorities or poor people or by both. [add statistics]

We visited the offices of Jamaica Housing Improvement, Inc., to discuss what this community-based organization's staff calls an "epidemic" of equity theft in Jamaica. [TK—re: kinds of frauds they see, the human impact]

B. Anatomy of a Fraud

The Introduction scenario outlined how a home equity fraud is typically accomplished. Additional details follow.

Most of the contractors we found engaging in equity frauds were approved by one or more of several finance companies to be "contractor-dealers" for them. This entitled them to carry a packet of the finance company's financing forms for presentation to homeowners.

LETTER TO SENATOR DONALD W. RIEGLE, JR., FROM JOHN B. LONG, LAW OFFICES OF DYE, TUCKER, EVERITT, WHEALE & LONG

March 17, 1993

Dear Chairman Riegle:

I have been furnished with a copy of Mr. John P. Hamill's letter to you dated March 1, 1993, together with a copy of certain comments made concerning my oral testimony before you on February 17, 1993.

I have reviewed the draft of my oral testimony, which is true in all respects. Statements made by Mr. Hamill to the contrary have no basis whatsoever.

In Exhibit "B" to Mr. Hamill's letter, he attributed a statement made by me that loans with interest rates over 35 percent are the rule in Fleet's portfolio, not the exception. That was not my testimony. My testimony generally related not just to Fleet loans, but to the overall problems nationwide which have been created by regulated banking institutions' failure to lend to minorities and that void being filled by more unregulated mortgage companies and finance companies. The first example given by me was that of Ms. Lucille Williams. I specifically stated, "This is not a Fleet loan. In fact, Resolution Trust Corporation owns it." Ms. Williams was in fact charged 35 points, plus an interest rate of 18 percent. I did state that the rates that were charged on Ms. Diggs' loan, which the Senate Banking Committee had before it, was the rule, not the exception. I stand by my testimony. While I specifically stated that we have not reviewed all of Fleet's files, the loan files which we have reviewed and have been originated through Fleet's system of

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master brokers, shows that there is nothing unusual about the rates charged on Ms. Diggs' loan and that this particular type of loan is the rule, not the exception.

Mr. Hamill accuses me of having a complete lack of understanding of the home equity business when I was critical of a 2.67 foreclosure rate by Fleet. The 2.67 figure was derived by taking the more than 20,000 loans testified by Mr. Hamill and dividing that figure into the approximately 530 foreclosures in one year, to which he admitted. Chairman Riegle, according to the Table No. 793 of the *Statistical Abstract of the United States, 1992,* the foreclosure rate in the United States in 1991 was 1.0 percent; in 1990, .9 percent; in 1989, 1 percent; etc. I am enclosing a copy of that table for your reference. Admittedly, the number of loans in the beginning of any one year are not necessarily the exact same loans at the end of the year. However, that is the way averages and foreclosure rates are computed. If the period of time were not one year, but were 15 years, which appears to be the general term of most of the master broker produced loans that we have reviewed, then one can project that 40 percent of these loans on the average will end up in foreclosure. I find it hard to believe that anyone could state that my assertions are false. However, more importantly, I find it difficult to believe that any financial institution could try to deflect attention from its unusually high foreclosure rates by making such accusations.

Mr. Hamill refutes my comments made about Fleet's foreclosure profits. I specifically pointed out that we had not seen all of the foreclosure records, but of the records we have seen, we have found that Fleet was making a profit on foreclosures. I stand by my testimony. I also pointed out to the Committee that the loan-to-value statistics that we were seeing were 40 percent or so. When one lends at such a ratio, how can a company not make a profit?

Chairman Riegle, in presenting testimony, both written and oral, before the Senate Banking Committee, I specifically pointed out that the problems as we perceived them are as follows:

1. Regulated banking institutions do not lend primarily in minority neighborhoods. This failure to comply with the Community Reinvestment Act creates a void.

2. This void is filled by certain unregulated finance companies and mortgage companies who charge what we perceived to be exorbitant rates.

In both my written and oral testimony, examples of loans other than Fleet loans were pointed out. I specifically pointed out in my testimony that I was not before the Committee to criticize any one financial institution. What I said then is true today. I trust that the Senate Banking Committee will not look at one finance company's policies, no matter how deplorable, but will look at the overall problems in the dual system of lending that we have created in this nation.

At one time during his testimony, I recall Mr. Hamill mentioning the fact that late charges were 5 percent. The Fleet loans that I have reviewed which are secured by home in Georgia have a 10 percent late charge provisions. Rather than attribute that statement to a "falsehood," I choose to believe that Mr. Hamill merely made a mistake. I assume that, rather than reviewing the files

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himself, he had merely relied upon information furnished to him by another employee of his company.

Currently, Blacks are more often than not denied access to our traditional means of credit, and a second tier of lending made by certain finance companies and mortgage companies, who are largely unregulated, fills this void. Despite personal attacks made against some of those who have tried to bring these issues before the Committee, I trust that the Committee will not be diverted by such unfounded accusations, but will address the broad issues which are real and cry for immediate attention by Congress.

Currently, Congress is looking for ways to boost our economy without increasing federal spending. Requiring regulated banks to increase their lending presence, especially for housing loans in minority communities will cost the taxpayers nothing and will in fact help to boost our economy. Furthermore, if these regulated banking institutions would not engage in such discriminatory lending practices, certain unregulated, fly-by-night mortgage companies and finance companies would not have a free hand in charging what I perceive to be exorbitant and unconscionable interest rates, front-end fees, prepaid finance charges, and prepayment penalties. Regulating the non-bank banks by placing a nationwide cap on these charges and interest rates will further prevent these sharp practices from continuing. I would also like to again state that, to my knowledge, no savings and loan, bank or other institution has been placed into receivership for lending on housing units in minority neighborhoods. The 200 billion dollar savings and loan crisis has been created by greed on behalf of some bankers, lack of regulation, and the failure to make money available for housing loans across the board, regardless of race, at fair and reasonable rates.

I ask that this letter be made part of the official record of your February 17, 1993 hearing.

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MORTGAGE AND OTHER LENDING DISCRIMINATION

WEDNESDAY, FEBRUARY 24, 1993

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:05 a.m., in room 562 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

OPENING STATEMENT OF CHAIRMAN DONALD W. RIEGLE, JR.

The CHAIRMAN. The hearing will come to order.

Let me welcome all those in attendance this morning. I think this overflow crowd today is an illustration of the importance of today's subject.

This morning's hearing is the third in a series that the committee is holding in this Congress on the lack of an adequate flow of capital into our distressed communities. This committee has already held hearings on this issue in the past two Congresses, and today we'll focus on discrimination in lending, particularly in the home mortgage market.

Redlining and housing discrimination were directly outlawed in 1968 by the Fair Housing Act. I remember that well because I supported that act at the time and was invited down to the White House when Lyndon Johnson signed that bill into law. I was present when he did that.

All forms of lending discrimination were banned in 1974, by the Equal Credit Opportunity Act. I actually have that here. I want to just make a brief reference to it because it's now found in the United States Code, 15 U.S.C. 1691. I want to read just a few lines from that law, so we understand where we start from because we're not talking about writing a law. We're talking about enforcing a law that now exists. It says:

> It shall be unlawful for any creditor to discriminate against any applicant with respect to any aspect of a credit transaction on the basis of race, color, religion, national origin, sex or marital status or age, provided the applicant has the capacity to contract, because all or part of the applicant's income derives from any public assistance program, or because the applicant has in good faith exercised any right under the Consumer Protection Act.

It makes it very clear, without going on to read the rest of it, that discrimination based on race, color, religion, or these other factors, is absolutely prohibited by law. It is a violation of law when it occurs. And that's what we're here to talk about today. It's not

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only the fact that that is the law of the land, but how that law is to be carried out and enforced.

Also, in 42 U.S.C., we have another aspect of the law in this area which has to do with outlawing discrimination in the financing of housing. I'll just read a small amount of that into the record, too, again, so we understand where we start from. It reads:

After December 31, 1968, it shall be unlawful for any bank, building or loan association, insurance company or other corporation, association, firm or enterprise whose business consists in whole or in part in making commercial real estate loans, to deny a loan or other financial assistance to a person applying therefore for the purpose of purchasing, constructing, improving, repairing or maintaining a dwelling, or to discriminate against him or her in the fixing of the amount, interest rate, duration, terms and conditions of the loan, and so forth, based on race, color, religion, sex, or national origin, and it goes on in that vein.

The law is very clear. And these are not new laws. These are laws that have been around for some period of time, and those that are charged with enforcing these laws have also been around for some time. And so, to have patterns that would lay out a serious problem of discrimination is really, I think, unjustified and unacceptable, and that's what we're here to talk about today.

Despite the fact that these laws exist and that there is no dispute, it is a plain fact that racial discrimination in these areas is both illegal and immoral, it nevertheless goes on, and there is evidence of widespread discrimination at the present time.

Home mortgage disclosure act data shows that blacks and Hispanics are twice as likely as their white counterparts to be turned down for mortgage credit. A recent study by the Federal Reserve of Boston, which we're going to hear about today, established that even after all legitimate credit considerations are taken into account, black applicants are still 60 percent more likely to be turned down than comparable white applicants.

The Federal regulatory response to discrimination in lending has not been adequate. Regulators referred only a handful of cases to the Justice Department for prosecution in the two decades since passage of the Equal Credit Opportunity Act. I think it's fair to say it's been given a low priority over that stretch of time.

Regulators have overlooked systematic, unfair treatment of blacks and Hispanic mortgage applicants. Monitoring and enforcement procedures I think have to be improved and they have to be improved now, before more weeks, months, years go by, so that we can root out this type of discrimination.

During my own tenure as chairman of this committee, now some 4 years, this committee has taken several steps to strengthen fair lending and community reinvestment laws. We've expaded the Mortgage Disclosure Act to require banks and thrifts to disclose the race, sex and census tract of every mortgage loan applicant so that we can track these patterns.

We have strengthened the Community Reinvestment Act by requiring public disclosure of not only the ratings and evaluations, but also the data relied upon by examiners to arrive at these ratings. Federal examiners are now required to refer patterns of mortgage discrimination to the Department of Justice. And lenders must provide applicants who pay for an appraisal with a copy of that appraisal on request, so that lenders cannot use the excuse that property is undervalued to disguise mortgage discrimination.

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Finally, we passed landmark legislation last year that required Fannie Mae and Freddie Mac to achieve housing goals for low- and moderate-income families and housing located in inner cities. And we also strengthened their fair lending responsibilities. I think this will prove to be a major help. These legislative changes have increased the tools available to the banking regulators and the Justice Department to enforce fair lending laws.

Today, we will explore how the regulatory agencies can better use these tools and the new information that has become available on lending patterns in order to strengthen enforcement of the law.

I think it's fair to say that racial discrimination in lending has had a material affect in starving our inner cities of much of the investment capital they need. It's helped accelerate the downward spiral in those communities, and that damage ought not to have taken place, and it's hurt America. It's wrong and it's got to be changed. Any regulator in any agency of the Government that doesn't want to carry out these laws ought to leave and find another line of work.

I want to thank all of our witnesses for coming today and we very much look forward to their testimony. I want to extend a special welcome to Retha Wilson, who is here from Detroit in my home State of Michigan. She is testifying on behalf of the community organization, ACORN. I'll have other things to say about the other witnesses as we introduce them.

Senator D'Amato.

OPENING STATEMENT OF SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. Thank you very much, Mr. Chairman.

Mr. Chairman, let me commend you for calling these hearings. The fact is that discrimination by lenders is illegal and it's that simple. But it is really immoral. It denigrates the person. It denigrates what this country is about.

The statistics that have been compiled indicate quite clearly that, unfortunately, this discrimination still continues. To quote the Federal Reserve Bank, a black or Hispanic applicant in the Boston area is roughly 60 percent more likely to be denied a mortgage loan than a similarly situated white applicant.

Now it's important to remember that this study compared white and minority applicants with similar income credit histories and property characteristics. There are numerous other studies indicating that discrimination is a serious problem. And it really goes to the core of what we're supposed to be about.

We judge people on their ability. In this case, it's the ability to meet the minimum requirements. And if they can meet those requirements, they should not be discriminated against because they are black or Hispanic.

In 1991, the Equal Credit Opportunity Act was amended to require the banking agencies to refer suspected cases of lending discrimination to the Justice Department. Yet, since that time, only four cases have been referred by agencies.

Mr. Chairman, this hearing provides the committee an opportunity to discover why the existing laws are not successful in ending mortgage discrimination, and to find out what Congress needs to do to prevent and deter discrimination.

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I'm particularly concerned about the low rate of referrals to the Department of Justice. Are the regulatory agencies asleep at the switch or worse—turning a blind eye to discriminatory activities. Do the referral requirements need to be modified? What are the other weaknesses in our current system of enforcement?

These are some of the questions that need to be addressed. But after we have the answers, we must implement the necessary changes to make sure that our anti- discrimination laws are obeyed and enforced.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Faircloth.

OPENING STATEMENT OF SENATOR LAUCH FAIRCLOTH

Senator FAIRCLOTH. Mr. Chairman, I have been reading and have read the Federal Reserve study and I believe the conclusions by the Federal Reserve study are misleading. It just doesn't make common sense to conclude discrimination is the reason for different rejection rates when the study ignored the credit history of loan applicants. The study did not take into account common sense mortgage lending criteria like net worth, debt level and default rate. Here's what respected economist and professor, Thomas Sowell, wrote about the study:

> Racial statistics have become an industry, if not a hustle. Typical of these statistics was a recent study by the Federal Reserve Board showing that black applicants for mortgage loans are turned down 34 percent of the time, compared to 14 percent for white applicants.

Professor Sowell goes on to say:

> To the media, and sometimes even to the courts of law, statistical differences are the same thing as discrimination. Buried in the newspaper account of this study is mentioned some of the limitations of the study; namely, that it didn't take into account the applicant's credit history or the level of their existing debt.

When confronted by these kinds of facts by Forbes magazine, Ms. Alice Monell, who did the study, finally admitted, I do not have evidence, no one has evidence of discrimination in mortgage lending.

Mr. Chairman, Forbes magazine found that black borrowers who met the mortgage criteria and get a loan have the same default rate as white borrowers who meet the same criteria and get a loan.

The bad risks are weeded out up front. That's enough for me, Mr. Chairman. I think any study of credit discrimination should look closely at the credit history of the borrowers studied. Any valid study should look at the common sense lending criteria of net worth, debt level and default rates, just as mortgage lenders do.

The CHAIRMAN. Thank you, Senator Faircloth.

I've had a chart done here that I want to share with my colleagues. We've taken a look at the percentage flow of home mortgage loans in the PMSA area that covers Detroit. We looked at the number of loans for owner-occupied one-to-four family structures in 1991, to try to identify the degree to which persons of color end up having a lower incidence of mortgage credit made available to them than those who are white.

What is interesting, if you come across from a low-income grouping into the moderate-income grouping, into the middle-income grouping, and then finally, into the higher-income grouping, white persons seeking these loans, which constitute the red areas, in

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every instance, right across the income spectrum, had a much higher incidence of those loans being approved. And you find that the more the community tends not to be white and is a mixed community, with minority persons, that you see this same pattern of a fall-off in lending. It goes right across the income scales in the community.

I think, in its own way, this reinforces what the Boston Fed has found, and what they'll tell us about today. And that is, these patterns are very pronounced and they cut across the income scales. In fact, the Boston Fed study, as I think Mr. Syron will indicate, made an effort to isolate out differences in creditworthiness. In other words, to try to match comparable borrowers in terms of their actual financial circumstances, with race being the only real difference, and found, nevertheless, that there were these marked patterns of lack of credit coming through the system.

In any event, we'll start, Mr. Syron, with you, and we'll make your full statement a part of the record. We'd like to hear your comments at this time.

Senator FAIRCLOTH. Mr. Chairman, may I ask a question?

The CHAIRMAN. Yes.

Senator FAIRCLOTH. In the chart, you kept mentioning income. Did you take in net worth, debt level, and default rates? Income is meaningless.

The CHAIRMAN. I wouldn't agree with that. I don't think it is meaningless.

Senator FAIRCLOTH. If you owe more than you're taking in, income becomes meaningless.

The CHAIRMAN. It's certainly one factor. This chart is different than what the Fed study is. And frankly, the article that you cited by the columnist is just inaccurate on that point, which this witness, I think, will demonstrate, that the Fed study did compare people of comparable credit circumstances. This chart did not set out to do this. This took people——

Senator FAIRCLOTH. That's income.

The CHAIRMAN. This took people by income categories and separated them out based on the racial composition.

Senator FAIRCLOTH. OK.

The CHAIRMAN. You can make any assumption you want in terms of net worth and balance sheets and so forth. I think a person would have to be blind not to see this pattern sticking out as you come across the income scale.

If someone were to argue that that kind of pattern is justifiable, you would have to, I suppose, use an implicit assumption that somehow, all the black applicants are the lion's share as compared to the whites, and had impaired balance sheets or bad credit histories or things of that kind. That is not what the objective data that the Fed has looked at has found to be so. I think these patterns ought to be troubling. They're troubling to me, and they ought to be troubling to every Senator.

Senator FAIRCLOTH. Until you compare net worth, debt level and default rate, the income is a meaningless figure.

The CHAIRMAN. Well, you and I, I think, each have made our points there. We have a little different view on it.

Mr. Syron, why don't you go ahead and make your presentation.

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STATEMENT OF RICHARD SYRON, PRESIDENT, FEDERAL RESERVE BANK OF BOSTON, BOSTON, MA

Mr. SYRON. Thank you very much, Mr. Chairman and members of the committee, for this opportunity to discuss the Federal Reserve Bank of Boston's recent study of mortgage lending patterns and that report's implications for combatting discrimination in lending. As you suggested, Mr. Chairman, I'd like to submit a complete study for the record and will summarize it quite quickly.

As the committee knows, the Home Mortgage Disclosure Act data for 1990 showed substantially higher denial rates for black and Hispanic applicants than for white applicants. This was true in all of the major statistical metropolitan areas and was certainly true in Boston, where approximately 30 percent of black and Hispanic applicants were denied loans in the Boston metropolitan area, as compared to 11 percent of white applicants.

The 1991 data for Boston, which became available in the fall of 1992, showed a narrower, but still sizable gap, with 24 percent of black and Hispanic applicants denied compared to 11 percent for whites.

When the 1990 HMDA data were released, the implications of the racial disparities and denial rates were not clear. Although the HMDA data included income information on applicants, no information was collected on applicant's credit histories, loan-to-value ratios, debt-to-income (so-called obligation ratios), or other factors that are commonly considered by lenders when they make mortgage loan decisions.

Accordingly, some felt that this missing information could explain the high denial rate experienced by minorities. Others argued that even if all the relevant information was included, substantial bias in mortgage lending still existed. This disagreement about the basic facts made it difficult to formulate solutions to improve credit flows to poor and minority neighborhoods. This was the reason that we undertook this study.

The Federal Reserve Bank of Boston, with the support of the Federal Reserve Board, other supervisory agencies and, importantly, the cooperation of mortgage lenders in the Boston area, took a major study of mortgage lending in an effort to clarify this issue.

Racial disparities in mortgage lending patterns have been a concern in Boston for a substantial period of time. In 1989, the Boston Fed had undertaken a study of mortgage lending within the city of Boston. While that study had found that housing and mortgage markets were functioning in a way that was economically detrimental to black neighborhoods, because of data constraints you could not distinguish the role played by lenders from the action of buyers, sellers, realtors, and other market participants.

With the release of the 1990 HMDA data on applications, the Boston Fed was able to improve upon its earlier research and focus on the activities of the mortgage lending industry.

I would like to submit for the record, Mr. Chairman, a copy of that study, which I think you may already have.

The CHAIRMAN. We'd be pleased to have it and we'll make it a part of the record.

Mr. SYRON. The 131 financial institutions that had been most active in making mortgage loans in the Boston metropolitan area

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were asked to provide additional information on 38 variables for each loan. These variables included not only income, but credit history, net worth, employment history, and a host of other data that we believe is related to creditworthiness.

We collected this data on all 1,143 black and Hispanic applicants who had applied for mortgages at the 131 financial institutions. And to get a comparable size sample for whites, we got the same data for 3,300 white applicants from these 131 institutions.

In order to protect the confidentiality of borrowers, we assured lenders that all information collected would remain in the Federal Reserve and other bank regulatory agencies. Response from lenders was actually quite good. Although there was some missing information and recording errors in the data, we were able to get a final sample of more than 700 applications from blacks and Hispanics and about 2,500 from whites; in total, we used about a 3,200-size sample.

The additional variables chosen were collected after numerous converations with underwriters, examiners, lenders, and others familiar with the mortgage lending process. We attempted to include all the variables that lenders viewed as relevant to their mortgage decision. The information collected from the financial institutions was then combined with information from the 1990 census on the geographic area in order to develop a model, if you will, of the lending process.

With this model, it was possible to test whether race was a significant factor in the lending decision, once financial, credit history, employment, and neighborhood characteristics had been taken into account. This last factor is absolutely essential.

Now I would like to quickly review the results of the study. The analysis revealed that the additional information about each applicant, which was reviewed on an applicant-by-applicant basis, did reduce the disparity in denial rates, but it didn't eliminate it entirely.

Black and Hispanic mortgage applicants in Boston, on average, did have higher debt burdens, higher loan-to-value ratios, weaker credit histories and poorer employment histories, and in other respects didn't fare as well according to the evaluation criteria that are used by mortgage lenders.

But after taking all of these factors into account, black and Hispanic mortgage applicants were still more likely to be turned down than white applicants. Minority applicants with the same financial credit history, employment and neighborhood characteristics as the white aplicants in Boston would have experienced a denial rate of 17 percent, as compared to 11 percent for whites. Another way of putting it is that 89 percent of whites out of a sample of 100 who would apply for mortgages would be approved. Everything else being the same, 83 percent of blacks would be approved.

Thus, while the study did diminish the difference, there still is this statistical difference—if you can use that terminology—between approval for the two groups. The information gathered provided some insight into how this could happen. Many observers, including myself, initially, would ask why would a rational lender want to turn down a perfectly good application, just because the applicant was black or Hispanic?

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What we found, which we didn't realize beforehand, is that very few applications are completely perfect. When applicants are completely perfect as measured by all the criteria, they invariably are approved, whether they are white, black—no matter what they are.

But most applicants, white as well as minority, exceeded some of the guidelines for obligation ratios or loan-to-value ratios. They may have had some credit history problems or possessed some characteristic that required additional documentation, such as self-employment or the fact that they were buying a two-to-four-family house.

As a consequence, the mortgage process is not a purely mechanical one. This was an important factor illuminated by the study. Loan originators must exercise judgment, and they have considerable discretion in the way they evaluate these deviations from perfection and the degree to which they take compensating factors into consideration.

On balance, this discretion is both necessary and desirable. Historically, residential mortgages have been very, very safe investments. Applicants need not be perfect to be creditworthy. However, discrimination may enter into the decisionmaking process. Precisely how that happens may be related to human nature and cannot be definitively answered by this study. It could be as simple as loan officers being more willing to exercise discretion and put their own reputation at risk for people that they feel more comfortable with.

It could also be that, once they are turned down nonminority borrowers are more persistent and do things such as get credit counseling to improve their next application.

However, whatever the cause, the discrimination does occur. Black and Hispanic applicants are more likely to be turned down for mortgages than white applicants with the same economic characteristics. What can be done to address the problem? I think this is really what we need to talk about.

In our own judgment, the most critical step is for mortgage lenders to acknowledge and to realize at least the possibility that their lending process, while not intentional may have a discriminatory effect. As long as lenders sincerely believe that their procedures are beyond reproach, efforts to get them to change are going to be very, very difficult. This is the area where we hope we've made a contribution. At least in Boston, our study seems to have ended the debate about whether there has been discrimination.

There is a broad recognition among banks, among the community groups and among regulators that while economic factors explain some of the disparity in denial rates, race also plays a role.

Lenders' reaction to this data suggests that they are now questioning what they've always taken for granted. They are starting to recognize that simply having a policy that prohibits discrimination doesn't necessarily mean that you will always prevent it. A number of strategies have been developed by consumer advocates, Government agencies, and lending institutions to address this issue. The Federal Reserve Bank of Boston is in the process of compiling these strategies into a guide that will soon be available and we've had several meetings with lenders about ways they can improve their own internal procedures.

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I suspect that the members of this committee have heard many of these ideas. They include working with all of the employees in the loan process to be sure they are familiar with fair lending laws; having a staff that reflects the racial and ethnic composition of the communities that they serve; ensuring that compensation structures for employees don't create artificial impediments to serving low-income and minority markets; using carefully designed second-review processes for denied minority applications; and a number of other approaches.

While not presenting something totally new or, I must add, a magic solution to this, we hope that the guide and other things that we've done make a contribution by tailoring the recommendations to individual institutions' management and boards of directors, in a way that makes the recommendations viable. The commitment to eliminating discrimination must begin at the top of organizations if it's going to be filtered down to where the institution meets the face of the public.

Financial institutions' efforts will have to be reinforced by enhanced regulatory methods. Because so many mortgage applications violate some guideline or in some way require the lender to exercise judgment, most denials can appear appropriate by objective criteria. Thus, discrimination can be very difficult to root out or determine when you look at it on a case-by-case basis. It's also necessary to examine broad patterns and an institution's entire loan-making process. The Federal Financial Institutions Examination Council is aware of this problem and is working on improving it's examination procedures.

Finally, I'd like to emphasize that while lender discretion may permit discrimination to occur, removing the discretionary element would be a real mistake. If current guidelines were to become rules, to be applied in a strictly mechanical way, with no exceptions, then even if these rules weren't as tight as the guidelines that we have now, many creditworthy applicants would be denied loans as reflected by the results that we have. And if the Boston experience is typical of what goes on nationally, and I think it may be, black and Hispanic applicants would be denied even more because they do have somewhat higher obligation and loan-to-value ratios, lower incomes, and weaker credit histories.

In conclusion, the Boston Fed study of lending patterns in the Boston metropolitan area shows that large disparities and denial rates revealed by the HMDA data are partially attributable to the fact that black and Hispanic applicants have greater credit burdens, higher loan-to-value ratios, weaker credit histories, and other economic characteristics that lenders view with disfavor.

However, even after taking all of these factors into account, a statistically significant and economically important gap remains in denial rates for white and minority applicants. Eliminating this gap requires that regulators, lenders, and community groups understand the nature and the likely cause of that gap, stop arguing about whether a problem exists, and work more effectively together to resolve it.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much. That's very powerful testimony and I want to say to you and your colleagues how much I

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appreciate all the work that's gone on. You've obviously worked very hard to track this problem down and I think you've done so in a way that is solid, and it's much appreciated.

We've been joined by other members and I'm going to see if they have any opening comments before I go to Mr. LaWare.

Senator Moseley-Braun.

OPENING STATEMENT OF SENATOR CAROL MOSELEY-BRAUN

Senator MOSELEY-BRAUN. Thank you very much, Mr. Chairman.

This hearing is critically important. Discrimination in the credit market is something that has concerned this committee and you've had hearings in this regard previously, and I've been delighted to have an opportunity to participate in those hearings.

This issue, however, strikes at the heart of the condition of some inner-city communities, particularly because of the findings and the showings of the Boston Fed study of mortgage discrimination. I think it does put to bed the question whether or not this exists. And the question now before us is what we can do about it. And so, I am very interested in Mr. Syron's testimony and look forward to the testimony of Mr. LaWare and Mr. Turner and others, including, I understand, one of my constituents from the days of the civil rights movement in Chicago.

Ms. Cincotta is here. I don't see her in the audience—there she is back there. I look forward to hearing from the community groups as well.

I have an opening statement, a full opening statement, Mr. Chairman, which I will dispense with reading and actually ask to be accepted into the record.

The CHAIRMAN. Without objection, it is so ordered.

Senator MOSELEY-BRAUN. Thank you, sir.

But to say that this hearing is of vital importance and I think goes a long way toward doing what Mr. Syron suggests needs to happen, which is a change of the mindset and the attitudes and the approaches to the issue of mortgage applications and creditworthiness by minority buyers and the reverse redlining issue that we talked about in the previous hearing.

I do have some specific questions that I'd like to have addressed going to the kind of underwriting standards that are used in making determinations about mortgage applications and specifically, the role of the credit-reporting agencies and whether or not those reporting agencies, in their activities, do less well by minority borrowers than others.

Mr. SYRON. I don't have any direct information on that, to be honest, Senator. But I do know that, in looking at the study that we did, that we found obviously that that—and we made some attempt to sort of rank the relative importance of different factors that could influence acceptance or denial. And credit history is important. Now, we only know credit history as it was reported on the sheets actually that were in the individual files for applicants.

You're asking a very good question which, unfortunately, I don't have the answer in terms of the accuracy of the credit history. There's been a lot of concern about that as a general matter and it's conceivable that that could be another problem.

The CHAIRMAN. We'll take a look at that.

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Mr. SYRON. Thank you.

Senator MOSELEY-BRAUN. I would specifically, Mr. Chairman, that's an area, access to credit and the responsiveness and the accuracy and the fairness of the credit-reporting agencies is a major concern in the community and I think goes a long way, not only in this area, but in other areas having to do with access to credit by minority borrowers.

Thank you, sir.

The CHAIRMAN. Thank you.

Senator Campbell.

OPENING STATEMENT OF SENATOR BEN NIGHTHORSE CAMPBELL

Senator CAMPBELL. Thank you, Mr. Chairman.

In the interest of brevity, I would prefer to hear the witnesses. But I do have a written statement and with your pemission, would like to introduce it into the record.

The CHAIRMAN. Very good. We'll make it a part of the record.

Senator Sarbanes.

OPENING STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Mr. Chairman, I do want to make a few comments this morning because I regard this hearing as extraordinarily important.

I want to commend you, first of all, not only for holding this hearing, but the others that we have held. This is part of a series addressing the issue of the availability of credit to people of low- and moderate-income.

On February 3, 1993, we held a hearing on community based lending institutions, such as community development banks, community development credit unions, community development corporations. And then last Wednesday, we had a very, I think, moving hearing as we listened to the individuals testify about the so-called reverse redlining in the secondary mortgage market. The practice by finance companies, second mortgage companies, and finance subsidiaries of bank-holding companies of targeting low- and moderate-income neighborhoods for the granting of home equity loans at exorbitant interest rates.

The effect of this practice is to place homeowners in the position of either paying the exorbitant rates or losing their homes. They were really just putting these people right up against the wall.

Actually, it was a real tribute to the low- and moderate-income people, the lengths to which they would go to meet their payments in order not to lose their home.

If you want to talk about fiscal responsibility on the part of the individual, we had ample manifestation of that at last week's hearing. And in fact, some of those who run up these large credit card accounts and then take personal bankruptcy and sort of operate at a different level in society ought to go out there and learn some lessons from these folks.

This morning's hearing on the fundamental issue of racial discrimination in mortgage and other lending I think is very, very important, and I particularly welcome the study that the Federal Reserve Bank of Boston has done.

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We appreciate that you went out and really tried to develop much more of a full-scale examination of the problem and got the additional information, which, together with the census information on neighborhood characteristics, were able to develop this model of the determinants of mortgage lending decisions in the Boston area.

The study concluded, and I quote it now:

> A black or Hispanic person in the Boston area is roughly 60 percent more likely to be denied a mortgage loan than a similarly situated white applicant.

I want to underscore the words, similarly situated. This means that even if the black or Hispanic person had the same obligation, ratios, credit history, loan-to-value, property characteristics, as the white applicants, they were 60 percent more likely to be denied the mortgage. Now that's really a staggering factual statement of the situation, and it obviously cries out to be addressed in a way that ensures that all of our people would be treated fairly. Furthermore, there's every reason to believe that what was discovered in the Boston area on the basis of this survey applies across the country. I don't really know anyone who would seriously contend otherwise.

Mr. Chairman, as I understand it, the purpose, or one of the purposes of this hearing is not only to review the evidence of discrimination in mortgage and other lending, but also the response by the Federal bank regulatory agencies, by HUD, and the Justice Department, which are charged with the enforcement of Federal laws prohibiting such practices. And I take it the second panel will actually discuss some of the deficiencies in the enforcement record compiled by these agencies.

But, again, I close by commending you for holding this hearing. I think it's an extremely important subject. We've got to get at it, and I'm looking forward to hearing from the other witnesses. I do want to say I'm doing three hearings at one time this morning. I may have to move in and out. But I wanted to be here, at least for a while, to underscore the importance of this particular hearing, and the importance of the whole series which the Chairman has held.

Thank you very much.

The CHAIRMAN. Thank you, Senator Sarbanes. We do have important hearings going on right now in the Finance Committee, where Secretary Bentsen is appearing, and I serve as a member of that committee. Obviously, I cannot be there because I'm here. The Budget Committee, likewise, has an important hearing today with Secretary Shalala. Senator Sarbanes and I are both members of that Budget Committee, and others may be as well. So we do have conflicting meetings going on at the same time.

Chairman LaWare, you serve as the Chairman of the Federal Financial Institutions Examination Council. You're the officer within the Federal Reserve, as I understand it, that's responsible now for overseeing the examination activities that go on within the banks. And you really are the chief officer in that area of responsibility within the Fed. Is that a fair description?

Mr. LAWARE. Well, yes. But as you know, Senator, the responsibility for compliance examinations having to do with consumer and civil rights matters is handled by a special group of examiners within the Federal Reserve system. They generally come under the

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supervision of our division of consumer and community affairs. The oversight committee for that division is chaired by Governor Lindsey.

The CHAIRMAN. I see.

Mr. LAWARE. But we all accept fully responsibility for each others areas as well.

Senator SARBANES. Should we have brought Governor Lindsey in here this morning as well?

Mr. LAWARE. Sir?

Senator SARBANES. Should we have brought Governor Lindsey here this morning as well?

Mr. LAWARE. No, I don't think so. Governor Lindsey has been almost flat on his back for about 2½ weeks now with a very serious back condition and has been participating in board meetings by teleconferencing. And I doubt very much that he would have been able to be here this morning.

The CHAIRMAN. But apart from the health issue, I hope he recovers and we want him to. I'm wondering, in light of that delineation of responsibility, you carry some, he carries some, but he's the direct line officer at the Fed responsible for getting into the very specifics of this issue. Would that be fair to say?

Mr. LAWARE. That's fair to say. I serve on his oversight committee and if you find my testimony incomplete in that regard, certainly, I'm sure he'd be delighted to come before you.

The CHAIRMAN. I know you've worked hard in this area and I know you have a statement to make and we want to hear it. But I don't want to not hear from him when he is feeling better, if he's the line officer that would be directly responsible.

I think, in addition to your testimony, it seems to me that he may need to be given an opportunity to appear because he is really the Fed officer in charge in this area. Would that be fair to say?

Mr. LAWARE. Yes.

The CHAIRMAN. OK.

Mr. LAWARE. I understand that my role here this morning is as Chairman of the Examination Council.

The CHAIRMAN. Right.

STATEMENT OF JOHN P. LaWARE, CHAIRMAN, FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL, WASHINGTON, DC

Mr. LAWARE. I appreciate the opportunity to speak to the committee about concerns related to credit discrimination and mortgage lending. The hearing is very timely, given the troubling questions that have been raised about fairness of the mortgage lending process.

Parity in how applications are considered—that is, without regard to race, sex or other prohibited bases—is absolutely essential in our country. Let no one have any misunderstanding on the point—racial discrimination, no matter how subtle, and whether intended or not, must not be tolerated. Simply stated, excluding any segment of our society from fundamental economic opportunities such as home ownership and equal access to credit, is morally repugnant as well as illegal. Moreover, it robs the lending industry and our economy of growth potential.

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I want to assure you that the Board, the Federal Reserve Board, is committed to vigorous enforcement of fair lending laws.

As Chairman of the Federal Financial Institutions Examination Council [FFIEC], you asked that my testimony focus on current efforts by the member agencies to strengthen enforcement of fair lending laws. I am pleased to do so. In addition, a representative from each of the other Examination Council agencies is here today to respond to specific questions about their individual agencies' fair lending enforcement programs, if that happens to come up.

Before I describe the Examination Council efforts, however, let me give you a sense of some of the actions of the Board of Governors which have been taken to demonstrate commitment to enforcement of fair lending laws.

First, in consultation with the other agencies, we have significantly enhanced our ability to use HMDA data in our fair lending and CRA enforcement efforts.

Second, we are working closely with the Justice Department on fair lending issues. This includes a recent referral of one institution to the Department, where evidence of credit discrimination arising from the Boston study was discovered. I should note that prior to recent statutory changes, only those cases of credit discrimination where the Board could not bring the lender into compliance with the law were required to be referred to the Justice Department.

Third, we have referred consumer complaints about Fair Housing Act violations to HUD. Fourth, we have used our formal enforcement powers to compel compliance with fair lending laws by State member banks. And fifth, we have denied applications by financial institutions due to their poor CRA record.

The Board has had a consumer compliance program for a number of years which has always placed high priority on assessing compliance with fair lending laws. We think our program has been good, but we will continue to work on improving the effectiveness of our fair lending examinations.

Recent developments have changed the nature of the discussion regarding the issue of credit discrimination. The debate has moved from the discussion about whether unequal treatment is occurring to how to strengthen enforcement of fair lending laws.

One of these developments was the study completed by the Boston Federal Reserve Bank, which has been described to you this morning. Another event was a settlement between the Department of Justice and an Atlanta savings and loan association resulting from a fair lending investigation by the Justice Department. And you will hear more about that in a few minutes.

In each case, evidence was found of disparate treatment in mortgage lending between minorities and whites. This evidence has increased our awareness and understanding of this complex issue and will provide a basis from which the Federal Reserve can better focus efforts to strengthen the enforcement of fair lending laws.

While the Examination Council agencies have separate programs through which they enforce fair lending laws, we all take our enforcement responsibility seriously. We've been working to ensure that our efforts are responsive to the concerns expressed by Congress and others. I want to describe a number of those efforts.

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Following the release of the Boston study, the member agencies of the Examination Council issued a joint statement which emphasized the need for new initiatives that will ensure fair lending practices. Accordingly, the agencies encouraged financial institutions to intensify their fair lending education programs for management, for lending personnel, as well as for consumers.

In addition, each of the agencies has underway investigations of those financial institutions they supervise which took part in the Boston study where evidence of disparate treatment was present. The results of the Boston study, the Board and the other Examination Council agencies have also made increased use of the HMDA data.

Over the past 2 years, the Federal Reserve, in consultation with the other Examination Council agencies, has developed and implemented a computer-based HMDA data analysis system. The system, which uses both HMDA data and demographic information, was designed to maximize the utility of the HMDA data by allowing examiners to formulate and test specific hypotheses regarding lenders' treatment of different groups.

The agencies continue to pursue discussions with the other Federal agencies with significant enforcement responsibilities for fair lending laws. These include the Department of Justice, HUD, and the Federal Trade Commission.

One example of coordination involves targeted examinations of financial organizations with mortgage lending records that raise concerns about their compliance with fair lending laws. Justice Department staff may, in some instances, participate with examiners from the Examination Council agencies in these reviews. Another example is a memorandum of understanding between the agencies and HUD, calling for formal referral of complaints alleging fair housing violations to each other and coordination of investigations when that is feasible.

In my view, the actions taken by the agencies work to assure equal treatment of minorities in credit markets. We've known for some time that certain segments of our society, particularly minority consumers and minority small business owners, have difficulty obtaining credit.

This has had an impact on the ability of minorities to build businesses, own homes, accumulate wealth, and generally participate in our economy on an equal footing. We also know that this difficulty may not be justified by economic factors alone.

Bringing all citizens into the economic mainstream as quickly as possible should be the ultimate goal of efforts to strengthen enforcement of the fair lending laws.

I have described for you today the efforts that the Examination Council, as well as the Board, have made to improve the enforcement of fair lending laws. We should not overlook, however, those actions that lenders themselves have taken to help improve access to credit. Many lenders have reviewed their operations and, as a result, have taken positive actions such as re-examination of credit criteria, second reviews of lending decisions—that is, denials—which affect minority applicants, self-testing, automatic coaching for denied applicants, and specialized consumer credit education on

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qualifying for credit. These are only a few of the initiatives undertaken by the lenders.

In conclusion, I thank you for the opportunity to appear before you today to testify on this important issue. The Board and the Examination Council share your concerns about credit discrimination and we will work with the Congress and others to address this important problem. I would be happy to respond to any questions the committee may have at the appropriate time.

Thank you, Madame Chairman—Chairwoman. I'm sorry. I always bungle that one.

[Laughter.]

Senator MOSELEY-BRAUN [presiding]. Thank you. We changed.

[Laughter.]

Senator MOSELEY-BRAUN. I may not look like Don Riegle, but we're working on it.

[Laughter.]

Senator MOSELEY-BRAUN. Mr. Turner.

Mr. LAWARE. He'd be flattered.

[Laughter.]

STATEMENT OF JAMES TURNER, ACTING ASSISTANT ATTORNEY GENERAL FOR CIVIL RIGHTS, DEPARTMENT OF JUSTICE, WASHINGTON, DC

Mr. TURNER. Madame Chair, I have served in the Civil Rights Division of the Justice Department since 1965, and as ranking Deputy Assistant Attorney General, I have had the privilege to serve during several transitions as Assistant Attorney General.

But this is the first time that I've had the privilege of appearing before this committee and therefore, I want to thank you and the chairman for the invitation to testify on this important matter today.

The ability to obtain a mortgage is essential to the fulfillment of the promise of the Fair Housing Act. That Act was passed to permit all citizens to live where they can afford to, and thereby, break down the segregated living patterns that too often have blocked access of minority citizens to quality schools and jobs, as well as desirable housing.

The Civil Rights Division of Justice began a major investigation of discrimination in the mortgage lending industry in 1989. Based on a series of articles published in the Atlanta Journal-Constitution, we looked at mortgage lending in the Atlanta area and came to focus on one institution, Decatur Federal Savings and Loan, because it was large, had a poor record of loan origination in black neighborhoods and rejected a high percentage of black loan applicants. I want to emphasize that Decatur, the organization, proved very cooperative as we pursued this investigation and they deserve recognition for a willingness to get to the bottom of the loan practices involved and to serve as an example for the lending industry in general.

Also, I need to emphasize that we are strictly in the law enforcement business. We investigate not to establish some social science theory or economic principle, but to present proof of a violation of Federal law to a United States court and seek appropriate relief.

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Our investigation in the Decatur case broke down into two parts. First, we learned that Decatur, during its 65-year history in the Atlanta area, had chosen to serve the white community while excluding the black community. All but one of its 43 branches had been opened in predominantly white areas, and that one exception closed after 3 years. It defined its territory for purposes of the Community Reinvestment Act, which has been so important to this committee, to exclude over 76 percent of the black population of Fulton County, where this organization operated. Its account executives, we found, almost all of whom were white, did little business with black builders or agents, and its advertising was concentrated in the white community.

Accordingly, we concluded, and it should surprise no one, that there, proportionally speaking, were a relatively small number of black homebuyers who filed applications for loans with Decatur.

In the second part of our investigation, we examined the treatment afforded those blacks who did apply for loans to Decatur for financing. We found that the only meaningful way to do this—and we have a tradition in the Civil Rights Division, we do whatever is necessary: we approach it the old-fashioned way and do some hard work—was to copy and examine thousands of loan files that this organization had compiled and to identify the variables that best predicted the success of an applicant.

We did a multiple regression analysis with expert assistance that showed that the race of the applicant was a significant factor in whether or not an applicant received a loan. Interestingly, we found that there were objective reasons for denying financing in just about every loan file. But white applicants under such circumstances were frequently counseled on how to correct deficiencies in their applications, while black applicants were simply rejected.

We were able to negotiate a consent decree after this investigation that brought significant relief to victims of discrimination, which we identified as black applicants who would have met the lending standard established by the files, by the records, for white applicants. And we put in place, with the assistance of the Decatur leadership, procedures that are required by court order now that we hope will prevent future discrimination.

Our findings in Decatur were corroborated over a much larger and different geographic area by the study you've heard about conducted by the Federal Reserve in Boston. That study suggested that the problems we identified in Decatur, in one single institution in the South, are not limited to that institution or that region of the country.

Our concerns led us to call a meeting in November 1991, of all the agencies that regulate lending institutions to explore ways to coordinate and enhance our efforts in combatting lending discrimination. We have met on several occasions since.

In June 1992, we proposed to the agencies that they join us in joint investigations of targeted lending institutions. We continue to discuss this suggestion and have exchanged a good bit of correspondence on the subject, but have yet to reach a complete agreement on how we should proceed. We are convinced, Madame Chair, that in many instances, investigations of the type that we under-

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took in Atlanta will be the only way to root out discrimination. Like most investigations, establishing a pattern or practice of discrimination involves an expensive and time-consuming process, one that we believe can best be accomplished by joint application of the expertise of the regulating agencies and the experience and enforcement of the Department of Justice.

We will continue to work with the agencies toward that end because I think if we file a number of these suits, there is a spillover deterrent effect. I think that all of the lending institutions in Atlanta profited from the experience of Decatur in going through this process.

In closing, let me say that the Civil Rights Division has undertaken a major enforcement effort to identify and eliminate discrimination in mortgage lending. We have every reason to believe that the incoming political leadership in our Department will continue this commitment, in what I hope will be a cooperative effort with the regulatory agencies. We will continue our commitment to seek the day when race will no longer be a factor in these mortgage lending decisions.

Senator MOSELEY-BRAUN. Thank you, Mr. Turner.

Senator Sarbanes.

Senator SARBANES. Thank you very much.

Gentlemen, the first question I want to put to you is that, clearly, these practices are taking place. Does anyone contest that statement?

[No response.]

Senator SARBANES. Well, why aren't we doing more to try to get at them? What's the problem?

Mr. SYRON. Senator, I think that's a good question. I think until relatively recently a lot of people didn't fully understand the degree to which there was discrimination in the mortgage generating process and the degree of imperfection, if you can call it that, in most mortgate applicants.

Looking at applications on an individual file basis will not illuminate trends, so it is useful to look at it in a much broader way. I think this is one reason why we haven't turned these things up in the past, although I'm not saying that's a good reason.

Mr. LAWARE. Also, Senator, I think it's fair to say, and I hope nobody would violently disagree with this, but I think it's fair to say that the evidence that we have of discrimination does not indicate an intentional policy of discrimination on the part of these banks. But the discriminatory result is the result of the failure of certain processes to be carried out completely. Now, it has been——

Senator SARBANES. Would you say Decatur had a specific intent to discriminate?

Mr. LAWARE. I think Mr. Turner would have to answer that.

Senator SARBANES. But I mean, in your view. When you say you don't find—I'm curious as to whether you regard the Decatur case, where that falls in your perception.

Mr. LAWARE. If you adopt, in a community like Atlanta, if you adopt a geographic strategy which places your branches and your operations only in white, upper-income neighborhoods, then there's an implication of discrimination. But a lot of banks make a deliberate strategic decision to focus on a certain market segment.

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Now, to the extent that that is a segment which implies discrimination on the basis of race or color, then I think, yes, that is discriminatory. But many banks who have adopted those kinds of strategies in the past were not doing it consciously to be racially discriminatory, but, rather, because that was the market segment that they chose to serve.

The large trust companies, for example, obviously target people with wealth. That doesn't mean that they are intending to discriminate against people on the basis of color or where they live. Yes, I think that——

Senator SARBANES. Now do you think that under the Community Reinvestment Act, a financial institution can legitimately do that kind of targeting?

Mr. LAWARE. I think the full testimony of Mr. Turner has outlined the fact that they had drawn the lines of the community as they defined it, in pursuit of compliance with the CRA Act to exclude those portions of the city that had a high percentage of black population or the low-income areas. That was an accepted practice for a while and that's now being changed as we redefine communities and put the emphasis on servicing the credit needs of the whole community. We are vigorously going after that kind of an attitude on the part of banks, whatever kind of community they may be in.

Senator SARBANES. Is it your view that the Fair Housing Act requires that you show an intent to discriminate?

Mr. LAWARE. No. My reading of that, or the analysis of it that we have is that discrimination, whether intended or not, is illegal.

Senator SARBANES. That's right. That's my understanding as well. So I'm not quite clear why the intent issue is relevant to the discussion.

Mr. LAWARE. Let me just take an example. The issue of coaching we have determined to be a very significant part of the disparate result in terms of approvals and denials. The fact of the matter is that it is more likely that white applicants have been coached as to how to make their application conform with the requirements for approval than have minority applicants. Now whether that is intentional——

Senator SARBANES. Coached by whom?

Mr. LAWARE. By the lending officers in the banks. The scenario is like this. The applicant comes in. The lending officer says, I'm sorry, we can't approve your application. If the applicant gets up and says, well, thank you for your time, and leaves, then nothing further is done.

If the applicant says, hey, wait a minute. I don't understand why you're turning me down. Is there any way I can fix this application to be qualified? And the lending officer then says, well, if your debt load was lower or if your income-to-debt-service ratio was different, then we could approve it. So the fellow may go out, change things around, pay off his credit card outstandings or something like that and come back in and say, how about it now? And he gets approved.

Now, many banks who were equally shocked with the results of this HMDA data when they saw it, and what many of them are

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doing is making coaching mandatory at the time when the denial is given to the applicant.

I think that's going to help in this area. Whether or not the lack of coaching before was deliberate or not, the fact of the matter is that if it is done, there is an appreciable influence on those ratios. I think that that will begin to show up.

Another area is whether or not people are encouraged at the time that they first come in for the first interview, the first screening, whether they are encouraged to go forward with their application or whether they're discouraged.

And banks, to correct that situation, are now shopping their own institutions. That is, they are doing some internal testing, having people come in with equal financial characteristics and say, "I'd like to apply for a mortgage loan."

If in fact the minority person is being discouraged at that point, then they know that they've got a problem on their hands, that somebody is not playing it fair.

So this kind of voluntary testing program I think will also help to identify some of the problems early on before we even get to the approval or denial ratio.

Senator SARBANES. Does the Fed do testing?

Mr. LAWARE. No.

Senator SARBANES. Why not?

Mr. LAWARE. In order to do it properly and accurately, it would take about $150,000 for each testing example. And the results, the statisticians tell us, are highly unreliable in terms of really determining that discrimination is going on. And so we have——

Senator SARBANES. What do you think the response would be in the industry if they knew that the Fed might be testing?

Mr. LAWARE. Well, let me answer that in a little different way. I think the response in the industry now, because they have been alarmed by these data, is already a very positive force. I'm not sure that it would be significantly different if we started a testing program. That's my opinion.

Senator SARBANES. I see my time is up, but that's obviously a matter we ought to explore.

I'm becoming increasingly concerned that this is a kind of reporting exercise. In other words—and even there, I think we've been somewhat deficient. But the focus tends to be on, well, let's enhance the reporting exercise. And meanwhile, the practices go on and opportunities—I don't think you need many instances like Decatur and others before the message starts getting through that someone better get busy and start doing something about these things. Would you agree with that?

Mr. LAWARE. The regulatory agencies are currently reviewing a list of approximately 200 banks that the Justice Department has identified from the HMDA data as being suspicious situations. We are looking at those 200 situations, each of us for the banks that are under our supervision, to try to confirm some targets for a more intensive joint effort between the Department and the regulatory agencies to go in and do this more complete preliminary analysis.

If at that point it is discovered that there is reason to believe that there's discrimination going on there, using the Justice De-

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partment standards, then we will go forward with a more intensive analysis so that we can either confirm or deny that discrimination is taking place, get compliance from the bank, and try to take care of the victim.

Senator SARBANES. What's the strongest regulatory action the Fed has taken against an institution for discriminating on the basis of race?

Mr. LAWARE. We have a variety of things available to us. We can deny applications——

Senator SARBANES. No.

The CHAIRMAN. No, no. The question is what have you done.

Senator SARBANES. I don't want to know what's available. Exactly. I don't want to know what's available to you. I want to know what have you done.

Mr. LAWARE. We have had formal agreements that have to be agreed to by the board of directors of the bank. We have cease and desist orders.

Senator SARBANES. How many of those have there been?

Mr. LAWARE. I don't know that I have those figures right in front of me, but give me a moment to look and see.

[Pause.]

Mr. LAWARE. At the end of 1992, the Board had 11 formal actions that contained provisions related to enforcement of consumer protection laws.

Senator SARBANES. When you say consumer protection, you mean more broadly than racial discrimination.

Mr. LAWARE. Yes. Just let me finish.

Senator SARBANES. Sorry.

Mr. LAWARE. Seven written agreements and four cease-and-desist orders. In addition, while these were not outstanding at the end of 1992, there have been civil money penalties assessed in the past 2 years that have been included in the following figures.

Five of the formal actions mentioned above contain provisions relating to credit discrimination, 5 of the 11.

Senator SARBANES. And what kind of formal action are we talking about?

Mr. LAWARE. In those specific discrimination cases?

Senator SARBANES. Yes.

Mr. LAWARE. I don't have that in front of me, but I would be glad to supply——

The CHAIRMAN. Would the staff that's here with you know that?

Mr. GARWOOD. I'm Griff Garwood. I have responsibility for the Board's Division of Consumer and Community Affairs. There have been these very few actions and I think it's fair to say that most have involved marital status, age, and not race. The one instance involving race related to installment lending, as a matter of fact, not mortgage lending, which is the subject of this discussion.

So I think the sum and substance of the answer is that there have been very few formal actions, particularly in light of the kind of statistics we've heard. One of the reasons is what President Syron talked about. That is the fact that if you look at any given loan, you will find reasons for denial and it will make sense.

We now know from these studies that that is a misleading indicator of what's going on. And a number of actions are being under-

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taken both by the agencies individually and by the FFIEC to improve our procedures, and I think that's a question that should be asked not only today, but a year from now and 2 years from now, to benefit from some of these improvements.

Senator SARBANES. I think it will be asked because I think Chairman Riegle has started a process here that I know he's going to carry through, and the members of this committee are going to want to carry it through.

The CHAIRMAN. Could we just have you identify yourself by name and position for the record?

Mr. GARWOOD. Yes. I'm Griffith Garwood. I'm Director of the Board's Division of Consumer and Community Affairs.

The CHAIRMAN. Thank you.

Senator SARBANES. Governor LaWare, are you familiar with this report on the status of the Community Reinvestment Act that was issued just recently by the committee about a month ago, by Senator Cranston?

Mr. LAWARE. I have not read it, sir, but I——

Senator SARBANES. Are you familiar with it, Mr. Turner?

Mr. TURNER. Not intimately, no, Senator.

Senator SARBANES. Mr. Chairman, I've trespassed on my colleagues' time, but I must say, if there's anything that comes through here rather clearly, it's that these regulators that we're depending on are very much behind the curve, it seems to me, on this issue. I don't say that in any—well, I do say it in a critical way, I must say.

But, you know, it's clear we've got a problem. A few well-sent messages in terms of enforcement by the regulators, it seems to me, are going to send a very important message through the industry. And then you're really going to start getting some voluntary compliance. Would you agree with that, Mr. Turner?

Mr. TURNER. Absolutely. That was the thrust, I hope, of my remarks, was that these pattern and practice lawsuits that the Department of Justice has brought are very expensive and time consuming, but they have ripples far beyond the institution that's involved. I think we've done a lot for Atlanta by suing one bank in Atlanta.

Senator SARBANES. That's right. But to reach your point, you're pretty far down the line at that point. I think the regulators come in much earlier. They can be sending constant, almost daily messages about this issue and people can start paying attention, which I think is desperately needed.

Thank you very much.

The CHAIRMAN. Well, thank you, Senator Sarbanes.

I'm struck by the fact that, of the enforcement actions that Chairman LaWare spoke about, when you get down into the guts of what was going on, as Mr. Garwood pointed out, they really were not aimed in any significant number to the racial discrimination issue. They were aimed essentially at other issues—marital discrimination.

I think what it says is that, you know, we're sort of blind in one eye. We haven't been able to see this problem. And there's really no excuse for that because the problem is out there. I think it's very hard for citizens across the country who are facing this dis-

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crimination to feel very good about the way the country works as it relates to them.

I know that, Mr. LaWare, you're a man of goodwill and decency. I've known that for a long time and have seen you here and so forth. But I think if you were to imagine yourself as a black citizen in this country who might have been denied credit for yourself and your family, I think you'd feel a great anger about it. I know I would. And I do, about the fact that others have gone through that. I don't know how we get the level of concern and intensity up to the point where we really address this problem with some force.

Frankly, it's a piddling number of cases, and essentially, they've missed the racial discrimination aspect, except in very minor degrees. Having said that, I appreciate what the Boston Fed has done. I think you've performed a valuable service. But now that you have, I think it's the responsibility of the Federal Reserve Board as a whole to take what you have found and really get moving.

I think you ought to be using testers. They're doing it over in the Department of Housing and Urban Development because they think it's important to carry out the mandates of the law.

I don't think you can in effect say, well, look, we're doing a fine job over in one area carrying out the law, but we just are having a hard time carrying out the other part and it's expensive to have testers or it's just hard for us to do it.

If that's what comes through as a policy, I don't think that's an adequate policy. I think more is needed than that because we're talking about a real-time problem. We're talking about people who are applying for mortgage credit today, this very day, and who may be turned down simply because they're a minority person. And that somebody with the exact same, or comparable credit history, according to the refinements of the study that you've done, who is not a minority person will get the mortgage loan.

The minority person will not get it. And if they don't get it today, then their life is affected today. Their community is affected today. Now how do we get this sort of up the priority ladder in a way so that we're getting a more aggressive approach to the problem?

Mr. LAWARE. Senator, if I thought that testing was the answer to confirming or denying the existence of discrimination in the banks, we'd be doing testing. But in all of the analysis that we've done, and we've done extensive analysis of the testing techniques and how they can be applied to the banking situation, we don't get confirmation that that's really going to help us to get the evidence necessary to make referrals to the Justice Department or to impose these sanctions against the banks that are within our administrative power.

The CHAIRMAN. Now you were talking earlier about the signal that's gone out. Mr. Turner was talking about the signal that went out by pursuing one case.

I think the Fed has tremendous ability to send signals. And you can send a passive, weak sort of signal, or you can send a very strong signal. And I think if a signal is sent that steps are going to be taken—testing is one alternative. I don't say that solves the whole problem, although I think there's some burden on the Fed here when other agencies of Government are using it and finding

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it useful and you've got a problem that you're having a hard time solving and that's one tool and you don't think it's going to work very effectively.

I think, then, there's a burden on you to come up with tools that you think will work in an accelerated way, and much faster than you've managed to do at the present time. I think probably when you find instances where this happens, the penalties that are applied probably also send a pretty strong signal.

You talked about the money penalties in a couple of cases, although those were not principally mortgage discrimination cases. How much were those money penalties?

Mr. GARWOOD. We have not assessed civil money penalties in those cases you talked about. In those institutions, the people who were turned down were notified that they could reapply. They could reapply on the terms that they had first sought, and that was the kind of corrective action we sought in those cases, although we do have the authority, which I believe is subsequent to many of those cases, impose civil money penalties, and certainly, that will be considered as part of this inquiry as to what we'll do.

The CHAIRMAN. So, in effect, what the remedy was was to try to take the person who had been unfairly discriminated against, and say to the lending institution, you ought to take another look here, with a little moral persuasion behind it, and they went ahead and made a loan that they should have made in the first place. And presumably, it was a profitable loan. That seems to me to have been a help to the institution, and presumably, a help to the person discriminated against.

But it seems to me that if you've got a pattern of this happening, you've got to use stronger medicine than that. I don't see how that is a very powerful remedy. That's a one-by-one remedy.

Mr. SYRON. Senator?

The CHAIRMAN. Why don't you go ahead? Mr. Turner, you wanted to go, and then Mr. Syron. And then I'll yield.

Mr. TURNER. Mr. Chairman, could I just take a second to give you my Department's view on this testing thing, because we do have a testing program and we worked with HUD in designing their testing program?

Testing is a way to—we use it for rentals and sales, to determine whether there is discrimination in the actual contact on a rental or a sale. There are several different aspects to the credit discrimination problem revolving around mortgages. One is the individual level, where minorities are screened out at the door, and I spoke a little bit about that in my testimony, where they were not the targets of the business. Therefore, they didn't get in. And if your idea is that they're screened out from applying, then you could use testing to verify that kind of a thesis.

When you get down to the HMDA data and whether they show that a particular institution has a pattern or practice such that its whole institutional life has turned into a discrimination pattern, then you have to go deeper. And it seems to me you can't do that with testing. You can't manufacture couples that have two kids and Social Security numbers and all that stuff. You just can't turn it into that kind of a drama.

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But the testing that is helpful—and what I think HUD is doing—is individual case testing where you're looking at the intake of the institution to see if they're screening out minorities illegally.

The CHAIRMAN. Just one other thing, Mr. LaWare. As best you can judge professionally, when do you think you could certify to this committee that this problem, for all practical purposes, will have been corrected in the banking system, at least the part of the banking system that's under the jurisdiction of the Fed?

Mr. LAWARE. I think it would be almost impossible to certify that 100 percent elimination had ever taken place.

The CHAIRMAN. How about 75 percent?

Mr. LAWARE. Well, I don't know. We could argue all day long.

The CHAIRMAN. My point is I'm not asking for perfection. But where you are today is so far from perfection, that I think we've got to have a commitment that this problem is going to be addressed so that these instances of racial discrimination in lending become very isolated cases, very rare events. They are not now. They are very common events now.

Mr. LAWARE. We're talking here about changing institutional and individual behavior patterns. You don't do that by the stroke of a pen overnight. It takes training. It takes institutional acceptance of the principles. And we're working on it. Some of the things I outlined——

The CHAIRMAN. Doesn't it take enforcement of the law?

Mr. LAWARE. Yes, it does.

The CHAIRMAN. Don't you have something to do with that?

Mr. LAWARE. It takes more, however, than enforcement of the law. It takes——

The CHAIRMAN. Well, won't that help change behavior patterns?

Mr. LAWARE. Yes, sir, it certainly will. And now we think we have the necessary tools to be able to identify the violations of the law.

I testified here 2 years ago when Senator Dixon was the chairman of the subcommittee. I said that we were looking forward to have the HMDA data because it would give us a better way to trace the outliers, the people who were obviously engaging.

The CHAIRMAN. Right.

Mr. LAWARE. And that is proving to be true.

The CHAIRMAN. So the Justice Department, in all likelihood, then, could be expecting more traffic.

Mr. LAWARE. Yes. We made a referral recently to the Justice Department.

The CHAIRMAN. A referral?

Mr. LAWARE. A referral. I would expect that there would be more of them as we go forward using these new techniques where we're applying the HMDA data to the individual institution. But it's a complex problem.

The CHAIRMAN. I understand it's a complex problem. That's why we hire very talented people like you and your colleagues to do these jobs, to figure out answers to complex problems.

We're talking about people at the other end of the credit stream whose lives are being hurt this minute. It's very frustrating to have people in charge, who have enforcement mechanisms and have regulatory oversight and great power to see that these laws are being

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obeyed, to say, it's a very tough problem. We're working on it. It's been out there for a long time. We haven't made a lot of progress. We're changing our methods, and so forth and so on. But you've got a real time problem occurring each day out there in the lending community.

And so, I think there's an affirmative obligation to bring a remedy to bear much faster. There's probably several parts to that strategy. One is moral leadership. One is talking about it. One is meetings, by yourself and other Fed members with bankers around the country. One is tough enforcement actions.

I think the message does spread quickly. If people learn from Fed actions that these are very serious infractions and that there are serious penalties involved that are going to happen, that will change the internal culture faster than anything else.

Mr. LAWARE. Senator, we also feel we have an affirmative obligation to be equitable in the way we administer these sanctions and we must be able to prove our case.

Senator SARBANES. Mr. LaWare, there's no contradiction between being fair and equitable and being vigorous and forthcoming in the application of the law and its enforcement. There's no contradiction between those two things. Any sort of regulator worth their salt does both of those things.

Now the problem here is obviously, we perceive this as having some dimensions of a crisis to it. We see people are being denied credit. They ought not to be denied credit. It's grossly unfair to them. It has impacts in the community in terms of the community development. And then what we get is a kind of, well, yes, we're now getting the figures. Things look like maybe there's sort of a problem. We're trying to get at this thing.

We're really seeking an action program out of the regulators to try to deal with this thing, and to deal with it in an energized way, in order to turn this thing around. We've long passed, I would hope in this country, beyond the point where you could sort of tolerate those attitudes or those sort of things just kind of happened, and if you got a really grossly egregious case affecting some individual, why, you tried to turn it around.

We can't go on doing business that way. I agree with the Chairman. The burden is—you're the chairman of this committee, but the burden is on you and the members of that committee and others to try to move this thing.

I very sharply take issue with the assertion that you can't be vigorous and forthcoming in the enforcement and at the same time, be fair and equitable to the parties that are involved.

Mr. LAWARE. I didn't say that, and I assure you, we accept responsibility to do what you're saying.

The CHAIRMAN. Senator Moseley-Braun.

Senator MOSELEY-BRAUN. Mr. LaWare, and to the members of the panel, I'll share a story with you.

When I was in high school, a young lady got pregnant and she thought that she got pregnant from swimming in the school swimming pool during gym. It took some counselors to explain to her that that was not how you got pregnant. The water didn't just bloat you up and make it look like that.

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Quite frankly, this situation is, in my mind, close to analogous to that situation. We've got a lot of people out there being discriminated against. A study that shows a 60-percent difference and banks doing the discriminating. Lending institutions discriminating. It's no secret to anybody. And for you to sit there now and for this testimony to say, well, we don't now how this happened, is nothing short of stunning to me. It's clearly unacceptable and I think that's been the import of the Chairman and Senator Sarbanes' reaction, that this is not only unacceptable, but this kind of ignorance coming out of our regulatory agencies is just not to be tolerated. It is outrageous.

I'm looking at some of the information that was provided and listening to your testimony very closely, sir. Among the things that you referenced in terms of your regulatory efforts in this regard, is the passing out of brochures to financial institutions, Home Mortgage Lending and Equal Treatment. And another one: Home Mortgages—Understanding the Process and Your Right to Fair Lending.

I daresay that the fact that these documents don't really say very much in terms of giving direction to financial institutions may be part and parcel of the reason that we have this problem. This doesn't go very far, in my opinion, to shedding any light for the financial institutions on what they need to do to avoid, if you will, being pregnant with this particular evil.

To go a step further, your testimony indicated that you spend hours in the review and examination process, and I think you indicated a total of 68 hours examination procedures for detecting loan discrimination. Twenty-nine hours per examination to complete. An additional 39 hours on CRA enforcement. That's an awful lot of time and energy and manpower, and yet, it does not appear that all of this examination activity has given rise to any sanctions being taken against anybody. Even in the Decatur case, as I understand it, the FHLBB gave Decatur a satisfactory rating after the Justice Department filed its action.

I guess my question to you, sir—well, it's kind of a comment. It's more than a question—how is it that with the staff and the people that you have working on this, that you so far neglected altogether to put any teeth, any muscle, any oomph behind enforcement of these laws, these fair lending laws, and yet, you've been spending all this time monitoring the banks? Let me take this out one step further. We get complaints from bankers all the time that they are overregulated. We get complaints all the time that they've got people in there pouring over their books for any number of different reasons.

But if the pouring over of the books just results in somebody cranking out paper, and no actual substantive enforcement of the laws, then I think, quite frankly, we may well be wasting the taxpayers' money. And that is really a fundamental issue. Why do we have regulators if they're not regulating? And why do we have regulators who don't seem to comprehend how it is that this discrimination happened in the first place?

That is a fundamental issue and a fundamental problem, frankly, that I have with this testimony and with the testimony that we've heard over the last few days. And I would very much like for you

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to expand for us today on what specific steps you intend to take as the chairman, as the Chairman of the Federal Financial Institutions Examination Council. What do you intend to do to direct the regulators in the direction of enforcing our fair credit laws of this country?

Mr. LAWARE. Well, that's kind of a big order since I don't have any executive authority over the member agencies of the Federal Financial Institutions Examination Council.

Senator MOSELEY-BRAUN. OK. Who does?

Mr. LAWARE. The parts of the Government to which they are responsible. The FDIC and the Federal Reserve are independent agencies. The OTS and the OCC are responsible to the Treasury.

Senator MOSELEY-BRAUN. OK. But, now, this institution is a Council of what kind? What is your level of authority?

Mr. LAWARE. It is a Council put in place to coordinate activities among the regulatory agencies, to standardize reports and to standardize, to the extent that we can, examination procedures and standards. And we are working toward that.

Senator MOSELEY-BRAUN. All right. And in that role, you would not see a role in standardizing antidiscrimination efforts?

Mr. LAWARE. Yes, I would. And we are doing that. And as a matter of fact, because this issue of compliance and the effectiveness of compliance examinations has come up, we are employing an outside consultant to review with the agencies the effectiveness of our examinations.

That decision was taken some time ago. We are not yet in the position to go forward with that study because the staffing for it is incomplete. When that study is complete, we intend to consult with community groups who have a vested interest in this question of discrimination to see if they feel that the recommendations are consistent with improving our examination process. And if they are not, then we will make further changes to it.

Senator MOSELEY-BRAUN. Let me ask you a question, Mr. LaWare. How many employees, how many people are on the Council and how many employees are there, total, for this Council?

Mr. LAWARE. There are five principal members of the Council. I represent the Federal Reserve Board. The Comptroller of the Currency represents the OCC. The Director of the Office of Thrift Supervision represents that organization. The Chairman of the Federal Deposit Insurance Corporation represents the FDIC. And the Chairman of the National Credit Union Administration represents that organization.

Senator MOSELEY-BRAUN. Specifically, with regard to the coordinating function, how many employees are—you say coordinating between these various agencies. Specifically, how many people work at that?

Mr. LAWARE. The Council has on its own payroll maybe 12 people. But we work through task forces with representation from all the different agencies on these various issues.

Senator MOSELEY-BRAUN. All right. And with regard to the task forces, the total complement of people who are involved with coordinating the activities of the various agencies, under the auspices of this Council, how many people are we talking about?

Mr. LAWARE. With regard to which issue?

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Senator MOSELEY-BRAUN. With regard specifically to the issue of enforcement of the nondiscrimination.

Mr. LAWARE. There would be at least five basic members, and then they will draw on the staff of their various agencies for staff work to support that task force.

Senator MOSELEY-BRAUN. And you're saying that you have to have a consultancy to come in and help you because you don't have the talent within the agencies to do this?

Mr. LAWARE. No. But we like to check and make sure that what we're doing is effective. This is an auditing technique; that is, it is an auditing technique to go into a bank. An examination is an auditing technique. Now we are use to examining for safety and soundness issues. We're trying to find out if the auditing techniques we've been using for compliance purposes are adequate. And we're trying to get some professional outside advice.

They may find that we're doing a fine job, or that at least our procedures are fine. We might have a difference of opinion whether the result is OK. But if it is not, if there are ways that we can improve it, that's the intent of our effort here.

Senator MOSELEY-BRAUN. But, again, Mr. LaWare, you contracted out with a group to advise you with regard to auditing techniques. Does the group have any experience with regard to fair housing or fair lending?

Mr. LAWARE. We put this out for competitive bid, I think we had only five or six bidders. The agency that got the bid was the one that had the most proven auditing experience. We asked them if they would be willing, if they got the contract, to acquire a staff augmentation of people experienced in this issue.

Senator MOSELEY-BRAUN. But, again, Mr. LaWare, isn't the issue not just auditing in the simple sense of calculation of numbers, but, rather, taking a look at the bigger picture of their lending practices, abuse of discretion in this cases?

Mr. LAWARE. Well, auditing isn't just an accounting process. Auditing, the way we do it for examination purposes, looks at procedures and policies and all those kinds of issues. So that what we're trying to do is make sure that we're doing it the best way there is.

The CHAIRMAN. On this issue that Senator Moseley-Braun has raised, regarding this contract you've gone into, you talk about their augmentation of staff. You put it out for bid. The Arthur Andersen Co. has now been given the contract. But, as I understand it, they really have no background in fair housing or fair lending. Isn't that a fact?

Mr. LAWARE. That's correct.

The CHAIRMAN. So they're starting from scratch. Now your hope is that they can build some expertise in this area.

Mr. LAWARE. And if they can't, they won't go forward.

The CHAIRMAN. Was there no one in the country that could be found that would have expertise in this area?

Mr. LAWARE. There were no bidders on this contract that we felt were qualified.

The CHAIRMAN. And an effort was made to go out and find people who might have that ability?

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I'm wondering if there are people in the country that might have not only had the ability, but would have been quite willing to bid on this contract and may not have known about it.

Mr. LAWARE. We went through the usual procurement procedures. That gets very wide distribution. We were very surprised that we didn't have more offers of help.

The CHAIRMAN. I guess what would occur to me, and this is the hard part for me and maybe there's some logical answer to it.

At that point, if somebody was sort of overseeing this process and said, you know, we put this out for bid and we can't find anybody that really has any experience in fair housing or fair lending that wants to do this job, my reaction would be to say, that's hard to believe. Why don't you go out and look a little harder. Let's see if we can find somebody who properly can do this who doesn't start from a cold start.

Mr. LAWARE. That's exactly where we are. If Arthur Andersen can't find that kind of augmentation, then we're not going to go forward with them.

The CHAIRMAN. Well, we've got other panelists that we need to hear from this morning and I don't want to bring this panel to a conclusion before the members have finished with it. Do you want to proceed at this point, Senator Moseley-Braun, and then Senator Sarbanes, if you have anything else, and then I think we'll go on.

Senator MOSELEY-BRAUN. And I'm going to just really conclude, Mr. LaWare, by saying to you that the response that we've heard so far, in my mind, is a functional equivalent of saying you won't go swimming any more not to get pregnant.

It's just not responsive. It doesn't seem to me to indicate any appreciation for what goes into these situations. And certainly no active steps to send a strong signal, and I guess this gets to what the Chairman was saying in terms of weak signal versus a strong—to send a strong signal that de facto discrimination will not be tolerated in these United States when it comes to access to credit. And that's got to start some place, and pointing the finger and passing the buck is not going to do it.

It seems to me that as the regulators—you guys are in a situation in which nobody is happy with what it is you do. The bankers don't like it because they say you're spending too much time pouring over and tying them up and keeping them from doing their job and are pointing the finger at the regulators as reason for the credit crunch, even, on the one hand.

The consumer groups don't like it because they're saying you're not doing anything. And quite frankly, to be honest, I'm the new person on this committee, but I haven't seen anything to redeem you. I'm willing—not you, personally, but to redeem the regulatory community, if we can call it that.

I'm willing to listen and to get something back to hear that you're doing the job, but I just don't see it. And to have the Justice Department have to invent procedures, as in the Decatur case, when we've got a regulatory staff out there that's supposed to do this on an ongoing basis, is not the answer, it seems to me.

Mr. Syron.

Mr. SYRON. If I could, Madame Senator. I don't think anyone's satisfied with the way things are or the way things have been. But

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I think it's a little unfair to say that steps aren't being taken to make things better. While I can only speak about the institutions I regulate in my district, I know steps are being taken with Governor LaWare's encouragement, and this is true in other districts as well.

I can tell you that at least the institutions that I'm familiar with are highly aware of this now. Is everything perfect? No. But they're paying a lot more attention to this, at the very highest levels, and are developing internal processes to improve in this area. Getting there is not strictly a numerical process. I think Senator Sarbanes is absolutely right in that respect. I do have some reservations about how much more time we spend collecting data instead of going forward and fixing this problem. This requires working on processes. And I believe those processes are being worked on. Is everything right? No. Is it better than it used to be? Yes.

The CHAIRMAN. Shouldn't every Fed district do what the Boston Fed district has done? Would it be helpful?

Well, let me put it this way. It seems to me it would be helpful to have exactly what's happened there, where now you have a higher sensitivity. One thing that Mr. LaWare could do is he could tell the other Fed districts to do what you have done. Couldn't he do that?

Mr. SYRON. I'm not sure you really need to do it, and I'd like to tell you why.

The CHAIRMAN. Well, let's leave that aside for a minute. The point is that that could be done, could it not?

Senator SARBANES. Why should only the Boston Fed show leadership in this area? Why don't we get the other regional Federal Reserve banks to do the same?

Mr. SYRON. I don't think its value-adding to be grabbing kudos and claiming leadership in this area. The plain fact of the matter is this issue was very hot issue when I came to the Boston Fed. It was the right thing to do to follow it up, so we did follow it up. I think anyone in another district in the same circumstances would have done the same thing. In terms of doing——

The CHAIRMAN. All well and good. That's fine. The facts are as they are. The point is it's been a very useful exercise and good results are coming from it. Now I'm quite certain in my mind that this problem is not isolated to the Fed district. I think it's a national problem.

And so, it seems to me that it might well serve the Fed in this instance to take a look at the Boston experience and say to the other Federal Reserve district governors, we think it's time that you did something like this in your district, not a year from now or 5 years from now, but we'd like you to do it now because we'd like the discrimination to stop now.

I assume the telephone lines work all across the country. They don't just work to the Boston office, and from Boston to Washington. I assume that if somebody at the Fed here, particularly somebody as distinguished as John LaWare, got on the telephone and talked to the other districts and said, we'd like to see you show a response such as we've seen in Boston, not giving you any special medals of honor here——

Mr. SYRON. I don't deserve them.

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The CHAIRMAN. But we'd like to see something done in your district like we've had done in Boston. There's nothing to prevent that from happening, is there? That could happen today, couldn't it?

Mr. SYRON. Yes, and I think it is happening to a certain extent. But my only point, Senator, is we can pursue the same remedies across the country without necessarily having to do studies all across the country. I personally don't think we would want to take the time necessary to do the studies. Thye are not done overnight.

The CHAIRMAN. Well, that phone call could take place, too, couldn't it?

Senator MOSELEY-BRAUN. Right. Mr. Syron, I agree. But the problem is I just heard the response we got, is that we've contracted out a contract to some outside people who don't know anything about this area to conduct yet another study about how to go about creating some remedies.

Mr. LAWARE. But we're not dead in the water while that's going on. All we're trying to do is find out if we're doing it as well as it can be done. In the meantime, we're going forward as aggressively as we can to pursue these situations. I don't know why you don't believe me when I tell you that we are pursuing these issues aggressively.

Senator MOSELEY-BRAUN. Mr. LaWare, it's not that I don't believe you. I just haven't heard what it is that you're doing, what pursuit consists of. What are you doing specifically to move this point? Again, I saw the brochures referred to. This doesn't tell me anything.

Mr. LAWARE. I tried to explain that we are working with the Justice Department now on a list of about 200 banks that they have identified as having HMDA data which separate them from the rest of the crowd. Therefore, they are perhaps suspicious.

Each of the agencies is sifting that list to identify five or six banks that each agency is responsible for, where we can go in and do this more intensive investigation to try to determine whether there is discrimination going on.

I think Mr. Turner has already stated that just the HMDA data are not a proof of discrimination. You have to apply these other characteristics and you have to get the information and you have to match up the files. In order to do that, we have to be able to start somewhere. And that's where we are at the moment. Now we're moving as aggressively as we can on the thing, I assure you.

The CHAIRMAN. Mr. LaWare, there are a couple of things that I think maybe we could do here today. I think we appreciate the difficulty of this problem. We want to get it solved. You want to get it solved. And that's what we're looking for, is a way to get it solved and solved faster.

Mr. LAWARE. Yes.

The CHAIRMAN. I think there are two things that could be said here today by you that would be very helpful, in a public sense. This is a public hearing. It's a public setting, and it's being widely followed by people who care about this issue.

I think if the Federal Reserve speaks clearly to everyone within your regulatory purview in this area, if the Fed says, look, we want this discrimination brought to an end and we want it brought to an end right now—we know there are problems there. They have

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been pointed out by the Boston Fed study. We know there are differentials in credit here that have nothing to do with credit-worthiness. But there's a racial discrimination element.

We are saying, the Fed is saying and we're saying it to every bank officer and to every bank organization, we want the discrimination based on race to stop and we want it to stop now. And that is a clear, powerful signal, in that there are no ifs, ands, or buts about it, that that's the law of the land and it's to be obeyed, and that anybody that doesn't want to live by that law, either ought to get out of the banking business or be prepared to suffer the penalties of breaking that law. And that any citizen out there who's in that situation, who feels that that's happening to them, will have a remedy, and that they either ought to contact yourselves or they ought to contact the local district attorney and come up through the Justice Department route, and bring these cases to light.

I think there needs to be a statement of purpose and intent that's just as clear as two- and three-syllable words can make it, that what the Fed expects to be done, says should be done, and is going to measure against. When that is said with as much clarity as you can give it, and I'd like to hear some kind of a statement right here today before we end this panel, I think that will have an effect because you are listened to.

It's not just the banking institutions that may be the worst offenders that need to hear the message. But I think the rest of the country needs to hear it. The people out there that are being discriminated against need to know that you're on their side.

Mr. LaWare. Well, I don't know how to make it any clearer than in the opening couple of sentences of my commentary. I'll use that as the statement:

This hearing is very timely, given the troubling questions that have been raised about the fairness of the mortgage lending process. Parity in how applications are considered without regard to race, sex or other prohibited bases is absolutely essential in our country.

Let no one have any misunderstanding on the point. Racial discrimination, no matter how subtle, whether intended or not, must not be tolerated.

Simply stated, excluding any segment of our society from fundamental economic opportunities such as homeownership and equal access to credit is morally repugnant and illegal. Moreover, it robs the lending industry and our economy of growth potential.

I want to assure you that the Board is committed to vigorous enforcement of fair lending laws. That states our policy position and that——

The Chairman. Would it be fair to amend that statement by the preamble—we put pulls in here and we have long preambles, which is sort of the statement of the problem and then we have the action clause. The action clause came in the last sentence that you said there.

I think it would be very constructive if a statement could come from the Fed, come from yourself, come from Alan Greenspan or the Board as a whole, to say the Fed will not tolerate discriminatory practices in lending through banks, and that wherever it is

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found, that the Fed will use every tool that it has, including vigorous enforcement actions and penalties as applicable, to put a stop to it, so that there is an action clause that delivers a signal that is absolutely unmistakable. Otherwise, because these things are hard to find and it can take a long time, everybody can sort of become more casual about it.

I know you don't want people to become casual about it and we don't want them to be, either. I think you ought to consider how you can beef up the action part of what the Fed will do both to stop it and what happens when you find it, because I think you can have a big impact on behavior. I'm not sure that the action line at the end of what you just read is going to give you the kind of impact or cause the kind of impact out there that I think we need to have. And I'd ask you to think about how that can be beefed up.

Mr. LAWARE. We'll put some more explosive in that last sentence.

Senator SARBANES. It would seem to me the language of the Chairman shouldn't pose any problem for you, as he put the last question.

Mr. LAWARE. It's a principle which we have embraced and which we believe in. Maybe we haven't stated it strongly enough. I have no problem with anything you said.

Senator SARBANES. Good. We're pleased to hear that.

The CHAIRMAN. Thank you all.

Senator SARBANES. I think that ought to be underscored, Mr. Chairman, as the sort of message out of this hearing.

The CHAIRMAN. Thank you. We'll excuse this panel and now call our next panel to the witness table.

Let me invite everyone in the room to try to find a seat. We'll let the people who are leaving exit the room.

Let me now introduce the panel of four witnesses that constitute our second panel. We have Retha Wilson here, who is a board member of Michigan ACORN from Detroit, MI. We're very pleased to have her here. John Gamboa, who is the executive director of Latino Issues Forum, in from San Francisco. We appreciate you coming from across the country.

We have Allen Fishbein, who is the general counsel of the Center for Community Change, here in Washington, DC. And we have an old friend of this committee, Gale Cincotta, who is the executive director of the National Training and Information Center, from Chicago, and long a leader in this field and related fields.

We're pleased to have you all. We'll make your full statements and a part of the record. Ms. Wilson, we'd like to hear from you first.

STATEMENT OF RETHA WILSON, BOARD MEMBER, MICHIGAN ACORN, DETROIT, MI

Ms. WILSON. Mr. Chairman and committee members, I am Retha Wilson, a board member of Michigan ACORN. I appreciate the opportunity to testify today. I would like to take this opportunity to commend Chairman Riegle for your record of leadership on behalf of low- and moderate-income and minority families. We appreciate your strong record on consumer protection and community reinvestment issues.

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Mortgage discrimination remains a real obstacle to the attainment of the American dream of home ownership for millions of minority families.

This year, we mark the 25th anniversary of the passage of the Fair Housing Act. It is 18 years since the passage of the Equal Credit Opportunity Act [ECOA], and 16 years after the passage of Community Reinvestment Act [CRA]. Yet, America remains a Nation of two banking systems, separate and unequal. The Nation's regulators have done almost nothing to enforce laws passed by this committee.

The current situation is a scandal. This committee and the new administration need to launch a crusade for equal opportunity in lending. The full resources of Government need to be brought to bear on credit discrimination.

President Clinton has stressed the need for investment in our Nation's future. There is no single investment that could be of greater importance than ensuring that families that work hard and play by the rules are not denied opportunity based solely on the color of their skin. Each unfair denial represents more than the loss of a dream of an individual. It is a real economic loss to the nation.

Mr. Chairman, the time for studies has long passed. We have waited and watched as data establishing discrimination has been released time and time again, and ignored by the agencies and the industry time and time again. It undermines our democracy to place laws on the books, collect data that reveals massive violations, and leave it there, without any action being taken.

African-American communities in Detroit and around the Nation must have the confidence that the fair lending laws really mean something. We all know the denial numbers. Blacks are rejected twice as often as whites of the same income. Upper-income blacks are actually rejected more often than lower-income whites and there is no telling how many thousands of minority families may be discouraged from even filing an application.

How does mortgage discrimination affect our neighborhoods? Discrimination has caused the destruction of many minority communities. In many neighborhoods in Detroit, for example, there are hundreds of abandoned houses. Abandoned properties are havens for drug use and crime and are often burned down. This increases the burden of all taxpayers, no matter which side of town they happen to live in. Mortgage discrimination then represents a hidden bank tax on the whole community. The enforcement of the fair lending laws, the Fair Housing Act, and the Equal Credit Opportunity Act, as well as the Community Reinvestment Act, has been a national disgrace.

Indeed, the agencies had to be sued by the National Urban League and other civil rights organizations before agreeing to enforce the Fair Housing Act. Since then, studies of mortgage lending in Detroit, Atlanta, and Boston have resulted in no action by the regulators. After the Federal Reserve study of the 1990 HMDA data, the most that any of the agencies would say was that the numbers were worrisome. The four banking agencies have referred only five violations of the ECOA to the Justice Department in the

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last 10 years. And the FDIC's three referrals came only after Senator Cranston insisted that they make the referrals.

This took place after the FDIC Improvement Act, which requires such referrals, meaning that the FDIC was ignoring the law.

The agencies almost never finds violations of ECOA based on racial discrimination. When the agencies do find violations of ECOA, they require the banks to merely correct the problem and appear to have never actually fined or otherwise punished a lender for a violation.

While the Justice Department found the pattern and practice of illegal discrimination under ECOA at Decatur Federal S&L, the OTS not only missed any discriminatory practices as part of its compliance examination, but gave Decatur a satisfactory CRA rating. Enforcement of CRA is equally poor. Nearly 90 percent of banks get passing grades, when everyone in the community knows that most banks are doing a poor job.

There is very little that Congress can do to stop lending discrimination without cooperation by the Federal banking agencies. After 25 years of hostility by the regulators, we now have an historic opportunity to reverse the pattern. Most of the change is needed are fully within the power of the administration. President Clinton should fill regulatory posts with people who have a commitment to fair lending. We hope that this committee will be vigilant in carrying out its duties in the confirmation process.

The CHAIRMAN. Let me just stop you there to say, I agree with you absolutely on that point. And, as a matter of fact, we will be confirming all of those nominations in this committee.

There are some 56 ahead of us to be handled, and not all of them in the bank regulatory field, but many are. I've already interviewed one who will be coming forward in one of the top bank regulatory positions. This is a central question that I am posing to each one, because if each one is not prepared to address this issue forcefully and strongly, then, to me, they lack a qualification they need for consideration.

The one I have interviewed feels as strongly about it as you do and as I do, and said to me, and these were his words, that if he has the particular position that he's to be nominated for, it's a very high bank regulatory position, that on discrimination in lending, he intends to do everything within his power to rip it out, root and branch. That was his phrase. I haven't heard that for a long time, but I was encouraged by that. So you can be sure that will be one of the measuring sticks we use on every single person that comes to this table seeking one of these positions.

Ms. WILSON. Thank you. I have attached a list of recommendations in my written testimony. I would just like to mention a couple of things that could be done right away by the new administration. The new administration should create separate consumer compliance divisions within the agencies to enforce the fair lending laws. Contract with fair housing groups to use testers. And collect data on lending to minority owned small businesses.

I have faith that this committee will work with the administration to ensure compliance with the fair lending laws.

Thank you, Mr. Chairman. This concludes my testimony.

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The CHAIRMAN. Thank you very much. I appreciate it and that's very helpful to us.

Mr. Gamboa, we're pleased to have you and we'd like to hear from you now.

STATEMENT OF JOHN GAMBOA, EXECUTIVE DIRECTOR, LATINO ISSUES FORUM, SAN FRANCISCO, CA

Mr. GAMBOA. Thank you, Mr. Chairman.

I also wanted to express my gratitude for being invited all the way from California here to give testimony on this very important subject. I'll be very brief.

The CHAIRMAN. I should say that Barbara Boxer is keenly interested in your testimony. She had two conflicting things that she had to attend to and she intends to get here as promptly as she can and discharge those other duties. But I want to just say to you that she is keenly interested in all of this discussion, but particularly your testimony.

Mr. GAMBOA. Thank you. I have meet with her and I understand that, in fact, she encouraged me to attend today. Like I said, I was going to deviate from my prepared talk because much of what I was going to say has already been said. I'll try to concentrate on some of the questions that were asked by yourself and other members of the committee, the questions of why.

But I'd like to first open up with, it's particularly disheartening to us of the minority community to see in the papers what's been happening in the last few years, where millions of dollars have been poured into former Iron Curtain countries to reinforce, to support a free enterprise and democratic movement in those countries, while we deny the same to people in this country simply because of the color of their skin.

It's very frustrating to us, disheartening, and kills really any incentive for people to try to advance. I think there are several reasons why loan discrimination still exists today. But the primary reason I think everybody's hit on today has been the failure of the Federal agencies to truly enforce the spirit as well as the letter of the CRA.

In California, we have 14 million minorities residing. Of the seven largest banks who make up 95 percent of all the bank loans, we found that only one home loan per bank branch is going to a Latino family.

The CHAIRMAN. One home loan per bank branch is going to a Latino family.

Mr. GAMBOA. That's correct.

The CHAIRMAN. And, of course, you have a very substantial Latino population in California.

Mr. GAMBOA. Twenty-five percent of the State.

The CHAIRMAN. Twenty-five percent of the State.

Mr. GAMBOA. As bad as that is, it's even worse for African-Americans. One bank loan for every four bank branches is being made to African-Americans.

The CHAIRMAN. One bank loan for every four branches is being made to an African–American family.

Mr. GAMBOA. Right. And in spite of this kind of a record, 99 percent of banks receive CRA ratings of satisfactory or above. In fact,

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90 percent receive, if they were given grades like in school, would be given A or B grades.

The CHAIRMAN. You know, I must just say—excuse me for interrupting—but it's astonishing to me how the Federal Reserve somehow can't see that, with all due respect to the last witness.

The data is so powerful, that it speaks for itself. And yet, there's this incredible blind spot where they look out there and somehow, they can't see this problem. Even though the problem is manifest and it's there and in such a striking manner, they just can't see it.

Senator MOSELEY-BRAUN. Mr. Chairman, they think it's the swimming pool.

Mr. GAMBOA. As bad as this record is for HMDA data, it's our belief on cursory review that it's much, much worse in business loans to the minority community.

The CHAIRMAN. Business loans, now.

Mr. GAMBOA. Yes.

The CHAIRMAN. Yes.

Mr. GAMBOA. Our cursory evidence shows that only 1½ percent of all commercial loans in the State of California go to minorities, go to Hispanics and to African-Americans combined. That's 1½ percent.

And in regard to what you were saying, I don't think—it's no secret to me. It's no secret to the people of our community. Most of them are gone to lunch now. But these two rows were reserved for the Federal agencies. If you take a look at them, there was one minority there from the top agency. In fact, we've done just a cursory review. We've asked the Federal agencies, the regulatory agencies, to give us the data on the highest-ranking managers by race and ethnic background.

What we have found is, at the OCC, out of the top 169 officials, one is Latino, and only 3 percent were African-American. And that's the best record of the three agencies. So it's no secret to us why it's not being enforced.

Senator MOSELEY-BRAUN. Yes. But Mr. Gamboa, we can't let people off the hook just because they are white males from enforcing the law that's supposed to apply to all Americans.

Hiring is one issue and you're right to pursue that and that's important. But we can't just excuse the lack of sensitivity by virtue of the fact that they are so few minorities.

Mr. GAMBOA. Absolutely. I'm not trying to excuse them. I was trying to point out one of the reasons why there's such lax enforcement.

The CHAIRMAN. A blind spot.

Mr. GAMBOA. Yes. Also, I forget who the Senator was earlier this morning, made a reference to the creditworthiness of individuals. I don't believe that we have to make any changes in the credit criteria because we have banks that do outstanding work in our communities.

We have a bank, Great Western, and I have nothing to do with Great Western. But Great Western Bank is a very small bank in California who has double the loans to the minority community of all the other banks combined. And the only difference they have made between the larger banks and the others is that their loan

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officers are people of the community they're trying to make loans from.

I'll conclude with——

The CHAIRMAN. No, take your time. Don't worry about the lights.

Mr. GAMBOA. OK. It made me nervous.

[Laughter.]

The CHAIRMAN. You've come a long way. We want to hear you.

Mr. GAMBOA. One of the statements you made at the beginning was that loan discrimination was immoral and it was illegal. But I think it's also one element that as left out. It's also very stupid. It's not economical.

In California, we have 500,000 small businesses. Half of those small businesses are owned by minorities. In fact, in the State of California, we have more Hispanic businesses than there are total businesses in the State of Oregon or the State of Washington. Yet, they are ignored by the banks. None of the banks of Oregon or Washington would ignore the total commercial market there. Yet, it's done in California.

I think the basic reason they're not being able to see the economic value of doing business with our communities is the same reason that I pointed out about the Federal agencies. The policymaking people are not people of our communities. They're not comfortable with us. The loan officers are not comfortable with us.

I just went through the loan process to buy a home myself. I think I'd rather do that than run through a gauntlet. It was terrible for me in that I had to report 5 years of income, and not only bring my tax returns, copies of my tax returns, but I had to bring the originals when I brought my tax returns. They didn't believe me. And then I was held up simply because I did not keep my check stubs for the last 6 months. I had the last 2 months, but I didn't have the last 6 months. Even my loan broker said, I don't understand why you're having so much trouble with the loan officer. Your debt-to-credit ratio is all right. You have the downpayment. Your credit history was all right. And it wasn't until I called the president of the particular bank that we were negotiating with and the next day, my loan was granted.

That's all.

The CHAIRMAN. Thank you very much.

Mr. Fishbein.

STATEMENT OF ALLEN FISHBEIN, GENERAL COUNSEL, CENTER FOR COMMUNITY CHANGE, WASHINGTON, DC

Mr. FISHBEIN. Thank you, Mr. Chairman, and Senator Moseley-Braun. It really is a privilege and an honor to be here and testify on this very important subject today. I want to commend you, as the other witnesses have, for holding these hearings.

Although 25 years have elapsed since the passage of the Fair Housing Act, making all aspects of housing discrimination illegal, study after study continues to show that racial factors influence the flow of credit both to neighborhoods and to individuals.

For many years, the banking regulators have presumed that lending discrimination was not occurring, and I think you heard that philosophy reflected in part here this morning.

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They routinely dismissed as inconclusive research showing disparities in the rate of mortgage lending between minority and white neighborhoods and even downplayed the significance of the home mortgage disclosure data that was reported last year that showed African-Americans and other minorities being rejected twice as frequently as their white counterparts.

However, and fortunately, the events of the past year have combined to erode the regulators' long-standing presumption that such disparities are not indicative of discrimination. There has been considerable reference today to the Boston Fed study and the Decatur lawsuit.

Now the study and the suit also destroyed the presumption that the regulators' compliance examinations were an effective tool in uncovering lending discrimination. After all, that is the primary enforcement effort that the banking regulatory agencies put forward.

Although the institutions involved in the Boston study are routinely examined, the examination process, and these institutions were being examined by their regulators on a regular basis, yielded no evidence that mortgage discrimination existed.

Similarly, the compliance examinations conducted by Decatur's regulator, which at the time was the Federal Home Loan Bank Board, apparently did not find any evidence of discrimination existing in that institution, either.

Like the French inspector in the movie, "Casablanca," who feigned shock at learning that gambling is occurring in Rick's Cafe, only to be handed his night's winnings a moment later, the regulators would have you believe that they were shocked and surprised to hear about these recent revelations.

But community and fair housing groups for many, many years have been telling these agencies that lending discrimination is a fact of life and pervasive. Only the regulators have not wanted to listen to them.

Moreover, as I've attempted to illustrate in my written submission, in an attachment, the regulators for almost 20 years have been on notice and have had access to similar types of information pointing to the existence of lending discrimination, but have failed to develop an adequate response. And I think it's interesting, as we sit here and listen to this testimony this morning, that it took public disclosure of information, and literally, public embarrassment of the banking regulators before we saw a study like the Boston Fed study undertaken. This is a study that could have been undertaken by these Federal regulators at any time, but clearly, they did not choose to do it, did not see it as a priority of theirs.

The lax enforcement of the fair lending laws stems from a heavy emphasis on safety and soundness within the banking agencies.

The CHAIRMAN. Mr. Fishbein, let me just stop you for a minute. Isn't it also fair to say, because these laws have been on the books for so long and the fact that they have not been enforced, it's helped build the economic underclass that we talk about.

You can't starve a part of the community from its fair access to credit, among other things, and not expect that you're not going to get an enlargement of economic hardship and deprivation. This has

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hurt the country. It's not just hurt people. The whole country has been harmed by this.

Mr. FISHBEIN. Clearly. I would agree that it's kept home ownership levels down, wealth accumulation levels depressed, and since most banks at this point will only lend to start up small business as if the business owners are willing to personally collateralize the loan, which is often in the form of a second trust on their mortgage, prevented minorities from getting into small business. And I think that's a fact of life that we have to deal with.

But as I was saying in my testimony, a lot of the laxity stems from the very heavy concentration on safety and soundness within the banking agencies, which, to be sure, is not a bad thing and we'd be expecting them to do it. But fair lending and other compliance responsibilities are viewed by the regulators as a second-tier status about their overall responsibility.

Similarly, the appointees that are selected to head these agencies often reinforce the institutional biases that already exist among the career professionals within the agencies.

Traditionally, the top regulators are selected from a small pool of individuals from banks, law firms and Wall Street, and while they may be knowledgeable about the prudential side of regulation, they usually know little or care almost nothing about consumer compliance, fair lending and community reinvestment.

Consequently, they have done little to prod the careerists within the agencies to do a better job at compliance. This must change, in our opinion, before we can expect to see meaningful reforms in fair lending enforcement.

The CHAIRMAN. If I can interrupt one more time.

We had a nominee for renomination to be Comptroller of the Currency. In going through that record carefully, we found in this particular area what was clearly a major shortfall in both performance and orientation. We did not confirm that individual. That position has remained open and will be filled by someone who I know from my discussions on this issue, will perform very differently. So this committee is very sensitive to that issue and I'm very sensitive to that issue.

Mr. FISHBEIN. And we commend you, Mr. Chairman, and the committee for the action you took in that instance. We supported the stand that the committee took in not reconfirming that nominee.

The key issue that this committee must address is whether the regulators have gotten the message. You can judge for yourself by listening to their testimony this morning. They will constantly be telling you about how they are reorganizing and reconsidering and reviewing existing compliance procedure. In one way or another, they have been doing that for 20 years, but nothing ever seems to change and the record speaks for itself.

Only a handful of substantive violations of racial discrimination have been found by the regulatory apparatus.

If history is any meaningful guide, change will only occur through strong prodding from this committee and the appointment by the administration of a set of regulators with a strong commitment to reform. And I was delighted to hear you say, Mr. Chair-

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man, that the administration's nominees to regulatory posts will be reviewed very carefully for their commitment in this area.

In my written——

The CHAIRMAN. I'm not going to support anybody that isn't committed in this area.

Mr. FISHBEIN. I think that hopefully will get the message across. In my written testimony, I cited a series of illustrations of recent examples of how the regulators still seem to be dragging their heels with regard to fair lending enforcement.

In view of these illustrations, we believe strong medicine is needed to restore the public's confidence that the fair lending laws are being enforced. We were pleased to see that President Clinton has indicated in his public statements his intention to strengthen enforcement of the bans against redlining and other forms of lending discrimination, and we believe much can be done at the administrative level, especially with oversight from this committee.

Now, I want to close with a couple of recommendations for reforms that we believe are needed. Last year, we had proposed that the primary responsibility for fair lending enforcement be stripped from the banking regulatory agencies.

When we made those recommendations to various congressional panels, the reaction we received is that that was radical and a bit extreme. But after hearing the testimony this morning, we would encourage you to reconsider that, whether they have gotten the message and whether institutional change is likely to occur. But short of that, we believe that fair lending enforcement must be elevated within the existing regulatory enforcement agencies, that there need to be separate independent divisions within these agencies that are on the same level with safety and soundness, and that does not currently exist in any of the agencies, and that this function also be elevated within HUD and the Federal Trade Commission.

We also, with regard to small business lending discrimination against minority owned firms, believe that much can be done if the FFIEC reverses its position on the implementations of sections of FDICIA and requires banks to report on their loans outstanding to minority owned businesses. This is something that was authorized in the law, which the FFIEC could have done as part of the instructions it promulgated last November.

Mr. Chairman, you sent a letter to the FFIEC in which you encouraged them to require that kind of systematic reporting. And they blinked and they didn't do it, and the response from strong industry pressure.

We think with your nudging and with the administration's support, this is something that could easily be reversed and we can create for the first time a systematic data base about the extent to which banks are lending to minority owned small businesses.

In addition to the administrative recommendations, we favor new legislation to bring the appraisal, the private mortgage insurance and property insurance industry under effective regulation to ensure that discriminatory practices do not exist in these areas of the home finance system as well. And just one last comment.

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I know there's been discussion about regulatory burden and you've been hearing from the industry about the extent to which they have to do recordkeeping.

I think we can all agree that this is one area that recordation of home mortgage disclosure data and the reporting of it has been absolutely essential. And to the extent that it involves a burden on the industry, in terms of recordkeeping, that the pay off has been very substantial as well.

There is absolutely no doubt in our minds, and there shouldn't be in anyone in this room, that but for the disclosure of this information, the issue would not be on the front burner to the extent that it is today, and we would not be talking about ways of seriously reforming the way fair lending laws are enforced.

I conclude my testimony with that and I'd be glad to answer any questions you have.

The CHAIRMAN. Thank you very much. It is very important to us.

Ms. Cincotta, welcome back.

STATEMENT OF GALE CINCOTTA, EXECUTIVE DIRECTOR, NATIONAL TRAINING AND INFORMATION CENTER, CHICAGO, IL

Ms. CINCOTTA. Thank you very much for inviting me here. And it's a great pleasure to see you sitting there, Carol—Senator. Excuse me. Senator Braun.

The CHAIRMAN. I'll tell you. I'm glad to have her.

[Laughter.]

Ms. CINCOTTA. What's interesting, usually after hearings like this and we're outside and the regulators are coming out, they say, whew, we got off easy. I don't think that this time they're going to be able to say that, so we really commend you on that.

It's over 15 years and they still don't get it, or really don't want to get it. When I go to the meetings at the FFIEC, I wonder if the statue of Don Quixote is out there on purpose.

[Laughter.]

Ms. CINCOTTA. What I'd like to do is give you several sets of recommendations and maybe then go back and talk on them.

We would very much like to see the business loan disclosure available, that when you look at credit and you look at rebuilding communities and you want to deal with not having another L.A. in every city in this country, you have to combine the ability to start a business, get a job, as well as being able to buy a home or get a home improvement loan, et cetera.

We do have disclosure in Chicago. Any bank that wants to be a depository of city funds, has to disclose. Three of the banks, and I've included this paper for you to show, and I'm doing this for another purpose, is that, in our loans, in our agreements, over the last 8 years, there were over $298 million lent out. Out of that, about $145 million were business loans—commercial, industrial, mixed use, et cetera. And also, $7 million were grants for capacity building of community COC and LDC's.

I'm bringing this up because I'm hearing about what I would maybe call a quick-fix, community development banks, and then Senator D'Amato saying maybe—and I wish he had stayed for this part of the hearing—that if the larger institutions put in a portion

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of their money to a community development bank, they would be exempt from CRA.

What I'm worried about on that is that, here you have these institutions that have buildings, rooms, furniture, faxes. They know how to do it! That they could give a little bit in the collection plate; you're talking about creating institutions that do have not even have a building to start with.

Where are you going to find the staff for these community development banks? And if you take all the rest of the lending industry out of this, out of the lending, with the kind of figures that I said of what we have from three banks in downtown Chicago that are doing business lending because there is business loan disclosure, we could be setting ourselves up for something that looks good on paper, but doesn't fill the need.

You need every single financial institution to be part of the solving of the problem. So, as far as making recommendations; what the Federal Reserve Board has done, and should be reversed in light of discrimination, is to take away Reg C, where they are now not letting you go into the lending institution on March 31 and pick up the Home Mortgage disclosure data. We do not get that data until the end of the year and it's on Loan Application Registers rather than the data we were able to get before.

The Federal Reserve said they wanted to mesh the discrimination, the individual data, (under FIRREA) with the data by census tract. You cannot mesh them. They are two separate things.

So not only have they not been dealing with the discrimination by these banks; they've been denying access to information to the folks who do deal with it and do want to be able to get that data while it's current.

The other thing that's happening that the regulators have done is that, in our institutions in Chicago, they have put most of the, multifamily loans that the banks have made on a watchlist, which then the bank has to have a higher reserve because they are complicated loans. And yet, in a $5 million loan, the bank has first position. They may be in for $2 million. Layered on top of that are tax credits, the State of Illinois IHDA, and city CDBG, et cetera.

Yet, that loan can go on a watchlist because it's a CRA loan or complicated. In other words, they are penalizing the financial institutions for doing these kinds of loans and saying, you have to put up more reserve. So those are two very specific things that they can do.

The other thing is that we see that, as Allen has said, of combining the CRA, the fair lending, the testing, into one regulator.

When the banks are frustrated about CRA examinations—what does it mean to have a CRA rating of one? How much paper do I have to keep? What do I have to do?

So that we're in agreement with the banks saying, we keep paper because we never know which drawer we're going to have to go into, or which closet.

The CHAIRMAN. Right.

Ms. CINCOTTA. Define, have them define, what is a one? What is a two? What is a three? What is a four in the rating system? And exactly say how much paper the lenders have to have for that. We

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have been meeting with the regulators, the FFIEC on this. We haven't got resolve on that.

Either they should have to come under either one regulator or the FFIEC at the lender's expense, so it's not going to take an appropriation, where they come together, and so that each regulator doesn't have a different set of ones, twos, threes, fours, and a different set of how much paper you keep and a different set of rules.

Our sense is if they could do that, you might avoid the banks having to fight and look for safe harbor, exemptions, et cetera, and have the time to put the loans out, rather than worry about examinations.

Senator MOSELEY-BRAUN. On that point, Ms. Cincotta, I think, really, the point that we discussed, everybody is concerned about that point. I think the objective is to try to make the regulators work smarter, so that they don't require 16 different forms, so that they don't burden the bankers, but at the same time, they actually start to do the job that they're clearly not doing in terms of encouraging the lending in minority- and low-income communities.

Ms. CINCOTTA. Well, it's even more than that. The regulators and whoever this whole team from all the regulatory bodies is, they have to have intensive training by fair lending folks, by folks in the community what to even look at, because you have a disparity amongst the different regulators of how they look at the CRA law.

When a Harris Bank in Chicago, who had a good rating before our CRA agreement, went from almost no loans to over $35 million in loans, plus grants, and they get a three, a bad rating, after they do all that, because the regulator now says, "well, even though you're downtown and you don't have branches, your service area includes the suburbs."

If you know now how to do loans in these low-income, minority neighborhoods where there are no financial institutions, because that's were Harris' money went—the way we (the regulators) read CRA, you have to do the same in the whole area, even if they're overserved, even if they have 25 banks, you've got to put loans in there. So they (Harris Bank) got a bad rating.

And the other thing, and you being from Chicago would appreciate that, we got an agreement Harris would put ads in the Chicago Times, The Defender, the Puerto Rican, on the buses, the ELs, et cetera, and we saw that as where the minority community, would be reached. The regulator said, to Harris Bank, "you didn't put enough ads in the Chicago Tribune." So there's that kind of disparity.

At the same time, the Columbia National Bank gets a one, which is perfect, in their defined community, which is more upward mobile, and the only census tract they had minorities in, they had one loan, to somebody who was gentrifying, who was white. That's again the disparity. So when you talk to the lenders, they say, "if we're good, we're bad."

The CHAIRMAN. And when we're bad, we're good.

Ms. CINCOTTA. Yes. And what the regulator says, in essence, to Harris, "if you had made no loans anywhere, you were being equal throughout your service area, we could give you a one. But since you put these loans here in the low-income neighborhoods, we are going to give you a three (unsatisfactory)."

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You have to stop that, so that when you do get lenders to do good, you don't have this kind of problem come down on them.

That's why the training, is crucial as much as the one regulator, on what they're all looking for in CRA enforcement—and you can have several regulators from the same agency in your office and they're all going off in other directions of how they read the fine print.

I would also like a 5-year moratorium on any forms of legislation or recommendations on safe harbor, bank exemptions, anything!

Let's put this process together and then look at it. You can have oversight hearing, but no legislation coming in where the ABA mobilizes and the community mobilizes, and we spend all our energy fighting rather than getting down to business. So at least a 5-year moratorium please.

Again, passing business loan disclosure as part of HMDA and going back to the name of the bill as it originally was called, the Financial Institutions Reporting Act, which included business loans and got changed to HMDA, when the business loans were dropped.

The other thing that may sound maybe a little off, but formerly called S. 244, the Community Development Partnership Act, if you want to get business loans, that's an integral part of what will help in the minority- and low-income communities especially, with the business loan disclosure. Also, a really hard look at the development banks because we're all reaching and we want an answer. But if you do the wrong thing and you let everyone else off the hook, really, you ought to get the——

The CHAIRMAN. We're not going to let anybody else off the hook.

Ms. CINCOTTA. You ought to get the folks from Southshore in because the development banks, Southshore Bank in Austin and the one Hillary Clinton sat on, Little Rock, are the examples.

You have a handful of people who have spent over 20 years of their life putting this one example together. Are you going to clone them? Where are you going to find the folks? How long will it be for all of them to even find a building to operate in? And in the meantime, here we have the resources of all our financial institutions that deserve to be spent in our neighborhoods and our cities, so we don't have the tragedies like the L.A. So let me stop here.

The CHAIRMAN. All right. Let me just say on that last point, we've had one good hearing, I think, on the community development bank concept. I was struck by exactly your points. And that is that the Southshore Bank is an impressive example. But you've had a 20-year run at it by a very dedicated group of people. And I question the likelihood of being able to generate a similar group in a lot of other places, without the 20 years that it takes to do that. We've got to move a lot faster than that.

But I think there are places where we've already seen a demonstration of interest, people who really want to get going with a community development bank, and so we want to encourage that, where that can be made to work. But that is not a replacement, and cannot be seen as a replacement for the proper flow of credit out of existing institutions. I feel just as strongly as you do that the danger in the concept as a gossamer concept, is that, somehow or another, that this will let other people walk away from their

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lending obligations and opportunities that are out there now that have to be met by existing institutions.

One is not a replacement for the other. It ought to be an augmentation to the other, but we've got to get the other up to the point where it ought to be. I'm talking about the existing institutions today. So you and I are of precisely the same mind on that issue. I can't speak for everybody up and down the table here, but as we develop the community development bank concept, this is not designed to relieve existing institutions of the job they should be doing, and in many cases, some are, but many are not.

Ms. CINCOTTA. My concern was when I heard Senator D'Amato saying, if the larger institutions put some money in there, they're going to be exempted. And I thought, my God, let me show you the story in Chicago where Southshore Bank does their multifamily lending using money from Harris Northern and First National. And they've had a lot of support from other financial institutions. It's scary because we hear the safe harbor exemption and we get ready for war again.

The CHAIRMAN. Right.

Senator MOSELEY-BRAUN. Something tells me, Ms. Cincotta, that you are uniquely situated to communicate that thought to Senator D'Amato.

[Laughter.]

Ms. CINCOTTA. I know he left the room.

The CHAIRMAN. Well, in fairness to him, he had something else he had to do this morning.

Ms. CINCOTTA. I know.

The CHAIRMAN. He was here, and I know that these are matters of concern to him, and of interest to him. I think he will welcome your views. I can't speak for him, but I think he'll certainly welcome hearing what you have to say on this.

Ms. CINCOTTA. Thank you.

The CHAIRMAN. I thank you all very much for what you've come to say today. I think we've got a very important hearing record that we've now established. I think the time and the care that's gone into the presentations that each of you has made really give us a lot of solid rock from which to work in terms of where we go from here.

To take what you've laid out here together with what we heard earlier and the road we've been over, I think really brings us to the point where it's much clearer where we should go and how we should do it at this point.

Now we've got to get the right leadership in front of that effort and we've talked about that here today as well.

It's very interesting. If you'll just permit me a personal observation. I came to the Congress 27 years ago. I came into the House of Representatives in the year 1966 and was at that time in the other party, as a matter of fact. I changed parties over some big differences I had with Nixon and Agnew and a few other things. I had the opportunity to vote on the fair housing legislation, and it was actually a small group of cross-over Republicans in the House that provided the margin of victory at that time. It was one of the votes that I was proudest of casting at that time.

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Lyndon Johnson invited several of us down to the White House for that bill signing, the very bill that we're talking about here today. I remember being in that room with him because he gave moral leadership on civil rights questions. It's one of the things that he did that I think was such a powerful contribution to the country. I remember being in that room with him and down in my office, he afterward presented me with a pen that he used that day to sign that bill. It's a treasured momento to me because of what it meant.

I must say I'm filled with emotion as I think about the fact that here we are now, over a quarter of a century later with that law on the books, and it isn't working. It isn't working the way it should.

With all due respect to our earlier witnesses, we heard a top regulator today, I think, in effect, concede that while, on the one hand, there's an intention to want to do something about this problem, they're having an awfully difficult time figuring out what to do and how to do it. Time is slipping away every single day. When I think of all the damage that's been done to the country, to individual families, to people out there who missed out—you talk about the American dream, but the American dream wasn't available to them because of the color of their skin or they were in a redline neighborhood or their ethnic origin.

The country is the loser for all that. We talk about all these huge inner-city problems. We've sort of starved our inner cities to death. This isn't the only problem, but this is a critical problem. What would the suburbs look like if they hadn't had access to credit? Or what would the other robust areas of our society look like if they hadn't had the access to credit that they did? Or even our witnesses earlier today.

We all come down a certain individual track and we've had access to opportunities. Those that have a lot of opportunities and take advantage of them get to the top of these positions of power and what have you.

I think we have to be asking about the problem of who's being left out and who's being left behind and why it is we're sort of fracturing into a country of separate and unequal parts. And why people in our society today don't have an opportunity to participate.

We can talk all the free enterprise jargon that anybody wants to talk about, but if you're not able to participate in it, it doesn't mean anything.

It's a sham and a fraud if we say it's there and it's not there. Or if we say it's there and the law guarantees that it's there, but then the law isn't enforced and so it isn't there. And then a person's life goes by or the moment goes by where maybe they have an opportunity to start a business or to get the home mortgage that you were just going through. And if that moment is missed, it may not come around again. It may not come around again because other things happen. And in a situation where there is a discouragement and a turning away of kind of opportunity that our law says should be there equally to everybody, people's lives go down, different tracks.

I think we're losing part of America's future every single day. I'm not sure that it dawns on some of the people at the top of our eco-

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nomic system, both in the Government and outside. But whether it does or doesn't, we have laws. Those laws were signed—I saw them signed with my own eyes. We've written some laws in here that are now on the books that are at least forcing this data out into the light of day and it's to be collected so that we have a way of figuring out what's happening and how we can fix it.

But the laws have to be obeyed. And I think that anybody that takes a position of responsibility in our Government that can't discharge the laws, then they're in the wrong job. They should go and do something else some other place.

Part of the duty of anybody who's going to take one of these positions today is to see that the law is carried out, fully, fairly, now, today, across the country, in the inner cities, every other place, and that ought to be part of the heartbeat of what anybody has when they get up in the morning and they have all day long and as they go to bed at night and then they get up the next day, because that is so central to making the whole American system work.

Otherwise, it can't work. If we're going to be separate and unequal, and if an Hispanic American or a black American is going to be put in an absolutely inferior position in terms of access to credit and opportunity in this country, and the Government is going to allow it to go on in the face of the laws saying that it shouldn't exist and has to be stopped, you can't hold a country together. That's the way to wreck a country and to split it apart.

I'm encouraged by the fact that we've got a President that I believe understands this issue and cares about it. I think he cares about it all day long, and I think it's part of the heartbeat. I think it is of this administration.

But we've got a lot of catch-up to do because we've let the country get badly damaged. The racial discrimination in our society goes way back before this century that's coming to an end. We've got an opportunity to change it and you've made, I think, some very important recommendations to us today. It's going to take a lot of moral leadership as well as tough enforcement of the laws.

I don't think people should be allowed to operate under the sanction of Government with the support and authorization of Government if they're not going to obey the laws. I think the laws have to be obeyed. These laws, that are extremely sensitive as to whether our country has a chance to thrive and be fair and decent, are among the most important laws. They're not something that ought to be looked at after 9 million other things are looked at. They ought to be looked at right at the very beginning, right up front, with everything else we're looking at.

The safety and soundness of the American system, and of our country, and where we fit as people in our society—I don't understand how we don't have that up in the top tier. That's got to be up in the top tier. It's got to be up in the top tier.

There's a wonderful book out now about the Gettysburg Address. It's an interpretive book by Garry Wills as to what Lincoln was talking about that day in terms of that very seemingly simple and short address. I think he was really talking about what we're talking about here today. And that is, how we really make our stated ideals real in practice for all the people of this country.

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That's in a large part what that war was about. But we're still fighting the war. The war is going on right now out there. And somebody today who either knows they're not going to have a fair shot at a mortgage or a business loan doesn't go and ask for it, their life is being reduced in opportunity and possibility in this country. Or if they go and they're turned down because they're black or brown or they are in some other measure discriminated against, it's cheating America. It's just cheating the country. And it's cheating our future. It divides us one from the other and we just can't have it.

So I couldn't feel more strongly about it. Even people that have fixed-terms of office—we've got some people that have been carry-over appointments, people whose appointments occurred previously and came out of other administrations—if they can't get this straight in their heads and their hearts, they ought to leave Government. They ought to go do something else some other place, because Government has to be for all the people in this country.

That's what it's all about, being for all the people. Not just some of the people, but all the people. If we can't get an aggressive commitment to that from people who run the key parts of our system, then they ought not to be in Government. They ought not to be in public service. They ought to be in the private service. If you are going to pursue goals that are narrower than the broad public good, then they ought to be pursued outside of Government, quite frankly.

Thank you for listening to me and permitting me to say that. I feel very strongly about it.

Senator MOSELEY-BRAUN. Thank you.

The CHAIRMAN. Senator, do you have a final comment?

Senator MOSELEY-BRAUN. You're a great Chairman and I'm honored to serve on this panel. I look forward to actually beginning to light a fire under the regulators to begin to make these laws, these 25- and 18-year-old laws, make them real and make them work.

I couldn't agree more with what you've just said. It was very eloquent. It was very heartfelt. It was clearly heartfelt. And, quite frankly, it made me feel even more comfortable and more excited about being a member of this committee and the potential of this committee for doing real good for our country.

I want to thank you for that. You've done a great job here and I feel very confident that we are going to get some action out of these people.

The CHAIRMAN. Thank you very much. Thank you all. We appreciate it.

Ms. CINCOTTA. Thank you.

The CHAIRMAN. The committee stands in recess.

[Whereupon, at 12:55 p.m., the committee was recessed.]

[Prepared statements and additional material supplied for the record follow:]

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PREPARED STATEMENT OF SENATOR BEN NIGHTHORSE CAMPBELL

Thank you, Mr. Chairman, for organizing hearings in the past few weeks that help us understand ongoing areas of concern in the banking industry.

From my contacts with bankers and lenders in my own State, know that most of them are honest citizens who work hard to support their communities. Unfortunately, I know from personal experience that sometimes the color of one's skin can make it harder to get a loan. That can happen in small rural communities just as easily as it can in large cities.

I don't always know what causes differences in people's access to credit. Sometimes there, are legitimate financial reasons; sometimes there are structural problems that discourage banks from lending to minorities; sometimes the problem is ignorance and prejudice. The end result is the same, though: people that need credit the most, get it the least.

Since I'm new to this committee, bankers have been giving me an earful about regulatory burden. After seeing some of the hoops they have to jump through, I can understand their frustrations. Yet despite all this paperwork, we still can't seem to weed out the problems. I hope, Mr. Chairman, that we can work with banking and community groups to make banking regulations more effective and more efficient at the same time. Thank you once again, Mr. Chairman, for your efforts.

PREPARED STATEMENT OF SENATOR CAROL MOSELEY-BRAUN

Mr. Chairman, we are here today to discuss a critically important issue—discrimination in our credit markets. The distinguished president of the Federal Reserve Bank of Boston is among our witnesses this morning, and that is appropriate, because his institution has made a significant contribution by conducting a study of the discrimination problem. The study's basic conclusion—that minority borrowers are 60 percent more likely to be turned down for a mortgage loan that a white borrower—is not a new one. What is new, and to my mind, compelling, is that the Boston Fed documented that discrimination in a very careful way.

Because of the Boston Fed study, it is no longer possible to excuse discrimination against minorities with claims that disparities in lending patterns were due to income differences, bad credit, housing patterns, or any of a number of other economic factors. The Boston Fed study, therefore, helps force us to see the problem for what it is, instead of what we would like it to be—and that is a good thing.

One of the most interesting findings of the Boston Fed study was that only about 20 percent of all potential borrowers have completely clean credit records. Lending decisions, therefore, are not strictly mechanical exercises; instead, they involve the exercise of considerable discretion by lending officers and lending institutions. Credit histories can be cleaned up; lenders can help do that. What the Boston Fed study demonstrated is that minorities get less of this kind of help than whites.

I know that much of this discrimination is not intentional, but that fact does not mean we should let it continue for even one minute longer. We have to act. We have to face the problem in all of its complexity, but we have to act.

African-Americans and other minority Americans want the same things every American wants. They want a decent job; they want the opportunity to achieve the American dream of home ownership. They want the same access to credit that other Americans enjoy, and like other Americans, they expect to pay back what they borrow.

No one expects lenders to make unprofitable loans. What I think every minority American is entitled to expect, however, is that lenders make profitable loans on a nondiscriminatory basis.

We need to improve enforcement vis a vis bank and savings and loan lenders; we also need to take a hard look at other, nondepository lenders who, after all, originate over 50 percent of all mortgage loans. We need to act to see that the managements of lending institutions do what it takes to see that their lending officers and their credit granting systems operate in nondiscriminatory ways. We also need to look at the influence of the secondary market to ensure that it is not inadvertently encouraging loan originators to discriminate; secondary market guidelines, after all, are a very important influence on the mortgage market. I could go on for some time, but the bottom line is that we need to do what it takes to deal with the discrimination problem—and we need to do it now!

We have a good group of witnesses before the committee this morning and I look forward to their testimony. As I conclude, I want to recognize one witness, in particular. Gale Cincotta, whom I am proud to have as a constituent, is a person who has really made a difference, both to her community and to her Nation. She has fought, and continues to fight, a tough-minded, dedicated battle for more community lending. She has helped improve our financial system. She has helped make lenders

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more responsible to their communities. I know the committee will benefit greatly from her testimony.

TESTIMONY BY RICHARD F. SYRON

President, Federal Reserve Bank of Boston

February 24, 1993

Thank you, Mr. Chairman and members of the Committee, for this opportunity to discuss the Federal Reserve Bank of Boston's recent study of mortgage lending patterns and the report's implications for combatting discrimination in mortgage lending.

As the Committee knows, the Home Mortgage Disclosure Act (HMDA) data for 1990 showed substantially higher denial rates for black and Hispanic applicants than for white applicants. This was true in all the major metropolitan statistical areas, and it was certainly true in Boston. Approximately 30 percent of black and Hispanic mortgage applicants were denied loans in the Boston metropolitan statistical area in 1990, compared to only 11 percent of white applicants. The 1991 data for Boston, which became available in the fall of 1992, show a narrower but still sizable gap, with 24 percent of black and Hispanic applicants denied compared to 11 percent of whites.

When the 1990 HMDA were released, the implications of the racial disparities in denial rates were unclear. Although the HMDA data included information on applicant income, no information was collected on applicants' credit histories, loan-to-value ratios, debt-to-income or so-called obligation ratios, and other factors that are commonly considered by lenders when they make mortgage loan decisions. Some felt that this missing information could explain the high denial rates experienced by minorities. Others argued that even if all relevant information was included, substantial bias in mortgage lending still existed. This disagreement has made it difficult to formulate solutions to improve credit flows to poor and minority neighborhoods.

The Federal Reserve Bank of Boston, with the support of the Federal Reserve Board and other supervisory agencies, and the cooperation of mortgage lenders in the Boston area, undertook a major study of mortgage lending in an effort to clarify this issue. Racial disparities in mortgage lending patterns have been a concern in Boston for some years, and in 1989 the Boston Fed had undertaken a study of mortgage lending within the City of Boston. While that study had found that housing and mortgage markets were functioning in a way that hurt black neighborhoods, the data available at that time could not distinguish the role played by lenders from the actions of buyers, sellers, realtors, and other market participants. With the release of the 1990 HMDA data on applications, the Boston Fed was able to improve upon its earlier research and focus on the activities of the mortgage lending industry. I would like to submit for the record a copy of the Boston Fed's study, *Mortgage Lending in Boston: Interpreting HMDA Data.*

The 131 financial institutions that had been the most active mortgage lenders in the Boston metropolitan area were asked to provide additional information on 38 financial, credit history, and employment variables for all 1,143 of their black and Hispanic mortgage applicants and for a random sample of 3,300 white applicants. To protect the confidentiality of borrowers, we assured the lenders that all information collected would remain with the Federal Reserve and other bank regulatory agencies. The response from lenders was excellent, although missing information, errors in recording the original data, and withdrawn applications resulted in a final sample of 722 black and Hispanic applicants and 2,340 white applicants.

The additional variables collected were chosen after numerous conversations with underwriters, examiners, and others familiar with the mortgage lending process. We attempted to include all the variables that lenders view as relevant to their mortgage decisions. The information collected from the financial institutions was then combined with information on neighborhood characteristics from the 1990 Census and used to develop a model of mortgage lending decisions in the Boston area. With this model, it was possible to test whether race was a significant factor in the lending decision once financial, credit history, employment, and neighborhood characteristics were taken into account.

The analysis revealed that the additional information about each applicant substantially reduced the disparity in denial rates, but did not eliminate the gap. Black and Hispanic mortgage applicants in Boston, on average, had larger debt burdens, higher loan-to-value ratios, and weaker credit histories, and in other respects did not fare as well according to the evaluation criteria used by mortgage lenders. But after taking all these factors into account, black and Hispanic mortgage applicants

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were still more likely to be turned down than white applicants. Minority applicants with the same financial, credit history, employment, and neighborhood characteristics as the white applicants in Boston would have experienced a denial rate of 17 percent rather than the actual white denial rate of 11 percent.

The information gathered in this study provides some insight into how this outcome occurs. Many observers have difficulty accepting that discrimination exists because they do not believe that rational lenders would turn down a perfectly good application simply because the applicant was black or Hispanic. The problem is that few applications fit a narrow definition of perfect. Most applicants, white as well as minority, exceed some guideline for obligation or loan-to-value ratios or credit history; or some possess a characteristic that requires additional documentation, such as self-employment or the fact that they are purchasing a two- to four-family home. As a consequence, the mortgage decision is not a purely mechanical process. Loan originators must exercise judgment, and they have considerable discretion in the way they evaluate these deviations from perfection and in the degree to which they take compensating factors into consideration.

On balance, this discretion is both necessary and desirable. Historically, residential mortgages have been very safe investments. And applicants need not be perfect to be creditworthy. However, discrimination may enter into the decision-making process. Precisely how this happens is not something that can be answered by this study. It could be as simple as loan officers being more willing to exercise discretion and put their own reputations at risk for people who look or talk like themselves than for others. However the discrimination occurs, black and Hispanic applicants are more likely to be turned down for mortgages than white applicants with the same economic and other characteristics.

What can be done to address the problem of discrimination in mortgage lending?

In my judgment, the most critical step is for mortgage lenders to acknowledge at least the possibility that the results of their lending process are discriminatory. As long as lenders sincerely believe their procedures are beyond reproach, efforts to get them to change will have limited success. This is the area where we hope we have made a contribution. At least in Boston, our study seems to have ended the debate over how to interpret the HMDA data. Economic factors do explain some of the disparity in denial rates, but race also plays a role. Lenders' reactions to the study suggest that they are now questioning what they always took for granted. They are starting to recognize that simply having a policy that prohibits discrimination does not prevent discrimination.

A number of strategies have been developed by consumer advocates, government agencies, and lending institutions to help lenders ensure that they are treating all prospective borrowers fairly. The Federal Reserve Bank of Boston is in the process of compiling these strategies in a guide that will soon be available for distribution to lenders. I suspect that the members of this Committee have heard many of these ideas. They include ensuring that all employees involved with the loan process are thoroughly familiar with laws related to fair lending; having a staff that reflects the racial and ethnic composition of the communities served by the lending institutions; ensuring that compensation structures for employees do not deter them from serving low-income and minority markets; using carefully designed second review processes for denied applications; and a number of other approaches.

While not presenting something totally new, the guide makes a contribution by tailoring each recommendation to the lender's board of directors and senior management as well as to loan originators. The commitment to eliminating discrimination must start at the top and continue right through the organization to those who meet the public face-to-face.

Financial institutions' efforts will have to be reinforced by enhanced regulatory methods. Because so many mortgage applications violate some guideline or in some way require the lender to exercise judgment, most denials can appear appropriate by objective standards. Thus, discrimination can be difficult to prove when one looks case by case. It is also necessary to examine broad patterns and an institution's entire loan making process. The Federal Financial Examination Council is aware of this problem and is working on improving its examination procedures.

Finally, I would like to emphasize that while lender discretion may permit discrimination to occur, removing the discretionary element would be a major mistake. If current guidelines were to become rules to be applied with no exceptions, then even if these rules were not as tight as the guidelines are today, many creditworthy applicants would be denied loans and, thus, the opportunity to own a home. And if the Boston experience is representative of that nationally, black and Hispanic applicants would fare worse than white applicants, because they have higher obligation and loan-to-value ratios and weaker credit histories.

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In conclusion, the Federal Reserve Bank of Boston's study of mortgage lending patterns in the Boston metropolitan statistical area shows that the large disparities in denial rates revealed by the HMDA data are partially attributable to the fact that black and Hispanic applicants have greater debt burdens, higher loan-to-value ratios, weaker credit histories, and other economic characteristics that lenders view with disfavor. However, even after taking account of all these factors, a statistically significant and economically important gap remains in denial rates for white and minority applicants. Eliminating this gap requires that regulators, lenders and community groups understand the nature and likely causes of that gap, stop arguing about whether a problem exists, and work more effectively together for the future.

STATEMENT BY JOHN P. LAWARE

CHAIRMAN, FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL AND MEMBER BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

FEBRUARY 24, 1993

I appreciate the opportunity to speak today to this Committee about concerns related to credit discrimination in mortgage lending.

This hearing is very timely given the troubling questions that have been raised about the fairness of the mortgage lending process. Parity in how applications are considered, without regard to race, sex or other prohibited bases, is absolutely essential in our country. Let no one have any misunderstanding on the point. Racial discrimination, no matter how subtle and whether intended or not, cannot be tolerated. Simply stated, excluding any segment of our society from fundamental economic opportunities, such as home ownership and equal access to credit, is morally repugnant and illegal. Moreover, it robs the lending industry and our economy of growth potential. I can assure you that the Board is committed to vigorously enforcing fair lending laws.

As chairman of the Federal Financial Institution Examination Council (FFIEC), you asked that my testimony focus on current efforts to enforce fair lending laws and the steps being taken to strengthen them by the member agencies. I am pleased to do so. However, as my recent letter to Chairman Riegle indicated, I will be unable to answer detailed questions about the fair lending enforcement programs of the other federal banking agencies. Each of the other FFIEC agencies (OCC, OTS, NCUA and FDIC) is represented here today and they will respond to any questions you may have about their specific programs.

Before I move on to a discussion of the efforts of the FFIEC, let me give you a sense of some of the actions the Board has undertaken. First, in consultation with the other FFIEC agencies, we have implemented a system which increases our ability to analyze HMDA data for use in our fair lending and CRA enforcement efforts. Second, we are working with the Justice Department to target certain state member banks for fair lending examinations where HMDA data suggest disparate treatment of minority mortgage loan applicants. Third, we have referred a number of consumer complaints alleging violations of the Fair Housing Act to HUD and recently referred a matter to the Department of Justice. Fourth, we have taken formal enforcement actions, including assessment of civil money penalties, to enforce compliance with consumer protection laws, including the prohibitions against credit discrimination based on marital status, age and race found in the fair lending laws. Fifth, the Board has denied three applications in the last two years from financial institutions primarily because of poor CRA performance. In each case, there was significant evidence in the record that these banks were not adequately serving the credit needs of their communities. These actions demonstrate, I believe, the strong commitment the Federal Reserve has made to enforce fair lending laws.

RECENT DEVELOPMENTS

Some recent developments have changed the nature of the discussion regarding the issue of credit discrimination. The debate has moved from a discussion about whether unequal treatment is occurring, to how to strengthen enforcement of fair lending laws. One of these developments was a study completed by the Boston Reserve Bank. Another event was a settlement between the Justice Department and an Atlanta savings and loan association resulting from a fair lending investigation by the Department. In each of these cases, evidence was found of disparate treatment in mortgage lending between minorities and whites. This has increased our understanding of this complex issue and will provide a basis from which the Federal Reserve and other agencies can better focus our efforts to strengthen the enforcement of fair lending laws.

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Boston Study—As I mentioned, the Boston study furthered our understanding of issues related to credit discrimination, and I would like to share with you some of its findings. During 1992, the Boston Reserve Bank undertook a detailed study of mortgage lending in the Boston metropolitan area, in cooperation with the other federal financial supervisory agencies and the Department of Housing and Urban Development (HUD). The study was initiated in response to the large differences in rates of home loan denials among white, black, and Hispanic applicants in Boston as revealed by the 1990 HMDA data: a ratio of nearly three rejections for black and Hispanic to one for white applicants. The study sought to analyze whether disparities in mortgage loan denial rates among surveyed lenders reflected the equal application of legitimate credit standards or whether race was a factor in the decisions.

Because income is the only financial attribute of loan applicants collected under HMDA, the Reserve Bank augmented the HMDA data with thirty-eight additional items of information pertaining to financial characteristics, employment experience, and credit history—data that the lenders participating in the study voluntarily provided from their files. The study revealed substantial differences in the financial and other economic circumstances of typical white applicants and those of minority applicants. Statistical analysis also revealed, however, that even after controlling for significant economic factors, unexplained differences remained in loan approval rates for blacks, Hispanics, and white applicants. Specifically, the study revealed that minority applicants with the same credit characteristics as white applicants would experience a 17 percent denial rate compared to an 11 percent denial rate for white applicants.

Significantly, racial background generally was not found to be a factor in the case of clearly qualified or clearly unqualified applicants, whatever their race. Disparities were evident, however, among applicants with some imperfections, such as a relatively high debt-to-income ratio or weaknesses in credit history. For such applicants, national origin or ethnic background appeared to be a consideration. The authors of the study suggest differences in treatment may reflect differences in the level of assistance applicants received from loan officers to address those deficiencies, although no specific evidence from the Boston study is available on this point. The degree to which the findings reflect outright discrimination by individual loan officers and financial institutions in the market is unclear. The reason for this lack of clarity is that this was a study of the lenders in the Boston market in general and did not include a review of individual lenders to assess whether any specific individuals were treated differently because of their race. The findings do confirm, however, that greater attention is needed to ensure the fairness of the mortgage granting process.

EFFORTS BY FFIEC TO STRENGTHEN FAIR LENDING ENFORCEMENT

While the FFIEC agencies have separate programs through which they enforce fair lending laws, I know that all of us take our enforcement responsibility very seriously. We have been working hard to ensure that our efforts are responsive to the concerns expressed by the Congress and others. In this regard, the FFIEC has undertaken a number of initiatives to strengthen its member agencies' enforcement of fair lending laws.

Boston Study Follow-Up—Following the release of the Boston study results in October, the member agencies of the FFIEC issued a joint statement that addressed the issue of disparate treatment. In it, we attempted to shift the focus from a debate about whether unequal treatment is occurring to an emphasis on initiatives that will ensure it does not. The interagency statement reiterated the agencies concerns about fair treatment of applicants for mortgage loans. The statement pointed to increased empirical data suggesting that differences in denial rates may be unsupported by economic factors. The agencies also encouraged financial institutions to intensify their fair lending education programs for management, lending personnel and consumers. We encouraged efforts to identify and promote examples of successful techniques used by institutions to ensure equal treatment of loan applicants, such as self-testing and second reviews of minority applications.

In addition, each of the agencies has underway investigations of those financial institutions that took part in the Boston study where evidence of disparate treatment was present. These investigations include review of loan files and other relevant documents to discover if any individual applicants were treated less favorably due to race. As I previously indicated, the Board did refer the name of one institution to the Department of Justice where the data from the Boston study raised concerns about that mortgage company's compliance with fair lending laws.

HMDA Analysis—Like the HMDA data for 1990, the data for 1991 indicate that greater proportions of black and Hispanic loan applicants are turned down for credit than are Asians or whites. Income levels account for some of the variation in loan

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disposition rates among racial groups. However, even after controlling for income, white applicants for conventional home loans in all income groupings had lower rates of denial than black and Hispanic applicants. There are, of course, many factors other than income that are relevant to a credit decision. And it would be erroneous to conclude that the HMDA disparities themselves necessarily all reflect discriminatory practices. Nevertheless, some of them may be due to the unequal application of lending criteria, and the data as a whole are obviously troubling.

Analyzing the disturbing disparities revealed by HMDA data for use in our fair lending and CRA enforcement efforts has become a high priority for the FFIEC. In this regard, I am pleased to report that the FFIEC has made significant progress in the manner in which HMDA data are both utilized and the ways in which this data are analyzed. Prior to 1989, HMDA data revealed information only about the geographic distribution of residential lending by covered institutions. Statutory amendments to HMDA, enacted in 1989, expanded disclosures to include the disposition of applications—approved, denied, withdrawn, or files closed for incompleteness—and the race, or national original, income and sex of all applicants, whether approved or denied. The amendments also expanded coverage to independent mortgage companies, that is, those that are not subsidiaries of depository institutions or holding companies.

The HMDA data enable the agencies to select specific loan files to review during onsite examinations, and also to target specific lenders for more extensive fair lending and CRA investigations. Several of the supervisory agencies, as well as the Department of Justice, are using the new HMDA data to identify institutions to review, based either on the large disparities in denial rates among different racial groups or the low number of applications from minority households compared to the racial composition in the community.

Over the past two years, the Federal Reserve, in consultation with the FFIEC agencies, has developed and implemented a computer-based HMDA data analysis system. The system, which uses both HMDA data and demographic information, is extremely versatile, and allows the new data to be examined and analyzed in a variety of ways. It provides a series of set reports (in addition to the standard HMDA tables) as well as the capability of querying the database for more tailored information about an institution's lending activity. The FFIEC is also working to develop a set of standard paper based reports for examiners to use without electronically accessing the data base.

The FFIEC has also worked to ensure that the HMDA data is as accurate as possible. In this regard, the FFIEC issued a revised version of "A Guide to HMDA Reporting, Getting it Right," to assist institutions compile and report their data. The guide discusses the law's requirements, coverage, and management responsibilities; it also sets forth detailed directions for gathering data, plus step-by-step instructions for completing the reporting form. We have also provided, free of charge, computer software that may be used for reporting HMDA data which will help screen out inaccuracies before the data are submitted. In addition, the FFIEC has developed a process which assists reporting institutions in identifying and correcting errors.

The FFIEC agencies continue to pursue discussions with the Department of Justice, HUD, and the Federal Trade Commission to strengthen enforcement of civil rights laws. In particular, the banking agencies also are exploring ways to work with the Department of Justice in detecting possible patterns of discrimination against minority applicants. One example of coordination involves targeted examinations of financial organizations with mortgage lending records that raise concerns. Justice Department staff may, in some instances, participate in these reviews by going into the financial institution with our examiners.

The FFIEC has also been working to increase coordination with HUD. This reflects the expanded enforcement authority assigned to HUD by amendments to the Fair Housing Act in 1990. One example is a memorandum of understanding among the agencies calling for formal referral of complaints alleging fair housing violations to each other and coordination of investigations, when that is feasible.

In December 1992, the FFIEC contracted with an outside consultant for a review of the agencies' examination procedures to enforce civil rights laws. The contractor will also review the existing training processes and recommend improvements. We believe that this third-party review will ultimately help to strengthen the enforcement of fair lending laws by providing a fresh look at the current examination procedures and training.

In March 1992, the agencies distributed to the institutions they supervise a brochure, prepared by the FFIEC agencies, entitled "Home Mortgage Lending and Equal Treatment." The brochure identifies and cautions lenders about lending standards and practices that may produce unintended discriminatory effects. It fo-

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cuses on race and includes examples of subtle forms of discrimination, such as unduly conservative appraisal practices in minority areas; property standards such as size and age which may exclude homes in minority and low income areas; and unrealistically high minimum-loan amounts. I might add that the Federal Reserve published a companion brochure in 1991, entitled "Home Mortgages: Understanding the Process and Your Right to Fair Lending," to inform consumers about the mortgage application process and about their rights under fair lending and consumer protection laws.

The FFIEC is also offering specialized training for examiners from the member agencies responsible for enforcement of fair lending laws. In fact, one of these training sessions will be held next week. The issue of credit discrimination and use of HMDA data will be a focus during this session.

The Federal Reserve is committed to working within the FFIEC to develop ways to enhance enforcement effectiveness under the fair lending laws. Although substantial progress has been made, the FFIEC recognizes that its job in this area is certainly not finished.

FEDERAL RESERVE EFFORTS

At the beginning of my testimony I described particular efforts that the Board has taken to enforce the fair lending laws. Those actions—denial of applications, formal enforcement actions, civil money penalties, referrals to HUD and the Justice Department, and, coordination among the agencies to make the best use of the HMDA data have each been possible because the Board has had a solid program in place System-wide for many years to address our fair lending responsibilities. I would next like to describe these efforts for you in some detail.

The Board supervises approximately 1000 state member banks for compliance with fair lending laws. This has involved consumer compliance examinations, consumer complaint investigations, and community affairs efforts. The consumer compliance examinations area conducted by examiners at the Reserve Banks who are specially trained in consumer affairs and civil rights examination techniques. The Board and each of the Reserve Banks also have staff members who deal with consumer complaints. In addition, the system has a substantial Community Affairs program, many of whose activities help to advance fair lending. The Board provides general guidance and oversight to Reserve Banks in these areas.

COMPLIANCE EXAMINATIONS

The Board first established a specialized consumer compliance examination program in 1977. Through it the twelve Reserve Banks conduct examinations of state member banks to determine compliance with consumer protection legislation by using a cadre of specially trained examiners. The scope of these examinations specifically include the Equal Credit Opportunity and Fair Housing Acts. From the beginning, the examiners were instructed to place special emphasis on violations involving potential discrimination of the kind prohibited by those statutes.

Over the years, the Board has reassessed its enforcement responsibilities and made several changes to its consumer affairs program. This included increased training for examiners in detecting discriminatory lending practices. Changes were also made in the System's processing of consumer complaints to place increased emphasis on investigating serious complaints such as allegations of loan discrimination. We have made it clear that failure to comply with certain provisions of the fair lending laws were viewed by the Board as particularly serious and would require retroactive corrective action.

The Federal Reserve System's consumer compliance examinations are scheduled at regular intervals, are comprehensive, and are conducted by specialized examiners. Each state member bank is examined on a regular basis. An average of two-thirds of state member banks are examined each year. Examinations are scheduled every eighteen months for a bank with a satisfactory record. A limited number of banks with exceptional records can be examined every two years. Those banks with less than satisfactory records are to be examined every six months or every year, depending on the severity of their problems.

The examination procedures focus primarily on comparing the treatment of members of a protected class with other loan applicants. First, the bank's loan policies and procedures are reviewed. This is done by reviewing bank documents, as well as interviewing loan personnel. During this phase, the examiner will seek to determine, among other things, the bank's credit standards. After the standards have been identified, the examiner will determine whether those standards were, in fact, applied uniformly using a sample of actual loan applicants. Special note will be taken of applications received from minorities, women, and others the laws were designed to protect. This means that the examiner is looking at the same information

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that the bank used to make its credit decision, including credit history, income, and total debt burden. If those standards appear not to have been used, or not used consistently, this would be discussed with lending personnel and a more intensive investigation would typically be undertaken. Finally, ban overall analysis of the bank's treatment of applications from minorities, women, and others with the characteristics described in the laws is conducted to determine whether there are any patterns or individual instances where such applicants were treated less favorably than other loan applicants.

Another regular part of the examination includes conversations with persons in the community knowledgeable about local credit needs. The examiners will routinely ask about public perceptions of the availability of credit to minorities and low- and moderate-income persons. This information may suggest that a particular area of the bank needs additional scrutiny and may provide insights into how the bank is serving the credit needs of its local community, particularly those protected by the anti discrimination statutes.

The Board believes that expecting a bank examiner to master both the "safety and soundness" and consumer affairs/civil rights aspects of bank examinations is not practical given the existing complexities of both areas. Consequently, the Federal Reserve has developed a separate career path for consumer affairs examiners equivalent to that of our commercial examiners. The Board provides them with special training, including instruction on CRA and fair lending laws. New examiners attend a three week basic consumer compliance school. Examiners with 18 to 24 months of field experience attend a week long advanced compliance school and the one week advanced CRA class. This training is supplemented as necessary by special training sessions at the Reserve Banks. For example, last week, the San Francisco Federal Reserve sponsored a conference for all the agencies which focussed on issues relating to credit discrimination.

The examination procedures for detecting loan discrimination are set forth in the Board's *Consumer Compliance Handbook*. These procedures take on average 29 hours per examination to complete, and result in a comprehensive assessment of the institution's lending practices. Assessing a bank's performance under the Community Reinvestment Act takes, on average, an additional 39 hours to complete.

While much of the Board's recent effort to improve its fair lending examination procedures have been in concert with the FFIEC, we have underway a number of individual initiatives that we believe will strengthen our own consumer compliance examination program. They represent a continuation of our ongoing efforts to improve our examination techniques and are indicative of our commitment in this area.

The Board has authorized its Division of Consumer and Community Affairs to hire an individual whose primary job responsibility will be to work in the area of fair lending enforcement. This person will help to coordinate our efforts in this area and assist our examiners in analyzing the complex issues associated with detection of credit discrimination.

The Federal Reserve is also developing the capability to map the geographic location of a bank's lending products, including mortgage loans with computer programs. This mapping will include demographic information for the bank's local community. We believe that this type of analysis and presentation will enhance our ability to assess a bank's CRA performance in meeting the credit needs of its local community, including minority areas. It should also be helpful in evaluating a bank's geographic delineation of its local CRA service area to ensure that it does not exclude low- and moderate-income neighborhoods.

Finally, Federal Reserve examiners have begun testing a system that will use a statistical model, much like the model used in the Boston study, to analyze HMDA data and information drawn from loan files from individual institutions for purposes of helping to determine compliance with fair lending laws. Notwithstanding the usefulness of the HMDA data, the data alone are not sufficient to determine whether a lender is discriminating unlawfully. Specifically, the data do not reflect the wide range of financial and property related factors that lenders consider in evaluating loan applications. Consequently, our use of a statistical model will include detailed information from specific application files. We hope, and expect, that use of such a model will enable our examiners to more effectively identify any questionable application files.

CONSUMER COMPLAINT PROGRAM

The Federal Reserve's consumer complaint program is an important element in our overall efforts to enforce fair lending laws. The investigation procedures in this regard provide special guidance with respect to complaints involving loan discrimination. Such complaints, given appropriate circumstances, will prompt an on-site in-

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vestigation by Reserve Bank personnel at the state member bank accused of discrimination. As mentioned previously, we have a referral agreement with HUD for mortgage complaints. I should note that the Federal Reserve System receives few complaints alleging loan discrimination and few of these, after investigation, have been resolved in favor of the complainant.

COMMUNITY AFFAIRS PROGRAM

The Board believes that ensuring fair access to credit can, in addition to enforcement of fair lending laws, be advanced by focussing on positive actions that a lender may take to address such concerns. Consequently, through its Community Affairs program, the Federal Reserve conducts outreach, education, and technical assistance activities to help financial institutions and the public understand and address community development and reinvestment issues. During 1992, resources devoted to Community Affairs activities at the Reserve Banks were increased to enable the Federal Reserve System to respond to the growing number of requests for information and assistance from banks and others on the Community Reinvestment Act, fair lending, and community development topics. Efforts were expanded to work with financial institutions, banking associations, governmental entities, business, and community groups to develop community lending programs that help finance affordable housing, small and minority business, and other revitalization projects. For example, the Federal, Reserve Bank of Kansas City sponsored a conference for bankers on "Credit and the Economically Disadvantaged," focusing on barriers faced by minority borrowers and steps banks can institute to ensure that credit is offered on an equitable basis. The Boston and New York Reserve Banks cosponsored a conference on credit issues affecting economic development programs for Native Americans, especially those living on reservations. These are but an example of a comprehensive community affairs program at work throughout the Federal Reserve System.

CONCLUSION

In my view we are beyond the point of debating whether disparate treatment of minorities is occurring in credit markets. We've known for some time that certain segments of our society, particularly minority consumers and minority small business owners, have difficulty obtaining credit. This has had an impact on the ability of minorities to build businesses, own homes, accumulate wealth, and, generally, participate in our economy on an equal footing. We now know that this difficulty that may not be justified by economic factors alone.

The process of fully integrating the minority community into the economic mainstream of our country as quickly as possible should be the ultimate goal of efforts to strengthen enforcement of fair lending laws. I have concentrated today on agency initiatives. But it's important not to overlook those positive actions that lenders have taken to help improve access to credit. Many lenders have undertaken critical self-analysis of their activities and this has resulted positive programs like reexamination of credit criteria, second reviews of lending decisions affecting minority applicants, and specialized consumer credit education on qualifying for credit. These are only a few of the initiatives recently undertaken by some lenders.

In conclusion, I appreciate the opportunity to appear before you today to testify on the important and complex issues regarding credit discrimination. The Board and the FFIEC share your concerns about this issue and we look forward to working with the Congress and others to address this important topic.

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Department of Justice

STATEMENT

OF

JAMES P. TURNER

ACTING ASSISTANT ATTORNEY GENERAL

CIVIL RIGHTS DIVISION

BEFORE

THE

COMMITTEE ON BANKING, HOUSING, AND

URBAN AFFAIRS

UNITED STATES SENATE

CONCERNING

MORTGAGE LENDING DISCRIMINATION

PRESENTED ON

FEBRUARY 24, 1993

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STATEMENT OF JAMES P. TURNER

ACTING ASSISTANT ATTORNEY GENERAL CIVIL RIGHTS DIVISION

I am grateful for the opportunity to testify before this Committee to describe the efforts of the Department of Justice to address allegations of racial discrimination in the mortgage lending industry. The Civil Rights Division has substantial authority for addressing such issues under the Fair Housing Act, 42 U.S.C. 3601 *et seq.*, and the Equal Credit Opportunity Act, 15 U.S.C. 1691–1691f. The alarming indications of racial discrimination in the mortgage lending industry suggest violations of these statutes and implicate our enforcement authority. Our efforts to fulfill our enforcement responsibilities in the recent past have included the assignment of lawyers to develop expertise in the mortgage lending field, the development of litigation to address the issue, and meeting with the major federal financial regulatory agencies in an attempt to develop an enforcement structure for the future. I am pleased to share our experience with you with the hope that it will prove helpful to the Committee in considering how best to address the issue of racial discrimination in the mortgage lending industry.

The lessons we have learned thus far can be summarized as follows:

1. Mortgage lending discrimination on the basis of race can exist in spite of the fact that management of the lending institution has adopted clear policies against such discrimination. Many aspects of an institution's operation must be evaluated over an extended period of time. Branching, marketing, advertising, hiring, appraising, underwriting, and compensation schemes for loan originators, all must be assessed in an analysis of whether an institution is denying credit needs on the basis of race. And those minority applicants who do apply for financing can be the victims of discrimination through subtle acts, or failure to act, beginning with low or mid-level officials of the institution.

2. There are statistical methodologies available to inform investigators whether institutions with high rejection rates of blacks as compared to whites have permitted race to infect the underwriting decision process. The approach we utilized in the litigation I will describe today has been used in other fields for many years. But the statistical issues can be addressed only by expensive analysis of a large number of application files.

3. The sampling methodology used by the federal regulatory agencies in their fair lending reviews has not detected the type of discrimination that we have found. We hope for revisions in the methodology that would allow these front line detectors of discrimination in the lending industry to identify impermissible practices. Our Department is fully committed to prosecuting cases of mortgage lending discrimination, and we are willing, and eager to work with the regulatory agencies in carrying out our responsibilities. Solid referrals from the front-line agencies and, in some instances, joint investigations are essential to an effective enforcement program.

I. THE MORTGAGE LENDING DISCRIMINATION LAWSUIT.

The summary conclusions listed above stem from our analysis of the industry during the past four years. Our interest was first attracted by the Pulitzer Prize winning "Color of Money" series published in the *Atlanta Journal-Constitution* in 1988, contrasting the widespread disparities in the number of mortgage loans approved by certain lenders in white and black neighborhoods of Atlanta. The articles documented that many lenders placed about five times as many mortgages in white neighborhoods as in comparable black neighborhoods, that black applicants were rejected for mortgage loans at significantly higher rates than white applicants, and that many of the lenders had few, if any, branch offices in black neighborhoods. The series postulated that this denial of access to mortgage credit may have had a deleterious effect on the regeneration of many black neighborhoods in Atlanta's urban core.

Our attorneys knew little about the industry at the start and we began by conducting a survey of Atlanta-area lending institutions to learn their policies and practices. We eventually focused our investigation on Decatur Federal Savings and Loan because of its size, poor record of loan origination in black neighborhoods, and high rejection rate of black applicants. We ultimately filed a lawsuit on September 17, 1992, alleging that Decatur Federal engaged in unlawful discrimination in its mortgage lending program. The district court approved a consent decree the same day that had been negotiated by our lawyers and Decatur's representatives.

I want to emphasize that our focus is on Decatur Federal because that is the only case we have pursued. The institution should not be viewed as a scapegoat as we address the issues. Our initial standards for targeting could have captured other Atlanta-area institutions, and institutions in many other cities would exhibit similar characteristics. We focused on one institution largely because of the complexity and

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novelty of the task ahead. We were fortunate that the Decatur officials cooperated fully with our investigation and expressed a sincere desire to get to the bottom of the issue.

When we presented our findings, the institution, represented by very competent counsel, engaged in thoughtful discussions regarding remedy. It suggested many of the innovative provisions contained in the consent decree, and it was willing to compensate persons whom we identified to be victims of discrimination. The institution's officials and counsel expressed a recognition that problems found to exist might be applicable to the industry at-large, and expressed the desire to become a model for nondiscriminatory operation. Thus, we will describe the facts of Decatur's operation because it is the only institution we have studied in detail; but we also appreciate that institution's efforts to help us resolve this issue nationwide.

I also note at the outset, that the Community Reinvestment Act, 12 U.S.C. 2901 *et seq.*, provided an important framework for our investigation, in that the CRA requires institutions to meet the credit needs of the entire community in which the institution operates, including low- and moderate-income neighborhoods. We do not mean to suggest that a violation of the CRA, standing alone, establishes a violation of the Fair Housing Act, or the Equal Credit Opportunity Act. But lending institutions are required to serve all communities of their service area, and if their failure to comply is correlated with the race of the underserved neighborhoods, intentional discrimination, in violation of the Fair Housing Act and the Equal Credit Opportunity Act, can be inferred. The CRA thus sets lending institutions apart from other commercial businesses.

A. The History of Decatur Federal's Operation Revealed an Intent to Serve the White Community but not to Serve the Black Community.

We reviewed the practices of Decatur Federal Savings and Loan from the time the institution opened its doors in 1927 in a white neighborhood in the Dekalb County portion of the Atlanta area. Of course, all aspects of public life in Georgia were segregated at that time and the banking industry was no different. But even with dramatic changes in racial attitudes over time, this institution continued to serve primarily the white community.

For example, since its inception Decatur Federal has opened 43 branch offices, and it placed all but one of these in neighborhoods that were predominately white at the time. The lender closed the single branch that it did open in a predominately black area after only three years of operation. The institution had closed only one other full-service branch in its history, which it opened when the surrounding neighborhood was 3 percent black but closed when the neighborhood became 85 percent black. Other comparably sized Atlanta banks and thrifts had many more branches in predominately black neighborhoods. Of course, the institution claimed that it had nondiscriminatory reasons for each decision, but an analysis over time points to a policy of serving neighborhoods on the basis of race.

We found further evidence of discrimination from the manner in which the institution defined its CRA service territory in 1979. The lender excluded, most of the predominately black neighborhoods of Atlanta by following the tracks of the Seaboard Coast and Southern Railways, well known historical boundaries that separate black from white neighborhoods in the South Fulton County portion of the Atlanta area. As a result, over 76 percent of the black population of Fulton County at that time was excluded from the institution's defined service area.

Marketing practices provided another piece of the evidence. Decatur relies heavily on its force of account executives to develop the home mortgage loan business, and these persons were given wide latitude in their solicitation activities. Account executives were paid on a commission basis, and it was to their advantage to target high-priced neighborhoods, eschewing builders and agents, such as members of the identifiably black Empire Real Estate Board, who are active in most black residential neighborhoods of the Atlanta area. The pattern was further reinforced by employing few blacks as account executives, or in other key mortgage, lending positions, such as appraiser or underwriter. Advertising was concentrated on the white community. The lender never advertised on black-oriented radio stations and rarely, if ever, in black-owned newspapers. We learned that other lenders utilized the black-oriented media to market their products.

In sum, the totality of facts regarding the institution's method of operation over a period of 65 years supported a conclusion that it chose to serve the white community and was excluding the black community. In the face of this method of operation, it is understandable why only 6 percent of Decatur Federal's home mortgage loan applications were from blacks, even though the Atlanta Metropolitan Statistical Area is 26 percent black; and it is also understandable why 97 percent of Decatur's loans were in majority white areas.

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B. Black Persons Who Sought Mortgage-Loan Products From Decatur Federal Were Not Treated Fairly.

We also wanted to examine the treatment afforded to black persons who did apply for the mortgage-loan products offered by Decatur, and this proved to be the most complex, and time-consuming, portion of our investigation. We were aware, of course, of Atlanta-type studies of other major cities. And the release of the Home Mortgage Disclosure Act statistics in October of 1991 confirmed that the issue we were examining was not limited to the Atlanta area. The nationwide HMDA data showed, for example, that 33.9 percent of black applicants for conventional mortgage financing were rejected; the comparable figure for white applicants was 14.4 percent.

We heard the contentions of the fair housing and fair lending advocates that the HMDA statistics standing alone could establish discrimination at a particular institution. On the other hand, representatives of the lending industry argued that the HMDA statistics offered little, if any, support for claims of systemic discrimination since so many factors, such as credit histories, assets, wealth, job history, etc., are all implicated in the decision of whether to underwrite a loan. The statistics available to us, however, revealed that Decatur rejected 41 percent of its black applicants but rejected only 15 percent of its white applicants. Even if these statistics did not confirm a fire, the smoke raised demanded a thorough investigation.

We initially attempted to address the issue by having our attorneys review a sampling of files to determine if blacks were afforded treatment comparable to that given whites. We found the issue to be every bit as complex as some industry spokespersons claimed. Even after reviewing a sampling of some 500 application files and analyzing the file information with the help of an econometrician on loan from the Federal Trade Commission, we were unable to form a definitive conclusion.

Perhaps because we were novices to the area, we were surprised that so many mortgage applications are marginal to some extent. Standard underwriting guidelines are necessarily flexible, allowing lenders the discretion to balance a host of positive and negative factors in deciding whether the applicant has demonstrated the ability and willingness to repay a loan. We learned that many borrowers require assistance in perfecting their applications, particularly in documenting their explanations for poor credit items and the adequacy and stability of their incomes. Persons denied a loan are given an objective reason for the denial, and an examination of the treatment afforded that individual application generally raises no suspicion of unlawful discrimination. While at this stage we could not prove disparate treatment, we concluded that the flexibility of the process, as well as the essential assistance that is given to applicants, certainly would provide an opportunity for disparate treatment on a racial basis. For example, a lender's employees might adopt the role of gatekeeper when serving minority applicants, but transform into that of helpful expediter when serving whites. There might be no reflection in the files, but there would be a clear case of discrimination.

We thus concluded that, in order to address the issue properly, we needed to evaluate each factor considered in the underwriting process and determine whether the factors were applied without regard to race.

We interviewed officials of the institution at length to determine the factors they considered in evaluating an application for mortgage financing. We copied several thousand loan application files and created a data base of more than 70 variables, such as credit history, income, assets, education, job history, loan amount, and down payment amount. Our experts utilized a logit multiple regression analysis to identify approximately 20 variables, most related to credit issues, that best predicted success of an applicant. Even after controlling for all factors that the institution (and the industry) considered to be relevant, however, our statistical analysis revealed that the race of the applicant was a significant factor in determining whether or not Decatur would grant a loan.

Moreover, it was also clear that the effect of race was substantial. During the two-year period studied initially, Decatur Federal rejected 47, black applicants for fixed-rate conventional loans. By our analysis, if the lender had evaluated them with the same standards it used for white applicants, 12 of these applicants should have been accepted. In addition, Decatur Federal rejected 25 black applicants' for adjustable-rate conventional loans, of whom more than half (13) should have been accepted under the white standard.

After updating our analysis for more recent years, we identified a total of 48 black applicants that we determined were victims of disparate treatment since 1988. In each instance, we observed an objective reason for the denial of financing, but we were able to identify through the statistical study white applicants with very similar deficiencies who were approved for financing. As we compared the files closely, we saw that Decatur personnel at many different levels had counseled white applicants

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about their deficiencies and reworked their applications in order to make them qualify. In some instances, white applicants were encouraged to supply explanations for poor credit, or to pay off credit card and installment debt to meet underwriting guidelines. The files of rejected black applicants did not reveal similar actions, and, when interviewed, many victims told us that they were unaware of the opportunity or procedures for resolving deficiencies in their applications. Our review revealed that underwriters sometimes ignored certain debt obligations for white applicants or counted income from self-employment without the documentation required by the guidelines. We did not find similarly lenient treatment of black applicants.

C. The Remedy in the Decatur Federal Lawsuit.

As noted earlier, much to their credit the officials of Decatur Federal wanted to rid their institution of any racial bias, and worked with us over a several month period to address each of the issues that we raised. The resulting consent decree is targeted to remedy the specific problems that we found to exist. The decree provided one million dollars in damages for the victims of discrimination, but, even more importantly, was designed to alter the method of operation to ensure nondiscrimination in the future.

The institution agreed to redraw its CRA boundary to include the previously excluded black neighborhoods of Fulton County. It agreed to open a branch or a regional loan office in the black residential area, and, in future branching decisions, to pay particular attention to the service of low- and moderate-income areas. Its advertising program will be revamped to target black residential areas. Decatur agreed to alter its mortgage loan marketing program to target real estate agents and builders serving black residential areas, and to alter the account executive commission pay structure to provide increased incentives to market the products in black residential areas.

The decree contains specific provisions for the recruitment of black applicants for job openings, with particular emphasis on positions such as account executive, underwriter, loan counselor, loan processor, appraiser, assistant branch manager and branch manager.

Decatur Federal proposed to adopt a program of testing to help ensure that potential applicants would be treated without regard to race when they visit a branch of the institution, and that program will be implemented under the terms of the consent decree.

We also attempted to remedy the subtle discrimination that can be effectuated at various stages of the loan-application process. The approach adopted was an attempt to ensure that all applicants are provided the assistance and information necessary to complete an application without regard to race. We did not attempt to remove the flexibility or discretion from the underwriting process, but did mandate that such flexibility and discretion be exercised without regard to race. Loan processors and underwriters will utilize a "check sheet" to help ensure that they solicit all information necessary for a fair evaluation of all applications. The check sheet will also require that black as well as white applicants be told of the opportunity to offer an explanation for deficiencies in their applications; and that black and white applicants be offered the same assistance, which we discovered to be so important in obtaining a mortgage loan. Each rejection will be reviewed to ensure that all procedures were proper and that the decision was nondiscriminatory. Appraisals that might result in a denial of financing also will be reviewed by a person with expertise in appraising properties located in black residential areas. And persons who ultimately are denied financing will be afforded an opportunity for an additional review and to submit additional information.

The success of this program will depend largely on the efforts of Decatur's management. Many of the decree's provisions are aimed at attracting black applicants, and other provisions are an attempt to ensure that such persons, when they apply, are treated fairly. The decree provides procedures and tools—such as the check sheet—to help ensure fair treatment, but in the end the institution must convince its employees to exercise all of their responsibilities in a nonracial manner. In that regard, the training provisions of the decree are extremely important.

The decree represents the best ideas of our staff and of Decatur officials. We intend to monitor its implementation and evaluate its success carefully.

II. ENFORCEMENT ACTIVITIES AFTER DECATUR.

The *Decatur* lawsuits, of course, has ramifications beyond Atlanta. This was the first in-depth analysis of a lending institution to determine whether its policies were racially discriminatory, but the characteristics of Decatur that started the investigation are not measurably different from many other lending institutions in the country. And while our analysis was targeted upon only one institution, the results are

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strikingly similar to the results of the completely independent study conducted by the Federal Reserve Board in Boston. Two independent analyses, in geographically diverse areas, have demonstrated that race has been a factor in the underwriting process.

In these circumstances, we believe that the emphasis should be on law enforcement rather than on additional academic arguments regarding the meaning of the HMDA data. We recognized this need as our *Decatur* case was being completed and we convened meetings with the regulatory agencies in an effort to develop an enforcement plan.

The Federal Reserve Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision have substantial responsibility for ensuring that institutions under their supervision operate without regard to race, and we asked representatives of these agencies to meet with us in November of 1991. Other agencies involved in the enforcement process, including the National Credit Union Association, the Federal Trade Commission, and the Department of Housing and Urban Development also attended the meeting.

Historically, we had not received referrals of alleged mortgage lending discrimination from the regulatory agencies, and our experience in Atlanta explained that such discrimination was difficult to detect. We learned the hard way—through trial and error—that the question raised by the HMDA racial disparities cannot be answered by examining a small sampling of files and attempting to evaluate the correctness of each lending decision on a file-by-file basis. Our conclusion was that a complex statistical analysis is necessary. At the same time, we learned that the traditional type of investigation that our Division has conducted for many years—the review of all components of operation over an extended period of time—is appropriate for investigating some aspects of the lending industry. As we gain more experience with this approach, we can expect to complete such investigations quickly and less expensively.

I should note that our focus, as the Department responsible for enforcing the pattern or practice provisions of the Fair Housing Act and the Equal Credit Opportunity Act, is on answering the serious question raised by the disparities in the HMDA statistics. We do not suggest that a statistical analysis is required each time a person claims to be a victim of discriminatory lending practices. With an individual victim as a focus, it is easier to compare the individual's treatment with published standards or even to examine a sampling of files to evaluate disparate treatment; such methods have been used by private fair housing organizations for many years. But the task becomes exceedingly more complex when we start only with the HMDA statistics and attempt to evaluate pattern or practice concerns.

We have shared our views regarding this pattern or practice investigative approach with representatives of all of the regulatory agencies. In June of 1992, we asked them to work with us in joint investigations of lending institutions. We believe that the joint investigations would be beneficial: we would benefit from the regulator's knowledge of the industry and our experience in civil rights investigations could be helpful to them. We are continuing to confer with them in an effort to reach agreement about a proposal for joint investigations. We are convinced that the traditional approach to uncovering mortgage lending discrimination has been inadequate and that the issues raised by the HMDA racial rejection disparities require statistical analysis of a large number of application files.

Time and costs of investigations can be reduced. With the experience we have gained, we believe that a *Decatur*-type investigation can be completed in a period of six to nine months, assuming that the targeted institution cooperates. The costs of these types of investigations will be in the range of $300,000 to $500,000; this cost range is comparable to major employment discrimination litigation in which we utilize similar statistical methods of analysis.

Investigations that do not require complex statistical analysis, such as investigations of institutions serving black populated areas but receiving few applications from black persons, will be much less costly. And costs of investigations that require statistical analysis might be further reduced by a preliminary statistical review of loan files to determine whether the full-scale analysis is appropriate. But in those instances where the full-scale analysis is necessary to determine whether the institution is operating in a discriminatory manner, the required analysis will be expensive. We are unaware of any shortcuts.

While we have not yet reached full agreement with the regulatory agencies, we have found common ground. We are proceeding, for example, to work jointly to target institutions for investigation. We continue to hope that the regulatory agencies will be able to join us for some initial investigations of institutions with seriously problematic HMDA statistics. This would allow use of the agencies statutory authority for access to records and could provide a convenient vehicle for referral of serious

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cases to the Department of Justice for litigation. Also, we are presently pursuing a pattern or practice referral arising from the Federal Reserve study of lending practices in Boston, and we have been invited to teach our investigative techniques to the examiners.

In closing, let me say that we do expect to continue to devote significant resources to this important civil rights issue; but the Committee should be aware that if all of the complex cases are left to us to investigate and to fund, we cannot handle more than a few each year. At that pace, a remedy for this serious problem of discrimination in access to credit, and to housing, will be a long time coming.

TESTIMONY SUBMITTED BY RETHA WILSON

Board Member, Association of Community Organizations for Reform Now—(ACORN)—Michigan Chapter

Good morning, Mr. Chairman, and members of the Committee. I am Retha Wilson, a Board Member of Michigan ACORN. I very much appreciate the opportunity to present ACORN's views on the problem of mortgage discrimination and the enforcement of the nation's fair lending laws.

Let me take this opportunity to commend you, Mr. Chairman, for an extraordinary record in this area. Issues of fair lending and community reinvestment have been front and center in this Committee in recent years, thanks in large part to your leadership. This hearing, together with recent hearings on community development banks and "reverse redlining" have demonstrated your commitment to increasing credit availability in distressed neighborhoods. We expect that a new Administration committed to ensuring equal opportunity for all citizens will finally allow the gridlock that has plagued discussions of these issues to end.

I also wish to commend the Chairman for ensuring that the basic body of consumer protection, fair lending, and community reinvestment laws have not been eroded—despite a furious campaign by the industry trade groups. Ordinary Americans wish to see a safe and sound banking system, and one that is responsive to the needs of all Americans. Ensuring that these goals are realized has been the hallmark of your Chairmanship.

ACORN

ACORN, the Association of Community Organizations for Reform Now, is the country's largest grassroots organization of low- and moderate-income families. Founded in Arkansas in 1970, ACORN has grown to include 400 neighborhood groups in 26 states and the District of Columbia. ACORN members work on a broad range of issues that affect the quality of life in our communities—ranging from neighborhood safety to affordable housing to quality education and health card.

ACORN was the first group ever to file a challenge to a bank merger application under the Community Reinvestment Act (CRA), and has won over two dozen agreements with lenders that have generated nearly $500 million in lending in low-income communities since 1980.

Summary of Testimony

My testimony today has five principal points.

(1) Mortgage discrimination is pervasive and widespread.

Studies dating back to the mid-1970's have revealed wide disparities in the rejection of minority and white applicants of comparable economic characteristics. Most recently, the Boston Federal Reserve Bank's study has conclusively demonstrated that race and ethnicity account for a substantial portion of racial discrepancies in lending.

(2) Mortgage discrimination has a high cost to individuals, neighborhoods, and society.

Mortgage discrimination results not only in the denial of opportunity to minority families, but fosters abandonment and urban flight and undermines economic development and the tax bases of cities. Mortgage discrimination represents a hidden tax by the banking industry on society at large.

(3) Discrimination takes several forms, and may occur at several points in the application process.

Mortgage discrimination may take the forms of discouragement of applications, "steering" of applicants toward certain products, differential "coaching" of applicants, or the use of underwriting standards that have the effect of discriminating against racial and ethnic minorities.

(4) The bank regulatory agencies' record of enforcement of the nation's fair lending laws is a national disgrace.

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Twenty-five years after the passage of the Fair Housing Act, discrimination in mortgage lending remains pervasive, thanks in large part to the hostile and obstructionist role of the bank regulatory agencies. Virtually no lender has ever been punished for discrimination, despite abundant evidence of bias, and the agencies have resisted even the most basic reforms for decades.

(5) Abundant anecdotal evidence suggests that non-mortgage related discrimination is as serious a problem as discrimination in the mortgage market.

Minority-owned businesses and minority consumers face significant obstacles to obtaining credit, due in part to discrimination. The collection of meaningful data on small business and consumer lending—by census tract and by the race, gender, and income of applicants—is essential to monitor bank compliance with the ECOA.

Summary of Recommendations

The Congress and the Administration can take several affirmative steps to enforce the fair lending laws. Perhaps most importantly, President Clinton must appoint individuals to senior bank regulatory positions with a commitment to equal opportunity, and this Committee must ensure that such a commitment exists as part of the confirmation process.

My testimony has nine principal recommendations:

1. Create Separate Consumer Compliance Divisions Within Each Agency, or Within a New Consolidated Regulatory Agency, Whose Head Reports Directly to the Head of the Agency

2. Require Testing as Part of Fair Lending Enforcement Efforts

Testing is the most effective means of detecting illegal "prescreening." The Fair Housing Initiatives Program (FHIP) at HUD should be expanded to provide for increased mortgage lending testing.

3. Expand the Role of the Justice Department and HUD in Enforcement of the Fair Lending Laws

Aggressive prosecution of ECOA violations by the Justice Department will have a dramatic impact on the industry, while increased support and authority for Justice may spur increased activity by the banking agencies.

4. Conduct an Overhaul of Fair Lending Examination Procedures

5. Require Lenders to Make Underwriting Criteria Available to the Public & Conduct Aggressive Borrower Education

6. Bring Mortgage Banks, PMI Companies, Appraisal Firms and Homeowners' Insurance Underwriters Under Effective Federal Regulation

Other players in the mortgage lending chain must be brought under effective disclosure requirements and federal regulation to ensure non-discrimination and support for community lending.

7. Strengthen Enforcement of the Community Reinvestment Act (CRA)

8. Enhance Consumer and Community Participation in Regulatory Process

9. Collect Meaningful Data on Small Business and Consumer Lending

Introduction

Mortgage discrimination remains a principal obstacle to the attainment of the American dream of home ownership for millions of minority families.

At hearings in 1990 at the Consumer Affairs Subcommittee, Senator Alan Dixon said:

> "I'm not a statistician, but when blacks are getting their loan applications rejected twice as often as whites and, in some cities, it's three and four times as often, I conclude that discrimination is part of the problem. . . . It's 21 years since the passage of the Fair Housing Act. Fifteen years since the Equal Credit Opportunity Act was passed in the Congress; and 11 years since the Community Reinvestment Act became the law of this land, and still we have discrimination in mortgage lending. The problem today is not lack of laws, in my view, it is lackluster enforcement."

This year, we mark the twenty-fifth anniversary of the passage of the Fair Housing Act. It is 18 years since the enactment of the Equal Credit Opportunity Act (ECOA) and 16 years after the enactment of the Community Reinvestment Act (CRA).

Yet, America remains a nation of two banking systems—separate and unequal—and a nation of bankers and regulators that are flagrantly hostile to the enforcement of the nation's fair lending laws. The current situation in intolerable and outrageous.

Over the past decade, ACORN has testified before Congress on this subject on numerous occasions, but lender discrimination goes on unchecked, regulators continue to take a "see no-evil" posture, and our neighborhoods and families continue to suf-

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fer. Time and time again, the regulators have come before Congress and used every excuse possible to deny the very existence of mortgage discrimination, and to excuse a performance that is a moral disgrace.

As early as 1976, Chairman Proxmire reacted to this situation will outrage, concluding that "I thought the record was pretty disgraceful. There was really no effective enforcement of the antiracial discrimination laws." In 1990, Senator Alan Dixon, chairing an oversight hearing on the subject, was equally disturbed at the performance of the agencies. He noted that "it continues to be a miracle that the numbers are so bad and we never find anybody in this whole country that has done anything so gross that they ought not to be penalized on at least one occasion to send a message to the whole country: Look, a person should get more than a slapped wrist around here in continuing what I continue to suggest is an egregious practice."

This Committee and the new Administration need to launch nothing less than a crusade for equal opportunity in lending. The full resources of government need to brought to bear on credit discrimination in the same way as when lunch counters were desegregated in the south. Without such a massive and concerted effort, I fear that I will be back before you again next year discussing why nothing has changed.

President Clinton has rightly stressed the need for investment in our nation's future. There is no single investment that could be of greater importance than ensuring that families that work hard and play by the rules are not denied opportunity based solely on the color of their skin. Each unfair denial represents more than the lost dream of an individual: it is a real and tangible economic loss to the nation.

Mr. Chairman, the time for studies has long past. We have waited and watched as data establishing systemic patterns of discrimination has been released time and time again—and ignored by the agencies and the industry time and time again. Such a pattern of inaction is corrosive of our democracy. If citizens are left to believe that laws passed by this Congress are meaningless because they will never be enforced, that is a recipe for precisely the kind of hopelessness that turns into the urban rage that exploded in Los Angeles.

It is debilitating to our democracy to place laws on the books, collect data that reveals massive violations, and leave it there—without any remedial action being taken. African-American communities in Detroit and around the nation must have the confidence that the fair lending laws really mean something.

The bankers have waxed lyrical about their so-called burdens in recent months. They should get in line behind millions of Americans who have been waiting for redress for injustice for more than a quarter century.

(1) Scope of the Problem

To put the matter simply, mortgage discrimination is pervasive in this country.

The evidence for the existence of mortgage discrimination is now indisputable. Thanks to amendments to the Home Mortgage Disclosure Act (HMDA) in FIRREA, data was collected for the first time on the disposition on home loan applications by race, income, and gender in 1990.

Prior to FIRREA, the industry and the regulators refused to admit that the discrepancies in lending in census tracts of different racial composition suggested that discrimination was in fact occurring—this despite the fact that data revealing that minorities were rejected at a significantly higher rate than whites was in fact available to the agencies in the mid-1970's.

As early as 1974, the agencies surveyed lenders in 18 metropolitan areas to determine whether they were in compliance with the Fair Housing Act. The surveys generally found that lenders rejected minority applicants roughly twice as frequently as white applicants. The OCC's study, in fact, controlled for creditworthiness, income, gross assets, debt burden, and job continuity—and still found a significant racial disparity.

Bill Dedman's Pulitzer-Prize winning series in the *Atlanta Journal Constitution* in 1988 used data obtained from the Federal Home Loan Bank Board (FHLBB) through the Freedom of Information Act (FIA) to demonstrate wide disparities in the denial rate of minority and white applicants.

So, the data is in fact not as "new" as the agencies and the industry would have one believe. Rather, the regulatory agencies—working hand in glove with lenders—chose to spend the better part of two decades engaged in public relations trench warfare, denying that there was a problem, and obfuscating a problem of stark moral clarity with methodological equivocations.

Finally, recent events have ended the debate about whether mortgage discrimination exists.

The Federal Reserve's study of the "new" 1990 HMDA data, released in October, 1991, revealed that nationwide African-American and Hispanic applicants for home loans were two to three times more likely to be rejected than were white applicants

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of comparable income. Indeed, upper-income African-American applicants were actually more likely to be rejected than low- and moderate-income white applicants in 1990. The Boston Federal Reserve Bank's analysis of the data in 1990 revealed that the pattern was consistent in every metropolitan area in the country—with the most egregious discrepancies in Boston and Chicago.

The results of the Federal Reserve's study of the 1991 HMDA data revealed no significant change in the overall disparity in rejection rates by race and ethnicity. It should be stressed that the agencies and lenders have known about these disparities for decades, and further that if the agencies and the industry had taken corrective steps in 1990—when they first began to collect the data—rather than in late 1991, when the Federal Reserve released its study, we might not be discussing why so little has changed today.

ACORN's studies of the "new" 1990 and 1991 HMDA data—*Banking on Discrimination* and *Banking on Discrimination, Part II*—in some respects revealed even more alarming figures that are concealed by the industry averages in the Federal Reserve's studies. Some lenders actually rejected African-Americans 10 times more frequently than whites of comparable income. Other lenders with offices in communities with significant minority populations received virtually no applications from minorities. To cite but one example, in 1990, only 4 percent of applications received by Bank of America in Oakland were from African-Americans, despite the fact that African-Americans comprise 40 percent of the city's population.

It should be noted that the response of the federal banking agencies and the industry to these alarming numbers was consistently to deny that the disparities indicated that discrimination was in fact occurring. Indeed, Governor LaWare said at the release of the first Federal Reserve study that he found it implausible that lenders were discriminating against minority applicants. After all, he noted, he came from the industry, and knew that lenders were simply interested in making money. Governor LaWare's attitude illustrates the depth of the problem at the agencies.

The study revealing that high-income African-Americans were rejected more frequently than low-income whites was only "worrisome" to Governor LaWare—and generated yet another wave of industry-funded studies which attempted yet again to obfuscate the significance of the data.

The Boston Federal Reserve Bank in October, 1992, released a study *Mortgage Lending in Boston: Interpreting HMDA Data,* which conclusively ended the debate about whether or not mortgage discrimination in fact occurs. The Boston study controlled for 38 separate economic characteristics other than income, and looked at all applications filed by African-Americans and Hispanics, and a sample of 3,300 applications filed by whites in 1990. The study looked only at the 131 institutions in the Boston area that received more than 25 applications from all races in 1990.

The study concluded that African-American and Hispanic applicants were 60 percent more likely to be rejected than white applicants of identical economic profiles. Thus, 17 percent of African-American applicants were denied, compared to 11 percent of comparable white applicants. The pattern was consistent for large and small lenders alike. As the authors put it:

> "Thus, in the end, a statistically significant gap remains, which is associated with race. . . . The results of this study suggest that for the same imperfections whites seem to enjoy a general presumption of creditworthiness that black and Hispanic applicants do not, and that lenders seem to be more willing to overlook flaws for white applicants than for minority applicants. . . ."

I should add that the Boston Federal Reserve Bank study probably dramatically understates the level of discrimination in the mortgage market, for several reasons.

First, "prescreening," the practice of illegally discouraging loan applications from minorities, was not measured by the study. Discouraged applicants do not, of course, get the opportunity to file loan applications, and therefore there is no paper trail to document the dimensions of this problem.

Second, "objective" ratios may in fact themselves be the product of bias. Thus, while an application by a white individual may show a 33 percent debt-to-income ratio, this may reflect advice by the loan officer as to what income to "count" to meet the lender's standards, or what outstanding bills to pay off, while similar advice would not have been given to a minority applicant. Thus, the numbers themselves may be "cooked" to the extent that "coaching" of applicants occurs.

Lastly, the study compared the application of a lender's underwriting criteria to applicants of different race. The question of whether the criteria themselves are biased was not considered. So, for example, if a lender used minimum loan amounts or tiered pricing to avoid doing business in the minority portion of Boston, this aspect of bias would not be reflected in the 60 percent disparity.

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The disparity revealed by the Boston Fed's study—conducted using very conservative methodology—represents therefore a *minimum* estimate of discrimination in the mortgage market.

(2) Impact of Mortgage Discrimination

Mortgage discrimination results in the denial of economic opportunity to untold thousands of Americans every year. Mortgage discrimination crushes individual aspirations for home ownership and fosters frustration, despair, and social alienation and abandonment in affected communities. As members of this Committee are fond of noting, home ownership lies at the heart of the promise of the American dream, and there is little more devastating than the denial of access to the credit necessary to make this dream a reality solely on the basis of the color of one's skin.

Unfortunately, mortgage discrimination is not without its winners, as this Committee found out just last week. Bias by traditional lenders has spurred the growth of "fringe lenders" to fill the void. A predatory collection of finance companies, second mortgage companies, and pawnshops, charging usurious interest rates and fees, have exploded in number and activity in recent years. The number of pawnshops alone has increased by 60 percent nationwide in the past four years.

The irony of second mortgage scams is, of course, that these firms provide financing that mainstream lenders are unwilling to offer—but that doesn't seem to stop banks from buying these loans on outrageous terms and with handsome profits to boot. One could not perhaps conceive of a better scheme to destroy the limited equity capital in minority neighborhoods if one intended to do so. I might add that the profusion of second mortgage scams puts the lie to the claims of the industry that there is no demand for credit in minority communities.

Even more important, mortgage discrimination has been responsible for the wholesale disinvestment of minority communities, abandonment and urban flight, and the decline of urban tax bases. When an individual cannot secure a mortgage loan, they are likely to leave a neighborhood in search of a home, and when they cannot secure a home improvement loan, they may abandon their property altogether.

The phenomenon of widespread abandonment in inner-city neighborhoods has resulted in the further retreat of job creating small businesses, who are reluctant to start a business on a block with abandoned buildings. Middle- and working-class minority families are compelled to leave the neighborhoods in which they were raised, thereby contributing to the decay of the communities they leave behind. And finally, as Boston Mayor Raymond L. Flynn has pointed out, mortgage discrimination as greatly contributed to the erosion of urban tax bases, thereby undermining the ability of municipalities to provide basic city services.

I might add that all of us—rich or poor—pay a price for the cycle of decay and decline set in motion by mortgage discrimination. Abandoned, unmortgaged properties are havens for drug use and crime, and are frequently burned down, both of which result in considerable expense to all taxpayers, no matter which side of town they happen to live in. Mortgage discrimination, then, represents a hidden bank tax on the whole community.

As long as minority neighborhoods continue to be denied access to credit—and thereby to home ownership and the accumulation of assets—we will continue to breed hopelessness, poverty, and unemployment in our urban areas. As evidenced by recent events in Los Angeles, we are only beginning to reap what we have sowed in the past decade. Reversing a cycle of urban decline, despair, and violence requires a federal commitment to be the guarantor of equal opportunity for all Americans.

(3) How Does Mortgage Discrimination Happen?

ACORN operates over a dozen loan counseling offices around the country that help low- and moderate-income, predominantly minority families obtain home loans. We have seen many cases of applicants with sufficient income and good credit histories who have been rejected by a lender. How does this happen?

As a general rule, credit discrimination does not mean a loan officer hurling racial epithets at a loan applicant, and denying their application. Rather, discrimination on the basis of race or ethnicity may occur at several points in the application process.

- If a lender has an implicit policy of not lending to minorities, a loan officer paid on commission is likely to spend very little time with minority applicants, or discourage them from filing an application.
- A loan officer may steer minority applicants away from some loan products and toward others. For example, minorities may be urged to use FHA products.
- During the processing of a loan application, a bank may delay as long as possible going to closing in order to encourage an applicant to withdraw his or her loan

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application. Our analysis of the 1990 HMDA data indicated that many lenders rejected *zero* minority borrowers, but that all minority applicants had conveniently withdrawn their applications.

- As revealed by the Boston Federal Reserve Bank's study, and the Decatur Federal case, lenders are more likely to make exceptions to standard underwriting criteria for white than for minority applicants. For example, a white applicant may be allowed to submit a written explanation of a minor problem in his or her credit report, while a minority applicant is not told of this opportunity. Or a minority applicant may be told how they fail to meet the lender's underwriting criteria—but not what steps are needed to qualify—while white applicants are given numerous tips about how to comply with the standards. In other words, lenders may do everything possible to work out problems with a marginal white applicant, but prove extremely unwilling to help a marginal black applicant.
- A lender may do business with discriminatory appraisers or PMI companies. For example, a lender will generally not make loans with greater than 95 percent loan-to-value. Thus, if a "low-balled" appraisal comes out lower than the actual selling price of a house, the loan application may be denied.

Apart from discriminatory practices by bank personnel, lenders may employ lending standards that are discriminatory in their effect. Some of these underwriting criteria may be intentionally discriminatory, while others may reflect cultural gaps. Examples of underwriting criteria that have the effect of discrimination include:

- Minimum loan amounts that may exceed the average purchase price of homes in the minority portion of a lender's service area.
- Tiered fees that are higher in some neighborhoods than in others. One Chicago thrift, we found, charged significantly higher rates and fees for low-balance loans—originated in predominantly minority areas—than for high-balance loans.
- Criteria biased against elder housing stock. Some lenders require not only that a property be up to code, but that it meet certain cosmetic standards as well. Others restrict financing for property in areas with mixed land uses, or various types of residential property.
- There is considerably more occupational mobility at the lower end of the income scale than at the upper end. Yet, most lenders use job continuity as a key measure of creditworthiness, requiring up to five-years at the same job. Such restrictions may not accurately reflect the creditworthiness of minorities who are often "last hired, first fired," or low-wage workers who may change jobs frequently, in order to capture the gains of a very small increase in hourly wages. Bank standards should be geared toward measuring income continuity.

Case Studies of Mortgage Discrimination

Listed are 4 actual cases of experiences of mortgage discrimination that illustrate the points made above. The names of the victims of discrimination have been withheld. Testimony by Willard Brown, an applicant with a perfect credit history who was rejected by four separate lenders in St. Louis is attached. [Appendix 1]

CASE 1: St. Louis

A black woman living with her parents in a low-income neighborhood sought a loan to purchase the abandoned house next door, in order to prevent drug dealers from moving in. Her loan application was turned down, despite good income, good credit, and good ratios. She was turned down because of a high abandonment rate on her block.

She purchased the house with cash, giving her 100 percent equity in the property. She then sought a home improvement loan to install central heating in the house, but was again turned down, because the bank refused to make, loans on properties without central heating!

CASE 2: Chicago

A black woman applied for a home loan at a Chicago bank and was turned down. She had good credit, good ratios, and good income. The reason given for the denial of her loan was that she had changed jobs once in the past 5 years. The bank required minimum job continuity of 5 years.

The applicant had indeed changed jobs, but there was no interruption in her income stream, and she actually increased her income at her new job.

CASE 3: Philadelphia

A black woman who had excellent income, good credit, and long job continuity was rejected by a lender. The reason for denial was poor credit history, but upon obtaining her credit report, she found that all that was listed was a missed payment of four cents, and that the report was incorrect. If she had merely been asked, she could have easily have corrected the error.

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CASE 4: St. Louis

A black woman, considered a "perfect applicant" by our loan counselors, with a combined income in excess of $50,000 per year, good credit, and long job continuity was denied a loan by a local bank. No reason for the denial was ever given, despite repeated requests, and the only "negative" factor that bore on the application was one abandoned house in the neighborhood.

(4) Enforcement of the Fair Lending Laws

The enforcement of the fair lending laws—the Fair Housing Act and the Equal Credit Opportunity Act—as well as the Community Reinvestment Act has been a national disgrace.

There has been some variation among them, but the general pattern among the regulatory agencies is one of hostility and disinterest in the enforcement of the fair lending laws.

Historical Background

From the very beginning, the enforcement of the nation's fair lending laws has been at best a low priority at the banking agencies. Arguably, the agencies have been obstructionist and hostile to these laws.

As early as 1969, HUD recommended that the four banking agencies promulgate regulations to implement the Fair Housing Act, which made discrimination in mortgage lending illegal. Despite this request, a petition by civil rights organizations, and a survey of 15,000 lenders by the agencies in 1971 revealing the frequent use of explicitly racist standards by lenders, the agencies refused to promulgate regulations to implement the Fair Housing Act. Only the Federal Home Loan Bank Board ever did so, in 1974.

Indeed, the agencies had to be sued by the National Urban League and other civil rights organizations before agreeing to carry out their responsibilities under the Fair Housing Act. The suit resulted in a settlement with every agency except the Fed calling for the establishment of examination procedures, examiner training, and the collection of data to monitor compliance.

Since then, successive detailed studies of mortgage lending in Detroit, Atlanta, and Boston have elicited virtually no response from the agencies—and resulted in no new fair lending initiatives. Indeed, after the Federal Reserve's study of the 1990 HMDA data, the most any of the agencies would say was that the discrepancies were "worrisome."

The Center for Community Change has aptly termed the abominable history of fair lending enforcement "the trail of tears."

Recent Regulatory Performance: ECOA and Fair Housing Act

The top officials at the regulatory agencies—many of them former bankers—appear to view themselves as management consultants to the institutions they are charged to regulate. Given the close relationship of the agencies to the industry, it is understandable why the regulators find it incomprehensible that their dinner party associates are engaging in discrimination on a grand scale.

Robert J. Herrmann of the OCC stated at Senate hearings in 1989 that "illegal discrimination simply does not make good business sense," and that therefore it could not be a significant problem. The presumption of the agencies is that the industry is guilty of no wrongs.

The Federal Reserve has in particular consistently maintained that discrimination cannot be a serious problem. In Senate hearings in 1989, Governor John P. LaWare stated that:

> "Personally, I find it difficult to reconcile the notion that there is widespread racial discrimination in mortgage lending with the fact that bankers want to make loans . . . In my more than 30 years experience as a banker, I found the industry strongly committed as a matter of self-interest to make every sound loan possible . . . perhaps the bias of individual bankers may have clouded their judgment on occasion, but in the main, I think that the institutional commitment to doing business where it makes economic sense will win out over prejudice."

Under the Federal Reserve's analysis, we might as well repeal the fair lending laws, since discrimination is illogical and therefore cannot exist. Three years later—after the Boston Federal Reserve Bank's study established the pervasiveness of mortgage discrimination—one can only wonder whether Governor LaWare's innocent faith in the industry remains untarnished.

Given this pro-industry predisposition at the top of the agencies, is it any wonder that the regulators cannot name more than a handful of enforcement actions against lenders?

Examples of this poor performance include:

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- The four banking agencies have collectively referred only 5 violations of the ECOA to the Justice Department in the last ten years, according to responses to inquiries by this Committee. And, I might add, the FDIC's three referrals came only after Senator Cranston's staff noticed that violations of ECOA were mentioned in CRA evaluations, and Senator Cranston insisted that the FDIC make the referrals. This took place after the FDIC Act, which *required* such referrals to take place, meaning that the FDIC was apparently disregarding the statute.
- The agencies almost never find substantive violations of ECOA based on racial discrimination.
- When the agencies do find violations of ECOA, they appear to require the lender in violation merely to correct the problem—and appear to have never actually fined or otherwise punished a lender for a violation.
- In 1990, Comptroller Bob Clarke's own Special Assistant for Fair Lending resigned in protest, citing "vacuous management," and the OCC's "failure to adequately perform its compliance regulation responsibilities." Ronald E. Wienk commented that "regarding fair lending policy, the OCC actually has regressed over the 8 years since I accepted an offer to join the agency." Mr. Clarke's response to this indictment of the agency's fair lending enforcement efforts was to downgrade the position of the resignee's replacement.
- While the Justice Department found a pattern and practice of illegal discrimination under ECOA at Decatur Federal S&L, the OTS not only missed any discriminatory practices as part of its compliance exam, but gave Decatur a "satisfactory" CRA rating.
- Though the widely publicized Green discrimination case in Chicago resulted in a judicial finding of discrimination, the FDIC's examiners found no evidence of bias in their exams.
- In October 1990, the Federal Reserve's Consumer Advisory Council recommended that the Fed undertake a pilot project to explore the feasibility of using testers to detect illegal prescreening. In September, 1991, the Board of Governors unanimously rejected the recommendation.
- The response of the agencies to widespread evidence to evidence of mortgage discrimination was to contract with Arthur Anderson—a private accounting firm with no discernible fair lending expertise—to conduct an evaluation of the agencies fair lending examination procedures.
- The agencies are dramatically understaffed, and spend far too little examiner time ensuring compliance with the fair lending laws.
- The agencies have a disproportionately white examiner corps, and few minority supervisory personnel. For example, fully 87 percent of the FDIC examiner corps is white.
- The agencies have no clear policies guiding examiners as to how many loan files must be sampled during examinations, meaning that a huge institution may effectively have only a tiny portion of its files sampled. And the OCC reports selecting files that have been pulled by lenders themselves for internal review. If an examiner has reason to suspect discrimination, he or she is directed to sample only 14–26 additional files—far too few to detect discrimination.
- The OCC and FDIC have only recently moved to the use of specialized examiners for consumer and fair lending compliance, meaning that "generalist" examiners were charged with enforcing the anti-discrimination laws.
- With the exception of the Federal Reserve, the agencies persist in housing the consumer compliance function within a safety and soundness division. This effectively means that consumer compliance issues within the agency receive minimal attention.

Decatur S&L Case

In 1992, the Justice Department successfully settled a case against Decatur S&L in Atlanta for "a pattern and practice of discrimination," finding the discrepancies in the rejection of white and minority applicants was "statistically significant" evidence of discrimination. This landmark finding by an agency with far less resources to commit a fair lending enforcement effectively made a farce of the agencies' shameful efforts.

The OTS, of course, found no violations in the course of its compliance exams, and further gave Decatur an "outstanding" CRA rating.

Community Reinvestment Act Enforcement

Regulations under the CRA specifically instruct examiners to look for evidence on prohibited, discriminatory credit practices and for illegal "prescreening" of applicants. The enforcement of CRA has been extremely poor, with examiners giving "passing" grades to institutions that receive few applications from minorities, reject

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minority applications disproportionately, and extend little credit in minority neighborhoods. Nearly 90 percent of institutions get "satisfactory" or better grades under CRA, and only a handful of the tens of thousands of merger applications that come before the agencies have ever been denied because of poor community reinvestment performance.

A *Report on the Status of the Community Reinvestment Act* by the Senate Subcommittee on Housing and Urban Affairs found in November, 1992, that CRA had had "noteworthy success," and that "[c]ommunity groups working with the private sector have generated more than $30 billion in the last decade for reinvestment in underserved communities." The report credited CRA as "the impetus for developing partnerships between financial institutions and communities; for providing access to capital to communities traditionally underserved; and for creating new, innovative methods for meeting the credit needs of all segments of the community." Very little of the credit for these successes was given to the regulatory agencies.

Indeed, the report went on to note that CRA had not achieved its potential precisely because of regulatory malfeasance.

> "It is clear from the Subcommittee's review that the regulatory agencies have yet to fulfill their obligation to ensure that the CRA is properly and completely implemented. The supervisory agencies record of inconsistent and lax enforcement has encouraged the indifference and disinterest by the financial institutions. As a consequence, the agencies bear significant responsibility for the poor performance of many of the financial institutions . . . Inconsistent implementation and enforcement diminishes the CRA's tremendous potential, deprives neighborhoods and communities of one of the most effective Federal tools available to assist in meeting their credit needs, and denies financial institutions the benefits of a consistent, fair regulatory regime . . . The message is clear. CRA is a law whose purpose is as relevant today as when it was written 15 years ago. The issue is not the law, but its implementation and enforcement."

Among the flaws in regulatory performance identified by the report were: grade inflation, uneven quality of evaluations, lack of clarity about CRA's goals, inattention to identified cases of discrimination, infrequent use of enforcement powers, lack of attention to lending data in assessing performance, and obstruction of community input into the regulatory process.

The Subcommittee placed particular emphasis on the poor linkage of CRA to the fair lending laws. Indeed, the Subcommittee found three serious violations of ECOA that had been noted in CRA evaluations, but which had not been referred to the Department of Justice as mandated by law in FDICIA.

(5) Non-Mortgage Related Discrimination

There is no statistical data with which to evaluate whether discrimination is occurring in the consumer and small business credit markets. However, there is considerable anecdotal evidence that suggests severe problems of credit availability for minorities in these areas.

In particular, the *Wall Street Journal* reported last Friday that its survey of several hundred black business owners revealed that 92 percent of them had been turned down by lenders. One young African-American businessman told the *Journal* that he visited "basically every bank in and around Boston" and got a uniformly negative reaction. He said that "[w]e were young and persons of color. They looked at you skeptically right off the bat. Then they put you through the rigors to the nth degree. They all said no, no, no."

Rejected by the banks, the firm ultimately obtained a loan from the Massachusetts Minority Enterprise Investment Corporation. The result? The birth of the Skyline Communications Corporation, a successful mail and package delivery firm in Boston—a minority business that would have never seen the light of day if it had depended on the commercial banks.

The experience with mortgage lending gives us every reason to believe that there are problems of equal magnitude with regard to consumer and small business credit for minority consumers. Yet, the enforcement of ECOA appears to be given even shorter shrift with regard to non-mortgage lending.

There is desperate and compelling need for the systematic collection of data in this area.

(6) Recommendations

As the tragic history of fair lending enforcement has illustrated, there is very little that Congress can do to eradicate lending discrimination without at least desultory enforcement of the law by the federal banking agencies.

After 25 years of negligence and hostility from the agencies, we now have an historic opportunity to reverse the pattern. Most of the changes needed in this area

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are administrative, and thus fully within the power of the Administration to implement. President Clinton has the opportunity to fill regulatory posts with individuals who have a commitment to equal opportunity and fair lending. We trust that the President will make such a commitment a pre-requisite for appointment, and that this Committee will be vigilant in carrying out its duties in the confirmation process.

Let me add that it is our experience that the regulators attach great importance to issues that are of concern to members of this Committee. We would therefore urge you to communicate to the nominees the importance of fair lending enforcement as they are nominated.

ACORN recommends that the Administration and the Congress:

1. Create Separate Consumer Compliance Divisions Within Each Agency, or Within a New Consolidated Regulatory Agency

Issues of fair lending, community reinvestment, and consumer protection will never receive the attention they deserve unless and until the consumer compliance function is housed within a separate division, whose head reports directly to the head of the agency. Currently, consumer compliance personnel work in the safety and soundness division, ensuring that fair lending issues are buried within the agencies.

ACORN would support the consolidation of the four agencies into a single, independent agency provided that a separate division for consumer compliance was also created.

2. Require Testing as Part of Fair Lending Enforcement Efforts

The agencies freely admit that it is virtually impossible to detect illegal "prescreening" of applicants as part of the regular examination process. In response to the Committee's questions, the OCC noted that "The bank examination process is inherently unsuited to detect discrimination prior to application," while the FDIC commented that "testing . . . is probably the most effective means of identifying prescreening."

In addition, the agencies claim that discrimination is difficult to detect because it may involve subtle differences in the level of assistance given to equally qualified applicants of different racial backgrounds. Testing is arguably the surest way of detecting such differential treatment.

Given the intransigence and hostility of the agencies—particularly their ringleader, the Federal Reserve—with regard to testing, it will probably be necessary to increase dramatically the Fair Housing Initiatives Program (FHIP) at HUD for the purpose of conducting pre-application testing. Alternatively, the agencies could volunteer—or might be required—to contract with private fair housing groups to do testing. I doubt, however, that the agencies have either the inclination or sufficient knowledge to do testing on their own.

As for testing beyond the pre-application phase, this would require falsification of documents, and clarification that filing false information on a mortgage application is not illegal if for the purposes of testing. The Justice Department might be able to provide such a clarification.

3. Expand the Role of the Justice Department and HUD in Enforcement of the Fair Lending Laws

Unless prodded by aggressive competitors, the bank regulatory agencies are unlikely to ever undertake serious enforcement actions on their own. Indeed, one salutary effect of the Justice Department's settlement with Decatur S&L was that the other agencies were forced to scramble to catch up—although Governor LaWare's response was to attempt to obstruct Justice's request to accompany examiners on compliance exams.

And nothing will lead to a quicker understanding of fair lending than a few tough investigations and prosecutions by the Justice Department. When the banking industry learns that they are actually subject to prosecution for violations of the law—like any corporation or individual—we may have a sea change in attitudes and in practices in the lobbies of these institutions.

Specifically, Congress should:

- substantially increase funding available to the Justice Department to prosecute ECOA violations. It is our understanding that less than a dozen attorneys within the civil rights division are assigned to this task currently.
- give the Justice Department independent subpoena authority so that they are not wholly reliant on the minuscule number of referrals made by the banking agencies.

The Justice Department under the new Attorney General should dramatically step up the pace and frequency of investigations of lenders. HUD could take a simi-

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lar aggressive posture with regard to enforcement of the Fair Housing Act. I am pleased to report that Secretary Cisneros, speaking at our legislative conference in early February, indicated strong sympathy for strengthening Fair Housing Act enforcement with regard to mortgage lending.

4. Conduct an Overhaul of Fair Lending Examination Procedures

In light of their sorry record, the agencies need to overhaul basic examination procedures—but they would be well served by ignoring the advice of Arthur Anderson, and listening to fair housing experts who have been telling them what the problems are for decades.

Specifically, staffing, training, and compliance hours all need to be substantially upgraded. In addition, the number of loan files sampled by examiners should be dramatically increased, and interviews with loan applicants, community-based organizations, minority-owned businesses, and others should be an integral part of the compliance process.

In addition, examiners need to look not only for the "perfect" minority applicant who is denied, but also for disparate treatment of applicants with similar qualifications, but different racial backgrounds.

5. Require Lenders to Make Underwriting Criteria Available to the Public & Conduct Aggressive Borrower Education

The agencies receive astonishingly few complaints of discrimination from borrowers. In part, this is because minority borrowers do not know whether comparable white applicants are receiving different treatment, and in part because the bank's standards for evaluating applications are often not made clear to applicants.

OTS is the only agency with non-discrimination regulations issued under the Fair Housing Act. These regulations specifically prohibit redlining, and require lenders to make underwriting criteria available to the public. Such requirements have not resulted in the divulging of trade secrets, and have apparently not eroded the competitive position of any lender. Surely, the other agencies could require the same of lenders that they regulate.

Aggressive consumer education has never been a function that the agencies have emphasized. The agencies need to upgrade this aspect of their work, and go beyond producing glossy brochures. Agency personnel need to roll up their sleeves and go into minority communities to educate consumers, and work with neighborhood institutions to identify possible victims of discrimination.

6. Bring Mortgage Banks, PMI Companies, Appraisal Firms and Homeowners' Insurance Underwriters Under Effective Federal Regulation

Other players in the mortgage lending chain contribute to problems of bias, but are not subject to effective anti-discrimination or community support requirements. We recommend that:

- Mortgage banks be subject to community support reviews by a new Office of Mortgage Bank Supervision established within HUD, with the responsibility to ensure that mortgage banks are not discriminating on a prohibited basis, and are supporting low- and moderate-income housing
- PMI companies report under HMDA and be covered to community support requirements to ensure that they are not discriminating on a prohibited basis, and that they are supporting rather than obstructing, low- and moderate-income housing.

We are pleased that the trade association for the PMI companies has announced plans to voluntarily report under HMDA. However, this is not a substitute for effective federal regulation. The Boston Federal Reserve Bank study strongly suggested that as another layer in the mortgage decision making process, PMI companies may represent a real obstacle to getting a loan for minority families. Abundant anecdotal evidence suggests the same.

The FDIC pointed out in response to Committee questions that "Additionally, some PMIs base insurability on factors which may preclude certain neighborhoods. For example, a criteria that would require no less than 10 percent vacancy in the neighborhoods would preclude many borrowers in some inner-city areas from qualifying. To the extent that these neighborhoods are largely minority, this type of criteria would appear to have a role in mortgage discrimination."

We should point out that the new Loan-to-Value rules, which require PMI on loans with an LTV of greater than 90 percent make PMI a necessity rather than an option.

- Appraisers often "low-ball" properties in low-income and minority communities, making many homes unmortgagable. Uniform standards to guard against this practice should be created, and if necessary, a federal regulator within HUD should be established to monitor compliance.

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- Homeowners insurance is a necessity for a mortgage, but the price of homeowners insurance is substantially higher in minority than in non-minority communities, perhaps due in part to bias. In so far as insurance redlining begets mortgage discrimination, insurance companies should be subject to federal regulation and action under the Fair Housing Act.

7. Strengthen Enforcement of CRA

Great strides can be made in increasing credit availability for distressed urban and rural communities by strengthening enforcement of the CRA. Specifically, the Committee should work with the new Administration to:

- require the agencies to conduct more rigorous evaluations of lenders, and establish more rigorous standards for evaluations;
- make greater use of performance data in examinations and evaluations;
- conduct more frequent exams, particularly in the case of the OCC, and provide better training for examiners;
- make more frequent use of available enforcement tools, such as cease and desist orders and the denial of merger applications;
- facilitate, rather than obstruct, community input into the CRA process, and recognize partnerships between community groups and other local groups with lenders as an important component of a sound CRA program;
- in the case of banks operating in multiple MSAs in a state, conduct separate CRA evaluations for each MSA served by the institution, and one for rural portions of the state.

8. Enhance Consumer and Community Participation in Regulatory Process

Until and unless consumers and communities are given a voice in shaping the policies of the agencies in enforcing the fair lending laws, I fear we will never make any progress in enforcing the fair lending laws. The agencies have effectively been "captured" to date by the institutions they are charged with regulating, and there is no countervailing pressure.

To cite but one example, it required the direct intervention of this Committee in order for consumer and community groups to obtain even a meeting with the FFIEC as it developed its study on regulatory burdens—a study with ramifications for the broad public interest. This was despite the fact that the statute requiring the study specifically called for consultation with consumer and community groups.

The agencies should establish formal consumer and community advisory councils to solicit input on a regular basis from consumer, community, fair housing, and civil rights organizations on the full range of compliance issues, including fair lending enforcement. In addition, the Federal Reserve's Consumer Advisory Council, which is stacked with industry representatives, should be reformed to exclude such individuals.

9. Collect Meaningful Data on Small Business and Consumer Lending

Without the collection and public dissemination of meaningful data on lending to small businesses and consumers by census tract and by the race, gender, and income of applicants, we may be sure that the enforcement of the ECOA will remain anemic in this area.

The FFIEC made a farce of the rulemaking procedure with regard to provisions in FDICIA requiring reporting on lending to minority-owned small businesses. This rule should be revisited by the new Administration, and the Congress should enact disclosure requirements comparable to HMDA for small business and consumer lending.

A joint statement of a dozen civil rights, consumer, community, and elected official groups protesting the FFIEC's rule on small business disclosure is attached, together with an article in the *Wall Street Journal*. [Appendix 2]

Conclusion

President Clinton has promised the nation "change." Nowhere is change more desperately needed than at the bank-regulatory agencies which seem—despite numerous changes at the top—to have successfully resisted the civil rights revolution for a quarter century.

The time for studies and contemplation is well behind us. There is no mystery about what remains to be done. The only question is whether or not the political will exists in the final instance to take on the powerful interests that stand in the way of change. Minority families who have "worked hard" and "played by the rules" deserve no less than the full attention of this Administration and this Committee. There are simply no more excuses for delay or equivocation—and many compelling reasons for a coordinated and aggressive federal response.

Thank you, that concludes my testimony.

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APPENDIX 1

TESTIMONY OF MR. WILLARD BROWN

MAY 7, 1992

Good Morning, Mr. Chairman and members of the Committee. I am Willard Brown. I work at ———— in St. Louis, Missouri. I am happy to testify before you today on my experience in trying to get a home loan from banks in St. Louis.

In 1990, I went to St. Louis Mortgage Brokers to get a mortgage loan. They then referred me to Boatmen's Bank for a conventional loan and to Mark Twain Bank for an FHA loan.

I have worked 20 years at the same job, and earn an income of over $30,000 per year. I have good savings, and a perfect credit history. I have a R1 rating on all my outstanding debts, and have never missed a payment on any loan. Not once. I have my credit report here to prove it.

I was carrying a lot of credit card debt at the time I applied for a home loan, and so my ratios were high. But I also had a lot of cash in the bank, so all I needed to do to meet the criteria was to pay down some of this debt.

I was told by the mortgage broker to pay down some of my credit cards and to tear up my credit cards. I did this, but was still turned down by both banks because of high ratios. I could have met the bank's requirements, but they never gave me specific direction as to which debts I should pay off.

I then went to ACORN's loan counseling office in St. Louis. At this point my ratios were down to 38 percent of total monthly income, not including a short-term department store charge. I then went to Mercantile Bank for a Fannie Mae Community Homebuyers Loan. ACORN talked to the underwriters at the Mercantile, and the bank agreed to make the loan if I paid off the department store debt, and closed the account. I did that, and was approved by the bank.

However, I was turned down for Private Mortgage Insurance by General Electric, even though my ratios were now correct, and my payment history was still perfect. G.E. said that, since my payments were perfect, I could reopen my department store account at any time, and turned me down because of that possibility. They turned me down despite good income, perfect credit, acceptable ratios, and despite the fact that my credit card debt had been declining steadily for months, and a number of accounts had been closed.

ACORN loan counseling then sent me to Equality Savings & Loan for a Federal Home Loan Bank subsidized loan, which used FHA underwriting. FHA allows a total 41 percent debt ratio. My debt ratio was already under 41 percent, including house payments. ACORN called Equality, and told them that even though my ratios were in line, I was willing to pay off even more credit card debt if the lender required it.

When I went to Equality S&L to apply, the loan officer refused to take my application. When ACORN called to complain, Equality said they had just looked at the ratios and "didn't need to take an application, they knew it was a bad loan just by looking at it." ACORN then complained to the CEO of the S&L, who said that he didn't see any problem with not taking an application because "the loan officer knew what he was doing and if he said it was a bad loan, it was a bad loan." The CEO said that he didn't see any problem with making that decision based only on the address of the property and the on-line credit report—which was perfect—without taking a complete application.

ACORN then sent me to 1st Mortgage Bank, another S&L, after first calling and explaining the situation. ACORN told the bank that they might want to see more debt paid off, but that I wanted direction on which debts to pay off. 1st Bank approved me for a VA loan, and asked me to pay off two specific outstanding debts, which I did. The loan closed, and I have made every payment on time, with extra payments to principal.

Now, I was a pretty close to perfect applicant for a home loan. I have worked hard all my life, and always paid my bills on time. I firmly believe that if I wanted to buy a house in the suburbs—instead of the inner-city—I would have had a lot less trouble. And if I were white, it would have been even easier. Banks use any excuse not to make a loan in a neighborhood they want to avoid, or to people of a certain color that they view as not creditworthy.

But I just want you to think about what happens to a neighborhood when hard-working people, who want to stay and help their communities, can't get a loan for a house there because a bank has redlined the neighborhood. If nobody like me can get a loan, that means you need to pay cash to buy a house. Who has cash in our neighborhoods? Drug dealers and speculators.

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Our youth need role models, people who work hard and can someday make it and buy a house. What message does it send to them when someone plays by the rules, and still can't get ahead? We don't need handouts, we just need a chance, equal opportunity. And I hope you will take a hard look at the way the regulators are enforcing the laws that are supposed to ensure that we all get a fair chance.

APPENDIX 2

JOINT STATEMENT OF:

ASSOCIATION OF COMMUNITY ORGANIZATIONS FOR REFORM NOW (ACORN)

CENTER FOR COMMUNITY CHANGE

CENTER FOR THE STUDY OF RESPONSIVE LAW

CONSUMERS UNION

FIRST NATIONS DEVELOPMENT INSTITUTE

LEAGUE OF CITIES

NATIONAL ASSOCIATION FOR THE ADVANCEMENT OF COLORED PEOPLE (NAACP)

NATIONAL COUNCIL OF LA RAZA

NATIONAL NEIGHBORHOOD COALITION

PUBLIC CITIZEN'S CONGRESS WATCH

We are frankly outraged that the FFIEC has issued a final rule to collect data on small business lending that will not provide the public with useful or timely information regarding the availability of credit for small businesses, and altogether excludes collection of data on lending to minority-owned and startup small businesses.

The final rule was issued to implement Sections 122 and 477 of the Federal Deposit Insurance Corporation Act of 1991 (FDICIA), which require the four bank regulatory agencies to collect data on lending to small businesses and small farms, including data on loans to minority-owned and start-up small businesses.

We are appalled that the final rule fails to conform with clearly stated Congressional intent in several respects, fails to provide for reliable collection of data on lending to minority-owned and to start-up businesses, and is substantially weaker than the proposed rule issued earlier this year.

The FFIEC has chosen to disregard public comments and Congressional testimony, which has underscored the need for systematic collection of data on the extent to which insured depository institutions are meeting the credit needs of job—creating small businesses.

We are particularly disturbed that the rule does not require collection of data on lending to minority-owned and start-up small businesses. Substantial anecdotal evidence had long suggested that minority-owned and start-up businesses face unique barriers to access to credit that thwart economic development and job-creation, particularly in low- and moderate-income and minority communities.

Specific problems with the rule include:

(1) The rule provides for the collection of data on commercial and industrial loans by the *size of the loan*, rather than by the annual sales of the borrower firm, as originally proposed. This undermines the utility and credibility of the data as a yardstick to measure credit availability to small businesses, since low-balance loans may in fact be originated to mid-size or large businesses. Congress clearly intended that data be collected on credit availability for *small businesses*—not on the size of loans originated by depository institutions.

(2) *In clear violation of the statute*, the rule does not provide for disclosure of charge-offs, interest, and interest fee income. Section 122 of FDICIA clearly and specifically requires the agencies to collect this data.

(3) Despite overwhelming anecdotal evidence that minority-owned and start-up businesses have demonstrable problems accessing credit, the FFIEC chose to collect data on originations to such firms in a format *other* than reports of condition, leav-

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ing the public without access to systematic data to measure the extent and nature of the problem.

(4) Notwithstanding a requirement in Section 122 that the final rule be issued not less than 180 days after enactment, it has taken a full year for the FFIEC to issue implementing regulations. In addition, the rule provides for inclusion of small business data no earlier than June 30, 1993, nearly a year an a half after Congress enacted FDICIA.

We urge the new Administration and the new Congress to make the collection of accurate and timely data on small business lending—including lending to minority-owned and start-up small businesses—a high priority in the next few months.

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ENTERPRISE

New Banking Rules Limit the Law on Loan Disclosures

Angry Small-Business Groups Now Look to Clinton to Ease Credit Crunch

By Jeanne Saddler
Staff Reporter of The Wall Street Journal

WASHINGTON — Entrepreneurs and lawmakers, complaining of a shortage of bank loans to small businesses, have long pushed the federal government to do more to prod lending.

And now, they're lobbying the incoming Clinton administration as well.

Last year, Congress passed a law pressuring banks to lend more by requiring disclosure of how many loans they make to small businesses. But yesterday, the Bush administration apparently frustrated that legislative effort by issuing rules backed by the banking industry. The Federal Financial Institutions Examination Council, which coordinates regulations for federal banking regulators, told banks they must report only on the number of small loans — totaling $1 million or less — they make to companies of any size.

The regulations angered small business and consumer groups. They also raised the ire of the provision's Democratic sponsors, Rep. Richard Neal of Massachusetts and House Banking Committee Chairman Henry Gonzalez of Texas, who suggested they will pursue new rules with the Clinton administration next year.

Bush administration officials said the law passed last year makes suggestions about how the information should be collected, but doesn't mandate one method.

The new rules are the latest round in a simmering debate over whether small and midsized concerns face a credit crunch. Collecting data on the bank loans was supposed to help settle that question. The law also said that banks should report on the number of loans made to minority-owned firms and start-up enterprises — categories that the administration eliminated from the final regulations.

"We think it stinks. The rules are meaningless," said Allen Neece, a lobbyist who represents several small business organizations. A coalition of groups, including the NAACP and the Association of Community Organizations for Reform Now, issued a joint statement expressing "outrage" at the new rules. Rep. Neal charged that Bush administration officials too readily adopted the banking industry's view that it was difficult and costly to collect data by company size. "What's troublesome is that the banks are saying, 'Yes, we are making these [small business] loans. And no, we don't want to provide you with the data to prove it,'" he said.

Rep. Gonzalez criticized regulators' argument that banks aren't permitted to keep data on business borrowers' race and that they aren't required to track loans to start-up companies. "I believe there's some way data on loans to minority-owned businesses can be collected by the banks, and although banks don't currently maintain information [on start-ups], the [administration] could have required them to begin doing so," he said.

Banks argued that basing small business status on a company's annual sales is imprecise because that varies by industry and geographic region. Robert Storch, the Federal Deposit Insurance Corp. official who headed the task force that wrote the rules, said a Federal Reserve Board survey shows a strong correlation between loan size and the size of the business receiving the loan. He said the group decided to minimize banks' reporting burden by focusing instead on a loan's original amount.

Many entrepreneurs support more definitive disclosure of small business loans. But many also say one reason banks have rejected their business is bankers' fear of violating stiff new bank regulations adopted in the wake of the savings and loan industry scandal. Entrepreneurs are ready to press President-elect Clinton to make good on his promise to spur lending to small businesses.

> 'We've been talking about the credit crunch for three years in Washington. But no one wants to listen,' says Daryl Routzahn.

"My hope and the hope of other small-business people is that what we've heard from the Clinton administration is true: That they'll offer incentives to lenders to support small businesses in their efforts to grow," said Barbara Rackes, president of Rackes Inc., a Columbia, S.C., retailer of women's clothes and accessories. "There are tremendous opportunities right now as the business cycle improves, but we can't move." She said she had to end a successful marketing campaign and reduce her work force by 25% to 76 employees over the last few years as her bank reduced her line of credit.

When that bank merged with a larger regional bank, Ms. Rackes said, it took her three months to get a loan commitment, even though her company had never missed a loan payment. Last spring, when the company had to replace a van to move clothing between its two stores, she got a letter of reprimand from the merged bank for expanding the firm's capital assets without prior approval.

Daryl Routzahn, president of Routzahn's Inc., a Frederick, Md., retailer, says he's also hoping President-elect Clinton will show an early interest in the financial problems of small and midsized companies. "My challenge to the new administration is to say someone from small business has to be involved in the economic summit to take place before the end of the year," said Mr. Routzahn, chairman of the small retail stores board of the National Retail Federation. "We've been talking about the credit crunch for three years in Washington. But no one wants to listen."

Routzahn's, a retailer with $20 million in annual sales and 250 employees, has seen its line of credit reduced to $1.5 million from $5 million over the last two years. The capital limit put the business in "a survival mode," Mr. Routzahn said, and made it impossible to grow or invest in technology during a slow time in the economy.

President-elect Clinton has proposed easing some of the recently passed banking regulations to spur lending to small concerns. But many of the most relevant rules are those requiring banks to hold more capital to support their loans.

"Mr. Clinton is sympathetic to lightening up [the rules] in some ways, but there's much less consensus about anything that relates to capital standards," said an aide to Rep. John LaFalce, a New York Democrat who is chairman of the House Small Business Committee and a member of the House Banking Committee.

William McIlreynolds, director of the Economic Policy Center for the U.S. Chamber of Commerce, said one solution may be a system that would let a small business "pre-qualify" for a loan, by getting its collateral insured, or getting a realistic appraisal of its assets before approaching a bank. Such a system, he said, would save banks paper work and make it easier for them to determine a loan's risk.

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STATEMENT BY JOHN GAMBOA

THE FEDERAL RESERVE'S FAILURE TO ENFORCE CRA HARMS ECONOMIC GROWTH AND JOB DEVELOPMENT

I am the Executive Director of Latino Issues Forum and Co-Chair of the Greenlining Coalition.[1] The former is a major Latino public policy institute; the latter is a diverse, multicultural coalition of nineteen African-American, Asian-American, Latino, small business, disabled and consumer groups.[2] The Greenlining Coalition has been involved in more than a dozen CPA cases over the last thirteen years.[3]

We are joined in this testimony by the National Community Reinvestment Network with members in 38 cities across the nation,[4] the Sacramento and Phoenix Urban Leagues and the San Francisco Black Chamber of Commerce.

Our testimony focuses on the Federal Reserve's failure to enforce the Community Reinvestment Act (CPA) and its failure to use CRA as an economic and job development tool. Similar criticisms are also applicable as to the FDIC and the Office of the Comptroller of the Currency. All three agencies, due to the high quality of many of their top level officials, have the potential, with guidance and oversight by the President and this powerful committee, to incorporate the Greenlining reforms we urge as part of an effort to expand our economy and create jobs.

As set forth in our testimony, the Federal Reserve, and other regulatory bodies, have taken a Reagan-Bush hands-off approach to CRA. As a result, major banks that make few or no loans to minorities receive "satisfactory," and sometimes, "outstanding" CRA ratings and are given the green light to merge and expand across the nation. Banc One is a graphic example—107 consecutive expansions with little or no CRA regulatory scrutiny.

Our testimony is consistent with President Clinton's call for greater regulatory scrutiny and diversity among policy makers—including the Federal Reserve.

Recently, we concluded a historic CRA Greenlining Agreement with Sumitomo Bank. The January 22, 1993 front page headline of *The American Banker* was "SUMITOMO IN RECORD CRA PLEDGE: Sumitomo Pledges $500 Million In a Record CRA Commitment." *The Los Angeles Times'* front page headline proclaimed: "SUMITOMO PLEDGES 10 PERCENT OF ASSETS TO AID POOR AREAS." (Attached as Exhibit B is a *L.A. Times* editorial as to the importance of Sumitomo's commitment, if followed by other banks, to the economic future of inner cities.)

I. NINE REGULATORY WEAKNESSES AND FAILURES REGARDING CRA

A. OUTSTANDING CRA RATINGS, YET NO MINORITY LOANS

California is 45 percent minority—over fourteen million African-Americans, Asian-Americans and Latinos. Eight of ten *new* households in California (85 percent) are minority households.

For the last year for which data was available (1991), California's seven largest commercial banks[5] made just 438 home mortgage loans to California's 2.5 million African-Americans, the second largest African-American population in the nation. *This amounts to just one home mortgage loan per four bank branches per year to African-Americans.*

Similarly in 1991, these seven giant banks made just 2,053 home mortgage loans to California's 8.3 million Latinos, the largest Latino community in the nation. *This*

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[1] Latino Issues Forum—1535 Mission Street, San Francisco, CA 94103; (415) 552-3152. The Greenlining Coalition's General Counsel is Robert Gnaizda, a Senior Partner with Public Advocates. The address and phone number is: 1535 Mission Street, San Francisco, CA 94103; (415) 431-7430.

[2] The members of the Greenlining Coalition include: American G.I. Forum; Association of Latino Lawyers; Center for Southeast Asian Refugee Resettlement; Chinese for Affirmative Action; Comision Femenil Mexicana Nacional; Consumer Action; Filipino-American Political Association; Hermandad Mexicana Nacional; Interdenominational Ministerial Alliance; Latino Issues Forum; League of United Latin American Citizens; Mexican-American Political Association; New Bayview Committee; Oakland Citizens Committee for Urban Renewal; Phoenix Urban League; Sacramento Urban League; San Francisco Black Chamber of Commerce; and World Institute on Disability.

[3] CRA cases include Wells Fargo Bank, Bank of America, Banc One, Union Bank, Sumitomo Bank and Mitsui Bank.

[4] NCRN is chaired by Reverend Charles Stith of Boston. The address and phone number is 485 Columbus Avenue, Boston, MA 02118; (617) 424-6631.

[5] Bank of America, Wells Fargo, First Interstate, Union Bank, Bank of California, Sanwa Bank and Sumitomo Bank. These seven banks represent over 95 percent of all commercial bank home loans. Other large banks, such as Mitsui Manufacturers Bank and Westamerica Bank made *no* home mortgage loans to African-Americans.

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amounts to just one home mortgage loan per bank branch a year to Latinos. Attached to this testimony as Exhibit A is a summary of home mortgage loans for these banks, based on data they provided to us.

The data is even more embarrassing when analyzed by income. Only ten percent of the loans were made to minority families earning less than $30,000. *In 1991, for example, the seven largest California banks made less than 50 home mortgage loans to African-American families statewide who earn less than $30,000.*

Yet, none of our regulatory agencies has ever discussed this redlining, much less criticized offending banks.

Three of these seven giant California banks (Bank of America, Wells Fargo and First Interstate) were rewarded with "Outstanding" CRA ratings. Three others received "Satisfactory" CRA ratings. (Bank of California, Sanwa and Union) Only one, Sumitomo received a "Needs to Improve."

And one bank, a bank that made just one home loan per three branches per year to African-Americans, was granted the largest bank merger in American history. (Bank of America/Security Pacific merger in 1992.)

As you are aware, new homes create jobs, stimulate the economy and involve local expenditures. Yet, no regulatory body appears to care that minorities, even affluent minorities, can't get home mortgage loans from multibillion dollar commercial banks.

This regulatory silence is surprising, especially since California savings and loans have found the minority market to be quite lucrative. Great Western Bank (Savings and Loan) is just one-fourth the size of Bank of America. In 1991 it made five times as many home mortgage loans to African-Americans and Latinos as the *combined* total of the seven largest California commercial banks. (Great Western made over 2,000 home mortgage loans to African-Americans and over 11,000 to Latinos.)

B. INFLATED CRA GRADES WEAKEN THE ENTIRE SYSTEM OF SCRUTINY URGED BY PRESIDENT CLINTON

On April 23, 1992, we personally presented to Federal Reserve Chairman Alan Greenspan and the then Chairman of the FDIC our comprehensive study of the entire inflated CRA grading system. On December 7, 1992, *The San Francisco Chronicle* did an update on the 9,800 financial institutions that had received CRA ratings.

In summary, the results show that it is far easier for a bank to pass regulatory scrutiny than for a minority athlete to qualify under the new NCAA athletic eligibility grade requirements. For example:

—Less than one percent of all institutions received a failing grade ("in substantial noncompliance");

—Only nine percent received a "needs to improve," despite 99 percent of all financial institutions having a disparity in declination rates for home loans between minorities and whites; and

—Ninety percent of the institutions receive a"B" or better CRA grade ("Satisfactory" or "Outstanding").

C. REFUSAL TO EXAMINE LACK OF SMALL BUSINESS LOANS

Banks are not required to secure data on the race, ethnic background and gender of those to whom they deny or make consumer or small business loans.

Similarly, regulatory bodies refuse to gather such data when making CRA examinations or approving giant mergers, even when community groups request audits.

In the Bank of America merger, the Federal Reserve refused to examine our evidence that less than one half of one percent (00.5 percent) of all its commercial loans were made to African-Americans.

In the pending Banc One/Valley National Bank (Arizona, California and Utah branches) merger, both the Federal Reserve and OCC have refused to examine any data on the race or gender of consumer or business loans. These refusals occurred despite the Phoenix Urban League demanding an audit and contending that an invisible one-tenth of one percent of the dollar value of Valley National's business loans were made to African-American-owned businesses.

This regulatory refusal to gather business data, or to urge Congress to enact legislation requiring such data, has had an adverse impact on the development of jobs, economic growth and small businesses. For example, the top 100 California corporations have reduced their net work force over the last ten years, including Bank of America. All new jobs have come from small- and medium-sized businesses. In California, there are over 500,000 minority-owned businesses and over 700,000 women-owned businesses. These are the job creating businesses. But, they cannot get any

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credit; and banks refuse to make public the amount of loans to minority and women-owned small businesses.[6]

Why do banks oppose full business loan disclosure laws, such as are required for home loans? Perhaps, because the data would be as embarrassing as the home loan data that shows two to one disparities in declination rates between minorities and whites and less than one home mortgage loan per branch for African-Americans and Latinos in the world's seventh largest economy, California.

Why don't the regulatory bodies require this data or ask Congress for authority? The answer can best be secured by this committee.

D. Lack of Diversity Among Regulators

None of the three regulatory bodies' decision makers reflect the diversity of America. Top policy makers and senior examiners are almost all white. At the Office of the Comptroller, for example, only one of the top 169 employees (OC18 and above) is Latino and only three percent (6) are African-American.

The absence of minorities exists even at the CRA examiner level. At OCC only one of the 134 key examiners (OC18 and up) is Latino and only three (2 percent) are African-Americans.

This lack of diversity also prevails at the FDIC and the Federal Reserve. Neither has more than one percent Latino or three percent African-Americans among its key policy makers.[7]

A lack of diversity may, in part, explain the inflated and "outstanding" CRA ratings given to banks that make few or no loans to minorities. A lack of diversity may also explain why tide Federal Reserve believes that all white bank Boards of Directors and top management are irrelevant to CRA. In Banc One, for example, none of the 601 directors at the banks 61 affiliate banks is Latino. Despite this exclusion, Banc One affiliates always get "outstanding" or "satisfactory" ratings—never a "needs to improve."

E. The Federal Reserve Has Ignored Its Own October 7, 1992 Boston Study on Discrimination

On October 7, 1992, the Boston Federal Reserve concluded that discrimination was a major cause for the wide disparity in home loan declination rates between minorities and whites. Three months later, in the first major merger case since the study was completed, the Federal Reserve decided to ignore this study. The Cleveland Federal Reserve Bank, in examining the record of Valley National Bank as part of the proposed Banc One merger, found a major disparity in declination rates, but decided to ignore the Boston Federal Reserve study. In its January 19, 1993 report, no mention is even made of the Boston study, and no criticisms are made of the almost two to one disparities in declination rates. To date, the Federal Reserve *Board* has taken no action, although we have protested this premature burial of the Boston Federal Reserve study.

F. Regulatory Bodies Refuse to Use Their Skills in CRA Exams—Use of Outdated 1980 Census Data

Our experience in the pending Banc One/Valley National Bank merger demonstrates the unwillingness of regulatory bodies to do an effective job—although they clearly have the ability to do so.

Two months ago, the Federal Reserve decided to use outdated thirteen-year-old 1980 Census data, rather than updated 1990 Census data to determine if Valley National Bank was redlining. The problem with outdated data is that due to the shifting demographics of Arizona, 1980 low-income census tracts have become gentrified. Thus, 1992 loans to wealthy whites were counted as CRA-type home loans in formerly low-income areas, despite our protests. In fact, the Federal Reserve did not even issue a cautionary warning that the use of 1980 data could be misleading. (See "Whitewash of Redlining" January 29, 1993 report by the Greenlining Coalition to Chairman Greenspan.)

What high school student could get away with such a misleading study?

G. Federal Reserve's Failure to Protect Protestors From Bank Attacks

CRA merger protests are difficult to mount, partly because the Federal Reserve refuses to require institutions to supply crucial CRA data and partly because banks

[6] Nationally, the Fortune 500 companies cut 3.7 million jobs in the 1980's, while smaller companies created 19 million new jobs. (*San Francisco Chronicle*, February 11, 1993.)

[7] At FDIC, only one of its top 163 employees is Hispanic. The Federal Reserve Board has so far failed to break down its employees between middle and top management. Only one percent of middle and top management is Hispanic (6 of 461).

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are permitted to attack community protestors. A recent example occurred in the Westamerica/Napa Valley Bancorp protest.

Westamerica, a one billion dollar plus giant, attacked the San Francisco Black Chamber of Commerce and the Sacramento Urban League as outsiders, although they have offices close to its branches, then refused to meet to discuss the largest merger in the bank's history. The bank also refused to provide CRA data. And, finally, Westamerica helped write phony letters, on community group stationary, claiming that the Sacramento Urban League's CRA protest would endanger future CRA commitments to community groups.

A protest as to these anti-CRA tactics was filed with Chairman Greenspan. So far, no action has been taken. In fact, by the time of our testimony, the Federal Reserve may have approved this merger. Incidentally, in 1991 Westamerica made *no* home mortgage loans to African-Americans and only two to Latinos.

We urge a Department of Justice investigation as to whether First Amendment rights to petition government for redress of grievances have been violated by a regulated bank.

H. Failure to Protect or Expand Minority-Owned Banks

President Clinton's support for Community Development Banks is a good idea, but only if its part of a larger package that includes stricter CRA scrutiny, of *all* banks and the development of minority-owned banks.

Today, there are virtually no African-American or Mexican-American banks. Specifically:

—The thirty-six African-American-owned banks in the United States are all quite small. Their total *assets* are just two billion dollars, or only one percent the size of Bank of America. New York has no African-American-owned banks and California just one, Founders National Bank with only seventy million dollars in assets.

—Excluding Puerto Rico-based and Miami-based banks, there are but eighteen Latino-owned banks. Their combined assets are a mere one billion dollars ($1.1 billion), or far less than one percent the size of Bank of America.

During the course of major mergers, the Federal Reserve tends to ignore this sad reality of virtually no minority-owned banks. It rarely, for example, encourages major banks to help create or expand minority-owned banks as a condition for a mega-merger.[8]

I. Refusal to Follow President Clinton's Town Hall Concept

Under CRA, protestors have a right to public hearings and public meetings. Since the Reagan/Bush era (1981–1992), the Federal Reserve has decided to block effective public participation. It has *never* allowed a full-scale Public Hearing. And, it has allowed Public Meetings in only four cases since 1984—one bank public meeting under Reagan and three under Bush.[9]

This refusal to hold public hearings calls into question the fairness of the regulatory process.

A test case involving Banc One is presently before Chairman Greenspan and the Federal Reserve Board. Over eight hundred community people and sixteen community groups, including the NAACP, Western Region and Consumers Union, have called on the Federal Reserve to hold full-scale public hearings in the mega-merger involving Banc One and Valley National Bank. So far, the Federal Reserve has taken no action.

II. RECOMMENDATIONS TO END REDLINING AND TO GREENLINE AND REBUILD AMERICA

All of the regulatory abuses referred to in our testimony can quickly be resolved by a combination of Presidential and Congressional oversight and the passage of legislation requiring full disclosure of consumer and business loans, as is presently required of home loans. The effectiveness of legislative oversight depends in part on the commitments and independence of the new regulators you must confirm at OCC and FDIC and the role of the Attorney General in protesting mergers in violation of CRA.

On November 21, 1992, the Greenlining Coalition placed a full page ad in *The New York Times* (Western Edition) setting forth ten CRA recommendations to the

[8] To Bank of America's credit, it has as part of its recent merger, voluntarily spun off some of its branches to an African-American-owned bank.

[9] From 1984 to 1988, there were 37 requests; only one was granted. The Federal Reserve has not yet provided us with data on the number of CRA hearings requested under Bush.

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President. All either require or should have this committee's support. Entitled "Ten Point Plan to Rebuild America" our recommendations were as follows:

—Only appoint officials who will make a full commitment to ending redlining and to fully enforcing the Community Reinvestment Act to top vacant positions at the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision and the Federal Reserve.
—Impose a 100-day Moratorium on the processing of any bank mergers in order to develop effective CRA regulatory guidelines.
—Deny mergers to banks that fail to develop and attain meaningful, long-range CRA goals for producing economic development and low-cost housing.
—Require banks engaged in multibillion dollar mergers to create community banks by spinning off up to 10 percent of acquired branches to community or minority-owned institutions.
—Reward banks that effectively serve their communities by reducing their Federal Deposit Insurance Corp. assessment; and punish those that do not, by raising their FDIC assessment.
—Refuse to give a CRA passing grade to financial institutions that discriminate or fail to serve and market to all Americans.
—Prohibit any bank that discriminates from being a host bank for federally guaranteed student loans.
—Require that CPA examinations be conducted by auditors that understand and reflect the ethnic diversity of the communities they serve.
—Require CRA examiners to examine a bank's inner-city minority contract program and the diversity of its board of directors and top management.
—Require, through legislation, that banks annually publish the race, ethnic background and gender of all business and consumer loan recipients. (At present, this data is kept secret.)

In addition to these ten points, we:

(a) urge this Committee to investigate the charges of regulatory inadequacy we have made in our testimony;

(b) urge the regulatory bodies led by Chairman Greenspan to join us in a partnership effort to Rebuild America, create jobs and stimulate the economy; and

(c) urge banks across the nation to follow the Sumitomo Bank example by committing ten percent of assets to help Rebuild America. If all banks do this, over *four hundred billion dollars* in private funds will be committed over the next ten years.

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EXHIBIT A

1991 HOME PURCHASE LOANS MADE BY THE SEVEN LARGEST CALIFORNIA BANKS

1. **BANK OF AMERICA:**

Number of home purchase loans made to:

AFRICAN-AMER	LATINO	ASIAN	TOTAL ALL LOANS
344 (2%)	1,694 (10%)	5,741 (34%)	17,311

2. **WELLS-FARGO BANK:**

AFRICAN-AMER	LATINO	ASIAN	TOTAL ALL LOANS
32 (1%)	95 (3%)	118 (3%)	3,906

3. **FIRST INTERSTATE BANK:**

AFRICAN-AMER	LATINO	ASIAN	TOTAL ALL LOANS
34 (2%)	168 (8%)	48 (3%)	2,135

4. **UNION BANK:**

AFRICAN-AMER	LATINO	ASIAN	TOTAL ALL LOANS
23 (3%)	61 (7%)	169 (21%)	814

5. **BANK OF CALIFORNIA:**

AFRICAN-AMER	LATINO	ASIAN	TOTAL ALL LOANS
1 (1%)	15 (5%)	33 (10%)	329

6. **SANWA BANK:**

AFRICAN-AMER	LATINO	ASIAN	TOTAL ALL LOANS
4 (3%)	16 (12%)	18 (13%)	143

7. **SUMITOMO BANK:**

AFRICAN-AMER	LATINO	ASIAN	TOTAL ALL LOANS
0 (0%)	4 (7%)	31 (49%)	64

TOTAL NUMBER OF HOME PURCHASE LOANS MADE TO:

AFRICAN-AMER	LATINO	ASIAN	*AGGREGATE TOTAL
438 (2%)	2,053 (9%)	6,158 (25%)	*24,702

* TOTAL OF ALL HOME PURCHASE LOANS MADE BY THE SEVEN BANKS STATEWIDE.

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EXHIBIT B

B6 MONDAY, JANUARY 25, 1993 LOS ANGELES TIMES

Sumitomo Makes a Commitment

A coup for Greenlining Coalition in its continuing battle against financial redlining

In an impressive commitment to the neglected areas of California, the Japanese-controlled Sumitomo Bank has promised to invest $500 million—10% of its assets—in minority businesses and affordable housing. That action holds out promise to poor and moderate-income communities where more jobs, services and housing are desperately needed.

Sumitomo can make a great impact if the bank uses its business expertise to encourage economic development in Los Angeles neighborhoods devastated by the riots and in the other pockets of poverty throughout the state. Any significant new investment chips away at financial redlining by big banks that has frustrated business development and chased away potential jobs from those areas.

More jobs should result from the bank's promise to award at least 20% of its contracts for supplies and services to businesses owned by minority members or disabled people.

On the housing front, Sumitomo can provide the greatest help by investing in decent rental housing for families. That need is urgent. In addition to that investment, the bank needs to improve its record on home mortgages, another well-documented area of financial redlining.

To diversify the bank's leadership, Sumitomo has agreed to add minority members to its board of directors. A paid minority advisory board is also scheduled to advise top management.

These commitments should change some of the priorities of the bank. Additional management integration at the top will make Sumitomo more representative of the community it serves, and more responsive.

The Sumitomo commitment was negotiated by the Greenlining Coalition, a group of 19 minority and consumer organizations that battles financial redlining.

The coalition negotiated a similar agreement with the state's largest financial institution, Bank of America, which set a lending goal of $12 billion in low-income communities. Other banks are targeted.

Sumitomo's agreement has been filed with the Federal Deposit Insurance Corp., which in the past has been critical of the lack of community investment by Sumitomo. Stronger enforcement of federal community reinvestment requirements would lead more banks to make similar investments.

Minorities seeking mortgages have been consistently discriminated against regardless of income and credit records, according to Federal Reserve studies. The information on business loans, though based more on anecdote than on bank disclosure, is similarly damning.

Given the long history of neglect by the banking industry, Sumitomo Bank's commitment merits replication. Banking institutions should seek to serve California in all its diversity.

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TESTIMONY BY ALLEN J. FISHBEIN

GENERAL COUNSEL, CENTER FOR COMMUNITY CHANGE, WASHINGTON, DC

Good morning Mr. Chairman and members of the Committee. My name is Allen J. Fishbein and I am General Counsel of the Center for Community Change and Director of the Center's Neighborhood Revitalization Project. I should also add that I am a former member of the Federal Reserve Board's Consumer Advisory Council and currently serve on the Federal National Mortgage Association's Housing Impact Advisory Council.

CCC is a national, not-for-profit organization, based here in Washington, DC, that provides research and assistance to community groups in low income and minority communities across the country. Our work in the fair lending area spans nineteen years and includes publication of several major studies and reports, such as—*Opportunities for Abuse: Private Profits, Public Losses and the Mortgage Banking Industry (1977), Response to Crisis: A Study of Public Policy Toward Neighborhoods and Fair Housing (1980), Report on Mortgage Lending Discrimination Testing (1988), and New Research Shows S&Ls Shun Lower Income and Minority Neighborhoods (1989).* CCC is also a founding member and serves on the Board of the National Community Reinvestment Coalition, whose members are engaged in efforts nationwide to expand access to credit for low income and minority communities.

Chairman Riegle, I wish to thank you for the opportunity to testify here today before this Committee. We commend you for holding these oversight hearings on the important subject of lending discrimination. These hearings could not be more timely. Although twenty-five years have elapsed since the passage of the Fair Housing Act, making all aspects of housing discrimination illegal, study after study indicates that racial factors continue to influence those who get credit and where mortgage money flows in our nation's cities.

Further, it should be clear that to a considerable extent the ongoing problem of lending discrimination rests with weaknesses in the national enforcement apparatus, which has lacked both the capacity and will to aggressively police the banks, savings institutions and other lending institutions. In the words of former Senator Alan Dixon, who chaired this Committee's Consumer Affairs Subcommittee and demonstrated significant leadership on these issues, "The problem today is not lack of laws . . . it is lack-luster enforcement." (U.S. Congress, Senate Banking Committee, "Discrimination in Home Mortgage Lending," October 24, 1989, p. 2). Strong action is needed by the Executive branch and by Congress to prevent this shameful quarter-century legacy from continuing.

And make no mistake about it, reforming the enforcement apparatus is not an easy task. In my testimony here today I will concentrate on reviewing the record of federal fair lending enforcement, or more appropriately non-enforcement, and make some recommendations on what must be done in order to restore the public's confidence in the capacity of the federal government to ensure that all Americans, regardless of race, color, or creed are afforded equal opportunities to obtain credit from the nation's financial institutions. My remarks will focus on the four banking regulatory agencies (the Federal Reserve Board, FDIC, Office of Thrift Supervision, and Office of the Comptroller of the Currency), which supervise depository lending institutions (e.g., banks and savings associations). At the same time, I certainly recognize that other agencies are, also important to effective enforcement, such as HUD and the Federal Trade Commission, which monitor the practices of mortgage companies and other types of non-depository financial institutions.

RECENT RESEARCH "CHANGES THE LANDSCAPE"

Last October, the Federal banking regulators released the 1991 data reported under the Home Mortgage Disclosure Act (HMDA) by the nation's mortgage lenders. Not surprisingly, the data looked much the same as they did for 1990. Nationwide, African-American applicants were rejected for home loans 2.2 times more often than their white applicants, and Hispanic applicants were rejected 1.5 times more often than their white counterparts. Like the previous year, the figures showed that even within the same income categories, minority applicants were less likely to be granted a mortgage, and that as the percentage of minorities in a census tract increased, the chances of getting a loan decreased.

The release of 1990 HMDA data in the fall of 1991 had created quite a stir. For the first time the public had access to information about the race and income of mortgage applicants, not just the geographic location of mortgages, as was the case for prior years. The publication of the additional data made it possible for the public to compare how minority applicants and white applicants fared in their efforts to obtain credit. The results did not surprise community and fair housing groups that

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had been battling redlining for years, but the disparities in rejection rates indicated that lending discrimination was a bigger problem than many had suspected.

The "spin doctors" for banking industry and the regulatory agencies attempted to minimize the importance of the 1991 HMDA data findings. They were quick to suggest that no definitive conclusions about discrimination could be drawn from the data base, because HMDA did not include important factors that lenders rely on to make credit decisions, such as an applicant's credit record, employment history, and the value of the property.

The industry's and regulators' reaction was different this past year. Both of these sectors began acknowledging for really the first time that lending discrimination is a problem and that greater corrective efforts were needed. This realization certainly should not have come as no surprise to them. For years community advocates and the civil rights organizations had been telling them that lending discrimination was prevalent. Bankers and regulators also knew all too well about the discriminatory legacy of the fairly recent past when explicit forms of discrimination existed in the mortgage lending industry. For example, as recently as 1970, Prentice-Hall published a textbook for real estate appraisers which declared that "mixing of residents with diverse historical background within a neighborhood has immediate and depressing influence on value." Consequently, what caused this shift in the public positions of these two sectors over the course of twelve months between October 1991 and October 1992?

What appears to have knocked the bankers and regulators off stride were a series of intervening events, which has forced these sectors to adopt a different public posture. For almost two decades they dismissed the findings of study after study showing the disparities in lending activity between minority and non-minority areas. No doubt the extensive media coverage the 1991 HMDA disclosures received and public attention generated by the Los Angeles disturbances eroded their ability to sell the view that discrimination was not pervasive in the mortgage market. But, two other events have intervened over the course of the last year to force changes in the industry's and the regulators' public positions on the pervasiveness of lending discrimination.

Last September, the U.S. Department of Justice announced that it had reached a judicial settlement in the first "pattern or practice" suit it had ever brought against a mortgage lender for violations of the Fair Housing and Equal Credit Opportunity Acts. The case involved Decatur Federal Savings and Loan Association, the second largest mortgage lender in the Atlanta area. Before filing the suit, the Justice Department had analyzed more than 4,000 Decatur loan files, which revealed that even after controlling for all underwriting variables, race was a significant factor in the credit decision making process of the institution. The Justice Department's complaint also charged the S&L had pursued marketing policies that sought to limit the volume of mortgage loan applications received from blacks.

Decatur entered into a consent decree with the Justice Department under which it agreed to provide $1 million in damages to 48 African-American individuals whose mortgage loan applications had been rejected between 1988 and 1992. The settlement also required the institution to adopt a new marketing strategy to affirmatively reach out to the Black community, open a branch office or loan office in a Black neighborhood in Atlanta, and hire an outside auditor to monitor the processing of mortgage applications for discriminatory treatment.

On the heels of the Decatur case, last October the Federal Reserved Bank of Boston (Boston Fed) released a comprehensive study of mortgage lending discrimination in the Boston metropolitan area. This study was a direct outgrowth of the release of the 1990 HMDA data, which showed that the Boston area had particularly high denial rates for African-Americans and Hispanics (2.7 times greater than white applicants). In anticipation of similar results for the 1991 data, the Boston Fed undertook a statistical study to determine the extent to which this disparity would remain if all the factors employed by lenders in reaching credit decisions were taken into account.

In order to accomplish this, the Boston Fed examined loan application files for some 4,500 mortgage applications at 131 Boston area financial institutions. From each file the Boston Fed collected data on 38 variables, which included extensive details about each applicant's credit record, job history, appraisal reports, etc.

The analysis found that, "The only personal characteristic that appears to enter into the loan denial decision is the race of the applicant. . . . (A)fter accounting for obligation ratios, wealth, credit histories, stability of the applicants' incomes, loan-to-value ratios, private mortgage insurance, and neighborhood characteristics, the race of the applicant still plays a role in the lender's decision to approve or deny the loan." Thus, for an individual with average white economic characteristics and minority race, the probability of denial increases by 56 percent.

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According to a statement released by Richard Syron, the Boston Fed's President, "The racial disparity found in HMDA data is substantially reduced when additional economic factors are considered, but it remains significant and it must be faced directly. Unfortunately, race plays a role, perhaps an unconscious and unintended role, but a role nonetheless, in mortgage lending decisions."

The Boston Fed's study also helps to explain how discrimination enters the loan decision process. The study found that as much as 80 percent of all loan applicants, both white and minority, had some flaw in their credit credentials and that in many cases these flaws were overlooked. However, a minority applicant with the same strengths and weaknesses as a white applicant was much more likely to be presumed uncreditworthy, whereas whites seem to enjoy a general presumption of creditworthiness.

In short, the Decatur case and the findings of the Boston Fed study have undercut the presumption the regulators and the industry have strongly clung to that disparities in the mortgage loan approval process between white and people of color are not the result of discriminatory behavior. As the Office of the Comptroller of the Currency observed about the Boston study, "It changes the landscape."

WE'RE "SHOCKED, SHOCKED"

Remember the scene in the movie Casablanca when the French inspector, played by Claude Raines, searching for a pretext to shut down Rick's Cafe, professes to be shocked upon learning that gambling is taking place on the premises. Immediately after ordering the Cafe closed, he is handed his night's winnings.

In many respects, the regulators public reaction to the recent findings on lending discrimination remind me of the inspector's reaction. To be sure, for years they have been seeking to reassure this Committee that their enforcement procedures were adequate and that lending discrimination was not a serious problem. But the agencies internal data fair lending data collection efforts indicate that for some time now they have either been unwilling or unable to come to grips with the reality of discrimination in the mortgage market.

When pressed, as they, were by Senator Dixon's oversight hearings in 1989 and 1990, they will seek to convince you that they have gotten the message and are just about to undertake bold new steps to address whatever deficiencies exist in their enforcement programs. In light of the recent events, the Federal Reserve Board will tell you that it is in the process of reorganizing its Consumer and Community Affairs Division to include civil rights specialists, which the other agencies did years ago.

The Office of the Comptroller of the Currency also is reorganizing itself to establish a specialized unit for consumer compliance purposes, something it has already done and then undone in past years. The FDIC will say that it is placing higher priority than ever before on fair lending enforcement, yet as I will discuss later in my testimony, apparently is not even following its own procedures with respect to fair lending. And the Office of Thrift Supervision will announce that it has once again discovered that fair lending enforcement is a part of its supervisory responsibilities. And not to be outdone, the Justice Department, a relatively new player in fair lending enforcement, will discuss its plans for litigating pattern and practice suits against lenders who discriminate.

I may sound a little cynical, but the history of the agencies' enforcement in this area clearly warrants it. And to be clear, I am not suggesting this is a partisan issue. The "trail of tears" of fair lending enforcement extends far enough back to encompass the both Democrat and Republican Administrations.

While the general public has only recently become aware of revelations about the gross disparities in mortgage lending between whites and minorities, the banking regulatory agencies have been sitting on data for many years that points to the existence of lending discrimination. In fact, the four banking regulatory agencies had to be taken to court before they even acknowledged their responsibility to enforce the Fair Housing Act. Except for the rare occasions when this issue has been in the limelight, fair lending enforcement has been a very low priority for all of the banking regulators, as Attachment I illustrates.

During the 1970s and 1980s, three of the regulators (the Fed refused to keep this information) agreed to maintain systematic data on mortgage loan applications and dispositions as part of the settlement to the aforementioned lawsuit brought by civil rights groups against them. This information enabled several of the agencies to determine whether loan application rejection rates were higher for minorities than for whites. Data on rejection rates were generally not made available to the public, especially for individual institutions. Finally, in 1989, the *Atlanta Journal-Constitution* following up on its Pulitzer Prize winning series, the Color of Money, used the Freedom of Information Act to press the Federal Home Loan Bank Board to dis-

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close summary data on loan rejection rates for the one-hundred largest metropolitan areas. The data showed that on the average, applications from people of color were rejected by savings institutions at a rate twice as high as that for white applicants. The publication of this information help focused attention on mortgage discrimination, raised doubts about the adequacy of fair lending enforcement, and spurred the passage of amendments to expand the types of information reported by HMDA.

The banking regulators continued to presume that disparities in lending activity between minority and white neighborhoods and even disparities in application rejection rates between minority applicants and white applicants did not prove loan discrimination. They rigidly maintained up until this past year that disparities in loan activity between neighborhoods and different categories of borrowers do not take into consideration possible differences in mortgage loan demand or possible differences in the ability of minorities versus whites to meet underwriting criteria. As a result, they declined to expand their efforts to review the loan files of individual lending institutions to determine if racial factors play a part in the credit granting process, until public opinion forced them to do it.

In addition to intentional discrimination or disparate treatment of minorities, certain policies and practices of a lending institution may nonetheless by unlawful under certain circumstances if they have discriminatory effects on people of color and other categories of people protected under federal law (e.g., minimum loan size requirements, tiered pricing of loan products, customer only policies). Here to, the regulators have made little or no effort to carve but an "effects test" doctrine for fair lending purposes. As a result, there have been virtually no major judicial decisions in this important area of civil rights law.

The lax enforcement in this area appears to stem from the heavy emphasis on safety and soundness that is imbedded in the "culture" of the agencies. Fair lending enforcement is largely under the overall supervision of the folks that manage the safety and soundness function within the agencies. They are largely career professionals, mostly white males, and appear secure in the belief that their job performance will be based on safety and soundness related concerns and not fair lending enforcement.

Similarly, the political appointees that are selected to head these agencies reinforce the institution culture of the agencies. Traditionally, the chiefs of the banking agencies have been drawn from an incredibly small pool of individuals, typically they come from the banking industry, law firms, and Wall Street. While they may be knowledgeable about the prudential side of regulation, they usually know little or nothing about consumer compliance, CRA, and fair lending enforcement. Consequently, they have done little to prod the careerists to do a better job at compliance. This must change before you can hope to see meaningful reform in the fair lending area.

HAVE THEY RECEIVED THE MESSAGE?

You are likely to hear alot from the regulatory agency representatives who testify here today about how they are reconsidering their fair lending examination procedures in light of the Boston Fed study. For example, in recent testimony before a congressional panel, Federal Reserve Board Governor Lawrence Lindsey conceded forthrightly:

> "It is well known that regulators have faced considerable difficulties in identifying instances of discrimination . . . (W)e are very concerned about the results of the Boston study and have taken a number of steps that we hope will help strengthen the capacity of our examiners to detect and deter discriminatory treatment of applicants."

The regulators will tell you that they are in the process of "reconceptualizing" their examination procedures. Whereas, in the past, examiners would concentrate on whether unquestionably qualified minority loan applicants were denied credit for impermissible reasons, in the future, more attention will be paid to whether exceptions to an individual lender's underwriting rules are applied equally for whites and minority loan applicants.

It will be tempting to believe that they have gotten the message. However, if history is any guide meaningful reform will not occur without diligent oversight by this Committee. Let me give you a few illustrations about why you should continue to be concerned about whether their commitment to fair lending enforcement has changed.

1. Recent instances of a federal regulator acting in clear contradiction of federal anti-discrimination law.

As part of his opening statement during last September's oversight hearings on the status of the Community Reinvestment Act, the former Chairman of the Sub-

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committee on Housing and Urban Affairs, Senator Alan Cranston, stated that he had submitted for the record three instances in which FDIC examiners had found, clear indications of possible violations of the Equal Credit Opportunity and Fair Housing Acts, in which the agency had acted in direct contradiction of federal law by failing to report these occurrences to the Department of Justice. In response to prodding from Senator Cranston, the FDIC eventually conceded that it had acted improperly and made the referrals to the Justice Department (U.S. Congress, Senate Banking Committee, "Current Status of the Community Reinvestment Act," September 15, 1992, p. 2,3.).

2. Continuing evidence that the compliance examinations do not detect lending discrimination.

The compliance examination continues to be the primary enforcement tool the regulators use to deter and detect lending discrimination. Yet, evidence continues to mount that the compliance examination as presently constituted appears to be incapable of spotting patterns and practices of discrimination against people of color. As previously cited, the Justice Department's suit against Decatur Federal resulted in a consent decree involving a series of affirmative remedies to be provided by the lending institutions. In contrast, the S&L's primary supervisor, the Office of Thrift Supervision, conducted an on-site compliance examination around the same period as the Justice Department's investigators, but the agency's exam appears to have yielded no evidence of wrongful treatment involving African-American mortgage loan applicants.

Similarly, in 1991 Peter and Dolores Green brought a fair lending suit against Avenue Bank of Oak Park, Illinois, charging that the institution had discriminated against them in denying their mortgage loan application to finance the purchase of a 6-unit building in the West Garfield Park community in Chicago (*Peter Green and Dolores Green v. Avenue Bank of Oak Park*, Northern District of Illinois, Eastern Division, 1992). The Green's lawsuit was featured on the television program, *Frontline*, ("Your Loan is Denied"), which aired on PBS stations on June 23, 1992. Last December 8, Avenue's parent company, First Colonial Bancshares, entered an offer of judgment to the charges. The bank was ordered to pay at least $250,000 in damages and attorneys fees. Once again, the fair lending compliance examination conducted by the bank's regulator, the FDIC, failed to uncover any evidence of discrimination or illegal credit practices (source: The CRA Performance Evaluation for Avenue Bank of Oak Park, published on December 31, 1991).

Meanwhile, the regulators have hired the consulting firm of Arthur Andersen & Co. to advise them on how to revamp their fair lending compliance examination. They are paying Arthur Andersen close to $100,000 to provide these services, even though the firm has virtually no experience in the fair lending area and has been desperately searching for knowledgeable civil rights organizations to guide them on this project.

3. An example of an agency's failure to follow its own complaint procedures.

In addition to its failure to detect discrimination through the exam process, there is evidence to suggest that the FDIC in the *Greens'* case also failed to adhere to its own procedures for processing fair lending complaints. According to recent testimony provided to a House Subcommittee by Calvin Bradford, a fair lending expert who is familiar with the *Greens'* case, there is reason to believe that the FDIC did not properly handle the processing the couple's complaint (see Testimony of Calvin Bradford, President of Community Reinvestment Associates, before the Subcommittee on Consumer Credit and Insurance of the House Banking Committee, January 27, 1993, at 36–37).

According to Mr. Bradford, the FDIC acknowledged the receipt of the complaint, but never followed up with the Greens to discuss the substance of it. The agency did, however, contact the bank which offered an explanation as to why it had denied the couple's loan application. Six months after receiving the bank's response, the FDIC informed the Greens that in the agency's opinion the bank had not engaged in discrimination in denying their loan request. Mr. Bradford noted in his testimony that by not first contacting the complainant the FDIC had acted in contradiction of their own guidelines for the investigation of air housing complaints. FDIC guidelines also permit, after an investigation is completed, the complainant to obtain a copy of the investigation report. Apparently, the Greens were not informed of their right to this report in the final letter to them closing the case. The Bradford testimony goes on to cite seven other aspects of the guidelines that were not followed in processing of the Greens complaint.

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4. The regulators strict constructionist approach toward interpreting new fair lending legislation thwarts effective enforcement.

Over the years, legislation has been passed and signed into law in an effort to provide new tools for fair lending enforcement. The regulators, and in particular, the Federal Reserve Board through its rulemaking authority, consistently chose to construe these new mandates very narrowly. For example, when Congress amended the Home Mortgage Disclosure Act in 1989, it sought to expand the coverage of this law to virtually anyone in the business of mortgage lending. However, the Federal Reserve Board interpreted certain ambiguities in the statutory language in a way that captured only a handful of the thousands of mortgage companies and other mortgage lenders active in the market.

Once again, in 1991 Congress sought to close the HMDA reporting "loophole" by expanding coverage to additional mortgage companies. This was done by authorizing the Fed, in conjunction with the other regulatory agencies, to establish a new standard for determining which non-depository mortgage lenders should have to report under HMDA. And once again, in August of last year, the Fed issued proposed regulations that would have continued to exempt thousands of mortgage lenders from HMDA's reporting requirements. My organization and dozen of other commenters pointed out that the congressional intent required that a broader standard be used, one that would encompass more of the non-depository lenders that are making up an ever increasing share of the mortgage market. These recommendations were rejected by the Fed and final rules embodying the narrower standard were used.

Another example of the Fed's strict constructionist approach is it pending rules to implement a new statutory requirement guaranteeing borrowers the right to obtain copies of their appraisal reports. Originally proposed by Senator Dixon, the provision was enacted in 1991 and was clearly designed to help address problems of discriminatory appraisals, long a concern to fair housing groups. "Lowball" appraisals depress property values in minority neighborhood, making it difficult for borrowers in those neighborhoods to qualify for a mortgage, and can be a pretext used by a lending for denying otherwise qualified borrowers. The full extent and nature of the problem historically has been difficult to document because many lenders do not give borrowers copies of their appraisal reports. The new law requires lenders to make appraisal reports available if the borrower has paid for the report.

Surprisingly, some of the Federal Reserve Board Governors questioned the need for any regulations to implement this provision of the law at all. While the full Board nonetheless went ahead and proposed regulations, it followed the narrowest interpretive path. Although clearly not restricted by the statute, the proposed rules would only cover 1–4 family properties, which if in effect, would probably would have excluded the Greens from receiving a copy of their appraisal report. Also, the Fed is proposing to limit the ability of loan applicants to request such reports to no later than 90 days, even though the Equal Credit Opportunity Act requires lender to retain loan files for 25 months. If adopted, both of these approaches would limit the usefulness of these requirements as investigative tools for fair lending purposes.

5. The Federal regulators ignored an opportunity to require bank reporting on loans to minority-owned businesses.

The focus of most of the attention on lending discrimination has been directed at housing loan bias. There is a simple explanation for this—a more comprehensive data base exists to measure discrimination in mortgage lending than it does for other types of credit extensions. This certainly is not to imply that loan bias does not exist for commercial lending or for consumer lending. If anything, the sketchy information we have suggests that discrimination in lending to minority-owned businesses may be no less a problem than it is for mortgage lending. The same may be true for lending to consumers.

According to a recent article appearing in the *Wall Street Journal*, a recent study conducted by Timothy Bates of the New School for Social Research in New York found that black-owned firms are turned down for bank loans more often than are white-owned businesses and the loans they receive, particularly in poor, inner-city neighborhoods are smaller (See Attachment II). Other research appears to indicate that black entrepreneurs are required to put up more equity to obtain bank credit than their white counterparts.

Yet, the federal regulators seem determined to limit the quality of information that is available about bank lending to minority firms. Sections 122 and 477 of FDICIA authorized the regulators to require banks to report on the extent of their lending to small businesses. Mr. Chairman, last October you wrote the FFIEC to encourage that body to include a break-out of loans to minority-owned businesses

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in the Statement of Condition Reports banks are required to submit to their regulators. At that time you wrote:

> I am distressed by the FFIEC's proposal that the Federal Reserve acquire minority-owned small business loan information from alternative sources which may or may not be reliable. Regulators and taxpayers should have reliable information regarding the minority business community's access to adequate credit. The furnishing of such information should be included in the call report requirements.

Well, the FFIEC rejected your advice. The final instructions issued last November noticeably omitted itemized reporting in call reports for minority-owned businesses.

6. The regulators failure to incorporate matched-pair testing as a technique for detesting mortgage lending discrimination.

The problem of mortgage lending discrimination may be even greater than depicted by the disparities in rejection rates between minority and non-minority loan applicants. There is some evidence to suggest that blacks and other minorities are discouraged from even filing an application for a loan. The use of matched-pair testing is perhaps the single best way to investigate for discrimination at the pre-application stage. Testing is an investigative technique widely used to detect discrimination in the rental or sales of housing. In testing, matched pairs of individuals, similar in all relevant respects save race, are used to determine whether disparate treatment is occurring.

Some limited demonstration projects have been completed that employed paired testers who posed as mortgage applicants to investigate at the pre-application stage of the mortgage process. One of the studies was undertaken in 1988 in Louisville, under the auspices of the Kentucky Human Rights Commission, in conjunction with my own organization. The Louisville testing project revealed that African-American testers were less likely to be provided information about credit products and less likely to be given helpful information about how to qualify than their white counterparts.

Unfortunately, at least up to now, the banking regulators at least have steadfastly refused to employ the use of testers to augment their examination process. In fact, only two years ago the Federal Reserve Board unanimously rejected a recommendation from its own Consumer Advisory Council to undertake a pilot project to explore the efficacy of testing as a compliance tool. While this position may be softening in the face of the public outcry about recent events, the strong resistance to testing within the banking agencies reflects their ambivalence to toughening up their enforcement procedures in this area.

Again, the illustrations I have presented are intended to give Committee members a sense of what you are up against in efforts to get these agencies to take their fair lending enforcement responsibilities more seriously.

RECOMMENDATIONS FOR IMPROVING FAIR LENDING ENFORCEMENT

In view of the aforementioned, we believe strong medicine is needed to restore the public's confidence in the belief that the nation's antidiscrimination laws are being vigorously enforced. We are pleased that President Clinton has indicated his intention to toughen enforcement of the fair lending laws and we believe that much can be accomplished at the administrative level. Here is what we would like to see the new team of regulators do:

- First and foremost, the fair lending enforcement function must be elevated within the existing regulatory structure (including HUD and the Fair Trade Commission for mortgage companies). Separate consumer compliance divisions should be established within each agency, the heads of which would supervise the examiner force and report directly to the agency chief. It is also necessary to create separate career paths for fair lending examiners, *comparable* to that for the safety and soundness examiners.

While the regulators may say they are moving in this direction, to our knowledge, not one of them has instituted a division which operates on a truly equal footing with the safety and soundness function. As long as the compliance examination function is subordinate to the safety and soundness hierarchy within the agencies, fair lending enforcement will continue to occupy second-class status and not much will improve.

- Launch a major interagency effort to develop testing as a fair lending enforcement tool. A coordinated approach should be used using the FFIEC members, HUD, the Justice Department, and the FTC. The effort should focus on testing at both the pre- and post-application stages. The former would be used to augment the aforementioned gap in the examination process. The latter would involve overcoming some significant obstacles that only the federal government can remove (e.g., indemnifying testers from liability for filing false documents, reaching an arrangement

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with credit reporting agencies for developing fabricated credit records, etc.). Post-application testing would be especially useful in institutions whose loan volumes are too low for statistical analysis to be performed.

• Commit more Department of Justice resources to litigating pattern and practice lending discrimination cases, including questionable practices involve appraisal, mortgage, and property insurance providers. The federal government's active involvement in litigating discrimination cases can serve as an important deterrent to discrimination and help establish important legal precedents, such as carving out an "effects test" doctrine for determining loan policies whose disparate impacts are illegal for fair lending purposes.

• Continue HUD's Fair Housing Initiatives Program, and expand it to have a stronger emphasis on lending discrimination. Secretary Cisneros should be commended for already indicating that he intended to increase his agency's funding to private fair housing organizations and public agencies for lending testing. Experience suggests that increased activity in this area will encourage individuals to come forward in greater numbers about complaints about lending discrimination.

• Increase public access to data provided by HMDA. Experience has shown that the public disclosure of loan data is critical to efforts to improve enforcement. Changes in HMDA that made in 1989 added lenders under coverage, and also required lenders to disclose information about the race, gender, and income level of applicants for mortgage loans, whether those loans are approved or denied. With the lack of enforcement from the traditional regulatory apparatus, community groups and private fair housing agencies have had to become de facto bank monitors. These groups have to do their own research on mortgage lending patterns, and often have to present data directly to lending institutions to bring about changes in mortgage practices. In order to accomplish this task, however, these non-for-profit organizations must have reliable access to the data provided by HMDA, which is not now the case.

One problem with the way the agencies are handling the new HMDA data is the difficulty of access to the raw data, that is the loan application registers that lenders submit to their regulatory agencies. It is only in the registers that the public can get complete race, gender, income and census tract information for individual loan applications. Initially, the agencies refused to make the raw data available, but relented after complaints from community groups. The provision of these loan application registers to the public was legislated in the past Congress, but the law only encourages and does not require lenders to publish the LARs in census tract order. Census tract ordering makes the public's job of analyzing the data infinitely more manageable and is relatively easy for institutions using computer based programs to compile their mortgage lending activity. However, the Fed will need to be prodded by this Committee in order to do this by regulation.

Finally, I suspect the members of this Committee have been hearing from banking trade groups about the need to reduce the regulatory burden on the industry. A great deal of the thrust seems aimed at laws like the Community Reinvestment Act and the Home Mortgage Disclosure Act, which are designed to deter and detect redlining and other forms of lending discrimination. However, the history shows that this is one area in which recordkeeping and reporting can make an important different in the way in which lenders serve their local communities. Without HMDA, which the banking industry has fought every step of the way, the issue of lending discrimination would not be on the frontburner and it is unlikely that this hearing would be held.

Moreover, I am aware that this Committee has held hearings on the anticipated Administration proposal on community development banking. Some in the banking industry have called for investments of private capital into community development banks as a "buy out" from their CPA responsibilities or to provide them with a "safe harbor" to avoid regular CPA examination or protect them from public comments on their expansion requests. We fervently hope this approach will not be pursued. We believe CRA should remain a bottom line obligation that runs with the public charter an insured lending institution receives as a condition for doing business.

Further, some have suggested that banks and savings institutions should receive "CPA credit" for the extent to which they make equity investment or otherwise assist non-traditional lending institutions. In fact, they already do. The *Interagency Questions and Answers Regarding Community Reinvestment*, issued by the regulators last May, clearly discusses the wide range of options available to traditional financial institutions in meeting their CPA obligations (FFIEC, Notice 92–40, May 12, 1992). The document lasts the provision of support for community development credit unions and community development corporations as eligible activities for CPA purposes. A provision to the Housing and Community Development Act of 1992 extended this provision to support for minority owned banks. We believe new legisla-

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tion is needed at this time for traditional banks to receive CRA credit for investments in community development banking initiatives.

At the same time, while providing traditional lenders with CRA credit for investment and support for non-traditional lenders is consistent with current policy, we believe these activities should not receive undue weight in the CRA ratings process. Here is how this could happen.

The CRA examination process is far from being an exact science and the performance standards that are used by examiners are not formulaic. Agency examiners are required to rate lenders in 12 areas, ranging from ascertainment of credit needs, affirmative marketing efforts, participation in government sponsored lending programs, to direct evidence of discrimination. In essence, the examiners attempt to measure the level of efforts expended by the institution in meeting its CRA obligation.

Without proper guidance, we fear that the examiners may tend to give too much emphasis to relatively small amounts of investments that were made in nontraditional lending institutions. However, any attempt to quantify the weight that investments in these nontraditional institutions should receive could unintentionally unravel the entire CRA assessment process. In any event, we believe that this issue can best be dealt with at an administrative level.

This ends my formal testimony. I will be glad to answer any questions you may have.

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Appendix I

Center for Community Change

April 30, 1992

"THE TRAIL OF TEARS"
A CHRONOLOGY OF FAIR LENDING ENFORCEMENT

The history of enforcement of this country's fair lending laws by the federal banking regulatory agencies is little known and little publicized. The reason for this obscurity may be that there has never been a time when these laws have been aggressively enforced. The agencies had to be sued before they even acknowledged their responsibility to enforce the laws, and, except for the rare occasions when this issue has been in the limelight, fair lending enforcement has been a very low priority for all of the banking regulators, as the following chronology illustrates.

1968	Congress enacts the Fair Housing Act, making it illegal to discriminate in residential mortgage lending on the basis of race, color, religion or national origin.
June, 1969	HUD recommends that each of the banking regulatory agencies (FRB, OCC, FDIC, FHLBB*) adopt rules, regulations and procedures to insure that the institutions they supervise and regulate are in compliance with the Fair Housing Act. Agencies take no action.
March, 1971	Ten civil rights organizations (including the National Urban League, the National Urban Coalition, the NAACP and others) file a petition with each of the agencies requesting that the agency adopt rules, regulations and procedures to insure against discriminatory practices by banks and thrifts.
June, 1971	At the request of HUD, the banking agencies survey 18,000 lending institutions about lending practices that might discriminate against minority applicants. Responses from more than 15,000 institutions revealed widespread discrimination, including the use of the racial or ethnic character of a neighborhood in determining whether to make loans on property located in that neighborhood, refusal to make loans in minority communities, and consideration of the applicant's race in deciding whether to make a mortgage. In some large cities with large minority populations, over half of the S&Ls admitted refusing to make loans in minority neighborhoods.
December, 1971	Each of the agencies announces its intention to consider fair lending regulations. With the limited exception of the FHLBB (described below), none of the agencies ever adopted such regulations.
March, 1972	FHLBB releases results of a survey conducted among selected thrifts about their lending practices and criteria. Survey reveals thrifts admit to 11 different ways that they discriminate illegally against minorities, including requiring lower loan-to-value ratios, requiring shorter loan terms, charging higher interest rates, and disqualifying neighborhoods on the basis of their racial characteristics.
June-Nov., 1974	Agencies conduct fair housing information surveys covering lenders in 18 metropolitan areas to determine whether institutions are in compliance with fair lending laws. The results:

1000 Wisconsin Avenue, NW, Washington, D.C. 20007 202-342-0519 FAX: 202-342-1132

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Federal Home Loan Bank Board Survey (analyzed 53,705 mortgage applications in 6 cities)

City	White Rejection Rate	Black Rejection Rate
Atlanta	7.1%	12.4%
Buffalo	15.1%	28.8%
Chicago	7.0%	18.4%
San Antonio	8.8%	23.3%
San Diego	5.4%	18.2%
Washington, DC	8.8%	15.1%

City	White Rejection Rate	Hispanic Rejection Rate
San Antonio	8.8%	18.0%
San Diego	5.4%	8.7%

Federal Reserve Board/FDIC Survey (analyzed 20,000+ applications in 6 cities)

City	White Rejection Rate	Black Rejection Rate
Baltimore	12%	24%
Jersey City	12%	22%
Tampa-St. Petersburg	11%	18%
Galveston	7%	18%
Jackson	14%	17%
Valejo-Napa	24%	10%

Office of the Comptroller of the Currency Survey (analyzed 12,707 applications in 6 cities)

City	White Rejection Rate	Non-white Reject. Rate
Bridgeport	11.1%	15.8%
Cleveland	16.2%	26.5%
Memphis	13.1%	23.0%
Montgomery	15.6%	48.5%
Topeka	11.5%	33.5%
Tucson	9.3%	22.0%

NOTE: The OCC survey contained information on the creditworthiness of the borrower, allowing for a comparison between minorities and non-minorities with the same gross annual income, the same gross assets, the same outstanding indebtedness, the same monthly debt burden, and the same number of years in present occupation. In every case, the comparison shows minorities are rejected at a far higher rate than whites with the same characteristics.

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1974	Congress enacts the Equal Credit Opportunity Act (ECOA), prohibiting discrimination in lending on the basis of race, color, religion, national origin, sex, marital status, age, the receipt of public benefits, and the exercise of rights under the Consumer Credit Protection Act. Also amended the Fair Housing Act to prohibit discrimination based on sex.
1974	FHLBB enacts non-discrimination regulations, prohibiting discrimination based on certain characteristics of the borrower or the neighborhood in which the security property is located. The agency did not, however, establish procedures to monitor or enforce compliance with the regulations.
July, 1976	The National Urban League and nine other civil rights organizations file suit in US District Court for the District of Columbia against the four federal banking regulatory agencies. The suit charges the agencies with failure to discharge their responsibilities under the Fair Housing Act to insure that the institutions they regulate are in compliance with the law. (National Urban League et. al. vs. Office of the Comptroller of the Currency et. al., DC District Court, CA 76-0718)
1977	The National Urban League and other civil rights groups reach settlement agreements with three of the agencies (the suit against the Fed was dropped for lack of standing). The settlements call for the agencies to establish examination procedures and to train examiners in the implementation of those procedures, to insure compliance with fair lending laws. The settlements also call for each of the agencies to set up a computerized system to collect and analyze information about the mortgage lending practices of the institutions they regulate. Data produced by these systems are to serve as an aid for examiners, to focus their examination efforts on potential problems of discrimination.
1978	Agencies establish computerized fair lending data collection systems described above.
1981-2 (approx.)	Settlement agreements expire.
1981 to 1984	The number of examiner hours spent on consumer compliance, civil rights, and community reinvestment by the Fed drops by 25%. The number of examiner hours spent by the OCC, FDIC and FHLBB on these compliance exams drops by 74%. (Source: BankWatch, testimony submitted to the Senate Banking Committee Subcommittee on Consumer Affairs, October, 1989.)
May, 1988	The Atlanta Journal/Constitution publishes a Pulitzer Prize winning series, "The Color of Money," showing that minority neighborhoods receive 5 times fewer mortgage loans than white neighborhoods of the same income level in Atlanta.
August, 1989	The Federal Reserve Bank of Boston releases a study of mortgage lending in that city showing a 24% difference in the level of lending to minority versus non-minority neighborhoods, after controlling for income, wealth, housing value and housing development.
October, 1989	The Consumer Affairs Subcommittee of the Senate Banking Committee holds a hearing on discrimination in mortgage lending. Subcommittee Chairman Senator Alan Dixon comments, *"I'm not a statistician, but when blacks are getting their loan applications rejected twice as often as whites and, in some cities, it's three and four times as often, I conclude that discrimination is part of the problem...*

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It's 21 years since passage of the Fair Housing Act. Fifteen years since the Equal Credit Opportunity Act was passed in the Congress; and 11 years since the Community Reinvestment Act became the law of this land, and still we have discrimination in mortgage lending. The problem today is not lack of laws, in my view, it is lack-luster enforcement."

May, 1990	The four federal banking regulatory agencies testify before the Senate Banking Committee Subcommittee on Consumer Affairs that, within the previous three years, only one (the OCC) had referred a violation of the Fair Housing or Equal Credit Opportunity Acts to the Justice Department for prosecution.
October, 1990	Federal Reserve Board Consumer Advisory Council recommends that the Fed undertake a pilot project to explore the usefulness of testing as a civil rights compliance tool.
Sept., 1991	Board of Governors of the Federal Reserve unanimously rejects the CAC's recommendation on testing.
Oct. 21, 1991	Federal Reserve releases results of analysis of 1990 Home Mortgage Disclosure Act data, showing that minorities are rejected for mortgage loans more than twice as often as whites, and that a poor white applicant is more likely to be granted a mortgage than a wealthy black applicant. The Fed comments that the numbers are "worrisome," but do not prove discrimination. None of the other agencies issues a public comment, and none of the agencies announces any new fair lending enforcement initiative.

* The four banking regulators at that time were the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Federal Home Loan Bank Board (FHLBB). The Bank Board was abolished in 1989, and regulation of federally chartered savings and loan associations was transferred to the Office of Thrift Supervision (OTS).

This chronology of the major events in the history of fair lending enforcement by the federal banking regulatory agencies was prepared by the Neighborhood Revitalization Project of the Center for Community Change (CCC). CCC is a national, non-profit organization specializing in fair lending and community reinvestment. Rejection rates cited are quoted from a 1976 lawsuit filed by the National Urban League and other civil rights groups against the banking agencies over their failure to enforce the Fair Housing Act (National Urban League, et. al. v. Office of the Comptroller of the Currency et. al. DC District Court, CA 76-0718).

For more information, contact Allen Fishbein or Debby Goldberg, 202-342-0567.

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Attachment I — **Closing the Money Gap**

HOME EQUITY

The Community Reinvestment Act hasn't been much help to inner-city businesses. That may change.

Wall Street Journal 4/19/93

By Peter Pae

In 1977, amid much hope and promise, Congress passed the Community Reinvestment Act. The act, which required banks and savings and loans to lend in all areas in which they take deposits, was aimed at getting more investment in the inner city.

Sixteen years later, most black entrepreneurs agree: For them, the law has been pretty much of a dud.

"The focus [of CRA] has not been on minority-business lending," says Sunny-Brent Harding, former director of the State Office of Minority and Women Business Assistance in Massachusetts.

Brenda Alford, chairwoman of the American Association of Black Women Entrepreneurs, puts it more bluntly: "I haven't seen any impact [of the act] on our members," she says.

Encouraged by Clinton

That, however, may be changing. Community groups aren't yet ready to celebrate, but they do believe that changes are on the way that could finally bolster small business lending relating to the 1977 legislation. They are particularly encouraged by President Clinton's promise to strengthen the Community Reinvestment program by creating a network of 100 Community Development Banks to give out small business loans and mortgages in poor urban and rural areas.

Moreover, they say, states are already moving to enforce the program on their own. The New York State Banking Department, for example, is proposing changes to its banking rules that would strengthen and clarify the program with the idea of increasing loans to small businesses in low income areas. Acknowledging "a shortage in the availability of small business loans," the proposal calls for, among other things, the development of bank consortia to provide small business loans, particularly in amounts ranging from $50,000 to $300,000. Banks that participate in a consortium could help enhance their Community Reinvestment ratings.

The program has "had minimal impact on lending to minorities, but the handwriting on the wall is promising," says John Taylor, executive director of the National Community Reinvestment Coalition, an association of community groups in Washington, D.C.

Ignored in the '80s

Proponents say it's about time. The legislation was passed in 1977 in response to concerns that banks were "redlining" around economically depressed areas, excluding these poor neighborhoods from credit. But the act was relatively ignored in the deregulatory environment of the 1980s.

Then in 1989, as part of the thrift industry bailout, mortgage lenders were required to publicly report home loans according to borrowers' income, race and location. At last, community groups had the ammunition they needed: statistical evidence that black and Hispanic mortgage applicants, regardless of income, are much more likely to be turned down than white applicants are.

Black and White

According to one study, black-owned firms are turned down for bank loans more often than are white-owned firms. Moreover, the loans they receive, particularly in poor, inner-city neighborhoods, are smaller.

White-owned firms	
Percentage of applicants that receive bank loans	23%
Average loan	$51,630
Average loan for borrowers in low-income, urban areas	$62,000
Black-owned firms	
Percentage of applicants that receive bank loans	29%
Average loan	$28,604
Average loan for borrowers in low-income, urban areas	$26,334

Source: 1989 study of 10,139 small businesses in 28 U.S. cities by Timothy Bates, director of urban policy analysis at the New School for Social Research in New York

At about the same time, new banking provisions put more teeth into the long-ignored act. The provisions called for periodic reviews and grading of banks' lending activities. Good CRA ratings became one of the key criteria for obtaining regulatory approval for banks' merger and acquisition plans.

Community groups knew a good weapon when they saw one: Using the CRA legislation, the groups could win loan commitments by threatening to challenge proposed mergers and acquisitions.

But while the act has been used to obtain inner-city lending commitments from banks, much of the money has been targeted for housing, with little going toward small businesses. That's largely because banks aren't required to provide data on their small business lending practices, as they are with housing loans.

"That information is critical in assessing what is and what isn't happening to minority business lending," says Mr. Taylor of the National Community Reinvestment Coalition.

Adds Allen Fishbein, director of the Washington, D.C., Center for Community Change: "We're shooting in the dark, and that's not going to change without quantitative data."

Failed Amendment

An effort to insert an amendment to the 1992 banking bill calling for banks to report their small business lending record was unsuccessful. Bankers denied that they redline and argued that the provision would have added intolerable paperwork.

They also argue that the amendment isn't needed. "We've seen a lot of examples of special programs to provide lending to minority owned business," says a spokeswoman for the American Bankers Association. "It is a result of banks' increased sensitivity to CRA."

Community groups say the bankers overstate their contributions. But they do agree that the Community Reinvestment Act's impact, while minimal, is better than nothing.

"Without CRA, you would have no banks lending, period," says Pete Putnam, director of Community Coalition for Fair Banking in New York. He says, for example, that thanks to the act, the group last year was able to get Bank of New York Corp. to expand its lending area to certain lower-income neighborhoods in New York, even though the bank didn't have any branches and didn't take deposits in those areas. The group had threatened to hold up Bank of New York's acquisition of 62 Barclay Bank branches, alleging the bank rarely lent money in poor, mostly minority, neighborhoods.

Ted Wysocki, executive director of the Chicago Association of Neighborhood Development Organizations, concurs. "Things would be a lot worse if we didn't have CRA," he says, noting that "without it, I don't know if we could have put together our innovative program."

Chicago's Program

Indeed, Mr. Wysocki's association has recently been able to get 17 banks, in conjunction with the state, to finance a "microloan" program in Chicago. Under the program, which helps banks fulfill their Community Reinvestment requirement, the state government agreed to inject $15 million in state deposits with the banks, with the interest generated from the deposits to be used to provide loans and training to minority-owned business in the inner city.

Alfreda Dockery was one of the beneficiaries. When she started her travel agency—U Send Me Travel in the Jackson Park area of Chicago—in 1981, she couldn't get a bank loan. Instead, she borrowed $10,000 from close friends.

Banks, she says, wouldn't even consider the venture because she wasn't able to show a track record of running a business for two years.

"It's sort of like Catch-22," says Ms. Dockery. "You have to prove yourself that you can run a business, but how can you do that when they won't lend to you to start the business in the first place."

But last November, Ms. Dockery received a $5,000 bank loan through the Chicago program. Although the loan was for only half as much as she wanted, she used it primarily to add new office equipment. Moreover, Ms. Dockery says, it will be invaluable in eventually persuading banks to lend her more money, helping to establish bank credit for the company. Ms. Dockery hopes that eventually she can turn to the banks without fear of rejection when she needs financing to expand her business.

"I pursued the loan so that I could have viability with the banks," Ms. Dockery says.

Some similar programs are starting to appear, such as the Massachusetts Minority Enterprise Investment Corp., but they have been small and slow to grow. The Chicago program, for instance, plans to lend only about $100,000 a year.

"We're providing lending that couldn't be done by banks," says Tom Shumpert, president of the Massachusetts program. "The difficulty is that the kind of lending we do is time consuming and takes so much hand holding." ■

Mr. Pae is a staff reporter in The Wall Street Journal's New York bureau.

TESTIMONY BY GALE CINCOTTA

EXECUTIVE DIRECTOR, NATIONAL TRAINING AND INFORMATION CENTER

CHAIRPERSON, NATIONAL PEOPLE'S ACTION

DISCRIMINATION AND DISINVESTMENT

After decades of saying that we should stop arguing about whether there is discrimination or not, and start doing something about it, all the publicity around the HMDA data and the Boston Fed Study have finally brought us to the point where we can do this.

Despite public attention to this matter and general agreement on it, the regulatory agencies that are responsible for detecting and handling discrimination show no commitment to their job.

Lax enforcement is not the only reason we haven't made more progress in combating discrimination and disinvestment. We also lack information. The HMDA data has proved how useful it is in showing housing discrimination. But we don't have the same data for *commercial* credit availability.

The ability of disinvested communities to revitalize doesn't depend only on housing development; there has to be plenty of commercial development, as well. Small businesses development is especially important, since it lets neighborhood residents revitalize their own neighborhoods, and create jobs for their neighbors.

This discrimination that we have in housing and business lending means that the South Central L.A.'s of this country are just going to multiply. The American Dream that anyone can accomplish what they want in this country is really the Big Lie until we stop cutting off access to success for certain people and certain neighborhoods. Discrimination means that some people can never get the resources they need to make their lives and their neighborhoods better.

PROBLEMS WITH CRA ENFORCEMENT

Regulation C

In December 1989 the Federal Reserve Board of Governors published final regulation "C" which reversed 14 years of policy, and which denied the public access to HMDA data for an additional 8 months. We fought the change steadily with numerous meetings and letters, including letters of support from Senators on the Banking Committee and from then Secretary of HUD Kemp. These letters expressed that Regulation C contradicted Congressional intent, and needlessly deprived community-based organizations of HMDA data, the basis for all their reinvestment agreements. None of these efforts to reverse the 1989 regulation has been successful.

The reason given for the new regulation was that the FFIEC would process the new HMDA data required under FIRREA (which aggregates the number of applications and rejections by race, gender, and income) and release it together with reports on the "old" HMDA (which documents the number, type, and dollar amount of loans made by an institution, by census tract).

There are two reasons why this doesn't make any sense. First, the two reports ("old" HMDA and "new" HMDA) are not meshed in any way. They were always, and still are, separate reports. Second, lending institutions already had HMDA reports ready for release to the public, and were told to withhold them, pending release of the new HMDA reports by the FFIEC.

The one accommodation which has been made to the wishes of community groups has been to legislatively mandate public release of Loan Application Registers (or LARs). LARs contain the raw data from which HMDA reports of lending by census tract are made, however the information is not ordered by census tract, and there is often a huge quantity of it. LARs are not helpful to community-based groups, who cannot devote the enormous amount of labor that would be necessary to make sense out of raw data.

Watch-Listing Real Estate Loans

Around the same time Regulation C came into effect, we became aware that one of the regulators was placing all real-estate loans on a watch list, which required lenders to be capitalized at a higher rate. Thus lenders were between a rock and a hard place. They had to fulfill CRA requirements, but were penalized for it by having to increase their reserves to back those same loans, regardless of their real risk.

Regulators still periodically place more complicated community development projects on watch lists because of their layered financing, which penalizes banks, and treats such loans as if they were riskier than normal. In fact, the layered financing protects the bank's investment, and is especially safe.

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FAIR LENDING VIOLATIONS ARE NOT TRANSLATING INTO CRA RATINGS

Fair Lending Law

Since the Fair Housing Act of 1968 and the Equal Credit Opportunity Act of 1974, all the bank regulators combined have found one case of likely race discrimination to refer to the Justice Department for investigation. This is the simplest way to summarize the total lack of enforcement by regulators of the Fair Lending laws. Four specific examples, provided by Dr. Calvin Bradford, also show how the regulators have not picked up on blatant discrimination, even when another agency documents it.

1. Decatur Federal

On the same day that Justice Department officials pulled files at Decatur Federal to investigate discrimination, the Federal Home Loan Bank Board, who knew of the investigation, began its consumer compliance exam of the bank. Two weeks later, *the regulator gave Decatur the second highest rating (a 2 out of 5)*, and shortly after, the Justice Department sued the bank for violating the rights of 48 applicants to the tune of $1 million, and for showing a 20-year pattern of discriminatory practices.

2. The Green Case

After the Greens, an African-American couple from Chicago's west side, were denied a loan with no reason given, they filed a complaint with the FDIC. (It is illegal to deny an applicant without providing a written reason for the denial.) *The FDIC never contacted the Greens to respond to their complaint, and when they examined the bank one month later, no record of race discrimination was found.* The Greens were awarded an unprecedented $250,000 settlement, and the Justice Department is now investigating the bank for criminal fraud in lying to the FDIC.

3. Meridian Bank

New Jersey Citizen's Action challenged an application by Meridian Bank to move into New Jersey based on a pattern of discriminatory practices in Pennsylvania. Meridian's 1991 HMDA data from Philadelphia shows the bank made more mortgage refinance loans than home purchase loans, but hardly any to minority homeowners. Meridian made 223 refinance loans that year, and 210 home purchase loans. While 35 percent of the purchase loan applications came from minorities, only 3 percent of the refinance applications did. Data for another metropolitan area was similar.

In defense of these practices, Meridian cited the following profile of minorities as:

more likely to be single heads of households and therefore less likely to have dual incomes;
having significantly less income;
having higher unemployment;
more likely to live below poverty level;
more likely to live in renter-occupied housing units.

In addition to their obviously discriminatory tone, none of these statements is a valid underwriting criterion. Even more importantly, however, *each of these statements is completely irrelevant to refinance loans, where all applicants must already be homeowners.*

The Federal Reserve Bank Board granted the bank an "Outstanding," the highest possible rating, in a glowing, 35 image evaluation.

Support materials written by Dr. Calvin Bradford are available, which provide more detail on the cases summarized above.

WHAT CONGRESS CAN DO

Stop Attacks on CRA

It's ridiculous how I keep coming into town to testify about all the reinvestment that has happened under CRA, and that Congress asks for ways to strengthen it, while the ABA constantly gets bills introduced to kill CRA. We have, to fight these small bank exemptions and safe harbor amendments all the time. The most useful thing you could do would be to put a moratorium on these attacks so that we and the bankers could stop wasting all our time on this.

Commercial Loan Disclosure

We have every reason to believe that discrimination in commercial lending is at least as bad, if not worse, than it is in mortgage lending. Business investment is riskier, and there hasn't been much public attention focused on credit availability for business. The lack of data has meant a lack of exposure for this issue, little public discussion, little action, and little progress.

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One Regulator for Fair Lending and CRA

After all the discussion about how the regulators never find redlining, never find discrimination, I think it's time to make some sense out of this regulatory process.

We need one agency devoted exclusively to discrimination issues, where CRA and Fair Lending are merged, and don't have to compete with Safety and Soundness anymore. CRA and safety and soundness compete now, because the agencies are really set up for safety and soundness first. Most examiners are really trained in safety and soundness, and CRA is just a secondary job they have to squeeze in. Over 90 percent of the agencies' time is devoted to safety and soundness. The rest is split amongst three different areas, one of which is consumer compliance.

If all discrimination enforcement was in one agency that was set up for that purpose, they could link findings of individual cases of discrimination to CRA ratings and plans for improvement.

Until we can accomplish that, however, there is one immediate step that could be taken. The Agencies should be headed by people who are serious about enforcing CRA and other consumer laws. It's obvious that they aren't now, and this change would bring some immediate improvements.

No CRA Exemptions

There have been various suggestions made for exempting banks from CRA if they contribute a certain percentage of assets to community development banks. No exemption of any kind, for any reason, is acceptable.

The full resources and assets of every lender in the existing banking system should be available for lending to any qualified borrower. How can we evaluate what kind of contribution or commitment is equivalent to the maximum a lending institution could be deing to respond to the lending needs of the community? Each should perform to the best of its ability in this area. All we are asking is for credit to be available to all qualified borrowers.

We also cannot support a dual banking system where the regular institutions are for some kinds of people, while a special kind of institution is for other kinds of people, or I might add, people who are *perceived* to be different.

The narrow standards that the banking system has operated on for so long should not be enshrined as standards of "normal" berrowers and "different" berrowers.

A third point is that community development banks are a largely untried kind of institution. There are a handful of successful ones in the nation. How can we depend on these new, untested institutions when we have financial giants with the ability and expertise to do lending of all types?

Even if a new network of community development banks is created, I want to emphasize again that the conventional lending institutions still have to be required to do their part. Community development banks will never be big enough to replace the institutions we have now with billions in assets. Existing institutions have got to remain open to legitimate development projects.

Community Development Banks

This leads me to another point on CD banks. I do not believe that creating a whole new system of banks is necessary or even desirable.

We have a highly developed banking system with extensive resources in place now. If we set up a whole network of new institutions, we will spend an enormous amount of capital simply putting them in place. Whole new facilities will have to be established, new computer systems bought and set up, new management structures staffed and paid for.

With small additions in space, equipment, and personnel, existing institutions could add more lending for less money. To take money from existing banks to set up entire new ones, will swallow a lot of capitol that could have been more productive by devoting a greater portion directly to lending.

Community Development banks also require unusually visionary and skilled people to lead them. South Shore Bank in Chicago is the nationwide example for this kind of lending. Where are we going to find more Ron Grzywinskis, not to mention the rest of his staff, to multiply across the country?

Thank you Mr. Chairman and members of the Committee for hearing my testimony.

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NTIC National Training and Information Center
810 N. Milwaukee Ave. □ Chicago, Illinois 60622-4103 □ (312) 243-3035

NEIGHBORHOOD LENDING PROGRAM:
TOTAL LOANS AND GRANTS PLEDGED SINCE PROGRAM INCEPTION

Total Loans (in millions)

	1984-1989	1989-1994
1. First National Bank of Chicago	100mm	150mm
2. Northern Trust Company	18mm	25mm
3. Harris Trust and Savings Bank	35mm	50mm
4. Continental Bank	20mm	25mm
TOTAL:	153mm	225mm

Total Grants

1. First National Bank of Chicago	2mm	3mm
2. Northern Trust Company	400,000	1mm
3. Harris Trust and Savings Bank	600,000	1mm
TOTAL:	3mm	5mm
(TOTAL PRODUCED):	3.7mm	

December, 1992

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CHICAGO NEIGHBORHOOD LENDING PROGRAM:
Total Loan and Grant Goals and Commitments

Period	Bank	Loan Goals*	Loans Committed	Grant Goals*	Grants Committed
1984 to 89	First National Bank of Chicago	100,000,000	68,102,185	2,000,000	2,348,940
	Northern Trust Company	18,000,000	16,536,124	400,000	540,700
	Harris Trust and Savings Bank	35,000,000	32,850,751	600,000	737,955
	Continental Bank**	20,000,000	8,446,672	N/A	N/A
	TOTAL	173,000,000	125,935,732	3,000,000	3,627,595
1989 to 92	First National Bank of Chicago	150,000,000	111,237,815	2,000,000	1,192,000
	Northern Trust Company	25,000,000	20,363,876	1,000,000	664,500
	Harris Trust and Savings Bunk	50,000,000	33,840,060	1,000,000	608,433
	Continental Bank	25,000,000	6,465,439	N/A	N/A
	TOTAL	250,000,000	171,907,190	4,000,000	2,464,933
	Total Since Program Inception	423,000,000	297,842,922	7,000,000	6,092,528

*Loan and grant goals are for two five-year periods: 1984-1989 and 1989-1994.

**Continental has a separate neighborhood lending agreement which was initiated in 1987.

NTIC Analysis: January, 1993. NTIC, 810 N. Milwaukee, Chicago, IL, 60622. (312) 243-3035

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NTIC Analysis of Neighborhood Lending Program

NTIC, 810 N. Milwaukee, Chicago, IL 60622. (312) 243-3035

Table #1 - Neighborhood Lending Program Goals and Production

Lender and Program	Dollar Goals	Lender and Program	Dollars of Production	Number of Loans	Housing Units
First National Bank:					
Single-Family	15,000,000	Single-Family Purchase-Rehab*	4,263,507	56	111
Multi-Family Projects	10,000,000	All Multi-Family Projects	30,533,331	107	1,810
Multi-Family Non-profit	20,000,000				
Mixed-Use Real Estate	5,000,000	Mixed-Use Real Estate	12,000,305	28	116
Commercial/Industrial	50,000,000	Commercial/Industrial	20,410,012	41	
	$100,000,000		$ 66,182,165	232	2,006
Harris Trust:					
Home Improvement Loans	2,000,000	Home Improvement Loans	2,014,828	117	237
Single-Family New Construction	4,000,000	Single-Family Purchase-Rehab	1,462,830	23	35
Multi-Family Gap Financing	9,000,000	All Multi-Family**	17,806,693	63	1,088
Residential Cooperative	5,000,000				
Mixed-Use Real Estate	5,000,000	Mixed-Use Real Estate	6,347,800	23	167
Commercial/Industrial	10,000,000	Commercial/Industrial	5,130,400	13	
	$ 35,000,000		$ 32,020,751	230	1,527
Northern Trust:					
Single- and Multi-Family Pool	4,000,000	Single-Family Purchase	1,541,000	16	20
		Single-Family Purchase-Rehab	265,000	5	15
		Multi-Family***	7,079,004	61	460
Multi-Family Gap Financing	4,000,000				
Mixed-Use Real Estate	5,000,000	Mixed-Use Real Estate	5,160,578	36	144
Commercial/Industrial	5,000,000	Commercial/Industrial	1,884,362	9	
	$ 18,000,000		$ 15,930,124	107	645
TOTALS	$153,000,000		$117,100,040	572	4,070

*Includes an 18 unit new construction townhouse development.

[illegible]

[illegible]

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RESPONSE TO WRITTEN QUESTIONS FROM SENATOR RIEGLE BY RICHARD F. SYRON

Q.1. According to the Boston Fed study, more than 80 percent of mortgage loan applicants—white and black—have imperfect credit records. Both the study and the *Decatur* case suggest that loan officers are treating black applicants less favorably than white applicants. What can be done to detect whether financial institutions are practicing this kind of discrimination?

A.1. The Boston Fed study found that most applicants, white as well as minority, exceed some guideline for obligation or loan-to-value ratios or credit history, or possess a characteristic that requires additional documentation. Accordingly, loan originators must exercise considerable discretion in evaluating loan applications. This discretion, while desirable, makes the detection of discrimination using traditional examination techniques difficult, as most rejected applications contain plausible reasons for denial. However, statistical methods that aggregate over many applications, as was done in the Boston Fed study, can be used to determine whether the same imperfections are treated the same way for applicants of different races.

The Boston Fed study was intended to assess lending patterns in the Boston metropolitan area as a whole and was not designed to reveal discrimination at the institution level. Nevertheless, such methodologies can be used to assess the presence of discrimination in individual institutions when sufficient numbers of both minority and white loan applications exist. The procedure cannot be used for small lenders or for lenders which receive few minority applications. For a lender with sufficient applications, the methodology requires that information be gathered on all applicant characteristics that are important to the institution's credit decision; the analysis will then reveal the credit standards of the institution, including the role played by race.

Lenders can take various steps to help ensure that they are treating people of different races fairly; and an active program of self-assessment and outreach to minority communities would seem to provide some indication that the institution is not engaged in discriminatory practices. Elements of such a program would include training loan origination staff about the federal and state laws that protect prospective borrowers from biased treatment, adopting hiring and promotion practices that foster racial diversity within the institution, instituting second review processes, conducting self-examinations along the lines of the Boston study, and testing for discrimination in the pre-application state.

Q.5. According to the Boston Fed's study, an applicant turned down by a private mortgage insurance company was 600 percent more likely to be turned down for a loan than an applicant who was able to obtain insurance. It is crucial that private mortgage insurers not discriminate in making their decisions about who to insure.

The Mortgage Insurance Companies of America announced yesterday that they will voluntarily provide to the FFIEC the same information that mortgage lenders are required to provide by the Home Mortgage Disclosure Act. What are your views on whether

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this action will help to promote access to mortgages for minorities and low-income people.

A.5. Care should be exercised in interpreting the Boston Fed study's finding that an applicant denied private mortgage insurance is almost certain to be denied a mortgage. Only 2 percent of the applications in the Boston study experienced this problem. Excluding these applications from the analysis did not change the results: the higher denial rate experienced by black and Hispanic applicants, holding constant economic and other characteristics, cannot be attributed to the denial of private mortgage insurance. Nevertheless, since the minority applications in the Boston Fed study had, on average, higher loan-to-value ratios than white applications, minority applicants are more likely to apply for mortgage insurance. Thus, the fairness of the mortgage insurance decision is very important to minority applicants.

The data that the Mortgage Insurance Companies of America have offered to supply may provide some insight into whether differential treatment exists. At a minimum, the providing of this information suggests that the mortgage insurance companies are conscious of their responsibility to serve minorities fairly. However, the limitations of the Home Mortgage Disclosure Act data must be recognized. These data have not resolved whether discrimination exists among mortgage lenders. Since information is not collected on variables known to be important to the lending decision, racial differences in denial rates can be dismissed as attributable to the missing factors.

RESPONSE TO WRITTEN QUESTIONS FROM SENATOR RIEGLE BY RETHA WILSON

Q.1. How does mortgage and other lending discrimination impact the economic health of low-income and minority communities?

A.1. Mortgage and other lending discrimination can set in motion a spiral of neighborhood decay and abandonment that is difficult to stop. Discrimination in the mortgage market leads to housing abandonment, and to the decline of urban tax bases as residents move to the suburbs. Abandoned houses pose a real and present danger to urban communities, serving as havens of drugs and crime. At the same time, home ownership is traditionally the first step in the accumulation of assets that may culminate in ownership of a small business. The lack of access to mortgage credit, then, denies not only housing opportunities for individuals, but also employment opportunities for whole communities.

Lack of access to small business credit for minorities has an equally devastating impact. Would-be entrepreneurs who cannot access credit simply cannot start up or expand a small business. This contributes to widespread unemployment, and the erosion of urban tax bases—which in turn contribute to social deterioration in urban communities.

Without access to conventional bank credit, potential homeowners and entrepreneurs are forced to resort to a "fringe" banking sector—a predatory collection of pawnshops, rent-to-own companies, and finance companies—that may charge usurious rates an fees to minority consumers.

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Q.2. Last week the Committee held hearings on reverse redlining and home equity scams. We heard about unregulated lenders who target primarily low-income and minority individuals and provide second mortgages at exorbitant rates. Have you heard about this practice in your community?

A.2. We have heard only sketchy and anecdotal evidence of such practices in Detroit. Given the extreme paucity of conventional credit available in Detroit, however, there is ample reason to believe that many homeowners would be vulnerable to such practices.

Q.3. How does discrimination by insured institutions contribute to this problem?

A.3. Clearly individuals and communities that are unable to obtain credit from conventional sources are especially vulnerable to a range of credit scams—including second mortgage scams. Indeed, the consummate irony of "reverse redlining" is that many conventional lenders who were unwilling to provide credit to minorities directly, served as a key resource for predatory, unregulated lenders. And the same conventional banks who refused to lend to minorities due to stereotypes about risk, were proved wrong by heroic homeowners who did all they could to make their payments—even under the most abusive of conditions.

Q.4. What lessons can we draw from the Boston Fed study and the *Decatur* case about how we can better detect and combat mortgage discrimination? Given the widespread agreement that discrimination exists, why are the banking regulators not finding discrimination in their compliance exams?

A.4. The principal lesson of both the Boston Fed study and the *Decatur* case is that racial and ethnic discrimination does in fact exist, and is pervasive.

The second important finding is that the form of such discrimination is *not* the rejection of perfect minority applicants by loan officers hurling racial epithets at them. For many years, this is apparently all that the agencies considered to be discrimination.

Instead, loan discrimination takes the form of disparate treatment of applicants of different race or ethnicity, with comparable flaws in their applications. Generally, white applicants are given the opportunity to explain away credit blemishes more frequently than are minority applicants.

Therefore, it is imperative that compliance examinations look not merely for technical compliance with ECOA and the Fair Housing Act, but for instances of disparate treatment based on a comparison of *similarly situated* white and minority applicants.

Such a comparative technique may be made difficult in the case of small mortgage lenders, or lenders receiving few applications from minorities. In such cases, a review of loan files over several years—and pre-application mortgage testing—will prove to be essential compliance techniques.

The main reason that the agencies have not found mortgage discrimination is that examiners have not been instructed to look for it. Instead, examiners have traditionally looked for technical compliance on the part of lenders, and the existence of non-discrimination policies and procedures. Consequently, reviews of loan applications generally got short shrift in exams.

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At the same time, examiners were instructed to look for perfect minority applicants who were rejected, rather than to take a comparative approach to the analysis of loan files.

Q.5. What are the weaknesses in our current system of enforcement of fair lending and fair housing laws? How can current enforcement mechanisms be strengthened?

A.5. The main weakness in the enforcement of the fair lending and fair housing laws has been that we have had agencies that have strongly resisted devoting sufficient resources or attention to enforcement. The record of hostility to enforcement of these laws by the banking agencies dates back to their collective refusal to promulgate regulations to enforce the Fair Housing Act.

Among the steps that might be taken to strengthen enforcement are:

- creation of a separate consumer compliance division within each agency, whose head reports directly to the head of the agency, with oversight over specially trained examiners;
- increased use of testers to detect loan bias and "prescreening";
- reforms to examination technique to focus on comparative analysis of loan files; and
- increased personnel at each agency devoted to compliance.

In the past, ACORN has advocated stripping the four banking agencies of their fair lending responsibilities. Given the stated commitment of the new Comptroller of the Currency to improve matters in this area, it may be appropriate for Congress to delay action pending a review of agency performance in six months or so.

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The Greenlining Coalition

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MEMBERS:

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New Bayview Committee

Oakland Citizens Committee for Urban Renewal (OCCUR)

Phoenix Urban League

Rainbow Coalition, National Chair

Sacramento Urban League

San Francisco Black Chamber of Commerce

World Institute on Disability

CO-CHAIRS:

George Dean, President & CEO Phoenix Urban League

John Gamboa, Executive Director Latino Issues Forum

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LEGAL COUNSEL:

Robert Gnaizda, Public Advocates

March 17, 1993

Chairman Donald W. Riegle, Jr.
United States Senate
Committee on Banking, Housing
and Urban Affairs
Washington, DC 20510-6075

Attention: Ms. Breneman and Chief of Staff Steve Harris

Re: **ANSWERS TO MARCH 1, 1993 INQUIRY ON FEBRUARY 24, 1993 CRA HEARING**

Dear Chairman Riegle:

These responses to your March 1, 1993 questions regarding the Banking Committee's February 24, 1993 CRA hearing are from Latino Issues Forum, the Greenlining Coalition and other groups upon whose behalf we testified.

Question 1: How does mortgage and other lending discrimination impact the economic health of low-income and minority communities?

Inner city businesses, particularly African-American and Latino-owned businesses, cannot secure credit for business loans. In California, for example, far less than one half of one percent (00.5%) of the dollar value of all business loans are made to African-American-owned businesses and less than one percent to Latino-owned businesses. (There are over 500,000 minority-owned businesses in California.) As a result, there are few viable businesses in inner city communities such as South Central Los Angeles. The recent bank and regulatory decision to loosen credit by relying on the character of the owner may only further discrimination. Subjective character standards are often an euphemism for "white male."

In 1991, the seven largest California commercial banks averaged only one home mortgage loan per four branches to African-Americans

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and only one per branch for Latinos. Since there are few branches in inner cities, the result is essentially zero home mortgage loans in inner cities. At least three of California's seven largest banks (all with assets of five billion or more) made no home mortgage loans in South Central Los Angeles, a community whose population exceeds that of either Boston or Washington, D.C.

Combined with insurance redlining, the above "benign neglect" has artificially disempowered low-income communities, and adversely affected economic growth and job development.

Question 2: Last week the Committee held hearings on reverse redlining and home equity scams. We heard about unregulated lenders who target primarily low-income and minority individuals and provide second mortgages at exorbitant rates. Have you heard about this practice in your community?

Yes. In large measure it is attributable to the absence of a strong bank presence.

Question 3: How does discrimination by insured institutions contribute to this problem?

See answer to Question 1.

Question 4: What lessons can we draw from the Boston Fed study and the Decatur case about how we can better detect and combat mortgage discrimination? Given the widespread agreement that discrimination exists, why are the banking regulators not finding discrimination in their compliance exams?

In two recent merger cases we raised the Boston Federal Reserve study with the Federal Reserve and OCC (Banc One/Valley National and Westamerica/Napa Valley). In both cases, the regulatory agencies ignored the Boston Fed study and approved mergers where the home mortgage declination rate between minorities and whites was as high as in Boston. In both cases, despite our requests and protests, the regulatory bodies, without examination or reference to the Boston study, gave the banks a clean bill of health.

The reasons for the burying or ignoring of the Federal Reserve study are unknown. However, in the Banc One case, had it been used as a model for determining if discrimination existed, it is highly likely that the merger would not have been approved.

Question 5: What are the weaknesses in our current system of enforcement of fair lending and fair housing laws? How can current enforcement mechanisms be strengthened?

A. Refusal to Permit Public Hearings

Over the last eight years, the Federal Reserve has never granted any community group's request for a Public Hearing and granted only four Public Meetings. On March 1, 1993, the Federal Reserve refused to allow any public participation in the Banc One case.

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Over 800 individuals from Ohio, Tennessee, Arizona and California sought hearings. In addition, the Mayor of Cleveland, Consumers Union, the Phoenix and Sacramento Urban Leagues, the San Francisco Black Chamber of Commerce, the NAACP, Latino Issues Forum, the Mexican American Political Association and numerous other community groups sought hearings. Hearings were perfunctorily denied.

This blanket refusal is inconsistent with President Clinton's call for greater public participation and CRA's own specific provisions supporting Public Hearings.

Legislation: We urge that you enact legislation that requires Public Hearings in all major mergers whenever credible community groups call for such and to otherwise strengthen the public participation sections of CRA.

B. Refusal to Audit Lack of Business Loans

The Federal Reserve, as well as the FDIC and OCC, have refused, despite community requests since 1989, to audit the lack of business and consumer loans to minorities. In Banc One, for example, it was contended that in Ohio, African Americans received less than one percent of Banc One business loans, and in Arizona, Valley National made essentially no business loans to African Americans. The Federal Reserve and OCC ignored these contentions and refused to make any inquiries. This will continue until there is HMDA-type disclosure legislation for business and consumer loans.

Legislation: Enact legislation to require full disclosure of all business and consumer loans in a manner consistent with HMDA disclosure.

C. Refusal to Use Boston Federal Reserve Study on Discrimination

Despite home mortgage discrimination rates in Banc One that rivaled those in Boston, the Federal Reserve summarily approved Banc One's home mortgage lending patterns. In its 36-page, 32-footnote opinion, it failed to even mention the Boston Federal Reserve study and/or its implications. In effect, the Federal Reserve has buried its own study documenting discrimination.

Legislation: Enact provisions that ban any merger unless the acquiring and acquired banks can convincingly demonstrate that lack of minority lending or substantial disparities in lending are not due to discrimination.

D. Federal Reserve Stamp of Approval for Discrimination Due to Inflated CRA Rating

Inflated CRA ratings (90% of banks receive a "satisfactory" or better rating and less than one percent fail), continue to be used as a basis for approving major mergers. In Banc One, the Federal Reserve stated that it gave great weight to the CRA ratings received by

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Banc One affiliates (no failures and 98 percent satisfactory or better among its 61 affiliates). These ratings occurred despite 2 to 1 disparities in home lending and virtually no business loans to African Americans or Latinos.

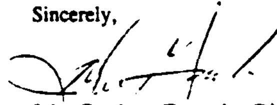
Legislation: Enact legislation requiring a "Needs to Improve" or lower rating whenever an institution has an unexplained disparity in home, consumer or business lending and bar mergers where a "Needs to Improve" rating is received.

E. Federal Reserve Ignores All White Boards of Directors and Their Impact on CRA

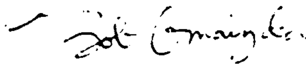
The Federal Reserve and other regulatory bodies have virtually no minorities in top policy positions. This lack of diversity may have influenced recent decisions holding that all white boards of directors and top management deciding CRA issues is irrelevant to CRA. In Banc One, for example, none of the 601 Board members on Banc One's affiliate Boards was Latino. The Federal Reserve found that this absence was beyond the scope of CRA.

Legislation: Secure annual legislative reports on diversity for each regulatory body (OTS, FDIC, OCC and Federal Reserve) and enact legislation that requires annual full disclosure by all financial institutions as to the diversity of their Board and top management as part of CRA.

Sincerely,



John Gamboa, Executive Director,
Latino Issues Forum & Co-Chairman,
Greenlining Coalition



Robert Gnaizda
General Counsel
Greenlining Coalition

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RESPONSE TO WRITTEN QUESTIONS FROM SENATOR RIEGLE BY JOHN P. LaWARE

Dear Mr. Chairman: I am pleased to submit the following answers in response to the questions set forth in your letter of March 1, 1993.

Q.1. According to the Boston Fed study, more than 80 percent of mortgage loan applicants—white and black—have imperfect credit records. Both the study and the Decatur case suggest that loan officers are treating black applicants less favorably than white applicants. What can be done to detect whether financial institutions are practicing this kind of discrimination?

A.1. As your question indicates, many mortgage loan applicants have attributes that negatively but legitimately affect a lender's perception of the applicant's willingness and/or ability to repay a loan. Possessing one or more of these attributes does not necessarily disqualify an applicant from receiving a loan, but it does require the lender to rationalize why this negative attribute should not disqualify the applicant. This process of judging the overall merit of an applicant when there is evidence in the application to suggest a possibility of default can be highly subjective. In addition, the decision whether to try to overcome it can also be subjective.

A decision that a loan application will be approved despite an imperfect credit record might be based on any number of factors. For example, the lender might consider extenuating circumstances for the poor record, or decide that there are strengths in the applicant's overall record that overcome the deficiencies. Lenders, in virtually all circumstances, can articulate reasons why one applicant with a negative attribute was granted a loan and another with that same attribute was denied by pointing to some factor that the lender felt made the difference. Since no two applicants are identical, these differences always, at least potentially, provide a rational basis for the different treatment. The examiner's job, then, is to determine whether the lender's stated reason for denying loans to minorities and others with characteristics protected from discrimination by the law was accurate and whether any exceptions from stated policy are made evenhandedly.

In light of the results of the Boston study, we have taken several measures to strengthen our fair lending examination procedures. First, we have begun testing a statistical model—similar to that used in the study—that we are very hopeful will significantly improve our fair lending examination procedures for mortgage loans, particularly in our larger banks. This model should enhance the ability of our examiners to identify similarly situated pairs of minority and white applicants to analyze and detect disparate treatment. Second, we are participating with the other agencies on a thorough outside review intended to identify areas where improvements can be made to our policies, examination procedures and examiner training relating to enforcement of fair lending laws. Third, we have developed a sophisticated computer-based HMDA data analysis system to help identify suspicious files and institutions.

It's important to keep in mind, however, that detecting this type of subtle credit discrimination is very difficult. This difficulty is

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compounded by fact that there is little, if any, direct guidance in the court cases on such issues. The fact that it took the Justice Department several years to develop the Decatur case is an example of the problem. The Board has committed a significant amount of resources to implementing and improving its efforts in fair lending enforcement. However, routinely spending the level of resources implied by the Justice Department's investigation to develop sufficient evidence to sustain a charge of discrimination against a single financial institution through the examination process is simply not practical. Clearly, however, there are improvements that can be made in the process, and we are actively seeking them.

Q.2. What kind of coordination exists between the banking regulatory agencies and Justice on fair lending enforcement efforts?

A.2. Until statutory changes made in late 1991, the Board was authorized to make a referral of a violation of the Equal Credit Opportunity Act to the Department of Justice if it was unable to obtain compliance itself. Heretofore, when Federal Reserve examiners have discovered violations, we have successfully brought banks into compliance with the law. FDICIA changed the law to require the Board to refer any matters which it has reason to believe involves a pattern or practice of discrimination and to permit it even in individual instances.

Since late 1991, the Federal Reserve, along with other agencies, has met periodically with the Department of Justice to discuss issues related to fair lending. These discussions have led to an agreement to work together to investigate possible illegal credit discrimination by lenders which were jointly identified for closer scrutiny. In fact, we are currently in the process of reviewing a list of potential target institutions for joint investigation.

Q.3. Do the banking regulators have an agreement with the Justice Department on enforcement procedures and referrals similar to the agreement they have with HUD?

A.3. The Federal Reserve's agreement to cooperate with the Department of Justice is set forth in the enclosed letter.

Q.4. How can coordination between the agencies and Justice be improved?

A.4. The discussions referenced in our answer to question 2 are ongoing, and we believe these discussions will further improve coordination between the agencies and Justice. In addition, our agreement referred to in question 3 contemplates continued cooperation on matters associated with fair lending examinations.

Q.5. According to the Boston Feds study, an applicant turned down by a private mortgage insurance company was 60 percent more likely to be turned down for a loan than an applicant who was able to obtain insurance. It is crucial that private mortgage insurers not discriminate in making their decision about who to insured.

The Mortgage Insurance Companies of America announced yesterday that they will voluntarily provide to the FFIEC the same information that mortgage lenders are required to provide by the Home Mortgage Disclosure Act. What are your views on whether this action will help to promote access to mortgages for minorities and low-income people?

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A.5. We believe that there are a number of factors which cumulatively result in reduced access to mortgage loans by minorities and low-income people. It does seem apparent that the ability of an applicant to obtain mortgage insurance may have an impact on their ability to qualify for a mortgage loan, particularly if the applicant can only afford a small down payment. Increased information in this area may be helpful in better understanding how access to mortgage insurance affects the lending process and to identify ways in which any negative impact might be minimized. I might add, however, that since the information proffered by the mortgage insurance industry will pertain to approvals and denials of insurance policies, it may not be identical to the loan application data submitted by mortgage lenders. The Federal Financial Institutions Examination Council staff is meeting with the mortgage insurers' representatives to work out the details at this time.

Q.6. The Federal Financial Institutions Examination Council is charged with promoting coordination and uniformity of procedures among the various banking regulatory agencies. Although there are uniform examination and enforcement procedures for safety and soundness, I believe there are no such uniform procedures for fair lending compliance. Is this true? If so, why has FFIEC not given equal attention to coordinating fair lending enforcement?

A.6. The FFIEC does not, at this point in time, have uniform examination procedures for fair lending enforcement. The agencies are, however, developing uniform enforcement guidelines for use when violations of fair lending laws are discovered. This process is well under way and we anticipate these guidelines will be adopted by the FFIEC in the near future. In addition, the FFIEC has hired a consultant to review the agencies' fair lending examination procedures and to develop a uniform approach to examiner training and examination procedures for fair lending.

Q.7. I recently asked the regulatory agencies what instances of discrimination by the Boston institutions their examination had uncovered for the period covered by the Boston study. I was shocked to hear that the examiners had found no discrimination by any institutions.

Given the widespread agreement that the study shows discrimination exists, why are banking regulators not finding discrimination in their compliance exams?

A.7. In this regard, I should note that none of the banks in the Boston study are subject to the supervisory authority of the Federal Reserve with respect to fair lending laws. Moreover, we do not have any specific knowledge regarding any results of the other agencies' fair lending examinations in the Boston area.

However, as a general matter, systematic bias in mortgage lending is very difficult to prove conclusively at the institution level, particularly when the number of minority applications is small, as it is in the vast majority of institutions. Finding a statistically significant disparity in lending based on race for an entire market using a large number of applications in a regression analysis, as was done in the Boston study, does not translate perfectly to using the same technique in individual institutions many of which have too few applications to do such an analysis. And it is only individ-

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ual institutions, and not the market in general, that can violate the law. In addition, I would refer you to my answer to question 1 which sets forth in some detail a number of the challenges faced by an examiner in detecting credit discrimination.

Q.8. The Justice Department did a great job in putting together its case against Decatur Federal. I am disturbed, however, by the performance of the banking regulators in this case. My staff recently reviewed the Office of Thrift Supervision's fair lending and Community Reinvestment Act compliance examinations of Decatur for the period covered by the Justice Department suit. The OTS gave Decatur better than satisfactory ratings for both CRA and fair lending. OTS found no evidence of discrimination.

In your view, why was the Justice Department able to find sufficient evidence of discrimination to gain a favorable settlement when OTS was unable to find evidence of discrimination?

A.8. As I indicated earlier, we are unable to answer specific questions concerning the results of other agencies' fair lending examinations. Consequently, we have referred this question to the Office of Thrift Supervision for their response which follows:

The Office of Thrift Supervision's (OTS) December 26, 1989 examination of Decatur was completed on March 19, 1990. This was a special examination to analyze lending disparities that the OTS identified in Decatur's loan application records. These disparities were apparent in data compiled by the OTS under its own fair lending regulations. The OTS also conducted a Community Reinvestment Act assessment and reviewed the institution for compliance with consumer protection laws.

At the time our examination began, the Department of Justice (Justice) was in the early stages of its investigation into the mortgage lending practices of Atlanta-area financial institutions. Justice indicated to OTS that it wanted to explore the use of an analytical model to see if systematic patterns of discrimination could be identified in a financial institution's application records. Their approach involved the compilation of a significant number of lending variables and criteria pertaining to loan applicants *not collected* under the Home Mortgage Disclosure Act or the supplementary OTS fair housing data system, and the introduction of these variables and criteria into a regression model. In order to use their model, Justice needed a subject institution that had a high volume of application activity from minority individuals and good internal records to facilitate data input.

We became interested in Justice's approach and believed that Decatur might be an appropriate institution in which to test the model. We were particularly interested in whether it would be feasible to use an analytical model to supplement our credit discrimination examination process. We informed Justice of our examination of Decatur and our belief that its application activity might be sufficient to use the analytical methods proposed by Justice.

OTS and Justice mutually agreed we would both benefit from cooperating with each other and that Decatur would be the test case. Justice was very interested in learning about our examination process and how we test for discriminatory treatment of mortgage loan applicants. To our knowledge, Justice had never participated with

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a Federal banking regulator in a field examination and the Decatur examination offered them an unprecedented learning opportunity to bolster their experience level and strengthen the overall investigation.

We agreed that OTS would follow its standard discrimination detection procedures while Justice would use their new approach. In our view, this was a good opportunity to see if our procedures yielded the same results as Justice's approach, and whether Justice's model was successful at finding discrimination.

We concluded our examination on March 19, 1990. However, Justice continued its investigation of Decatur. In May 1992, Justice informed Decatur of its conclusion that the institution had violated the Fair Housing Act and the Equal Credit Opportunity Act and gave Decatur the opportunity to settle the matter without protracted, costly litigation. Decatur opted for this approach and a settlement agreement was reached between Decatur and Justice in September 1992. Decatur also categorically denied all the allegations brought by Justice.

For the record, we have not physically examined any of the statistical evidence compiled by Justice to support its allegations against Decatur; Justice has only orally briefed us on its quantitative method and findings. Consequently, we are not able to comment on the strength of their findings or the applicability of their model to our examination process.

Our examination resulted in "satisfactory" CRA and compliance ratings for Decatur and we did not uncover any discriminatory lending practices. However, our findings were consistent with the approach that we used. During informal conversations, Justice confirmed that our examination findings were valid based on our procedures.

Since the Decatur investigation, we have had several meetings with Justice and are committed to continuing our working relationship with them. We are in the process now of helping them identify additional institutions that might serve as the bases for targeted investigations where their analytical model could be used.

In addition, we are taking affirmative steps to strengthen our discrimination detection techniques. To improve in this area, we will:

(1) Expand our compliance examiner training curricula by developing an advanced school on credit discrimination;

(2) Explore other discrimination detection techniques, such as testing, with the Department of Housing and Urban Development, Justice, and civil rights experts;

(3) Explore the use of statistical methods in our examination process. We are are interested in approaches that enable the identification of similarly-situated approved and rejected applicants with imperfect credit criteria to evaluate whether lending standards have been applied in an even-handed manner, regardless of the racial characteristics of the applicants; and

(4) Support the Federal Financial Institution Examination Council's effort to review and improve the fair lending examination process.

We are also taking steps to strengthen our fair lending enforcement efforts. We have developed an internal system for making re-

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ferrals to Justice under the Equal Credit Opportunity Act, and have made our first referral to Justice. We will ensure that our staff receives adequate guidance and support in the use of available formal enforcement actions, including civil money penalties, for fair lending violations.

JONATHAN L. FIECHTER
ACTING DIRECTOR, OTS

On a different matter, I would like to take this opportunity to correct a chart sent to you in recent correspondence (February 16, 1993) from Chairman Greenspan. The chart set forth on page 11 of the letter was inaccurate in that it showed that in the period 1989–1992 the Federal Reserve invoked corrective action due to findings of discrimination based on race on one occasion (in 1990). The chart should have included another instance of the same finding in 1992. For your information, I have attached a new, corrected page 11. Please accept my apologies for this error.

In conclusion, I would reiterate that the Board is committed to vigorous enforcement of fair lending laws. We know that our efforts in this regard can be improved and have already begun using information and insights from the Boston study and the DOJ case to enhance our fair lending enforcement efforts. In addition, I can assure you that the Board recognizes the importance of this issue to the Congress and the country.

Sincerely,
JOHN P. LAWARE

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Table included in February 16, 1993 letter from Chairman Greenspan. Corrected below-March 22, 1993.

forty-two banks in 1990, and forty-seven banks in 1989. The principal reason why the policy guide was invoked are listed in the table below. This table includes violations found in relation to all types of loans. Information is not available on violations that invoked corrective action under the Regulation B/FHA policy guide prior to 1989.

CORRECTIVE ACTION REQUIRED UNDER THE REGULATION B/FHA POLICY GUIDE 1989 - 1992

PRINCIPAL REASON POLICY GUIDE INVOKED	1989	1990	1991	1992
Failed to Provide Proper Adverse Action Notices	25	21	32	26
Improperly Obtaining the Signature of a Spouse or Other Person	17	13	16	18
Improperly Furnishing Credit History Information	3	4	10	9
Improperly Considering Age or Whether Income is Derived From Public Assistance	0	2	0	2
Improperly Considering Income in the Evaluation of Credit Applications	1	1	2	2
Discrimination on the Basis of Sex[1]	0	1	0	0
Discrimination on the Basis of Race[1]	0	1	0	1
Discrimination on the Basis of Marital Status	1	0	1	3
Discrimination on the basis of Age	0	3	1	2

[1]The two instances of discrimination involved the inconsistent application of the banks' loan policies relating to installment lending. Specifically, in the 1990 case, violations of discrimination on the basis of race and sex were found involving eight applicants who were black, Hispanic, or female. In the 1992 case violations of discrimination on the basis of race were found; three applicants who were black or hispanic were affected.

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U.S. Department of Justice

Civil Rights Division

Office of the Assistant Attorney General

Washington, DC 20035

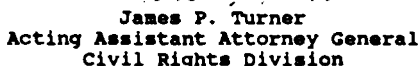
April 5, 1993

Senator Donald W. Riegle, Jr.
Chairman, Committee On Banking,
Housing, and Urban Affairs
Washington, D.C. 20510-6075

Dear Senator Riegle:

This responds to your letter of March 1, 1993, posing questions stemming from my testimony before the Committee on Banking, Housing, and Urban Affairs on February 24, 1993. I appreciated the opportunity to testify before the Committee regarding the very important subject of discrimination in mortgage lending and the efforts of the Department of Justice to combat this problem. Answers to the questions are enclosed. Please let me know if I can be of further assistance.

Sincerely,



James P. Turner
Acting Assistant Attorney General
Civil Rights Division

Enclosure

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RESPONSE TO WRITTEN QUESTIONS FROM SENATOR RIEGLE BY JAMES P. TURNER

Q.1. According to the Boston Fed study, more than 80 percent of mortgage loan applicants—white and black—have imperfect credit records. Both the study and the *Decatur* case suggest that loan officers are treating black applicants less favorably than white applicants. What can be done to detect whether financial institutions are practicing this kind of discrimination?

A.1. Statistical analysis is an important technique that can be used to detect broad patterns of discrimination. If an institution receives a sufficient number of loan applications, including a large number from minority applicants, a technique known as logistic multiple regression analysis can be used. This technique allows investigators to identify which factors—including race—affect loan decisions. We have used this methodology in numerous civil rights cases brought by this Division, most often in the area of employment discrimination, and we see no reason why it cannot be used successfully in future pattern or practice mortgage lending investigations.

It is also important to supplement any statistical analysis with an in-depth review of a sample of similar white and minority loan application files to determine if they have received comparable treatment. This examination can test the validity of the results of the statistical comparisons. It can also yield further evidence of discrimination that may not be detected by the statistical model, such as loan officers counseling white applicants to provide explanations for poor credit or pay off certain consumer debts to enhance their applications, but failing to provide the same assistance to similarly situated black applicants. This level of disparate treatment is often difficult to detect through a logistic multiple regression analysis, which accepts the loan qualification data in the files at face value.

Logistic multiple regression analysis to determine disparate treatment in loan underwriting is frequently less useful in investigations of small banks with few mortgage applications, or lenders who do not attract large numbers of minority applicants. As to the latter, careful examination of the lender's marketing, branching, advertising, and Community Reinvestment Act activities may be required to determine compliance with fair lending laws, particularly if the lender operates in areas with significant minority population. In such situations, it may still be possible to develop a statistical model based on the qualifications of white applicants in the lender's files. The qualifications of the minority applicants can be run through the white model to determine if they are being evaluated under the same standards applied to white applicants.

If a statistical analysis is not possible or feasible, then a painstaking review and analysis of all available files may be necessary to detect a pattern or practice of disparate treatment. We also wish to emphasize that in any investigation of a lender's treatment of white and minority loan applicants, it is always important to review and analyze a large number of loan files. In most cases, lenders will have an alleged justification for every loan they make and a seemingly legitimate explanation for every loan application they reject. The detection of a pattern or practice of unlawful bias in such cases is difficult and requires an intensive analysis of individual loan files.

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We do not, however, suggest that a complex review is required each time a person claims to be a victim of discriminatory lending practices. As we have stated previously to this Committee, if the focus is solely on an individual case of alleged discrimination, it may be easier to compare the alleged victim's treatment with the lender's published standards or even to examine a sampling of files to evaluate disparate treatment. In our view, however, complex and detailed analysis is required in virtually every investigation that is based on the type of racial disparity described by the HMDA data.

Q.2. What kind of coordination exists between the banking regulatory agencies and Justice on fair lending enforcement efforts?

A.2. Beginning in November, 1991, the Department of Justice, following an initiative from the Attorney General, coordinated approximately twelve meetings with the federal financial regulators, both individually and as a group. We have met with representatives of the Federal Reserve Board, Federal Trade Commission, Department of Housing and Urban Development, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, and National Credit Union Administration. Most recently we met with the regulators individually to discuss specific targets for possible pattern or practice investigations, and we have invited the regulators to join us in pursuing those investigations. In response to inquiries from Committee staff, attached is a chronology and copies of correspondence with the regulatory agencies on this initiative.

While we have not yet reached full agreement with these agencies on a coordinated enforcement program, our discussions with them are continuing and we have made some progress, particularly in the area of targeting institutions for possible joint pattern or practice investigations.

Q.3. Do the banking regulators have an agreement with the Justice Department on enforcement procedures and referrals similar to the agreement they have with HUD?

A.3. No. We are continuing to meet with the regulatory agencies to discuss a coordinated enforcement program that we hope will result in the referral of sound, well-investigated cases.

Q.4. How can coordination between the agencies and Justice be improved?

A.4. The regulatory agencies are the frontline of federal enforcement of our nation's fair lending laws. As such, they must be committed to developing sound investigative techniques to detect unlawful lending discrimination, including, where necessary, detailed statistical analysis of underwriting and other lending practices that would support a pattern or practice referral. They must also be committed to providing that information to the Department of Justice for enforcement action. In this way, both the number and the quality of cases that this Department will be able to consider for litigation will be greatly improved. This has been the goal of our meetings with the regulatory agencies and to facilitate that process we have made available our views and experience on developing pattern or practice cases and solicited their advice and input on effective enforcement strategies.

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Q.5. According to the Boston Fed's study, an applicant turned down by a private mortgage insurance company was 600 percent more likely to be turned down for a loan than an applicant who was able to obtain insurance. It is crucial that private mortgage insurers not discriminate in making their decisions about who to insure.

The Mortgage Insurance Companies of America announced yesterday that they will voluntarily provide to the FFIEC the same information that mortgage lenders are required to provide by the Home Mortgage Disclosure Act. What are your views on whether this action will help to promote access to mortgages for minorities and low-income people?

A.5. If private mortgage insurers are engaging in unlawful discrimination, it will have an obvious and direct impact on the ability of mortgage applicants to obtain loans without regard to race or other prohibited characteristics. Thus, the reporting of information on the activities of mortgage insurers may enhance the government's ability to combat mortgage lending discrimination. However, at this point we know very little about the extent to which unlawful discrimination may exist in this industry.

Chronology of Department of Justice Meetings With Federal Financial Regulators

1. 11/12/91—Meeting at Department of Justice with representatives from the Federal Reserve Board (FRB), Federal Trade Commission (FTC), Department of Housing and Urban Development (HUD), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), and National Credit Union Administration (NCUA) to discuss coordinated enforcement effort. Introduction of working group members.
2. 11/26/91—Meeting with same attendees to continue discussions of coordinated enforcement effort.
3. 1/29/92—Meeting with same attendees to continue discussions of coordinated enforcement effort. Discussion of targeting and investigatory strategies. *Decatur Federal* statistical expert Bernard Siskin attended.
4. 6/11/92—Meeting with OCC to discuss two-phase investigatory plan, with initial review of lenders to be followed by in-depth statistical analyses.
5. 6/12/92—Separate meetings with FDIC and FRB to discuss two-phase investigatory plan.
6. 6/16/92—Meeting with OTS to discuss two-phase investigatory plan.
7. 7/15/92—Meeting with all working group members to continue discussions of coordinated enforcement effort. *Decatur Federal* statistical expert Bernard Siskin attended and was questioned in detail on the methodology used in that case.
8. 12/4/92—Meeting with OCC to discuss specific lenders involved in the FRB study of Boston-area lending discrimination.
9. 1/9/93—Meeting with OTS to discuss possible targets for phase one investigations.
10. 2/3/93—Meeting with OCC to discuss possible targets for phase one investigations.

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11. 2/5/93—Meeting with FRB to discuss possible targets for phase one investigations.

12. 2/8/93—Meeting with FDIC to discuss possible targets for phase one investigations.

CORRESPONDENCE BETWEEN DEPARTMENT OF JUSTICE AND FEDERAL FINANCIAL REGULATORY AGENCIES

1. 11/6/91—Letter from John R. Dunne, Assistant Attorney General, Civil Rights Division, Department of Justice (DOJ) to John P. LaWare, Member, Board of Governors, Federal Reserve Board (FRB). Letter with same text sent to David Medine, Acting Associate Director of Credit Practices, Federal Trade Commission (FTC); Gordon Mansfield, Assistant Secretary for Fair Housing & Equal Opportunity, Department of Housing and Urban Development (HUD); John F. Bovenzi, Deputy to the Chairman, Federal Deposit Insurance Corporation (FDIC); Susan F. Krause, Senior Deputy Comptroller for Bank Supervision Policy, Office of the Comptroller of the Currency (OCC); and Jerauld C. Kluckman, Deputy Assistant Director for Policy Specialized Programs, Office of Thrift Supervision (OTS).

2. 11/8/91—Letter from John R. Dunne, DOJ, to Alonzo Swann, Director of Operations, National Credit Union Administration (NCUA).

3. 11/12/91—Letter from Susan F. Krause, OCC, to John R. Dunne, DOJ.

4. 11/14/91—Letter from John P. LaWare, FRB, to John R. Dunne, DOJ.

5. 11/18/91—Letter from John R. Dunne, DOJ, to Alonzo Swann, NCUA. Letter with same text sent to David Medine, FTC; Lea Guarraria, General Deputy Assistant Secretary for Fair Housing and Equal Opportunity, HUD; John F. Bovenzi, Deputy to the Chairman, FDIC; Susan F. Krause, OCC; Jerauld C. Kluckman, OTS; and John P. LaWare, FRB.

6. 12/10/91—Letter from Lawrence Riedman, Fair Lending Specialist, OCC, to Paul Hancock, Chief, Housing and Civil Enforcement Section, Civil Rights Division, DOJ.

7. 1/14/92—Letter from Paul F. Hancock, DOJ, to David Medine, FTC. Letter with same text sent to Lea Guarraia, HUD; John F. Bovenzi, FDIC; Susan F. Krause, OCC; Jerauld C. Kluckman, OTS; Alonzo Swann, NCUA; and John P. LaWare, FRB.

8. 6/25/92—Letter from John R. Dunne, DOJ, to Glenn Loney, Assistant Director, Division of Consumer and Community Affairs, FRB. Letter with same text sent to William Taylor, Chairman, FDIC; Jerauld C. Kluckman, OTS; and Ralph E. Sharpe, Director, Enforcement and Compliance Division, OCC.

9. 7/2/92—Letter from Paul F. Hancock, DOJ, to Griffith L. Garwood, Director, Division of Consumer and Community Affairs, FRB. Letter with same text sent to Larry D. Pearl, Director, Office of Program Standards and Evaluation, HUD; Stephen Cross, Deputy Comptroller for Compliance Management, OCC; Jerauld C. Kluckman, OTS; Janice M. Smith, Director, Office of Consumer Affairs, FDIC; Sandra Wilmore, Staff Attorney, Division of Credit Practices, FTC; and William P. Ryan, Compliance Officer, NCUA.

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10. 9/11/92—Letter from Donald G. Coonley, Acting Senior Deputy Comptroller for Bank Supervision Policy, OCC, to John R. Dunne, DOJ.

11. 9/23/92—Letter from Lawrence B. Lindsey, Member, Board of Governors, FRB, to John R. Dunne, DOJ.

12. 9/24/92—Letter from John Bovenzi, FDIC, to John R. Dunne, DOJ.

13. 10/9/92—Letter from Jonathan L. Fiechter, Deputy Director for Washington Operations, OTS, to John R. Dunne, DOJ.

14. 10/16/92—Letter from John R. Dunne, DOJ, to Lawrence B. Lindsey, FRB.

15. 12/11/92—Letter from Griffith L. Garwood, FRB, to John R. Dunne, DOJ.

16. 12/11/92—Letter from Lawrence B. Lindsey, FRB, to John R. Dunne, DOJ.

17. 12/23/92—Letter from John R. Dunne, DOJ, to Lawrence B. Lindsey, FRB. Carbon copies sent to David Medine, FTC; William McDonough, Vice President and General Counsel, FRB Boston; Alicia Munnell, Senior Vice President and Director of Research, FRB Boston; and Griffith Garwood, FRB.

18. 12/24/92—Letter from John R. Dunne, DOJ, to Griffith L. Garwood, FRB. Carbon copies sent to William McDonough, FRB; David Medine, FTC; and Leonora L. Guarraia, HUD. Letter with same text sent to Janice Smith, Director, Office of Consumer Affairs, FDIC; Timothy Burniston, Deputy Assistant Director for Policy, OTS; David Medine, FTC; and William Ryan, NCUA.

19. 12/30/92—Letter from Paul F. Hancock, DOJ, to Griffith L. Garwood, FRB. Letter with same text sent to Stephen Cross, OCC; Timothy Burniston, OTS; and Janice Smith, FDIC. Carbon copies sent to Lea Guarraia, HUD; David Medine, FTC; and William Ryan, NCUA.

20. 2/4/93—Letter from John F. Robinson, Acting Deputy Director for Washington Operations, OCC, to Lawrence Lindsey, FRB, copy to John R. Dunne, DOJ.

21. 2/18/93—Letter from Susan F. Krause, Senior Deputy Comptroller for Bank Supervision Policy, OCC, to Lawrence Lindsey, FRB, copy to John R. Dunne, DOJ.

22. 2/22/93—Letter from Janice M. Smith, Director of Consumer Affairs, FDIC, to Lawrence Lindsey, FRB, copy to John R. Dunne, DOJ.

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

LAWRENCE B. LINDSEY
MEMBER OF THE BOARD

September 23, 1992

Mr. John R. Dunne
Assistant Attorney General
Civil Rights Division
U.S. Department of Justice
Washington, DC 20530

Dear Mr. Dunne:

I would like to thank you and your staff for all the work they have done in coordinating an effort between the Department of Justice and the financial supervisory agencies to detect and eliminate illegal discrimination in mortgage credit. My staff tells me that your meetings have been most informative and useful. We look forward to working with your agency in the future to do what we can to assure that everyone is given equal treatment in their efforts to secure mortgage credit.

I have been informed that your staff has made a proposal to all of the financial supervisory agencies regarding how we might cooperate toward this end. I have reviewed the letter, dated September 11, 1992, sent to you by Mr. Coonley of the Office of the Comptroller of the Currency (OCC). Rather than try to restate what Mr. Coonley said, I think it is sufficient for me to indicate that we are prepared to cooperate with your agency in the same ways and under the same terms as were stated by the OCC in that letter.

Again, thank you for this opportunity, and I look forward to working with you on this important issue. Should you have any questions or need any further information, please contact me, Griffith Garwood (452-2631) or Glenn Loney (452-3585) of the Board's Division of Consumer and Community Affairs.

Sincerely,

Lawrence B. Lindsey

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Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

September 11, 1992

Mr. John R. Dunne
Assistant Attorney General
Civil Rights Division
U.S. Department of Justice
Washington D.C. 20530

Dear Mr. Dunne:

I wish to thank you and your staff for sponsoring a series of interagency meetings to discuss coordinated efforts to detect and combat acts of illegal discrimination in mortgage lending. We have benefited greatly from the exchange of ideas at those meetings and are prepared to build on those discussions by coordinating activities with you that confront discrimination in mortgage lending and strengthen enforcement of the Fair Housing Act and the Equal Credit Opportunity Act.

As you are aware, our examiners can provide you valuable assistance by conducting fair lending examinations in national banks where you suspect lending discrimination may exist. Our examination authority, detailed in 12 U.S.C. § 481, provides our examiners with access to documents not customarily available to other government agencies, including the Department of Justice (DOJ). The Office of the Comptroller of the Currency (OCC) can compel national banks to open their lending files, board minutes, and other internal documents for examination by national bank examiners. The examiner also has the power to administer oaths and to examine any of the officers, directors, employees, and agents of a national bank under review.

There is no explicit provision in our authorizing statutes, however, to accommodate your proposal that DOJ staff enter and investigate national banks under OCC authority. As set forth in 12 U.S.C. § 481, national bank examiners, assistant examiners, and other persons whose services may be required in connection with the examination of a national bank must be employed by the OCC. Also, 12 U.S.C. § 484(a) provides, in part, that "no national bank shall be subject to any visitorial powers except as authorized by Federal

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law." It is typically inappropriate, therefore, for employees of other federal agencies to accompany OCC examiners or in any way participate in an examination of a national bank.

We are prepared to take steps, however, to assist your department in investigating potential violations of the Fair Housing Act or Equal Credit Opportunity Act by national banks. As you have proposed, you may identify selected national banks and request their voluntary cooperation in permitting DOJ staff to accompany OCC examiners during examinations for compliance with fair lending laws. DOJ participation during those examinations must be agreed to in advance and conform to any conditions or stipulations specified by the targeted bank. We see no reason, however, why the voluntary cooperation that facilitated your investigation in Atlanta should not be forthcoming from targeted national banks as well.

We have also held extensive discussions with your staff to learn more about the information you need for your own investigations. Where appropriate, we will attempt to tailor our examination procedures to assist you in obtaining that information. This could include the collection of data for your use in determining whether to pursue a statistical analysis of the bank's mortgage lending patterns.

Following the initial on-site examination with DOJ staff, OCC examiners may wish, in some instances, to review additional loan files and conduct further interviews with people familiar with the bank's historical practices with respect to minority loan applicants. We will consult you as we develop strategies to interview bank customers, real estate brokers, community leaders, and others familiar with the bank's activities.

If we find indications that illegal discrimination may have occurred, we will immediately consult with your staff to ensure that any actions that we might plan to take are consistent with efforts that are planned or are underway at your agency. Normally, if we were to find evidence of illegal discrimination, we would take enforcement action or request the bank to adept specific corrective measures, as appropriate. We believe that a responsible institution, presented with credible evidence of discrimination, will take whatever reasonable steps the regulator recommends to correct the problem. We note that DOJ has publicly stated its optimism that the resolution of its Atlanta investigation will take that course.

Clearly, we are prepared to proceed with substantial cooperative efforts involving our two agencies. However, we do not believe that the prototype statistical analysis you conducted during your three-year Atlanta investigation and now propose to replicate in other selected lenders -- at a cost to be borne by the OCC of up to $500,000 for each institution analyzed -- offers an efficient or

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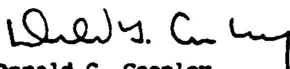
cost-effective approach to enforcement.

We believe that approaches to document differential treatment directly through examinations and investigations should be more fully explored; and we are doing so. Improved examination techniques may be able to identify differential treatment at substantially lower cost than the statistical analysis that you propose. Even in your Atlanta investigation, for example, you were able to obtain persuasive direct evidence that minority applicants received lower levels of service and assistance, after which you conducted statistical tests of the lender's loan files. Taking the lesson from your Atlanta investigation, we would investigate correspondence, notes of phone calls, and annotations on loan documents, among other materials, for evidence of discrimination in the quality of effort exerted by the lender on behalf of an applicant.

We share your concern about illegal mortgage lending discrimination -- wherever and whenever it might occur. Cooperative and coordinated investigations between our two agencies can make us both more effective in detecting and combating lending discrimination. Therefore, I look forward to formalizing the proposals made in this letter in the near future. If, in the meantime, you need further information, please feel free to contact Stephen Cross, Deputy Comptroller for Compliance Management, at 202-874-5216.

Sincerely,



Donald G. Coonley
Acting Senior Deputy Comptroller
for Bank Supervision Policy

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U.S. Department of Justice

Civil Rights Division

Office of the Assistant Attorney General

Washington, D.C. 20035

NOV 6 1991

Honorable John P. Laware
Member, Board of Governors
Federal Reserve Board
Washington, D.C.

Dear Governor Laware:

Thank you for your expressed interest in joining me and other federal lending officials to discuss how we can coordinate our respective responsibilities to confront acts of discrimination in the mortgage lending field.

I want to confirm that we will meet on Tuesday, November 12, 1991 at 2:30 p.m. in the Civil Rights Division Conference Room 5644 at the Justice Building to discuss possible action.

Please feel free to bring members of your staff or other advisors.

Looking forward to meeting you, I am,

Sincerely,

John R. Dunne
Assistant Attorney General
Civil Rights Division

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U.S. Department of Justice

Civil Rights Division

2

Office of the Assistant Attorney General

Washington, D.C. 20035

NOV 8 1991

Mr. Alonzo Swann
Director of Operations
National Credit Union Administration
1776 G Street, N.W.
Washington, DC 20456

Dear Mr. Swann:

Thank you for your expressed interest in joining me and other federal lending officials to discuss how we can coordinate our respective responsibilities to confront acts of discrimination in the mortgage lending field.

I want to confirm that we will meet Tuesday, November 12, 1991 at 2:30 p.m. in the Civil Rights Division Conference Room 5644 at the Justice Building to discuss possible action.

Please feel free to bring members of your staff other than advisors.

Looking forward to meeting you, I am,

Sincerely,

John R. Dunne
Assistant Attorney General
Civil Rights Division

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3

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

November 12, 1991

Mr. John R. Dunne
Assistant Attorney General
Civil Rights Division
Office of the Assistant Attorney General
Washington, D. C. 20035

RECEIVED
CIVIL RIGHTS DIVISION
91 NOV 20 AM 10: 38

Dear Mr. Dunne:

Thank you for inviting the OCC to participate with the Department of Justice and other agencies in an effort to combat mortgage lending discrimination. I think the idea of setting up a working group is an excellent and one we will all be able to benefit from.

The OCC's contact for the group will be Steve Cross, Deputy Comptroller for Compliance Management. Steve can be reached on (202) 874-4867. If I can do anything more to assist the effort, please let me know.

Sincerely,

Susan F. Krause
Senior Deputy Comptroller
for Bank Supervision Policy

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

JOHN P. LAWARE
MEMBER OF THE BOARD

November 14, 1991

RECEIVED
CIVIL RIGHTS DIVISION
91 NOV 19 AM 11:59

The Honorable John R. Dunne
Assistant Attorney General
Civil Rights Division
Department of Justice
Washington, D.C. 20530

Dear John:

I think your idea of coordinating the agencies' fair lending efforts is a very good one, and I appreciate your taking the initiative to bring us together. Our representative to the working group will be Glenn Loney, Assistant Director, Division of Consumer and Community Affairs. Glenn has responsibility for overseeing our examination effort, and has been deeply involved with this issue for some time. I know he will make a valuable contribution to the group.

Sincerely,

John

John P. LaWare

cc: Paul Hancock

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T. 11/18/91

2

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DJ 175-16-0

Mr. Alonzo Swann
Director of Operations
National Credit Union Administration
Rm. 6611
1776 G Street, N.W.
Washington, D.C. 20456

Dear Mr. Swann:

On behalf of the Acting Attorney General, I wish to extend my warm thanks and appreciation for your attendance at our meeting on November 12, 1991, to discuss a coordinated effort to confront acts of discrimination in the mortgage lending field. I found the meeting both informative and constructive. It was very helpful for me and the others members of my staff who attended this meeting to obtain your views on this subject and your agency's regulatory and enforcement responsibilities in this area. We noted your experience in investigating claims of mortgage lending discrimination, and were pleased to obtain your thoughts on what more could be done to address concerns raised by the recent release of data under the Home Mortgage Disclosure Act showing that minority applicants are rejected for home mortgages at much higher rates than white applicants in many cities.

We all agreed at the meeting that it made sense to coordinate our efforts and responsibilities to address this widespread and complex problem, and that we would all benefit from a mutual exchange of ideas and proposals on developing more intensive investigative programs to ensure compliance with the fair lending laws. We also agreed that it would be helpful to schedule further meetings between our staffs to discuss, among other matters, possible approaches to targeting lenders for in depth reviews, the types of records and information to be examined, and procedures for data analysis.

I suggest that the first such meeting be scheduled for November 26, 1991, at 10:00 a.m. in our Housing and Civil Enforcement Section Conference Room 7509. I have asked Paul Hancock, Chief of the Housing Section, to confirm this meeting and to find out who from your agency will be in attendance.

We very much look forward to this next meeting.

Sincerely,

John R. Dunne
Assistant Attorney General
Civil Rights Division

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6

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

BY FACSIMILE TRANSMISSION [FAX 514-1116]

December 10, 1991

Paul Hancock, Esq.
Chief, Housing and Civil Enforcement Section
Civil Rights Division
U.S. Department of Justice
Washington, D.C.

Dear Paul:

This is to confirm our meeting scheduled for December 16, 1991, at 2 p.m. at your office. I anticipate that the information you provide will be valuable for the wide-ranging Compliance Program Review (CPR) now being undertaken by the Compliance Management Department.

The key matters I want to discuss relate to equal credit opportunity. However, the CPR effort embraces the full range of consumer and community lending responsibilities of the Office of the Comptroller of the Currency (OCC), which include enforcement of: Bank Secrecy Act, Real Estate Settlement Procedures Act, Right to Financial Privacy Act, truth-in-savings regulations, Unfair and Deceptive Practices Act, Fair Debt Collection Practices Act, Truth in Lending Act, Expedited Funds Availability Act, consumer leasing regulations, interest-on-deposits regulations, Electronic Fund Transfer Act, and Flood Disaster Protection Act. Additionally, the OCC has responsibilities regarding bank securities operations, trust administration, adjustable rate mortgages, home equity lines of credit, and credit cards. If you have any comparable responsibilities, I would want to discuss those as well.

Our chief interest in talking with other Federal enforcement agencies is to see what lessons may be learned from their approaches and organization. However, we also welcome direct comments on the orientation and organization of the OCC's efforts.

DOCKETE

20 DEC 1991

CIVIL RIGHTS

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The key topics I want to cover about your agency's efforts regarding consumer rights and community lending include:

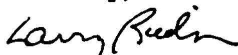
- o position and status of the consumer and community lending function in your agency;
- o internal organization of the consumer and community lending enforcement program;
- o balancing of monitoring, educational, and enforcement activities;
- o staffing levels;
- o staff qualifications, recruitment, and selection;
- o courses, on-the-job training, and career development;
- o career ladders and specialization;
- o staff workloads;
- o movement of staff in and out of the consumer and community lending area;
- o division of responsibility between headquarters and field levels; and
- o changes in progress or contemplated.

We would appreciate having copies of handbooks, training materials, etc., that support your compliance efforts regarding consumer rights and community lending responsibilities.

I have enclosed for your information the form of questionnaire we have used to structure interviews with the other financial regulatory agencies. While the questions are not entirely on point for our meeting, I trust it will add to your understanding of the meeting's objectives.

If you have questions, please call me at (202) 874-5232.

Sincerely,



Lawrence Riedman
Fair Lending Specialist

Enclosure

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INTERVIEW QUESTIONS
FOR OTHER FINANCIAL REGULATORS

Please be as candid as possible in responding to the following questions. Your answers should include, if possible, an assessment of perceived strengths and weaknesses, specific recommendations, and reasons which support your conclusions. Any comments you wish to be held in strict confidence will be, upon your request.

1. What major disciplines are included in your Compliance program? The OCC's program includes BSA and money laundering, consumer including CRA and fair lending, bank dealer, fiduciary, and the consumer complaint process.

2. How is compliance organized within your agency and how is this different from other functional areas of bank supervision? Please provide the following types of information if possible:

   o Organizational charts of agency and compliance program.
   o Identify any segregated oversight responsibilities between the agency's Washington and field management levels.
   o Key management areas such as communication, planning, policy development, internal controls, human resources, MIS support, and other management responsibilities.
   o The priority and level of management support for the compliance area.

3. What is the process you use in hiring/selecting compliance specialists? For example, do you: use written tests? conduct several interviews? look for specific characteristics such as strong communication skills? require writing samples?

4. What is the career ladder for compliance specialists for the five major disciplines (referenced in #1 above) within your organization? What are their responsibilities at each level of the career ladder? What are the requirements/prerequisites for advancement from one level to the next?

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5. What are the workload requirements for compliance specialists? Please provide the following information in connection with your answer.

   - o Annotated organizational charts that include staffing figures;
   - o General data regarding number of banks and asset size you regulate;
   - o General data regarding total examiner FTEs and number of dedicated compliance "specialists" and
   - o Guidelines for determining the frequency of compliance examinations for each institution.

6. What specific training courses/schools, OJT, career development programs, examination tools, materials or job aids do you have for compliance specialists for each of the disciplines noted in #1? Please include the frequency of training, mandatory courses and any prerequisites.

7. Do you require certification for compliance specialists? If so, at what grade, experience and training levels? How do you certify compliance specialists?

8. How does your agency provide opportunities for compliance specialists to move in and out of the compliance specialty area within the agency?

9. What are the pros and cons in having a compliance specialty? Are you planning any changes to your current organization of the compliance program?

   - o In response/anticipation of congressional initiatives?
   - o To improve efficiency and effectiveness?
   - o In response to internal reviews of your compliance program?

10. What are the pitfalls to organizing and structuring a compliance program?

11. How does your workforce perceive compliance examiners versus commercial examiners?

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JRD:PFH:RJR:gtb JAN 14 1992

Mr. David Medine
Acting Associate Director
for Credit Practices
Federal Trade Commission
Rm. 4037
6th and Pennsylvania, N.W.
Washington, D.C.

Dear Mr. Medine:

This is to confirm the next meeting of the inter-agency working group on mortgage lending discrimination from 10:00 a.m.-12:00 p.m. on January 29, 1992, in our Civil Rights Division Conference Room, Room 5644.

At this meeting, we hope each agency will provide its views on the possible targeting of lenders for in-depth compliance examinations under the Fair Housing Act and Equal Credit Opportunity Act, and the types of investigative analyses that might be undertaken. Our expert in the Atlanta investigation, Dr. Bernard Siskin, who attended the last meeting, will also attend this meeting.

Sincerely,

John R. Dunne
Assistant Attorney General
Civil Rights Division

By:

Paul F. Hancock
Chief
Housing and Civil Enforcement Section

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Mr. Glenn Loney
Assistant Director
Division of Consumer and Community Affairs
Federal Reserve Board
20th and C Street, N.W.
Washington, D.C. 20551

Dear Mr. Loney:

Thank you and Glenn Canner for meeting with members of my staff on June 12th to discuss a joint program to investigate possible patterns or practices of mortgage lending discrimination against minority loan applicants in various cities throughout the country. We believe that such a program, which will bring together the expertise of fair lending compliance examiners in your agency and our staff who have investigative experience in this area, is vital to a sound, effective, and coordinated effort to combat discrimination in mortgage lending. As you know, last November the Attorney General asked that we meet to develop such a program, and the several meetings that have been held since then have been directed toward this goal. This letter will recapitulate the proposal we outlined to you at the June 12th meeting.

This Division is in the process of targeting specific mortgage lending institutions in a number of major cities for possible pattern or practice investigations under the Fair Housing Act and Equal Credit Opportunity Act. Our targeting is based on the 1990 Home Mortgage Disclosure Act data which shows applicant acceptance and rejection rates by race and national origin for specific institutions. The lenders we are targeting rejected minority (black and Hispanic) mortgage applicants at significantly higher rates than white applicants, and they each appear to have a sufficient number of white and minority applicants so that we can conduct a statistical analysis of the lender's underwriting decisions similar to the one we conducted in our mortgage lending investigation in Atlanta, Georgia. The details of our targeting method were explained to you at the meeting. Also, as our staff emphasized at that meeting, if there are other lenders that your agency has targeted for pattern or practice investigations, we would welcome your suggestions and input on whether those institutions should be included in our joint investigative program.

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Our goal is to narrow the list of tentatively targeted lenders to one or more institutions at which we could conduct the type of intensive, full-scale investigation we recently conducted in Atlanta. To identify those lenders, we envision an initial review of the targeted lenders that would include an on-site inspection and possible copying of selected loan application files (perhaps no more than 100 such files), interviews with bank officials on underwriting and loan origination practices, an overview of the lender's marketing, advertising, and branching activities, and a review of minutes of governing board meetings and the lender's Community Reinvestment Act file. At least one attorney and possibly one paralegal from our staff would participate in this initial on-site review together with representatives of your agency. We also expect to have the expert we used in our Atlanta investigation accompany us on these visits to assist us in determining whether a full-phase analysis of the loan application files is likely to yield meaningful results.

Based upon the initial review, we would, if warranted, focus our investigation upon those lenders (perhaps no more than one or two) with the most troublesome indications of non-compliance with fair lending laws. These lenders would be targeted for the type of intensive investigation we conducted in Atlanta. That investigation would entail a more extensive review and copying of the lender's application files for a period of at least two years (either all applications or a sample, depending on volume), include applications for conventional purchase money mortgages and refinances, and FHA and VA loans, and the reduction of information from these files into a database. The experts retained to work on this project would analyze this database to determine whether race or ethnicity was a factor in the lender's decisionmaking process. The investigation would also include a more thorough examination into the other areas mentioned above (marketing, advertising, etc.), as well as field interviews of real estate agents, builders, and other market participants to gain an understanding of current and historical practices relevant to the lender's efforts to attract minority loan applicants.

We propose that the costs of both the initial reviews and any full-phase investigations be borne primarily by your agency and the lender involved. We believe this makes sense in view of the shared enforcement responsibility between your agency and the Department of Justice. I would hasten to add, nevertheless, that the Department of Justice would bear all costs in any litigation brought by it based upon the findings of the joint investigation, and these costs are often considerable in complex litigation.

The precise cost of any investigation to your agency would depend, of course, on the volume of applications to be copied and reviewed. We would ask that your agency cover the costs of the statistical analysis, including data input, the experts' fees,

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and copying costs if the lender refuses to bear such costs. The Department of Justice would bear the costs attributable to development of non-statistical evidence, such as the field interviews and reviews of governing-board minutes.

Because of the wide-spread attention that has recently been given to the problem of mortgage lending discrimination, particularly in the aftermath of the recent disturbances in Los Angeles, we must move expeditiously toward an agreement on a joint investigative program. We hope that once such an agreement is reached, we could begin our initial reviews of targeted lenders by late summer. I understand that it may be necessary for you to discuss our proposal with other officials of your agency, but I still hope for an early commitment from your agency so that we can get this important work underway as quickly as possible. Please feel free to contact Paul Hancock, at 202-514-4713, as needed for further information.

Sincerely,

John R. Dunne
Assistant Attorney General
Civil Rights Division

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(9)

Mr. Griffith L. Garwood
Director
Division of Consumer and Community Affairs
Federal Reserve Board
20th and C Street, N.W.
Washington, D.C. 20551

Dear Mr. Garwood:

We would like to schedule a meeting with representatives of the federal financial regulatory agencies, HUD, and the FTC on July 15 at 10 a.m. in our offices, to continue our discussions on a coordinated, industry-wide investigative program on mortgage lending discrimination set forth in our June 25 letter to your agency. We have met with representatives of all of the financial regulators individually, and would like to provide everyone together an opportunity to discuss this program further. Dr. Siskin, the expert in our Atlanta investigation, will attend this meeting to explain the statistical methodology we used in that investigation and to answer questions both about our current investigation in Atlanta and plans for future investigations. Please call me at (202) 514-4713 if there is a conflict with this time.

Sincerely,

John R. Dunne
Assistant Attorney General
Civil Rights Division

By:

Paul F. Hancock
Chief
Housing and Civil Enforcement Section

cc: Chrono Hancock Senger T.File

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Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

September 11, 1992

Mr. John R. Dunne
Assistant Attorney General
Civil Rights Division
U.S. Department of Justice
Washington D.C. 20530

Dear Mr. Dunne:

I wish to thank you and your staff for sponsoring a series of interagency meetings to discuss coordinated efforts to detect and combat acts of illegal discrimination in mortgage lending. We have benefited greatly from the exchange of ideas at those meetings and are prepared to build on those discussions by coordinating activities with you that confront discrimination in mortgage lending and strengthen enforcement of the Fair Housing Act and the Equal Credit Opportunity Act.

As you are aware, our examiners can provide you valuable assistance by conducting fair lending examinations in national banks where you suspect lending discrimination may exist. Our examination authority, detailed in 12 U.S.C. § 481, provides our examiners with access to documents not customarily available to other government agencies, including the Department of Justice (DOJ). The Office of the Comptroller of the Currency (OCC) can compel national banks to open their lending files, board minutes, and other internal documents for examination by national bank examiners. The examiner also has the power to administer oaths and to examine any of the officers, directors, employees, and agents of a national bank under review.

There is no explicit provision in our authorizing statutes, however, to accommodate your proposal that DOJ staff enter and investigate national banks under OCC authority. As set forth in 12 U.S.C. § 481, national bank examiners, assistant examiners, and other persons whose services may be required in connection with the examination of a national bank must be employed by the OCC. Also, 12 U.S.C. § 484(a) provides, in part, that "no national bank shall be subject to any visitorial powers except as authorized by Federal

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law." It is typically inappropriate, therefore, for employees of other federal agencies to accompany OCC examiners or in any way participate in an examination of a national bank.

We are prepared to take steps, however, to assist your department in investigating potential violations of the Fair Housing Act or Equal Credit Opportunity Act by national banks. As you have proposed, you may identify selected national banks and request their voluntary cooperation in permitting DOJ staff to accompany OCC examiners during examinations for compliance with fair lending laws. DOJ participation during those examinations must be agreed to in advance and conform to any conditions or stipulations specified by the targeted bank. We see no reason, however, why the voluntary cooperation that facilitated your investigation in Atlanta should not be forthcoming from targeted national banks as well.

We have also held extensive discussions with your staff to learn more about the information you need for your own investigations. Where appropriate, we will attempt to tailor our examination procedures to assist you in obtaining that information. This could include the collection of data for your use in determining whether to pursue a statistical analysis of the bank's mortgage lending patterns.

Following the initial on-site examination with DOJ staff, OCC examiners may wish, in some instances, to review additional loan files and conduct further interviews with people familiar with the bank's historical practices with respect to minority loan applicants. We will consult you as we develop strategies to interview bank customers, real estate brokers, community leaders, and others familiar with the bank's activities.

If we find indications that illegal discrimination may have occurred, we will immediately consult with your staff to ensure that any actions that we might plan to take are consistent with efforts that are planned or are underway at your agency. Normally, if we were to find evidence of illegal discrimination, we would take enforcement action or request the bank to adopt specific corrective measures, as appropriate. We believe that a responsible institution, presented with credible evidence of discrimination, will take whatever reasonable steps the regulator recommends to correct the problem. We note that DOJ has publicly stated its optimism that the resolution of its Atlanta investigation will take that course.

Clearly, we are prepared to proceed with substantial cooperative efforts involving our two agencies. However, we do not believe that the prototype statistical analysis you conducted during your three-year Atlanta investigation and now propose to replicate in other selected lenders -- at a cost to be borne by the OCC of up to $500,000 for each institution analyzed -- offers an efficient or

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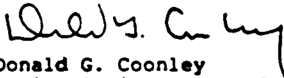
cost-effective approach to enforcement.

We believe that approaches to document differential treatment directly through examinations and investigations should be more fully explored; and we are doing so. Improved examination techniques may be able to identify differential treatment at substantially lower cost than the statistical analysis that you propose. Even in your Atlanta investigation, for example, you were able to obtain persuasive direct evidence that minority applicants received lower levels of service and assistance, after which you conducted statistical tests of the lender's loan files. Taking the lesson from your Atlanta investigation, we would investigate correspondence, notes of phone calls, and annotations on loan documents, among other materials, for evidence of discrimination in the quality of effort exerted by the lender on behalf of an applicant.

We share your concern about illegal mortgage lending discrimination -- wherever and whenever it might occur. Cooperative and coordinated investigations between our two agencies can make us both more effective in detecting and combating lending discrimination. Therefore, I look forward to formalizing the proposals made in this letter in the near future. If, in the meantime, you need further information, please feel free to contact Stephen Cross, Deputy Comptroller for Compliance Management, at 202-874-5216.

Sincerely,



Donald G. Coonley
Acting Senior Deputy Comptroller
for Bank Supervision Policy

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

LAWRENCE B. LINDSEY
MEMBER OF THE BOARD

September 23, 1992

Mr. John R. Dunne
Assistant Attorney General
Civil Rights Division
U.S. Department of Justice
Washington, DC 20530

Dear Mr. Dunne:

I would like to thank you and your staff for all the work they have done in coordinating an effort between the Department of Justice and the financial supervisory agencies to detect and eliminate illegal discrimination in mortgage credit. My staff tells me that your meetings have been most informative and useful. We look forward to working with your agency in the future to do what we can to assure that everyone is given equal treatment in their efforts to secure mortgage credit.

I have been informed that your staff has made a proposal to all of the financial supervisory agencies regarding how we might cooperate toward this end. I have reviewed the letter, dated September 11, 1992, sent to you by Mr. Coonley of the Office of the Comptroller of the Currency (OCC). Rather than try to restate what Mr. Coonley said, I think it is sufficient for me to indicate that we are prepared to cooperate with your agency in the same ways and under the same terms as were stated by the OCC in that letter.

Again, thank you for this opportunity, and I look forward to working with you on this important issue. Should you have any questions or need any further information, please contact me, Griffith Garwood (452-2631) or Glenn Loney (452-3585) of the Board's Division of Consumer and Community Affairs.

Sincerely,

Lawrence B. Lindsey

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FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF THE CHAIRMAN

September 24, 1992

(12)

Mr. John R. Dunne
Assistant Attorney General
Civil Rights Division
U.S. Department of Justice
Washington, D.C. 20530

Dear Mr. Dunne:

We wish to thank you and your staff for sponsoring a series of interagency meetings to discuss coordinated efforts to detect and combat acts of illegal discrimination in mortgage lending. We have benefited greatly from the exchange of ideas at those meetings and are prepared to build on those discussions by coordinating with you activities designed to detect acts of discrimination in mortgage lending and strengthen enforcement of the Fair Housing Act and the Equal Credit Opportunity Act.

We are most interested in reaching an agreement with the DOJ regarding how, and in what circumstances, we could cooperate in investigating possible lending discrimination since the Equal Credit Opportunity Act requires the FDIC, in certain circumstances, to refer to the DOJ instances of apparent discrimination that we find. Consequently, it would serve both of our agencies' best interests to develop a clear understanding of what can be expected by way of cooperative efforts and what results will be of interest to you for further investigation under your own authority and responsibilities. Nonetheless, there are some aspects of the proposals that have been put forward by your staff during the series of meetings that, for various reasons, we are unable to accommodate.

We may provide information obtained in the course of an examination to others in accordance with applicable laws and regulations. Normally, it would be inappropriate, however, for employees of other federal agencies, including the DOJ, to accompany our examiners or in any way participate in an examination. Despite this limitation, we are prepared to take steps, consistent with our responsibilities under the relevant law, to assist your department in investigating potential violations of the Fair Housing Act or Equal Credit Opportunity Act by the institutions we supervise.

As proposed, if the DOJ requests, and receives, the voluntary consent of selected institutions to do so, DOJ staff or other persons designated by, and acting on behalf of, the DOJ will be permitted to accompany our examiners during an examination for compliance with fair lending laws. Our staff will be pleased to work with yours to select which institutions the DOJ should approach for this consent and to arrange our examination schedule to conduct a fair lending examination of the selected institution. We would like to emphasize, however, that participation by the DOJ, and others acting on behalf of the DOJ, in these examinations within the institution must be limited to those institutions for which the DOJ has received permission in advance.

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We have participated in discussions with the DOJ staff to learn more about the information you need for your own investigations, and hope to hold more such discussions. Whenever possible, we will do whatever is feasible in our examination activities to assist the DOJ in obtaining the information you need for your own investigation, whether or not the DOJ is granted permission by the institution to accompany our examiners. Consequently, should you be denied permission to accompany our examiners into a particular institution, we would still be willing to work with your staff to make our investigation useful to the DOJ as well as to ourselves, consistent with our regulations. This could include the collection of limited data for your use in an institution's mortgage lending patterns.

We will inform the DOJ of any follow-up activities or actions that we plan with regard to an institution. In some instances, we may wish to review additional loan files and conduct more extensive interviews with bank customers or others familiar with the institution's historical practices with respect to minority loan applicants. We will also investigate correspondence, notes of telephone calls by lending and other relevant personnel, and annotations on loan documents because we believe that discrimination may involve the quality of effort exerted by the lender on behalf of an applicant.

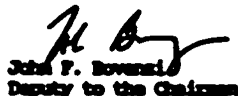
If, through our examinations, we find indications of illegal discrimination, we will inform the DOJ of that fact, whether or not the institution involved has been jointly targeted for review. However, we have our own responsibilities to take enforcement actions or request the institution to take specific corrective measures, as appropriate, which we would continue to do. We would, of course, plan to consult with DOJ staff to ensure that any actions that we might plan to take are consistent with enforcement efforts underway at the DOJ. We believe that a responsible institution, presented with credible evidence of discrimination, would take whatever reasonable steps the regulator recommends to correct the problem.

Clearly, we are prepared to proceed with cooperative efforts involving our two agencies. However, we do not believe that the prototype statistical analysis the DOJ conducted during the Atlanta investigation, and now proposes to replicate in other selected lenders under our primary supervisory jurisdiction — at an estimated cost to the FDIC of up to $500,000 per institution — is an efficient or cost-effective approach to our enforcement responsibilities.

The decision to employ a particular consultant and use a specific statistical methodology is the DOJ's. If the DOJ were to decide that the type of intensive investigation conducted in Atlanta is warranted in a particular institution, we would share our own examination findings, to the extent permissible by law and regulation, and assist in any way possible in your dealing with the institution. We would also facilitate, if possible, the DOJ's access to the institution's data necessary for such an analysis.

The FDIC shares your concerns about illegal mortgage lending discrimination, wherever and whenever it might occur. Cooperative and coordinated investigations between our agencies can make us both more effective in detecting and combating lending discrimination. Therefore, we look forward to formalizing the proposals made in this letter in the near future. If, in the meantime, you need further information, please feel free to contact Janice M. Smith, Director, Office of Consumer Affairs, at (202) 898-6777.

Sincerely,



John F. Bovenzi
Deputy to the Chairman

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Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6590

Jonathan L. Fiechter
Deputy Director
Washington Operations

(13)

October 9, 1992

Mr. John R. Dunne
Assistant Attorney General
Civil Rights Division
U.S. Department of Justice
Washington, D.C. 20530

Dear Mr. Dunne:

Thank you for your letter of June 25, 1992, proposing a joint program between OTS and the Department of Justice (DOJ) to investigate possible patterns and practices of mortgage lending discrimination in savings associations. Since the receipt of your letter, we have had several extensive discussions with your staff about the proposal, its methodology, its costs, and possible alternatives. We have also discussed the proposal internally.

To summarize your proposal, DOJ and OTS would jointly target several savings associations for review. Home Mortgage Disclosure Act data would serve as the primary selection criteria. Each targeted association would receive an initial review, consisting of an on-site investigation by a team comprised of DOJ and OTS representatives. DOJ's participation is contingent upon the approval of the savings association. Your part of the team would include the outside consultant whom you used in your Atlanta investigation. The outside consultant would assist the team in determining whether a full-phase analysis should be be pursued. This determination would be made after a review of selected loan application files, interviews with the association's management on underwriting and loan origination practices, marketing, advertising, and branching activities, among other things.

If warranted by the initial review, the full-phase analysis would entail an exhaustive statistical study as well as an extensive examination of lending practices and comprehensive interviews with real estate agents, builders, and other housing market participants. The full-phase review would be conducted in no more than one or two of the targeted lenders.

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Under your proposal, DOJ would bear some of the costs for the development of non-statistical evidence such as the field interviews and reviews of the lender's policies and practices, and the costs for litigation expenses. In addition to the costs to OTS relating to our participation in the review, you propose that OTS fund the costs associated with any statistical analysis. Although not stated in your letter, your staff has estimated that the cost for the statistical analysis could be as high as $400,000 per investigation, depending on the volume of loan applications.

For the reasons explained later in this letter, we are not able to fully accommodate your proposal. We are prepared, however, to offer an alternative. We realize there is great benefit in our agencies working together on this most sensitive issue. Moreover, we have a firm commitment to enforcing the fair lending laws. We propose a more collaborative effort involving a joint investigation (where the savings association permits) that, we believe, more reasonably allocates resources between agencies, is based more heavily upon our respective strengths, and more closely carries out the somewhat differing missions of our agencies regarding credit discrimination. Our proposal places more of the examination burden on us and draws on DOJ's expertise for guidance, but leaves the responsibility of when to do a statistical analysis, and the funding of that analysis, with DOJ. Even when the savings association will not agree to DOJ involvement in the examination, we can expand our examination process on targeted institutions to provide a more in-depth analysis of the institution's practices. Specifically, we are prepared to:

- Assist in the identification of targeted institutions. We have experience in interpreting lending statistics and examining disparities in the context of an institution's underwriting criteria and loan policies. We have conducted targeted examinations of institutions using lending disparities as a basis for selection. From that exercise, we learned that simply targeting institutions with wide lending disparities may not be the most effective use of resources. Furthermore, field examiner input into the selection process would provide greater assurance that the best targets are identified.

- Expand our review of loan application files and where DOJ is on-site during the review, they could review those loan files. If the institution does not permit DOJ participation, we can easily expand our procedures to review a greater number of loan application files, focusing on the marginal applicants, in

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Mr. John R. Dunne
Page three

targeted institutions. In the event that we find a referral to DOJ would be appropriate, this expanded review would help determine whether a full-scale statistical analysis should be undertaken. We can also photocopy loan application files for marginal rejected and approved applicants and provide them to DOJ as part of our referral. We would expect DOJ to handle any Right to Financial Privacy Act matters that might arise.

- Expand our contact with loan applicants. In connection with any compliance examination, our examiners routinely hold detailed discussions with an institution's senior management, loan officers, compliance officer, loan processors, and underwriters. The purpose of these discussions is to probe the way in which applicants are treated and how they are evaluated against the institution's policies. We are prepared to go outside the institution to interview actual loan applicants for the purpose of comparing their experiences to the process described by the institution. Our interviews would focus on marginal applicants and include individuals who were rejected and individuals who were approved. We are also prepared to physically observe the loan application process with actual customers.

- Expand our contact with community representatives and market participants. As part of our CRA review, we conduct interviews with members of various interest groups, community organizations, and local government officials. These interviews help the examiner gain a balanced perspective about the way local financial institutions are perceived by the public. These interviews can be expanded to include minority real estate agents and brokers, builders, developers, and appraisers.

- Expand our examination of internal practices. We can expand our review of an institution's marketing efforts to minorities, review branch office locations with an emphasis on historical trends in opening and closing branches, analyze board and management meeting minutes for evidence of discriminatory mindset, and determine minority representation in key lending positions, such as account executive, loan officer, underwriter, or appraiser. We can also identify delinquency and charge-off rates for loans to minority and nonminority applicants, and the degree to which originated loans are held in portfolio.

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Mr. John R. Dunne
Page four

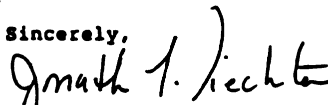
- o Should the results of our expanded loan application review and the findings from the expanded interview base indicate that race may be a factor in loan decisions, we will make an immediate referral to DOJ, complete with all examination workpapers and findings, where DOJ is not participating in the review.

- o Pursue enforcement actions. For example, if we identify any discrimination, we would pursue a formal enforcement action and seek corrective action of any policies or practices that contributed to the discrimination.

Our funding of the statistical analysis would seriously impair our ability to pursue other ongoing enforcement, supervisory, and examination initiatives. We are convinced that our routine examination presence in savings associations has a significant deterrent value that may explain why instances of overt discrimination are not found. We believe that continuing our compliance examination programs and having an on-site presence in a large number of institutions every year is the most cost-effective method of assuring compliance. Diverting a large sum of our scarce resources away from the examination program would be counterproductive. We currently have about 100 examiners who conduct about 800 compliance examinations per year. These examinations cover all the fair lending laws and regulations, in addition to other consumer protection matters.

We believe our proposal more appropriately allocates costs and takes advantage of areas where we can be of significant help to DOJ. We would be interested in implementing this approach and look forward to hearing from you.

Sincerely,



Jonathan L. Fiechter
Deputy Director for
Washington Operations

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DJ 175-36-0

OCT 16 1992

(14)

The Honorable Lawrence B. Lindsey
Member, Board of Governors
Federal Reserve Board
Rm 2022
20th and Constitution Ave. N.W.
Washington, D.C. 20551

Dear Mr. Lindsey:

We have reviewed with interest the study released by the Federal Reserve Bank of Boston on October 8, 1992, showing that black and Hispanic applicants for home mortgage loans in the Boston area are roughly 60 percent more likely to be rejected for mortgage loans than white applicants. Significantly, these disparities were found to exist even after controlling for all possible differences in applicant characteristics other than race, such as differences in credit, debt levels, employment records, and other standard underwriting criteria.

We applaud the Federal Reserve Bank of Boston for this ground-breaking study and believe it will materially assist our mutual efforts to combat discrimination in mortgage lending, a task to which we, as enforcers of our nation's fair lending laws, are deeply committed. As you know, we have held a series of interagency meetings designed to coordinate our efforts to target mortgage lenders who may be engaging in systemic discrimination in their lending practices. At these meetings we have shared with representatives from your agency and the other financial regulatory agencies our statistical analysis that led to the filing last month of our mortgage lending discrimination lawsuit against Decatur Federal Savings and Loan Association in Atlanta, Georgia. The computer tapes underlying the Boston study may contain statistical data on lenders who participated in the study that would be useful for our targeting program. In addition, analysis of those tapes may help us refine the statistical techniques developed during our Decatur Federal investigation. Accordingly, we would like your office or the Federal Reserve Bank of Boston to provide us with copies of those tapes and relevant support documentation. In this regard, I have asked Paul Hancock, Chief of the Housing and Civil Enforcement Section, to call on you or a designated member of your staff within the next 10 days to discuss arrangements for obtaining this

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information. Of course, if you would like to discuss this matter with me, please call on me at 202-514-2151.

We appreciate the efforts of your agency to work with us to develop an effective fair-lending enforcement strategy and look forward to further meetings and discussions on thia very important initiative.

Sincerely,

John R. Dunne
Assistant Attorney General
Civil Rights Division

cc: Records Chrono Hancock Ritter Zeleke McDowney

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

(15)

DIVISION OF CONSUMER
AND COMMUNITY AFFAIRS

December 11, 1992

Mr. John R. Dunne
Assistant Attorney General
Department of Justice
Civil Rights Division
Washington, D.C. 20530

Dear Mr. Dunne:

In connection with the study of mortgage lending data submitted under the Home Mortgage Disclosure Act by the Federal Reserve Bank of Boston of which you are aware, the Federal Reserve Bank undertook a separate analysis of the data related to Shawmut Mortgage Company, a subsidiary of Shawmut National Corporation. This analysis was done as one of the tests of the model. This analysis indicated that for Shawmut Mortgage Company the effect of race was large and statistically significant regardless of the other variables included. We have not, however, examined the individual files underlying this data. Whether or not there were legitimate reasons for the results of the statistical analysis can probably only be firmly established by a loan-by-loan review of the documentation.

These data have been considered in the light of the provision in the Equal Credit Opportunity Act relating to referrals to the Department of Justice (15 U.S.C. section 1691e). Under that statute, agencies are directed to refer matters to the Attorney General whenever the agency has reason to believe that a creditor has engaged in a pattern or practice of denying applications for credit based upon prohibited factors. While the application of the statistical Boston model, by itself, does not necessarily "prove" discrimination, the results of this test are sufficient in the Board's view to require referral of this matter to the Department of Justice for further investigation. We are also bringing the matter to the attention of the Federal Trade Commission, Shawmut Mortgage Company's primary regulator for compliance with the Act.

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John R. Dunne
December 11, 1992
Page 2

Individual customer data supporting this referral may be transferred to the Department only in accordance with provisions of the Right to Financial Privacy Act, 12 U.S.C §§3401 *et seq*. and the Privacy Act, 5 U.S.C. §552a. It appears that transfer of this information for purposes of the RFPA is permitted under 12 U.S.C. §3413(h)(4). With regard to the Privacy Act, however, it appears that a specific request from your office under 5 U.S.C. §552a(b)(7) would be required. We understand that the Attorney General has delegated the authority to make requests under this provision.

We suggest that you contact Alicia H. Munnell, Senior Vice President and Director of Research at the Federal Reserve Bank of Boston, Boston, Massachusetts, 02106, (617/973-3388) with regard to the data in question.

Very truly yours,

Griffith L. Garwood
Director

cc: Alicia Munnell--FRB, Boston

William McDonough
Vice President and General Counsel
Federal Reserve Bank of Boston

David Medine, Associate Director
Division of Credit Practices
Federal Trade Commission

Leonora L. Guarraia
General Deputy Assistant Secretary for
Fair Housing and Equal Opportunity
U.S. Dept. of Housing & Urban Development

Raymond A. Guenter
General Counsel and Secretary
Shawmut National Corporation

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

LAWRENCE B. LINDSEY
MEMBER OF THE BOARD

December 11, 1992

Mr. John R. Dunne
Assistant Attorney General
Department of Justice
Civil Rights Division
Washington, D.C. 20530

Dear Mr. Dunne:

The Board has considered your request of October 16, that it provide you with the computer tapes and relevant supporting documentation with regard to the study of mortgage lending data by the Federal Reserve Bank of Boston. We are pleased to cooperate with the efforts being undertaken by the Department of Justice and various supervisory agencies to deal with concerns about discrimination in mortgage lending.

As you may know, the institutions that participated in the study by the Boston Federal Reserve Bank were asked to do so voluntarily in order to facilitate the collection and analysis of the data to support this very important project. With regard to release of information, the institutions were told that "the Federal Reserve Bank of Boston will make summary, aggregate information available to the public" and that "the detailed data submitted by your institution will be supplied only to your primary regulator upon the regulator's request."

In order to both respond to your needs, and keep faith with our commitment to the survey participants, the Board will provide the data with regard to individual institutions to their primary regulators immediately upon the regulator's request. You should, therefore, contact them directly about the availability of the data. Should all of these regulators request the data, and in doing so authorize its release by us as their agent, we would be pleased to provide you with the complete dataset for all institutions.

As you know there are some technical matters that would need to be dealt with, for example, application of the Right To Financial Privacy and Privacy Acts, but we are confident that these matters can be resolved in a satisfactory manner.

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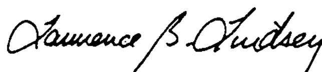
Mr. John R. Dunne
Page 2
December 11, 1992

The primary regulators with regard to the various categories of institutions are as follows: national banks, Office of the Comptroller of the Currency; state chartered insured banks that are not members of the Federal Reserve System, Federal Deposit Insurance Corporation; federal credit unions, the National Credit Union Administration; savings institutions insured under the Savings Insurance Fund of the FDIC and federally chartered savings banks insured under the Bank Insurance Fund, Office of Thrift Supervision; mortgage companies and other institutions not otherwise supervised, Department of Housing and Urban Development and/or The Federal Trade Commission. The Federal Reserve is the primary regulator for state chartered banks that are members of the Federal Reserve System, but no such institutions participated in the study.

Questions about this matter should be directed to Griffith L. Garwood, Director of the Division of Consumer and Community Affairs, (452-2631.)

Sincerely



Lawrence B. Lindsey

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DJ 175-36-5

DEC 23 1992

(17)

Lawrence B. Lindsey
Member of the Board
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Dear Governor Lindsey:

I am writing in response to your letter of December 11, 1992, concerning the detailed data supplied to the Federal Reserve Bank of Boston by lenders participating in its study of discrimination in home mortgage lending in the Boston area.

In your letter you set forth the procedures this department must take in order to obtain a complete set of the data submitted by the lenders for the study. I have enclosed a copy of the letter I am sending in response to your request to those agencies that regulate various of the study participants but that do not have custody of the data in question. The enclosed letter also makes reference (without naming the lender) to your agency's referral to the Department of Justice for investigation of a possible pattern or practice of mortgage lending discrimination by the Shawmut Mortgage Company, one of the largest participants in the Boston study. I am making this separate request to your agency in its role as regulator of some of the lenders involved in the study, custodian of the data, and as the regulator making the referral of a possible pattern or practice case.

For the reasons set forth in my letter to the other regulators, I believe that it is necessary for the Department of Justice to have access to the complete set of data used in the study. Therefore, I request that when the Federal Reserve Board has received the requests for release and authorization from the other agencies involved, it release the entire dataset to this department in order that our investigation into lending in the Boston area in general, and the Shawmut Mortgage Company in particular, may proceed. I ask that you forward the data pertaining to Shawmut as soon as possible. We intend to use that

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information standing alone, even if not all of the other regulators agree to make the request necessary for release of the data pertaining to the lenders they regulate.

I make this request pursuant to Section 552a(b)7 of the Privacy Act under the authority delegated to me by 28 C.F.R. §16.40(b). As described above and in the attached letter, the Department of Justice intends to use the requested data to investigate mortgage lending practices that may be in violation of Title VIII of the Civil Rights Act of 1968 or the Equal Credit Opportunity Act.

Sincerely,

John R. Dunne
Assistant Attorney General
Civil Rights Division

Enclosure

cc: David Medine
William McDonough
Alicia Munnell
Griffith Garwood

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JRD:PFH:RJR:tsj
DJ 188-36-5

DEC 24 1992

(18)

Griffith L. Garwood
Director
Division of Consumer Affairs
Federal Reserve Board
Washington, D.C. 20551

Dear Mr. Garwood:

Thank you for your letter of December 11, 1992, referring for investigation the matter involving the Shawmut Mortgage Company's lending practices in the Boston area. Since your referral arose from the information developed in the recent study by the Federal Reserve Bank of Boston on mortgage lending discrimination, I have enclosed a copy of a letter I am sending on the subject to Governor Lindsey and another letter that I am sending to the other agencies that regulate lenders that supplied data for the study.

In the letters to the other agencies I have made reference to your referral of the Shawmut matter and our desire to obtain the entire set of data supplied by the lenders in the study so that we may place the Shawmut data in context. In my letter to Governor Lindsey, I ask that the data as it pertains to Shawmut be forwarded as soon as possible without waiting for the authorizations necessary for us to obtain the entire dataset from the Boston study. I am writing separately to you to request additional information concerning Shawmut.

Your letter of referral mentions that the Federal Reserve Bank conducted a separate analysis of the data related to Shawmut as one of the tests of the model used in the Boston study. We would appreciate your sending us a copy of this analysis and its supporting data, as well as any information you have concerning the lender's stated mortgage underwriting standards. In addition we would like to have for our files copies of any examination reports, analyses, or related documents that deal with Shawmut's equal lending or Community Reinvestment Act compliance. We have

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already obtained from your office its standard set of HMDA and Census tract statistical analyses, for both Shawmut and its parent bank, that are supplied to the public at the designated HMDA data repositories. However, if the Federal Reserve Bank of Boston has conducted any special studies of Shawmut using the HMDA or Census data, we would like to have those also.

I understand from your letter that once you have made the decisions concerning our requests for additional information, we are to obtain any material you agree to release from Alice Munnell, Senior Vice President and Director of Research for the Federal Reserve Bank of Boston. Please communicate your decision to Paul Hancock (202/514-4715), Chief of this Division's Housing and Civil Enforcement Section, so that his staff may proceed with its investigation of the referral.

Sincerely,

John R. Dunne
Assistant Attorney General
Civil Rights Division

Enclosure

cc: William McDonough
David Medine
Leonora L. Guarraia

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U.S. Department of Justice

Civil Rights Division

PFH:RJR:gtb

Housing and Civil Enforcement Section
P.O. Box 65998
Washington, D.C. 20035-5998

(19)

Griffith L. Garwood, Director
Division of Consumer Affairs
Federal Reserve Board
Washington, DC 20551

DEC 30 1992

Dear ~~Mr.~~ Griff Garwood:

Our staff has been reviewing Home Mortgage Disclosure Act data for 1990 and 1991 to target lenders in major metropolitan areas for mortgage lending investigations under the pattern and practice provisions of the Fair Housing Act and Equal Credit Opportunity Act. Our review initially focused on high volume lenders that rejected black and/or Hispanic mortgage applicants at significantly higher rates than white applicants. We limited that review to lenders who received sufficient numbers of applications from whites and minorities to permit a statistical analysis of underwriting decisions similar to the one we used in our recently filed and settled lawsuit against Decatur Federal Savings and Loan Association in Atlanta, Georgia. We explained our methodology for identifying these lenders at one of the interagency meetings to discuss a joint mortgage lending discrimination investigative program.

Since our most recent interagency meeting, our staff has reviewed the HMDA data to identify high volume lenders who received few, if any, mortgage applications from minorities and who appear to be doing business in metropolitan areas with significant black and/or Hispanic populations. These lenders may be pursuing purposefully discriminatory home loan marketing strategies similar to those found in our case against Decatur Federal. We now wish to schedule a meeting to share with you and discuss the results of our targeting efforts and to solicit your advice and input.

We have a number of questions concerning our targeting analysis that we would like to raise with members of your staff, such as which agency is primarily responsible for conducting fair lending compliance reviews of certain institutions. We have been told that the regulatory agencies to whom certain lenders are required to report under HMDA may not in all instances be the same agencies that have primary compliance responsibilities for

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these institutions. It is also difficult to identify from the HMDA tape lenders that are mortgage company subsidiaries of banks or bank holding companies and the name and location of the parent companies. Members of your staff may be able to answer such questions for us. Your agency may also have information in its compliance files about some institutions that may assist in identifying lenders that may be the best targets for initial pattern or practice reviews.

As you know, under recent amendments to the Equal Credit Opportunity Act (15 U.S.C. §1691e) the federal financial regulatory agencies are required to refer matters to the Attorney General whenever they have reason to believe that a creditor has engaged in a pattern or practice of discrimination on a prohibited basis under the Act. In this regard we hereby request that your agency inform us of any active pattern or practice investigations of specific institutions and the status of those investigations. This information will prevent duplication of effort, confusion among lending institutions where parallel investigations may be underway, and enable us to make budget and staffing decisions based on matters that may be coming to us in the near future.

Not only are the Decatur Federal investigation and settlement and the Boston Federal study helpful guideposts for undertaking and completing lending discrimination investigations, we believe they underscore the need for implementation of consistent remedies for unlawful lending practices. To this end, we request that we be informed of any anticipated conciliation efforts in pattern or practice cases and provided an opportunity to review and comment on the remedies sought. If you have any questions in this regard we would be happy to discuss them at our next meeting.

In closing, we understand and acknowledge that this department and the federal financial regulatory agencies have yet to agree on a joint investigative program for any targeted lender, and that this has been the principal focus of the interagency meetings. We have received your agency's letter of September 23, 1992, responding to our proposals for conducting joint investigations and your response remains under review within the Department. However, we believe it is important to move forward with the process of identifying lenders for possible pattern or practice investigations while the issue of how those investigations are to be undertaken remains subject to discussion. As you know, the Decatur Federal case and the recent publication of the Boston Federal Reserve Board study, showing possible widespread discrimination in mortgage lending by some Boston area banks, makes it imperative that we move forward as expeditiously as possible with investigations. We welcome and very much appreciate your continuing interest in working with us to combat discrimination in mortgage lending.

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I ask that you or someone on your staff call me at 202-514-4713 at your earliest convenience so that we may schedule our meeting.

Sincerely,

John R. Dunne
Assistant Attorney General
Civil Rights Division

By:

Paul F. Hancock
Chief
Housing and Civil Enforcement Section

cc: Lea Guarraia
Housing and Urban Development

David Medine
Federal Trade Commission

William Ryan
National Credit Union Administration

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Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6000

February 4, 1993 (20)

The Honorable Lawrence B. Lindsey
Board of Governors of the
Federal Reserve System
20th and C Street, N.W.
Washington, DC 20551

Dear Governor Lindsey:

Your letter of December 11, 1992, to Mr. John R. Dunne at the U.S. Department of Justice (DOJ) indicates that the Federal Reserve Board will release to DOJ, with the approval of all relevant regulators, the supporting documentation with regard to the study of mortgage lending data by the Federal Reserve Bank of Boston.

The purpose of this letter is to authorize the Federal Reserve Board to release to DOJ all relevant records collected as part of the Federal Reserve Bank of Boston's study that pertain to savings associations and mortgage corporations under the administrative jurisdiction of the Office of Thrift Supervision. This authorization for release is made with the condition that all actual customer application numbers be replaced with substitute values. We believe your release of the documentation in this manner will eliminate legal problems involving privacy issues we would otherwise face under existing federal law.

Please let us know when the Federal Reserve Board makes the actual transfer of records to DOJ.

Sincerely,

John F. Robinson
Acting Deputy Director
for Washington Operations

cc: Mr. John R. Dunne ✓

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Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

(21)

February 18, 1993

The Honorable Lawrence B. Lindsey
Board of Governors of the
Federal Reserve System
20th and C Streets, N.W.
Washington, D.C. 20551

Dear Governor Lindsey:

Your letter of December 11, 1992, to Mr. John R. Dunne at the U.S. Department of Justice (DOJ) indicates that the Federal Reserve Board will release to DOJ, with the approval of all relevant regulators, the supporting documentation with regard to the study of mortgage lending data by the Federal Reserve Bank of Boston.

The purpose of this letter is to authorize the Federal Reserve Board to release to DOJ all relevant records collected as part of the Federal Reserve Bank of Boston's study that pertain to national banks and mortgage corporations under the administrative jurisdiction of the Office of the Comptroller of the Currency. This authorization for release is made with the condition that all actual customer application numbers be redacted. We believe your release of the documentation in this manner will eliminate legal problems involving Right to Financial Privacy Act issues we would otherwise face.

Please let us know when the Federal Reserve Board makes the actual transfer of records to DOJ.

Sincerely,

Susan F. Krause

Susan F. Krause
Senior Deputy Comptroller
for Bank Supervision Policy

cc: Mr. John Dunne

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FDIC
Federal Deposit Insurance Corporation
Washington, DC 20429-9990

Office of Consumer Affairs
(202) 898-3536 • (800) 934-3342

February 22, 1993

(22)

Honorable Lawrence B. Lindsey
Board of Governors of the
Federal Reserve System
20th and C Streets, N.W.
Washington, D.C. 20551

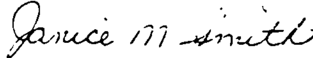
Dear Governor Lindsey:

Your letter of December 11, 1992, to Mr. John R. Dunne at the U.S. Department of Justice (DOJ) indicates that the Federal Reserve Board will release to DOJ, with the approval of all relevant regulators, the supporting documentation with regard to the study of mortgage lending data by the Federal Reserve Bank of Boston.

The purpose of this letter is to authorize the Federal Reserve Board to release to DOJ all relevant records collected as part of the Federal Reserve Bank of Boston's study that pertain to insured state non-member banks under the jurisdiction of the Federal Deposit Insurance Corporation. This authorization for release is made with the condition that all actual customer application numbers be replaced with substitute values. We believe your release of the documentation in this manner will eliminate legal problems involving privacy issues we might otherwise face.

Please let us know when the Federal Reserve Board makes the actual transfer of records to DOJ.

Sincerely,



Janice M. Smith
Director

cc: Mr. John R. Dunne

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TESTIMONY OF REBECCA ADAMSON

FIRST NATIONS DEVELOPMENT INSTITUTE

Chairman Riegle and Members of the Committee: I wish to thank you for this opportunity to address the critical issues surrounding community development and credit availability as they relate to Native American communities.

My name is Rebecca Adamson, and I am the President and founder of First Nations Development Institute (First Nations). First Nations is the country's oldest and largest American Indian development organization, specializing in culturally appropriate economic development. This includes the first microloan fluid in the United States, the first tribal investment model, and the only national Indian (non-federal) financing program, the Oweesta Fund.

We began our work in 1980, with a strict mandate to work with Indian people to decrease their dependency upon the Federal Government by enhancing their economic self-sufficiency in culturally appropriate ways. We accomplish this through educational efforts and the provision of technical assistance to help Indian communities develop economic programs that are culturally-appropriate, self-sustaining, and can serve as models throughout Indian Country. I think it is important to mention that we are a not-for-profit organization. By choice, First Nations neither receives nor uses Federal funding.

Our work over the past 12 years has shown us that there are no easy solutions to solving Native American economic development problems. By most indicators of economic well-being, Indian reservations are desperately poor; they exhibit the highest unemployment rates in the United States, sometimes reaching seventy and eighty percent; the economics of many reservations are heavily dependent on tribal or Federal Government employment and Federal transfer payments; and, viable, unsubsidized micro-economic enterprises are a rarity.

Hand-in-hand with economic distress are many of the social indicators commonly associated with poverty: housing is typically of poor quality, frequently crowded, often with substandard sanitation; life expectancies are lower and community health is generally poorer than experienced by surrounding urban and rural communities; levels of education are low; and, levels of alcoholism, suicide, and crime are often disturbingly high. Indian reservations are essentially underdeveloped economies, possessing the characteristics of underdeveloped Third World countries. Indeed, of the total 384 federally recognized tribes, not a single one has a private sector economy within their reservation boundaries. Yet collectively, they own 44 million acres of approximately 55 million acres of Indian trust land are range and grazing lands, and 2.5 million acres are farm lands in rural areas of the United States.

Basic obstacles encountered in trying to conduct economic development are: inadequate infrastructures, unskilled labor force, a lack of capital (compounded by state, tribal and Federal jurisdictional concerns and insufficient collateral for credit); and, instability resulting in a high turnover of tribal administrations.

Mr. Chairman, the most crucial prerequisite is for Indian people to control and manage their assets themselves. With lack of local control over their resources, coupled with Federal programs which are inflexible, piece-meal, and have no cultural relevance, social disruption is high. This situation has made us vulnerable to "fly by night" con artists, loan sharks and hustlers, has spawned fringe banking systems, and made Native Americans victims of discrimination by traditional banking institutions. Even the Bureau of Indian Affairs, the trustee of Indian lands and natural resources, has lost Indian trust fluid monies to bank hustlers and embezzlers.

Mr. Chairman, all too often banks soak up the savings from a reservation and pump it into border town economies or out of the regional economy entirely. The effects upon the reservation or regional economy are devastating. This leakage of economic resources is systemic and indeed epidemic.

Two studies of the Pine Ridge Reservation in South Dakota by First Nations, highlight this severe problem. A 1988 household survey by Richard Sherman found that over 80 percent of all households on the Pine Ridge Reservation had at least one micro-entrepreneur. The study identified over 100 activities that constituted on-going businesses, such as creating traditional arts and crafts, selling food at pow wows, repairing cars and locks, and providing heath care. These activities contributed 24 percent of the income in these households, as compared with welfare, which contributed on 20 percent.

The First Nations' Economic and Banking Impact study determined that the gross reservation income for Indians and Indian organizations on the Pine Ridge Reservation totaled over $82 million. Yet because of the scarcity of retail businesses on the reservation, tribal members spent less than eight and a half cents out of every dollar within the reservation. Approximately $74 million went directly to the border

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town economies; the rest was spent out of state. The study estimated that over $200 million in revenue to the surrounding area, was generated from the income derived directly from reservation members.

Native American communities, much the same as other rural communities, find development capital difficult to access. They lack sufficient financial resources, credit and technical assistance with which to buy affordable homes, or to start businesses that can be sustainable and viable, if the appropriate technical assistance and training are available. Without adequate banking relationships in the form of loans, interest and investments, money coming onto the reservation quickly dwindles away without contributing to the tribal economy.

In exchange for tribal and individual Indian monies deposited into their banks, Native Americans are only asking for competitive interest-bearing accounts, loans at competitive interest rates, and usual business partnerships. These practices are readily available to you or I, but not to Indian people living on reservations or in rural communities.

The potential for tribes to develop successful banking relationship is highlighted in the example of the Saginaw Chippewa Tribes ability to successfully manage their $10 million judgment fund. In 1986, Congress enacted legislation that awarded the Tribe control over its settlement monies. Since that time, the Tribe has matured in its management of the Fund, progressing from two outside investment managers operating under the review and direction of the Tribe, to assuming total control of the Fund's management. First Nations worked with the Tribe to select effective investment managers, and also to leverage these fluids with their local banking institution. There have been a number of intangible benefits. Tribal members have benefited from a home ownership program, and business loans. Effective relationships between the tribes' individual members and the banks have also been enhanced. This is a direct result of the Tribe's deposit of Fund revenues in several local banks.

In sharp contrast, First Nations has witnessed startling examples of the barriers that are experienced by the Native American community. Not long ago, a lawyer representing the Fort Peck Tribal Housing Authority withdrew the agency's several million-dollar deposit from their local bank and placed it in several banks in Denver, Colorado. This was done because the local bank had been holding the housing authority's funds in a noninterest-bearing account for years, a relatively common scenario in tribal banking relationships. This action got results. Local banks began treating the tribes in the area as preferred customers.

An article in the October 8, 1992 edition of the *Indian Country Today*, outlines the discriminatory "red lining" of reservations by banking institutions in South Dakota and Nebraska. After examining the CRA files of several border town banks, It was noted that seven banks excluded the Pine Ridge and Rosebud Reservations from their delineated lending areas. It is common knowledge among reservations members, that these banks will not even honor government checks presented to them by Indian people. I have attached a copy of the article, for the record.

In the midst of this current environment, First Nations has been successful in dealing with these barriers. By working with bankers, responsible investors, and foundations, First Nations has constructed several pipelines for injecting capital into the reservations. Through our Oweesta (Oweesta is the Mohawk word for money) Program, First Nations places capital on the reservations and builds Indian people's financial capabilities and skills. First Nations has received loans and seed capital grants of $1.8 million. That capital supplies matching loans to microenterprise loans funds, supports deposits in reservation-based credit unions and banks, provides partnership deposits in other financial institutions, and guarantees loans for field projects. Tribes select the commercial banks that work successfully with them. These banks receive the partnership deposits in recognition of their innovative lending in Indian Country. In addition, First Nations has successfully convinced other investors to deposit over two million dollars in Indian-owned institutions and businesses, thus helping capitalize Indian economic development while keeping their money safe and earning the fair market-rate return.

In 1987, First Nations established the Lakota Fund on the Pine Ridge Indian Reservation in South Dakota. It is the first reservation-based microenterprise loan fund, and the first micro-loan fund in the United States. By using culturally-appropriate development models, The Lakota Fund has made more than 200 loans. It has provided the capital needed to open a beauty salon, video store, auto repair shop, tire retread shop, and a carpet cleaning business. These may seem to be basic businesses to you or I, but they had not existed on the reservation prior to the establishment of the Lakota Fund. This model keeps money flowing into the reservation, enhancing the viability of the members and the tribe.

Although the loans are small, the rewards have been great. For many, it is the first loan they have ever received. The program is staffed and run entirely by local

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tribal members. A banker sits on the board and has served as a bridge for borrowers as they cross from fund borrowing to bank loans. In recognition of its' viability and sustainability, I am proud to say that The Lakota Fund is now fully independent of First Nations, and self-sufficient. The program is currently in replication in Southeast Alaska with the Tlingit and Haida Tribes, and in New Mexico with the Navajo Nation.

Mr. Chairman, economic development capital has always been supported on reservations by large infusions of Federal money. Small-scale financing is virtually non-existent. In 1992, First Nations received some 19 requests from tribes asking for technical assistance to establish microenterprise loan funds.

As your committee begins its deliberations on the issue of community development lending, I urge you to consider the needs of Native American and rural communities. Too often the needs of this low-income group falls through the cracks.

I encourage Congress to draw upon the expertise of existing community development organizations, such as First Nations, for input as you begin crafting legislation. Tribes are geographically isolated and diverse in their financial needs. Without the deliberate involvement of a national tribal perspective, only one or two specific tribes may benefit. In the end, the whole range of tribal development opportunities will go ignored.

Congress should expand the scope of community development lending beyond small business credit. Recognize that successful community development models are built over time and with incremental performance-based financial support. First Nations and other community development organizations are already in the "trenches". Drawing from the numerous successful and efficient development models of in existence, it will not take another twenty years to replicate these models in other low-income communities. We do not have the luxury of an additional twenty years.

With enhanced support from the Federal Government, partnerships between community development organizations and traditional banking institutions, will create more jobs. With increased access to resources and technical assistance we will see an increase in small business development and new housing construction. Reservations and rural communities need the financial vehicles to form capital for the right purpose, at the right time and in the right amount.

I would welcome the opportunity to discuss these issues with you and other members, in greater depth. Again, I wish to thank you and the members of this Committee for this opportunity to bring to the forefront, the unique concerns of Native American and rural communities as we work to enhance the economic self-sufficiency of the members of our communities.

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STEVEN B. HARRIS, STAFF DIRECTOR AND CHIEF COUNSEL
LAMAR SMITH, REPUBLICAN STAFF DIRECTOR AND ECONOMIST

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WASHINGTON, DC 20510-6075

January 15, 1993

The Honorable Alan Greenspan
Chairman, Federal Reserve System
Constitution Avenue and 20th Street
Washington, D.C. 20551

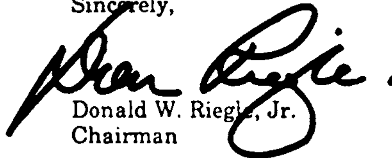
Dear Chairman Greenspan:

The Senate Committee on Banking, Housing, and Urban Affairs has tentatively scheduled a hearing to be held on Wednesday, February 24, 1993, to examine the problem of mortgage and other lending discrimination. In preparation for that hearing and in support of ongoing oversight activities, the Committee would like certain information from your agency concerning your fair lending compliance activities.

Enclosed please find a compilation of questions, the responses to which should be delivered to the Committee by Friday, February 12, 1993. Please deliver your responses to Matthew Roberts of my staff at the Dirksen Senate Office Building, Room 534, Washington, D.C. 20510.

Thank you for your cooperation.

Sincerely,



Donald W. Riegle, Jr.
Chairman

DWR/mr
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RESPONSE TO WRITTEN QUESTIONS FROM SENATOR RIEGLE BY ALAN GREENSPAN

LENDING DISCRIMINATION QUESTIONS

Compliance Structure

Q.1. What division within your agency conducts fair lending examinations? To whom within the agency do the examiners report? Do these supervisors have other responsibilities besides fair lending and/or Community Reinvestment Act compliance?

A.1. The Board has had a specialized consumer compliance examination program since 1977 under the general direction of the Division of Consumer and Community Affairs. The twelve Federal Reserve Banks each have a consumer affairs unit within the Reserve Bank's examination department. Specialized consumer affairs examiners conduct examinations of state member banks to determine compliance with all consumer legislation, including the Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Home Mortgage Disclosure Act and other consumer statutes like the Truth in Lending Act. The senior officer in charge of examinations at each Federal Reserve Bank is responsible for consumer, compliance examinations as well as all other types of examinations. The Compliance Section of the Division of Consumer Affairs at the Federal Reserve Board is responsible for reviewing and coordinating compliance activities, providing Reserve Banks with the information and assistance they need, and ensuring uniform approaches to compliance examinations are taken.

Q.2. Does the fact that the Federal Reserve, unlike the other Federal financial supervisory agencies, has a separate division for fair lending compliance enhance the effectiveness of your fair lending enforcement efforts?

A.2. We believe having the Division of Consumer and Community Affairs at the Federal Reserve Board enhances the effectiveness of the Federal Reserve System's fair lending enforcement efforts because it enables us to focus this particular expertise to benefit the Reserve Bank consumer affairs examination program. In addition, Federal Reserve compliance examiners have been organized separately since 1977 because we believe, given the depth of the areas they review, it is unrealistic to expect an examiner to do the best job possible with respect to both consumer compliance and safety and soundness issues. We do note, however, that some other agencies, such as the FDIC, also have separate divisions for fair lending compliance.

Q.3. Are there any structural factors (such as job classification) that preclude or impede consumer compliance examiners from being promoted to supervisory positions?

A.3. No, the Board's policy on examiner career paths directs Reserve Banks to provide compliance examiners with a career path comparable to that for commercial examiners. The policy does not make a distinction between supervisory and non-supervisory positions. In fact, a number of former compliance personnel have been promoted to senior positions in the Reserve Banks.

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Q.4a. How many staff personnel are allocated for fair lending enforcement?

A.4a. Data collected through the Federal Reserve's Planning and Control System indicate the number of personnel allocated throughout the Reserve Banks to consumer affairs examinations, which encompass fair lending and other compliance laws such as the Truth In Lending Act and the Expedited Funds Availability Act, in 1992 was 201. In addition the Board's Division of Consumer and Community Affairs currently has a full time staff of forty-two.

Q.4b. Approximately how much time do they spend per year on fair lending compliance related work?

A.4b. The number of hours spent per year on fair lending compliance related work was estimated based on the number of hours spent on consumer affairs examinations as recorded in the Federal Reserve's Planning and Control System and the portion of compliance examination hours spent on fair lending laws as recorded in the Consumer Affairs Report of Examination System. Based on our review, we estimate the following hours were spent examining for compliance with the fair lending laws, including the Equal Credit Opportunity Act, the Fair Housing Act, the Home Mortgage Disclosure Act, and the Community Reinvestment Act in 1990, 1991, and 1992:

YEAR	HOURS
1990	109,603
1991	147,751
1992	177,616

Q.5. What is the nature of the training for fair lending examiners?

A.5. The Federal Reserve provides extensive training for examiners in how to conduct compliance and CRA examinations. Federal Reserve examiners attend several training sessions for CRA, fair lending, and consumer compliance during their career. New examiners attend the Board's three week basic consumer compliance school, while examiners with eighteen to twenty-four months of field experience attend the Board's week long advanced compliance school and the one week advanced CRA examination techniques class. In addition, examiners attend HMDA Data Analysis System training. This training is supplemented as necessary by the Reserve Banks through regular departmental staff meetings and through special training sessions such as the Federal Financial Institutions Examination Council's (FFIEC's) 1990 CRA training sessions that covered the CRA provisions of FIRREA and the planned senior examiner seminar to be held this March. Examiners are trained on how to review the bank's loan policies, procedures, and lending standards, compare those standards with the bank's practices, and come to a conclusion on the bank's compliance with the fair lending laws. In addition, CRA training covers the various guidelines and information necessary to evaluate a bank's CRA

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record and to prepare a public evaluation. The training involves classroom lectures, a mock examination, and case studies.

Q.6. Please provide a breakdown of the race, ethnicity, and gender of fair lending examiners and supervisory personnel by job classification.

A.6. The Federal Reserve Board does not maintain information on its examination employees by race, ethnicity, and gender as a matter of practice. Similar information was, however, collected in response to a 1990 request. Following is a profile of the sex and race of Federal Reserve System Consumer Affairs examiners and managers as of March 31, 1990.

EXAMINERS:BY RACE & SEX	NUMBER	PERCENT OF TOTAL
White Males	50	45%
White Females	38	34%
Black Males	6	5%
Black Females	8	7%
Other	10	9%
Total	112	100%

MANAGERS & IN HOUSE REVIEW PERSONNEL BY RACE & SEX	NUMBER	PERCENT OF TOTAL
White Males	4	25%
White Females	6	37%
Black Males	2	13%
Black Females	2	13%
Other	2	12%
Total	16	100%

Examination Techniques

Q.1. What instructions do you give examiners on the types of loans and the number of files that they should review in a fair lending compliance exam? How many loan files are sampled as part of an examination? Does the number of files sampled vary by the size of the institution or other criteria?

A.1. Examiners are instructed on how to use "statistical" and "judgmental" samples in the examination process. Sampling Procedures from the Federal Reserve System Compliance Handbook are enclosed.

Statistical sampling is used to compare one item with a definite standard and to test for technical violations. Statistical sampling enables examiners to extend the conclusions drawn from a small

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portion of loans to the entire group of loans with similar characteristics ("the universe"). For statistical samples to be valid loans must have similar characteristics and each item in the universe must have an equal chance of being selected. The number of loans sampled depends on the number of universes and the size of each universe. Detailed instructions on choosing the types of loans and the number of files to be sampled are enclosed.

Judgmental sampling is crucial in examining for credit discrimination. Like statistical sampling, judgmental sampling is used to conduct an in-depth analysis of a portion of a group and draw conclusions about the universe. It is different from statistical sampling in that it involves the use and comparison of preselected files. The files are selected and loan information recorded on "applicant profile" worksheets so that the treatment of applications from one group of applicants, such as black applicants or female applicants, can be compared to applications of others similarly situated. To do this an examiner would develop a hypothesis, for example "Are blacks treated the same as whites in the credit evaluation process." The examiner then reviews as many application files as necessary in order to draw a reasonable conclusion about the validity of the hypothesis. The number of applications sampled during an examination varies depending on the circumstances at each bank. We have enclosed detailed instructions on judgmental sampling in connection with the fair lending examination.

Q.2. What indicia of discrimination are examiners instructed to look for in the files (e.g., perfect minority applicants who are rejected, comparable minority and non-minority applicants who receive differential treatment, etc.)?

A.2. The procedures used by examiners to detect illegal discrimination involve a comprehensive review of a bank's lending practices. The examiners focus primarily on comparing the treatment of members of one group of applicants, such as black applicants or female applicants, with another group of applicants such as white males. As part of this process, the bank's loan policies and procedures are reviewed. This is done by analyzing bank documents and interviewing lending personnel. During this phase, the examiner determines, among other things, the bank's credit standards. After identifying those standards, the examiner compares them with a sampling of actual loan applications, especially applications received by the bank from members of the group of applicants whose treatment is being reviewed. This means that the examiner is looking at the same information that the bank used to make its credit decision, including such things as the applicant's credit history, income, and total debt burden.

After the examiner has gathered the relevant data, an overall analysis of the bank's treatment of applications from the particular types of applicants is conducted. The examiner determines whether there are any patterns or individual instances where members were treated less favorably than other similarly situated applicants. The conclusions reached by the examiner with respect to this analysis of the bank's compliance with fair lending laws is discussed with bank officials. Discussions with bank officials would include any questions or comments the examiner has about the im-

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pact, or potential impact, of the bank's lending standards on applicants with particular characteristics, even if no violation of the fair housing laws is cited.

Q.3. Does your agency operate on the premise that you need to find statistically significant discrimination to take enforcement action?

A.3. No, the Federal Reserve does not look for "statistically significant discrimination" before taking enforcement action. As noted above, we use judgmental sampling and hypothesis testing in our discrimination analysis. Also, one clear case of improper differential treatment would be dealt with. The Federal Reserve holds a bank accountable for appropriate remedies and penalties as provided for in applicable laws and requires the bank to take prompt action to correct instances of unlawful credit discrimination. Enclosed for your review is an interagency Supervisory Enforcement Policy for the Equal Credit Opportunity Act and Fair Housing Act adopted in 1981. Reserve Banks require that banks take corrective action in appropriate cases. Banks are required to conduct a file search to identify all violations that have occurred within 24 months prior to discovery, except for violations concerning adverse action notices. Corrective action is required for violations concerning adverse action notices occurring within six months prior to the discover. The file search provisions of the policy guide are invoked in situations where a pattern or practice of violations is discovered. With respect to isolated violations, Reserve Banks require corrective action for those violations discovered in a sample, whether or not a file search is ultimately deemed necessary.

Q.4. Do compliance examiners interview loan officers?

A.4. Yes. Compliance examiners routinely interview lending personnel as part of their review of the bank's loan policies and procedures. The examiner's findings are also discussed with bank personnel.

Q.5. Please describe the circumstances under which examiners contact credit applicants to collect consumer's opinions on how their applications were handled by bank personnel?

Q.6. What percent of fair lending examinations include examiner outreach to credit applicants?

A.5. & A.6. Interviews outside of the bank are made when substantial discrimination is suspected in connection with specific complaints. Examiners may contact applicants during the examination process, but it is rare. The Federal Reserve does not maintain information on when credit applicants are directly contacted.

Q.7. Please describe the circumstances under which examiners contact representatives of the business and consumer community to collect their opinions on bank treatment of credit applications?

A.7. Examiners routinely contact representatives of the business and consumer community to understand the community, learn about community credit needs, and find any signs of discriminatory practices by the institution.

Q.8. How frequently are community organizations contacted? How frequently are legal service agencies contacted? How frequently are

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members of the small business community contacted? How frequently are members of the real estate community contacted?

A.8. Federal Reserve examiners normally make at least one contact, and often more, with individuals representing the types of groups mentioned above in the course an examination. Attachment 1 provides information on the number of organizations contacted by type. We note that the categories used do not correspond exactly to those you requested, but we think this information will be helpful to you.

Q.9. What percent of exams result in specific examiner discussion of fair lending compliance problems and recommendations with a bank's board of directors? With bank management?

A.9. Examination findings are always discussed with bank management. Examination findings that indicate a compliance position that requires more attention may result in a meeting with a bank's board of directors. In 1992, separate meetings were set up with bank board of directors in connection with forty-two bank examinations to discuss fair lending or other compliance problems, for example Truth-in-Lending violations. In comparison, data received as of January 29, 1993 indicates 627 examinations were conducted in 1992.

Q.10. What procedures do you use to monitor the quality and consistency of fair lending exams?

A.10. The Federal Reserve fosters high-quality examinations and ensures uniform approaches are taken to fair lending examinations through the development of uniform examination procedures and related report forms, the distribution of informational materials to examiners, examiner training, and oversight activities.

The Federal Reserve has distributed a number of documents to examiners that promote uniformity in fair lending examinations. For example, in 1992 the Federal Reserve distributed documents discussing the *FFIEC Community Reinvestment Act Policy Statement on Analyses of Geographic Distribution of Lending,* guidance on the inclusion of numerical data in public CRA evaluations, a Memorandum of Understanding between the FFIEC and the Department of Housing and Urban Development (HUD) regarding the exchange of information and complaints alleging a violation of the Fair Housing Act, and revised CRA examination procedures.

Training is uniform for all System examiners. The schools and seminars, discussed earlier in answer to question 5 on the Federal Reserve's compliance structure, is enhanced by the Board's Resident Examiner program. The Resident Examiner program is designed to give field compliance examiners an insight into the Board's activities and responsibilities. As part of the program, examiners review reports from other districts, helping to further ensure a uniform approach is taken during the examination process.

Board staff review and analyze compliance examination reports for compliance with System standards, and when appropriate, take follow-up steps with Reserve Banks on an ongoing basis. Board staff members also conduct in-depth reviews of the compliance function at each Reserve Bank to ensure Board policies and procedures are followed. As part of these reviews, Board staff review a

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sample of examiner workpapers to ensure high quality examinations are being conducted.

Complaints and Violations

Q.1a. How many complaints of ECOA and Fair Housing Act violations has your agency received each year for the past years?

A.1a. Attached are two charts that show the number of complaints about State-member banks involving allegations of ECOA and Fair Housing Act violations that the Federal Reserve System received for the last ten years. The first chart reflects information for the years 1983 through 1990 and the second reflects information for 1991 and 1992. The chart also shows the resolution of the complaints. The resolution descriptions for the 1983 through 1990 data vary somewhat from the 1991 and 1992 information because we began using a new on-line consumer complaint and tracking system in January 1991 which enabled us to retrieve a better resolution description.

Q.1b. Are the complaints investigated by the same examiner that conducted the routine compliance examination?

A.1b. The complaint units at the Reserve Banks are not all organized the same. Some Reserve Banks assign examination staff responsibility for investigating complaints while others do not. Only examiners, however, are authorized to conduct on-site investigations of complaints. While it is possible that an examiner who conducted a routine compliance examination could be asked to investigate a consumer complaint about the institution at a later date, this arrangement is in no way required.

Q.1c. How many have been resolved and with what resolutions?

A.1c. All complaints received from 1983 through 1991 have been resolved; nine are pending from 1992. As noted above, please refer to the attached charts for specific resolution information.

Q.2a. What distinguishes a technical violation from a substantive violation? Can an institution have technical violations and get a satisfactory Community Reinvestment Act rating? Can an institution have substantive violations and get a satisfactory CRA rating?

A.2a. Technical violations generally involve minor deficiencies, such as bank lending forms or typographical errors. On the other hand, substantive violations involve bank policy, practices or procedures.

A bank's compliance with the fair lending laws is reflected in its CRA rating. The bank's CRA record is evaluated in terms of twelve assessment factors, two of which deal directly with discriminatory practices. Thus, it is likely that an institution's CRA rating would be adversely affected if violations of the antidiscrimination laws and regulations were found, especially if the institution was found to have treated applicants in a discriminatory fashion. An institution may have violations that are nonsubstantive in nature and receive a satisfactory CRA rating.

Q.2b. What kind of enforcement action, if any, is taken for technical violations? For substantive violations?

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A.2b. Reserve Bank follow-up and the decision to enter into more formal enforcement actions varies with the nature and extent of violations found, as well as the banks history of compliance and taking corrective measures on its own. When technical violations are found, banks are required to correct their procedures and forms to prevent future violations of a similar nature. Reserve Banks routinely ask bank management to provide a written response to weaknesses raised in examination reports. In addition, a Reserve Bank may enter into an informal or formal supervisory agreement with a bank if it determines that closer supervisory attention is needed. Moreover, in cases involving violations of the substantive provisions of the Equal Credit Opportunity Act or the Fair Housing Act, corrective action as outlined in an interagency policy guide is required.

Q.3a. How many ECOA and Fair Housing Act violations have been found for each of the last 10 years?

A.3a.

	EQUAL CREDIT OPPORTUNITY		FAIR HOUSING ACT	
Year	Number of Violations	# of Banks w/ Violations	Number of Violations	# of Banks w/ Violations
1983	2,733	403	296	155
1984	2,474	393	273	133
1985	3,000	430	240	135
1986	2,933	329	173	104
1987	5,021	441	357	163
1988	4,421	435	840	129
1989	4,604	439	212	110
1990	4,829	428	413	129
1991	5,136	467	382	145
1992	3,946	401	281	121

Q.3b. Of these, how many were technical and how many were substantive?

A.3b. Most violations of the Equal Credit Opportunity Act involve the failure of the bank to collect monitoring information (race, sex, age, marital status) in accordance with Regulation B on applications for the purchase of residential real estate (accounting for 47 percent of Regulation B violations found in 1992). The second most common type of Regulation B violations involved the failure to provide proper adverse action notices in accordance with the provisions of the regulation (accounting for 32 percent of Regulation B violations found in 1992). Few violations involving illegal credit discrimination have been found. For instance in 1992, the rule prohibiting discrimination on a prohibited basis regarding any aspect of a credit transaction was cited at 5 of the 589 examinations conducted in 1992 and received at the Board as of January 29, 1993.

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Furthermore, when discrimination is cited, virtually all instances involve marital status discrimination. Most commonly, discrimination on the basis of marital status occurs when a lender requires a married person to obtain the signature of their spouse even though the spouse is not a co-applicant and the applicant is individually credit worthy for the amount and type of credit requested.

Nevertheless, violations that triggered corrective action, including a file search, under the Regulation B/FHA policy guide were found at fifty-seven banks in 1992, sixty banks in 1991, forty-two banks in 1990, and forty-seven banks in 1989. The principal reason why the policy guide was invoked are listed in the table below. This table includes violations found in relation to all types of loans. Information is not available on violations that invoked corrective action under the Regulation B/FHA policy guide prior to 1989.

CORRECTIVE ACTION REQUIRED
UNDER THE REGULATION B/FHA POLICY GUIDE
1989 - 1992

PRINCIPAL REASON POLICY GUIDE INVOKED	1989	1990	1991	1992
Failed to Provide Proper Adverse Action Notices	25	21	32	26
Improperly Obtaining the Signature of a Spouse or Other Person	17	13	16	18
Improperly Furnishing Credit History Information	3	4	10	9
Improperly Considering Age or Whether Income is Derived From Public Assistance	0	2	0	2
Improperly Considering Income in the Evaluation of Credit Applications	1	1	2	2
Discrimination on the Basis of Sex[1]	0	1	0	0
Discrimination on the Basis of Race[1]	0	1	0	1
Discrimination on the Basis of Marital Status	1	0	1	3
Discrimination on the basis of Age	0	3	1	2

[1]The two instances of discrimination involved the inconsistent application of the banks' loan policies relating to installment lending. Specifically, in the 1990 case, violations of discrimination on the basis of race and sex were found involving eight applicants who were black, Hispanic, or female. In the 1992 case violations of discrimination on the basis of race were found; three applicants who were black or hispanic were affected.

Virtually all violations of the Fair Housing Act have been of a technical nature, usually involving either the failure to have a post-

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er in all lobbies or loan areas as required, or to include the equal credit logotype, statement, or slogan in advertisements.

Q.3c. How many of these violations have been resolved and how were they resolved?

A.3c. In almost all cases banks have voluntarily corrected any violations that have occurred. The Board does, however, have a number of alternatives available to achieve compliance. For example under section 8 of the Federal Deposit Insurance Act, the Board can issue a Cease and Desist order, either upon consent or after a hearing. And under amendments contained in FIRREA, the Board may assess civil money penalties for any violation of law or of a prior Board order or written agreement. A Cease and Desist Order and an Order of Assessment of a Civil Money Penalty were issued against The Farmers and Merchants Bank of Long Beach, Long Beach, California with respect to alleged violations of federal consumer protection statutes and regulations by the bank, including violations of Regulation B which implements the Equal Credit Opportunity Act. In addition, a Cease and Desist Order and Order of Assessment of A Civil Money Penalty were issued against Glenwood State Bank, Glenwood, Iowa for recurring violations of the Truth-in-Lending Act and Equal Credit Opportunity Act in 1991.

Q.4. What specific practices by regulated institutions and their subsidiaries that constitute illegal discrimination are set out in your regulations? Do you make any effort to disseminate to the public a list of practices that they might encounter that would be illegal? If so, how?

A.4. Regulation B prohibits discrimination against an applicant on a prohibited bases regarding any aspect of a credit transaction. In addition, Regulation B prohibits the discouragement of applicants or prospective applicants on a prohibited basis through any oral or written statement, including advertisements. The regulation contains, among other things, rules concerning the taking and evaluation of applications, extensions of credit, special-purpose credit programs, and notification of action taken. The Board also distributes several publications to consumers pertaining to their rights under the fair lending laws. A pamphlet designed for lenders describing lending standards and practices that may have discriminatory effects entitled *Home Mortgage Lending and Equal Treatment* was published by the FFIEC in November 1991. A similar guide, *Home Mortgages: Understanding the Process and Your Right to Fair Lending* issued by the Federal Reserve after consultation with a number of outside parties, is available for consumers. Copies of Regulation B and pamphlets on the Equal Credit Opportunity Act and fair lending are enclosed.

Q.5. Over the past several years a number of highly publicized news reports have indicated evidence of fair lending problems in a number of metropolitan areas across the country (i.e., Atlanta, Detroit, and Boston). What responses has your agency made to these reports?

A.5. The Federal Reserve has committed considerable effort to strengthen our ability to analyze HMDA data in an effort to detect illegal credit discrimination. Federal Reserve staff has developed a

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HMDA data analysis system that is being made available to the FFIEC agencies to analyze the expanded data available under the new HMDA reporting requirements. The system provides a series of standard reports and tables as well as the capability of querying the database for more specific information about an institution's lending activity. Examiners are better able to select specific files to sample in their fair lending analysis by employing the HMDA data analysis system. In addition, the FFIEC recently hired a consultant who has begun conducting a complete review of fair lending examination procedures and training.

Training provided by the Federal Reserve (including the basic and advanced consumer compliance schools, the advanced CRA examination techniques class, and the HMDA Analysis System training) has been reviewed and improved and includes sessions on fair lending which have covered the various reports indicating fair lending problems in a number of metropolitan areas.

Q.6. For each of the following metropolitan areas, please provide the number of fair lending examinations conducted by your agency for every year since 1985: Atlanta, Boston, and Detroit.

A.6. Since 1985, six examinations were conducted for one state member bank located in the city of Boston, twenty examinations were conducted for four state member banks in the city of Atlanta, and three examinations were conducted for one state member bank in the city of Detroit.

Enforcement Powers

Q.1. What range of enforcement powers are available to your agency and how frequently has each power been used over the past 10 years?

A.1. Beyond the routine examination and examination follow-up, the Federal Reserve uses both formal and informal actions to enforce safety and soundness or legal requirements, the latter of which includes compliance with fair lending laws. The informal actions include board resolutions and memoranda of understanding. The formal actions include written agreements, cease and desist orders, and civil money penalties. Formal actions can be enforced by the Board, whereas informal actions cannot.

With respect to consumer compliance examinations, in general, both formal and informal actions are used for banks with less than satisfactory compliance with fair lending laws as well as a number of other consumer protection laws and regulations. The decision as to which is most appropriate would depend on a number of factors, including the seriousness of the violations and the Board's determination regarding the willingness and ability of management and the bank's board of directors to take necessary corrective action without formal action. The informal actions are used for the least serious circumstances and formal actions are reserved for the most serious situations. As a general rule, an examination finding that a bank has engaged in illegal credit discrimination would result in a formal action. Civil money penalties would be used in circumstances where a bank has committed violations of law and/or regulation and, in the Board's judgment, penalties are warranted.

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There were a number of enforcement actions that included provisions related to consumer protection laws that were outstanding as of January 1993. The informal actions include 28 board resolutions and 34 memoranda of understanding. The formal actions include seven written agreements and five cease and desist orders. In addition, there were civil money penalties assessed against two state member banks in 1992.

Q.2. Would any additional tools be useful?

A.2. We do not believe, at this time, that any additional enforcement tools are necessary.

Referrals of Violations to HUD and Justice

Q.1. During the past 10 years, on how many occasions has your agency referred violations of ECOA to Justice, and of the Fair Housing Act to HUD?

A.1. In May 1992, a Memorandum of Understanding (MOU) between HUD and the member agencies of the FFIEC became effective. The MOU facilitates interagency coordination and cooperation in the processing and investigation of FHA complaints. Since May, the Federal Reserve has referred nine complaints to HUD under the MOU. These nine complaints alleged violations of illegal credit discrimination. As of February 11, 1993, six of the nine complaints had been resolved. Investigations by the Federal Reserve of the six complaints indicated that there were no violations of federal laws or regulations.

One referral has been made to the Department of Justice.

Q.2. What documents (e.g., exam reports, examiner work papers or loan files) have been included in these referrals?

A.2. At the present time, we have only forwarded the actual complaint to HUD. Full documentation has been provided to the Department of Justice.

Q.3. Please provide a copy or describe the substance of the understanding between the financial supervisory agencies and HUD regarding Fair Housing Act referrals.

A.3. We have enclosed a copy of the MOU. In addition, we have enclosed a copy of a letter to the Reserve Banks related to the Federal Reserve's procedures for implementing the MOU and outlines the procedures that the Reserve Banks should follow for handling Fair Housing Act complaints.

Q.4. Please describe what coordination exists between your agency and the Department of Justice regarding referral of suspected fair lending violations.

A.4. Since late 1991, the Federal Reserve, along with other agencies, has met periodically with the Department of Justice to discuss issues related to fair lending. These discussions have led to increased cooperation which includes an agreement to work together to investigate lenders jointly identified for possible illegal credit discrimination.

Q.5. Does a memorandum of understanding exist?

A.5. The Federal Reserve's agreement to cooperate with the Department of Justice is set forth in the enclosed letter.

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Q.6. What factors account for the limited number of referrals?

A.6. Until recent statutory changes, the Board was authorized to make a referral to the Department of Justice if it was unable to obtain compliance itself. When Federal Reserve examiners have discovered violations, we have successfully brought banks into compliance with the law. The new law requires the Board to refer any cases on which it has reason to believe a pattern or practice of discrimination exists.

Q.7. Is there specific staff assigned to carry out referral functions?

A.7. Staff in the Division of Consumer and Community Affairs is assigned to carry out referrals.

Q.8. Who does DOJ contact within your agency regarding referrals?

A.8. The Department has been in contact with official staff in the Division of Consumer and Community Affairs regarding referrals.

Boston Federal Reserve Study

Q.1. How have you modified examination procedures in response to the findings of the Boston Federal Reserve study?

A.1. The FFIEC hired a consultant in December 1992 to conduct a complete review of fair lending examination procedures, policies and examiner training provided by the agencies to determine if they can be strengthened. We believe the consultants findings will assist us in addressing the issue of illegal credit discrimination.

In addition, Federal Reserve examiners have been able to make better use of existing Federal Reserve fair lending examination procedures in the area of mortgage lending by using the computer system developed by Federal Reserve staff to access and analyze HMDA data. The HMDA system provides examiners with a number of reports that enable them to better select loan application files to review in connection with their discrimination analysis.

Q.2. How do you plan to use statistical analysis in your future fair lending enforcement efforts?

A.2. 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. The reason being, very few institutions have a sufficient volume of loan activity or of denials of minority applicants to reliably document whether there is a "double standard" in loan qualification criteria using a statistical model. Moreover, state member banks tend to be smaller more rural institutions. For example in 1991, 596 of the 967 state member banks were HMDA reporters. And of those 50 percent had total assets under $100 million and received an average of 73 applications per bank.

Our examiners do, however, use HMDA reports with statistical flags when selecting mortgage application files to review. For example, statistical differences between different race/gender combinations and race/income combinations would be shown in reports on the disposition of loan type by race and gender. These statistical flags would cause an examiner to review the loan application more closely to see if discrimination was playing a role in the credit evaluation process.

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Q.3. How will you monitor compliance for lenders that receive too few applications from minorities to make statistical analysis possible? Would it be possible to aggregate data from multiple years for those institutions?

A.3. As noted above, we do not believe a statistical analysis would prove useful in most state member bank examinations. We believe that our current examination procedures are a useful tool in determining compliance with the fair lending laws.

Prescreening and Related Practices

Q.1. How do you determine whether lenders are prescreening or illegally discouraging applications from minorities? Do you have any exam techniques to focus on prescreening?

A.1. The ability of examiners to detect illegal credit discrimination in the preapplication, or prescreening, stage is limited. The most significant limitation is that there is no paper trail of prescreening activities that typically exists in a bank for the examiner to review. Prescreening activities, for the most part, would be verbal and, consequently, the examiner may not be able to determine whether an individual was illegally discouraged from making a credit application. In fact, the examiner may not even be able to determine how many, if any, individuals approached the bank to inquire about, or apply for, a loan that did not complete an application.

This difficulty notwithstanding, there are examination techniques used by System examiners in an attempt to determine whether banks are prescreening or illegally discouraging applications from minorities. One technique is to compare a bank's applicant pool with the demographics of the local community. Any significant percentage differences between minorities living in the community and minorities in the bank's applicant pool would be discussed with the bank. Another technique is to interview those bank staff who would initially interact with a potential applicant. These interviews would attempt to discover whether the bank's practices or policies might result in prescreening. System examination procedures also call for, if necessary, examiners to talk with individuals, such as real estate brokers, rejected applicants, or appraisers who might have knowledge of the bank's practices related to the applications process. In addition, if the examiner has suspicions that illegal prescreening is occurring, the examiner can recommend testing of the bank's preapplication practices. Finally, as part of the CRA examination procedures, System examiners routinely contact persons in the community knowledgeable about local credit needs. These interviews include questions concerning the availability of credit to minorities.

Q.2. HMDA data consistently show low numbers of minority mortgage applications in markets with significant minority populations. When your agency has found low numbers of applications from minorities in certain markets, what surveys or other information have you collected to determine the impact of discouragement on the flow of mortgage applications?

A.2. Our consumer compliance examinations focus on individual banks rather than markets. Consequently, we do not collect surveys or other information to determine whether minorities, in any

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given market, have been discouraged. We do compare the demographics of a bank's local community with the composition of its applicant pool in our effort to determine if illegal prescreening is occurring. Any significant differences between these two numbers would be discussed with the bank.

Q.3. What instructions are provided to examiners to determine whether a lender is steering applicants—based on race, neighborhood, loan size or other factors—to loan products less advantageous than other products offered or to a mortgage or finance company subsidiary?

A.3. We do not have any specific examiner instructions related to steering applicants. However, we must point out that System examiners are instructed, as a general matter, to determine whether a bank is complying with fair lending laws. Our examiners understand that this charge goes beyond determining whether or not a member of a class protected by fair lending laws receives a loan or is rejected. System examiners are trained to know that fair lending laws prohibit discrimination in any aspect of a credit transaction. Consequently, our examiners look for, and would criticize, any differences in treatment between applicants who are members of a protected class and other applicants.

Q.4. Are underwriting criteria examined to see if they are discriminatory? Are regulated institutions required to make the criteria public?

A.4. System examiners routinely determine a bank's lending criteria for all major loan types. In fact, review of these criteria are an essential element of our examination procedures. These standards are reviewed both to determine if they are discriminatory on their face as well as to determine if they are fairly applied to all applicants.

Banks supervised by the Federal Reserve are not required to make their lending standards public.

Private Mortgage Insurance

Q.1. Does private mortgage insurance play a role in mortgage discrimination? How?

A.1. We do not know if private mortgage insurance plays a role in mortgage discrimination. We do know, however, that private mortgage insurance plays an important role in whether or not many applications are approved or denied. Specifically, private mortgage insurance plays an important role in the case of applications involving a high loan-to-value ratio, say greater than 80 percent, because it reduces an institution's potential loss. The Federal Reserve Bank of Boston's study on mortgage loan denial rates indicated that any applicant with a high loan-to-value ratio who is denied private mortgage insurance is very likely to be denied the loan. Similarly an applicant granted private mortgage insurance is likely to be granted the loan. We note, however, that the Boston study states that it would be inappropriate to draw any conclusions about the role of PMI based on the results of the study.

Q.2. Should private mortgage insurers be subject to HMDA or similar disclosure requirements?

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A.2. We note that while private mortgage insurance companies are subject to the Fair Housing Act, they do not accept deposits and are not publicly regulated institutions. Some valuable information might be collected if the scope of HMDA were expanded to include private mortgage insurers; however, there would probably be some technical difficulties to overcome in collecting and processing the data.

Q.3. Do examiners attempt to discover whether an institution has engaged in discrimination by steering certain groups to particular insurers by making greater efforts to follow-up when insurance is denied to white applicants than when insurance is denied to minority applicants?

A.3. Our examiners do not specifically look to see if an institution has engaged in discrimination by steering certain groups to particular insurers. We believe, however, that it is unlikely that banks are steering certain groups to particular private mortgage insurance companies since there are few private mortgage insurers in the country.

Non-Mortgage Related Lending Discrimination

Q.1. What data does you agency have on the prevalence of non-mortgage related lending discrimination? In which markets, other than the mortgage market, is discrimination a serious problem?

A.1. The Federal Reserve has found few violations for non-mortgage related lending discrimination. As noted in the answer to the question on Regulation B and Fair Housing Act violations, the rule prohibiting discrimination on a prohibited basis regarding any aspect of a credit transaction was cited at 5 of the 589 examinations conducted in 1992 and received at the Board as of January 29, 1993. Those instances of discrimination involved marital status and age or receipt of public assistance.

Q.2. Do we nsed disclosure of non-mortgage related lending?

A.2. We do not believe increased disclosure of non-mortgage related lending would be cost effective or justified at this time.

Q.3. What examination technique's do you use to enforce ECOA with respect to non-mortgage related lending? Given the paucity of statistical data, what "flags" do you instruct examiners to look for to detect non-mortgage related lending discrimination?

A.3. Examiners use the same examination procedures described in the answer to question 2 in the section on examination techniques for non-mortgage related lending. Examiners compare the treatment particular types of applicants with other loan applicants by reviewing the bank's loan policies and procedures, analyzing bank documents and interviewing lending personnel. The examiner compares loan standards with a sampling of actual loan applications and conducts an overall analysis of the bank's treatment of applications from a group of applicants whose treatment is being reviewed to determine whether there are any patterns or individual instances where those applicants were treated less favorably than other similarly situated applicants. Of course, examiners have less information to work with in detecting discrimination on the basis of race or national origin. Therefore, examiners may use other in-

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formation available in their discrimination analysis. For example, surname or address may be used to the extent that minority applicants might be distinguished from other applicants by these attributes in the fair lending analysis. As is the case when conducting a fair lending analysis of mortgage related lending, an examiner's findings would be discussed with bank officials.

Q.4. How do these "flags" differ from those you look for to detect discrimination by mortgage lenders not falling under HMDA?

A.4. As noted above, these flags would be the same to the extent that the same information was available. However, in the case of non-mortgage related lending less information is available since monitoring information is not collected and written applications are not required by law in relation to other types of loan applications.

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Attachment 1

Contacts Made by Federal Reserve Examiners

Category	1991	Estimated 1992
I. GOVERNMENT OFFICIALS	337	200
II. CIVIL RIGHTS & CONSUMER ORGANIZATIONS	7	1
III. COMMUNITY DEVELOPMENT CORPORATIONS		
A. Economic Development Organizations	201	140
B. Housing Organizations	92	42
IV. GRASS-ROOTS COMMUNITY GROUPS	49	30
V. TRADE ASSOCIATIONS	215	124
VI. PRIVATE INDIVIDUALS	233	106
TOTALS	1,134	643

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Attachment 2

COMPLAINTS AGAINST STATE–MEMBER BANKS INVOLVING ALLEGATIONS OF VIOLATIONS OF THE EQUAL CREDIT OPPORTUNITY ACT AND FAIR HOUSING ACT (1991 – 1992)

Type of Institution and Resolution	1992	1991
Complaints about state–member banks	111	63
––Insufficient information 1/	1	2
––Information furnished to complainant 2/	18	16
Bank legally correct		
––No reimbursement or accommodation	60	30
––Reimbursement or accommodation––goodwill 3/	12	6
Bank Error		
––No Reimbursement	6	1
––Reimbursement	2	1
Factual Dispute 4/	2	2
Possible Bank violation 5/	1	3
Matter in Litigation 6/	0	0
Customer error	0	2
Pending	9	0

1. The staff has been unable, after follow–up correspondence with the consumer, to obtain sufficient information to process the complaint.
2. When it appears that the complainant does not understand the law and that there has been no violation on the part of the bank, the Federal Reserve System explains the law in question and provides the complainant with other pertinent information.
3. In these cases the bank appears to be legally correct but has chosen to make an accommodation.
4. These cases involve factual disputes not resolvable by the Federal Reserve or contractual disputes that can be resolved only by the courts. Consumers wishing to pursue the matter may be advised to seek legal counsel or legal aid or to use small claims court.
5. The Federal Reserve determines that a state–member bank violated a law or regulation, and the bank took corrective measures voluntarily or as indicated by the Federal Reserve.
6. Parties are seeking resolution through the courts.

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Attachment 3

COMPLAINTS AGAINST STATE - MEMBER BANKS INVOLVING ALLEGATIONS OF VIOLATIONS OF THE EQUAL CREDIT OPPORTUNITY ACT AND FAIR HOUSING ACT
(1983 – 1990)

Type of Institution and Resolution	1990	1989	1988	1987	1986	1985	1984	1983
Number of complaints about state – member banks	72	60	87	108	72	84	112	174
Resolution								
– –Insufficient information 1/	2	0	2	6	5	5	3	5
– –Information furnished to complainant 2/	9	5	11	27	17	15	7	27
– –Bank legally correct								
No accommodation	43	43	49	42	26	45	76	103
Accommodation made 3/	7	4	12	11	10	10	12	22
– –Clerical error, corrected	7	2	6	15	6	4	6	13
– –Factual Dispute 4/	1	0	2	3	1	1	4	1
· Bank violation, resolved 5/	2	4	4	2	5	2	2	2
– –Possible bank violation unresolved 6/	0	0	0	0	1	0	1	0
Customer error	1	2	1	2	1	2	1	1

1 The staff has been unable, after follow–up correspondence with the consumer, to obtain sufficient information to process the complaint.

2 When it appears that the complainant does not understand the law and that there has been no violation on the part of the bank, the Federal Reserve System explains the law in question and provides the complainant with other pertinent information.

3 In these cases the bank appears to be legally correct but has chosen to make an accommodation.

4 These cases involve factual disputes not resolvable by the Federal Reserve System or contractual disputes that can be resolved by the courts. Consumers wishing to pursue the matter may be advised to seek legal counsel or legal aid or to use small claims court.

5. In these cases a bank appears to have violated a law or regulation and has taken corrective measures voluntarily or as indicated by the Federal Reserve System.

6. When a bank appears to have violated a law or regulation, but not a law or regulation enforced by the Federal Reserve, customers are advised to seek civil remedy through the courts. Cases that appear to involve criminal irregularity are referred to the appropriate law enforcement agency.

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Policy Statement on Enforcement of the Equal Credit Opportunity and Fair Housing Acts

6–153.1

The following statement sets forth the general policies that the Board of Governors of the Federal Reserve System will generally apply in enforcing the Equal Credit Opportunity Act and the Fair Housing Act. The Board believes it appropriate to remind state member banks of their responsibilities under these laws and that the Board will vigorously enforce them. State member banks will be required to institute procedures to ensure that all violations of the acts, including those not cited in this policy statement, will not recur. In addition, failure to comply with certain specific provisions of the acts has been judged by the Board to be particularly serious and usually to warrant retrospective action to correct the conditions resulting from the violations.

The objective of this enforcement policy statement is to ensure that the rights of credit applicants are protected by requiring state member banks to take corrective action for certain, more serious past violations of the Equal Credit Opportunity and Fair Housing Acts as well as to be in compliance in the future. In an effort to achieve that objective, the Board will encourage voluntary correction and compliance with the acts. Whenever violations addressed by this policy statement are discovered, the state member bank will be required to take action to ensure such violations will not recur and to correct the effects of violations discovered.

The Board generally will require the state member bank to take action to correct conditions resulting from violations occurring within 24 months prior to the discovery of violations by the Board, except for violations concerning adverse action notices for which corrective action will be required for violations occurring within six months prior to discovery.

Violations in the following areas are considered serious by the Board and will usually be subject to retrospective corrective action:

- discouraging applicants on a prohibited basis in violation of the Fair Housing Act or sections 202.4 or 202.5(a) of Regulation B
- using credit criteria in a discriminatory manner in evaluating applications in violation of the Fair Housing Act or sections 202.4 through 202.7 of Regulation B
- imposing different terms on a prohibited basis in violation of the Fair Housing Act or section 202.4 or 202.6(b) of Regulation B
- requiring cosigners, guarantors or the like on a prohibited basis in violation of section 202.7(d) of Regulation B
- failing to furnish separate credit histories as required by section 202.10 of Regulation B
- failing to provide an adequate notice of adverse action under section 202.9 of Regulation B

This policy statement will not preclude the use of any administrative authority that the Board possesses to enforce these laws, limit the Board's discretion to take other action to correct conditions resulting from violations of these laws, or preclude referral of cases to the attorney general. Additionally, this policy statement does not foreclose a credit applicant's right to bring civil action under the Equal Credit Opportunity or Fair Housing Acts or to file a complaint with the Department of Justice or the Department of Housing and Urban Development for violations of housing laws. Further, this policy statement does not supersede or substitute for any regulations or enforcement policies issued by the Board or the Department of Housing and Urban Development under the Fair Housing Act.

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United States Senate

COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS

WASHINGTON, DC 20510-6075

January 15, 1993

The Honorable Andrew C. Hove, Jr.
Acting Chairman, FDIC
550 17th Street, N.W.
Washington, D.C. 20429

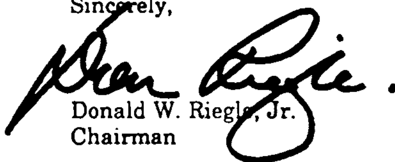
Dear Chairman Hove:

The Senate Committee on Banking, Housing, and Urban Affairs has tentatively scheduled a hearing to be held on Wednesday, February 24, 1993, to examine the problem of mortgage and other lending discrimination. In preparation for that hearing and in support of ongoing oversight activities, the Committee would like certain information from your agency concerning your fair lending compliance activities.

Enclosed please find a compilation of questions, the responses to which should be delivered to the Committee by Friday, February 12, 1993. Please deliver your responses to Matthew Roberts of my staff at the Dirksen Senate Office Building, Room 534, Washington, D.C. 20510.

Thank you for your cooperation.

Sincerely,



Donald W. Riegle, Jr.
Chairman

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FEDERAL DEPOSIT INSURANCE CORPORATION, Washington DC 20429

OFFICE OF THE CHAIRMAN

March 22, 1993

Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Riegle:

Thank you for your letter regarding mortgage and other lending discrimination.

The Federal Deposit Insurance Corporation will not tolerate credit discrimination with regard to race, sex or other prohibited bases. We are committed to enforcing fair lending in the institutions under our supervision by whatever measures are necessary and within our legislated powers.

In our response to your January 15, 1993 request, we described what the FDIC is doing about fair lending compliance and advised that our Fair Housing Act (FHA) examination procedures were under revision. This revision will be completed and disseminated to our regional offices and all compliance examination staff by the end of March. The revised procedures have been expanded significantly and include more direction and guidance to examiners on the three basic parts of the FHA examination process: collecting and evaluating information; selection and analysis of loan samples; and determining conclusions and findings. Specific instructions are provided for the examination of an institution's policies and procedures, marketing efforts, lending activities (including possible prescreening), appraisal practices and outreach efforts. In this regard, directions are given examiners on selecting loan samples and reviewing comparable loan files using a control group and a prohibited basis group. The procedures emphasize the determination and correction of violations of laws, rulings and regulations, policy and procedural deficiencies, and internal control weaknesses, one or more which could result in disparate treatment on a prohibited basis under the Fair Housing Act and related parts of the Equal Credit Opportunity Act.

Since our February 17 letter to you, the Director of the Division of Supervision has appointed a Fair Lending Working Group comprised of five, senior-level, Washington and regional staff. Oversight of the Working Group will be provided by the Director of our Office of Consumer Affairs and the Division of

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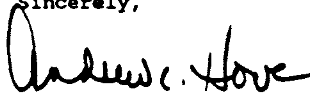
Supervision Assistant Director with responsibility for our compliance examination program. This group will find additional steps the FDIC can take to better prevent, detect and correct discriminatory credit practices in FDIC-supervised institutions. The group will look at not only our regulations, policies and procedures, and enforcement activities, but outreach and communication with the industry and community groups, and alternative measures, such as testing. A written report with recommendations will be presented to the Division Director and other senior FDIC officials by the end of May; appropriate measures will be initiated shortly thereafter.

Please contact me if you have further questions in this regard.

Sincerely,



Andrew C. Hove, Jr.
Chairman

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RESPONSE TO WRITTEN QUESTIONS FROM SENATOR RIEGLE BY ANDREW C. HOVE, JR.

LENDING DISCRIMINATION QUESTIONS

Compliance Structure

Q.1. What division within your agency conducts fair lending examinations? To whom within the agency do the examiners report? Do these supervisors have other responsibilities besides fair lending and/or Community Reinvestment Act compliance?

A.1. The FDIC's consumer compliance examination program, which includes examining for compliance with the fair lending laws, as well as the other consumer protection laws, is under the jurisdiction of the Division of Supervision (DOS), with oversight by the Office of Consumer Affairs (OCA). As with our other examination programs, this program is executed through the eight DOS Regional Offices, each headed by a Regional Director.

In 1990, the consumer compliance examination program was established as a separate examination program with specialized consumer compliance examiners who have career paths distinct from safety and soundness examiners. In each DOS Regional Office, an Assistant Regional Director, reporting through a Deputy Regional Director to the Regional Director, is designated with the responsibility for that region's compliance examination program as well as other supervision activities. The compliance examination staff essentially reports to this individual. In the Washington Office, an Assistant Director is assigned responsibility for the overall DOS compliance supervision effort. This person, who also has other responsibilities, reports through an Associate Director to the Director of the DOS.

The separate consumer compliance examination program is not yet completely staffed. Until this takes place, we continue to train and use safety and soundness examiners to assist in the compliance examination process. We expect the consumer compliance examiner force to be completely staffed and fully trained within the next 12–18 months.

Q.2. Would a separate division devoted to fair lending and community reinvestment examinations enhance your agency's compliance efforts? Why or why not?

A.2. We believe the FDIC's consumer compliance examination program, as described above, can most effectively be carried out within the Division of Supervision (DOS). The administrative structure for examination programs and staffing is in place within the DOS and the creation of a separate office or division for this purpose would be duplicative and not cost effective. Moreover, until a fully staffed and trained consumer compliance examiner force is in place, safety and soundness examiners will participate in consumer compliance efforts.

Q.3. Are there any structural factors (such as job classification) that preclude or impede consumer compliance examiners from being promoted to supervisory positions?

A.3. The career path for consumer compliance examiners is separate and distinct from that for safety and soundness examiners.

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Consumer compliance examiners can progress in a comparable manner as safety and soundness examiners within the Division of Supervision from the trainee level up to review/supervisory examination positions in the regional and Washington offices. In addition, the background and training of consumer compliance examiners may qualify them for senior level positions in our Office of Consumer Affairs (OCA).

Q.4a. How many staff personnel are allocated for fair lending enforcement?

Q.4b. Approximately how much time do they spend per year on fair lending compliance related work?

A.4a. & 4b. Within the Division of Supervision (DOS), there are 290 professional positions with responsibilities in the consumer compliance examination and enforcement program, and therefore, in fair lending enforcement. Of the 290 positions, 250 are field examiner positions and 30 are Regional and Washington Office Review Examiner positions dedicated solely to compliance supervision. The remaining ten positions include eight Assistant Regional Directors, and an Assistant Director and a Section Chief in the Washington office which have major responsibilities in consumer compliance supervision, but also have other responsibilities. At present, 186 positions are occupied including 157 (out of 250 authorized) field examiner positions, 15 (out of 30) Regional and Washington Office Review Examiner positions, eight Assistant Regional Director positions and the Assistant Director and Section Chief in the Washington Office.

In addition to the examination staff, the Office of Consumer Affairs (OCA) has staff devoted to the fair lending area. OCA's Community Affairs Program consists of a Community Affairs Officer and a Community Affairs Assistant in each of the FDIC's eight DOS Regional Offices. This staff is devoted full time to fair lending enforcement. Additionally, in OCA's Washington Office there is a Fair Lending Analyst and a Consumer Affairs Specialist devoted full time to fair lending enforcement. Also, two Senior Consumer Affairs Assistants devote a portion of their time to fair lending enforcement including personnel management and policy and procedure development. The Director and Deputy Director of OCA also devote over half of their time to fair lending enforcement.

An average of 94 examiners hours is spent at each compliance examination of which an average of 51 examiners hours is spent on examining for compliance with the fair lending laws. Examination report processing and review is averaging 15 hours per report of which about one-half is spent on the fair lending segment of the report. Nearly 4,000 compliance examinations were conducted in 1992 which results in 204,000 examiner hours and 60,000 examination report review hours spent on fair lending compliance for that year.

Additional hours are routinely spent at the regional and Washington office levels on policies, examination procedures, and other subjects pertaining to fair lending enforcement. Specific information on time devoted to fair lending matters is not tracked. However, these hours comprise a varying, but not inconsequential,

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amount of time for Assistant Regional Directors and the Assistant Director and Section Chief in the Washington office.

Q.5. What is the nature of the training for fair lending examiners?

A.5. Fair lending training is incorporated into three compliance examination schools offered by the FDIC. Two of these schools—the Bank Operations and Compliance School (two weeks in duration with approximately eight hours devoted to fair lending); and, the Advanced Consumer Protection School (one week in duration with approximately eight hours devoted to fair lending)—address various compliance laws, including fair lending. The third school, Compliance Examiner Loan/CRA Training, is an intensive two-week course, one week of which is devoted to the fair lending area. A fourth school—the Consumer Protection School (one week in duration with approximately 11 hours devoted to fair lending)—is targeted to safety and soundness examiners who also participate in compliance exams. This school will be phased out as the compliance examiner program becomes fully staffed. In addition to this national core curriculum, the FDIC held its first National Compliance Training Conference last year. This conference, attended by all professional staff involved in compliance enforcement, had a significant portion devoted to fair lending.

The Community Affairs Officers and Division of Supervision compliance examination staff in each region also provide fair lending-related training throughout the year. Additional interagency training is conducted on a regional basis. For example, in one region a three-day session on discrimination analysis is scheduled for mid-February. Also, the Federal Financial Institutions Examination Council (FFIEC) is sponsoring a joint interagency compliance conference in March 1993—a significant portion of which will be devoted to fair lending. The conference will be attended by senior professional staff from each agency. Finally, on-the-job training is provided by the more experienced compliance examiners.

Q.6. Please provide a breakdown of the race, ethnicity, and gender of fair lending examiners and supervisory personnel by job classification.

A.6. Based on our records, the following is a breakdown of FDIC professional staff involved in consumer compliance supervision:

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	DOS*	OCA**
Total positions	186	22
Supervisory positions	23	10
Non supervisory positions	163	12
Black, Hispanic, Asian and Native American staff	25	6
Supervisory	4	3
Non supervisory	21	3
Female staff	76	15
Supervisory	7	6
Non supervisory	69	9
White staff	161	17
Supervisory	19	10
Non supervisory	142	7

*As indicated in answer 1 above, DOS Consumer Compliance Supervision staff have responsibility for fair lending, as well as other consumer protection laws.

**OCA has additional staff involved in consumer compliance supervision. The totals represent only the staff involved in fair lending enforcement.

Examination Techniques

Q.1a. What instructions do you give examiners on the type of loans and the number of files that they should review in a fair lending compliance exam?

A.1a. A copy of the instructions provided to FDIC compliance examiners for the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA) are included as Attachments A and B. Examiners are instructed to review a sample of accepted and rejected applications for each type of loan extended. Examination procedures specify that the sample include applications from minorities and nonminorities, males and females depending on the needs and characteristics of the institutions and the communities. The sampling could also involve prohibited bases other than race or sex, such a marital status or age.

Q.1b. How many loan files are sampled as part of an examination?

Q.1c. Does the number of files sampled vary by the size of the institution?

A.1b. & 1c. The Examination Manual provides guidelines and instructions on sampling techniques. The number of loans sampled depends on the size of the institution, the number of loans and the institution's past history. The actual size of the sample is unspecified in the ECOA component of the procedures. The FHA component states that the sample size should depend upon the volume of home lending. If review of the sample identifies possible problems, the examiner will increase the size of the sample. Each of the various types or categories of credit or loans extended are expected to be sampled.

Q.2. What indicia of discrimination are examiners instructed to look for in the files (e.g., perfect minority applicants who are re-

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jected, comparable minority and non-minority applicants who receive differential treatment, etc.)?

A.2. The examination procedures define the control group as white males and couples. A sample of minority and/or female applicants are compared to the control group applicants for possible disparate treatment. Item 8 of the FHA procedures directs the examiners' attention to the institution's policies and procedures and any exceptions that were applied to minority/female and nonminority applicants.

Q.3. Does your agency operate on the premise that you need to find statistically significant discrimination to take enforcement action?

A.3. No, the FDIC does not operate on that premise. Pertinent examination support for an enforcement action need not be based on statistically significant findings but may rely on an investigation of a random sampling of loans in conjunction with the assessment of an institution's policies and practices.

Q.4. Do compliance examiners interview loan officers?

A.4. Yes, the examination procedures direct the examiners to interview both loan officers and management officials in order to determine the actual and articulated policies and procedures used by the institution.

Q.5. Please describe the circumstances under which examiners contact credit applicants to collect consumers' opinions on how their applications were handled by bank personnel.

A.5. Credit applicants may be contacted once an investigation of discrimination is initiated in response to a complaint or in response to evidence of possible discrimination found during an examination. Additionally, the examination process encourages interviews with community members, other than credit applicants, during which the examiner may encounter someone who has had credit experience with the financial institution under examination. A required question regarding knowledge of discriminatory practices against any protected classes is contained in the community contact form. This form is included in Attachment C.

Q.6. What percent of fair lending examinations include examiner outreach to credit applicants?

A.6. Credit applicants are not contacted as part of a routine examination other than that described in answer 5 above.

Q.7. Please describe the circumstances under which examiners contact representatives of the business and consumer community to collect their opinions on bank treatment of credit applications.

A.7. Examiners are encouraged to make outside contacts during both the CRA and FHA portions of compliance examinations. The CRA procedures state that the examiner should consult sources other than the institution being examined to better understand the credit needs of a particular community. The types of contacts examiners make include: federal, state, county, and local government officials; civil rights and consumer organizations; community development corporations; grass-roots community groups; trade associations; and private individuals.

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Each contact is documented on the uniform interagency Community Contact Form which is shared with the other financial institution regulatory agencies. FDIC examiners have access to the information gathered from interviews conducted by other agencies through the OCA staff in each regional office.

In addition, the Community Affairs staff meets with community representatives regularly and separately from the examination process. These contacts take the form of meetings with individuals, conferences, round table discussions on specific topics and other formats. Results of the Community Affairs staff's activities as well as their contact lists are shared with examiners through community reports prepared on various Metropolitan Statistical Areas and in response to examiner inquiries.

Finally, FHA complaint investigation procedures require examiners to contact real estate brokers and/or the owners of real estate firms. The Community Contact Form and FDIC complaint investigation procedures are included as Attachments C and D.

Q.8a. How frequently are community organizations contacted?

Q.8b. How frequently are legal service agencies contacted?

Q.8c. How frequently are members of the small business community contacted?

Q.8d. How frequently are members of the real estate community contacted?

A.8a., 8b., 8c., & 8d. A breakdown of the frequency of outside contacts is not readily available in the categories requested. Examiners using the community contact form identify the specific contacts as falling into one of six categories which are defined on the form as: government officials, civil rights groups, community development organizations, trade associations and private individuals. During 1992, FDIC examiners reported 1,876 outside contacts and had access to reports of 1,196 outside contacts conducted by other regulatory agencies. During 1992, reports of outside contacts for each of these six categories breaks down as follows:

	FDIC	Other Agencies
Government Officials (other than Federal financial institutions regulatory agencies)	830	401
Civil Rights Groups	33	13
Community Development Organizations	290	316
Grass-Roots Organizations	77	60
Trade Associations	287	176
Private Individuals	359	229
Total	1,876	1,195

Q.9. What percent of exams result in specific examiner discussion of fair lending compliance problems and recommendations with a bank's board of directors? With bank management?

A.9. All compliance examinations include a discussion of fair lending compliance problems and recommendations with bank management. Additionally, in problem cases, there is a discussion with the Board of Directors or a committee of the Board. In other cases, the

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decision of whether or not to present the examination findings to the directorate is generally left to the discretion of the examiner-in-charge. We have no statistics in this regard.

Q.10. What procedures do you use to monitor the quality and consistency of fair lending exams?

A.10. Every report of examination submitted by examiners is subject to review at various levels in the Regional Offices. Specifically, examinations are reviewed by the compliance review examiner, the appropriate Assistant Regional Director, and in some cases, the Regional Director. All examination reports reflecting problem cases are also reviewed in the DOS Washington office. Additionally, the FFIEC, through the Consumer Compliance Task Force (Task Force), provides uniform interagency policies and examination procedures as evolving circumstances require. In order to promote uniformity of presentation in reports of examination, training sessions and various conferences and seminars are required for examiners and other staff.

Complaints and Violations

Q.1. How many complaints of ECOA and Fair Housing Act violations has your agency received each year for the past 10 years? Are these complaints investigated by the same examiner that conducted the routine compliance examination? How many have been resolved and with what resolutions?

A.1. The following chart depicts the number of ECOA and FHA complaints, how many complaints alleged discrimination under Fair Housing and how many findings of Fair Housing discrimination the FDIC noted through complaints for the period 1990 through 1992.

	ECOA and FHA Complaints	FHA Discrimination Complaints	Findings of Discrimination
1992	857	6*	0
1991	728	1**	1
1990	841	13	0

* Two of these are still under investigation.

** We are currently reviewing all of the 1991 ECOA complaints to determine if other cases may have been processed solely as ECOA complaints.

In addition to the one finding of discrimination in 1991, there were four cases where an apparent violation of law by the institution was found (one in 1992, two in 1991, and one in 1990). The majority of the other complaints were resolved with bank initiated adjustments or accommodations, or by providing information to the complainant. In each year, there were a few instances where additional information was requested with no response from the consumer.

Detailed information regarding ECOA and FHA complaints for the period 1983 through 1989 is not available because the FDIC consumer complaint statistical system retrieves information for

only the past three years and files are maintained for just two years. However, we have information on the number of findings of discrimination. For the time period requested, there were four findings of discrimination—one in 1983, one in 1984, and two in 1986. We are unable to determine, however, whether the findings of discrimination were solely ECOA or FHA related.

Depending on the distribution of workload, the compliance examiner who performed the examination may or may not be the same examiner who conducted the complaint investigations. We have no policy as to whether a compliance examiner may or may not conduct a complaint investigation with respect to an institution he or she has examined.

Q.2a. What distinguishes a technical violation from a substantive violation? Can an institution have technical violations and get a satisfactory Community Reinvestment Act rating? Can an institution have substantive violations and get a satisfactory CRA rating?

A.2a. As related to fair lending, technical violations are defined as those of a procedural nature such as an adverse action notice given late, certain monitoring information is not asked or properly retained, or reasons for loan denial are too vague. Substantive violations involve actual apparent discriminatory practices on a prohibited basis. The rating assigned an institution that has either technical or substantive violations can depend on the severity of the violations, how widespread they are or whether there is a pattern or practice of apparent discrimination. An institution can receive a satisfactory CRA rating if the violations are isolated in nature and deemed correctable by management in the normal course of business, assuming that the other assessment factors considered point to satisfactory performance. For example, an institution with otherwise satisfactory CRA performance was found to be using loan documents containing wording implying discrimination. Upon being notified of the problem by an examiner, the institution revised the documents to exclude this wording and discontinued using the existing documents. The institution was rated satisfactory for CRA.

Q.2b. What kind of enforcement action, if any, is taken for technical violations? For substantive violations?

A.2b. Enforcement actions available to the FDIC for both technical and substantive violations of fair lending laws range from those of an informal nature, such as a Memorandum of Understanding, to formal actions such as a Cease and Desist Order or Civil Money Penalty. The decision to take a particular enforcement action is based on the severity and extent of the violations and the record and character of an institution's management.

Whether the FDIC decides to take an enforcement action related to consumer compliance against an institution is based on the compliance history of the institution, its current compliance record as reflected in the most recent examination report and the likelihood of voluntary compliance and corrective action within a reasonable time frame without resort to an enforcement action. We look at the severity and frequency of past violations, prior supervisory admonitions not heeded, assurances of corrective action not kept, etc.

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Q.3a. How many ECOA and Fair Housing Act violations have been found for each of the last 10 years?

Q.3b. Of these, how many were technical and how many were substantive?

Q.3c. How many of these violations have been resolved and how were they resolved?

A.3a., 3b., & 3c. Our examination records pertaining to consumer protection law violations do not go back beyond 1985. For the eight-year period from 1985 through 1992, compliance examinations revealed about 67,000 violations of the FHA and 43,000 violations of the ECOA. All but a very few violations reported were of a technical nature. There were 18 substantive violations of the Fair Housing Act and 96 substantive violations of the ECOA which involved apparent discrimination on a prohibited basis. These situations were resolved without the need for a formal enforcement action by institutions changing policies and practices and, in some instances, personnel.

Q.4. What specific practices by regulated institutions and their subsidiaries that constitute illegal discrimination are set out in your regulations? Do you make any effort to disseminate to the public a list of practices that they might encounter that would be illegal? If so, how?

A.4. The FDIC adheres to the regulations approved by the Federal Reserve Board with regard to the ECOA (Regulation B); HMDA (Regulation C); and to those approved by the Department of Housing and Urban Development with regard to the Fair Housing Act (as amended). The FDIC's CRA regulation (Part 345) is also consistent with the CRA regulations of the other regulatory consistent with the CRA regulations of the other regulatory agencies. In addition, the FDIC has developed its own Fair Housing regulation (Part 338).

Specific practices that are unlawful are more fully described in the fair lending compliance examination and investigation procedures. Several practices which may have the effect of discriminating include, but are not limited to, the following:

—A policy of making mortgage loans only to applicants who have previously owned a home.

—Setting high minimum mortgage loan amounts that effectively exclude low-income borrowers.

—A requirement that the property securing a mortgage loan must not exceed a particular age, or appraisal practices which establish unrealistically low values for older properties.

—Restricting mortgage lending to loans for certain types of properties such as single-family homes, properties having no more than two floors, those with large lots, garages, or with large square footage requirements.

Other indicators of possible discrimination are:

—A lack of applications from protected group members and/or from census tracts and neighborhoods with relatively large percentages of protected group members.

—A disproportionate number of applications from protected group members that are withdrawn.

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—A disproportionate number of denials of applications from members of protected groups.
—Delays in acting on applications submitted by protected group members.

The FDIC regularly disseminates fair lending related information. Some examples of specific information available to the public concerning practices that may constitute unlawful discrimination are:

—"Home Mortgage Lending and Equal Treatment"—This booklet highlights some lending standards and practices that may adversely affect the ability of credit applicants on the basis of race, sex, or certain other factors, to obtain home mortgages. It 'addresses the less obvious forms of discrimination.
—"Equal Credit Opportunity and Women"—This pamphlet points to what constitutes illegal discrimination and is in Spanish and English.
—"Equal Credit Opportunity and Age"—This pamphlet points to what constitutes illegal discrimination.
—"A Citizen's Guide to the CRA"—This booklet assists consumers in understanding efforts that help meet a community's credit needs.
—"Home Mortgages: Understanding the Process and Your Right to Fair Lending"—This pamphlet explains the role and responsibilities of mortgage lenders and a consumer's legal rights to fair lending.

A copy of each of these publications is included as Attachment G. These and other pamphlets and booklets are regularly distributed to anyone who makes a request or appears to likely benefit from this information, such as complainants.

We regularly provide speakers for, and participate in, fair lending conferences and seminars throughout the country. Further, FDIC staff works with trade associations to review fair lending related materials aimed at consumers and industry representatives. The FDIC also has a toll-free 800 number (934-FDIC) within the Office of Consumer Affairs so that the agency may be reached by consumers who have questions regarding their rights. In 1992, OCA responded to approximately 1,000 callers with questions about the ECOA, the FHA, and CRA. Additionally, the DOS Regional staff responded to approximately 5,400 such calls.

Q.5. Over the past several years a number of highly publicized news reports have indicated evidence of fair lending problems in a number of metropolitan areas across the country (i.e., Atlanta, Detroit, and Boston). What responses has your agency made to these reports?

A.5. Following the publication of news reports concerning each of the Atlanta, Boston, and Detroit areas, we directed the responsible FDIC DOS Regional Offices to determine if any FDIC-supervised institutions were cited in the news reports and supporting studies as evidencing fair lending problems. In those instances where our institutions were cited, the regional offices followed up on the reported problems by researching information on file at the regional office regarding each of the institutions and conducting a visitation or examination as deemed appropriate. This follow-up disclosed no

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evidence of fair lending problems involving discrimination at that time.

Q.6. For each of the following metropolitan areas, please provide the number of fair lending examinations conducted by your agency for every year since 1985: Atlanta, Boston, and Detroit.

A.6. For the period from 1985 through 1992, the FDIC conducted consumer compliance examinations which include fair lending examinations in the Atlanta, Boston and Detroit MSAs as follows: Atlanta—116; Boston—154; and Detroit—50.

Enforcement Powers

Q.1. What range of enforcement powers are available to your agency and how frequently has each power been used over the past 10 years?

A.1. FDIC sanctions for noncompliance with laws and regulations include: unsatisfactory ratings; Memoranda of Understanding; and ultimately, a Cease and Desist Order or Civil Money Penalties. More stringent administrative action is normally taken progressively until compliance is achieved. Additionally, institutions are more closely supervised e.g., subject to more frequent examinations or reporting requirements.

From 1990 through 1992, the FDIC issued four Cease and Desist Orders and 42 Memoranda of Understanding which included conditions requiring corrections of deficiencies in compliance with the FHA and/or ECOA. From 1985 through 1989, the FDIC issued four Cease and Desist Orders and 168 Memoranda of Understanding pertaining to consumer protection laws. However, prior to 1990, our records do not distinguish enforcement actions under the FHA and ECOA from any other enforcement actions.

Q.2. Would any additional tools be useful?

A.2. Clarification of our enforcement authority as it relates to the Community Reinvestment Act would facilitate strengthening our enforcement in this area. Otherwise, we believe that existing enforcement tools are sufficient to carry out our regulatory responsibility with regard to ECOA and the FHA.

Referrals of Violations to HUD and Justice

Q.1. During the past 10 years, on how many occasions has your agency referred violations of ECOA to Justice and of the Fair Housing Act to HUD?

A.1. The FDIC has referred three violations to the Department of Justice pursuant to the ECOA amendment in Section 223 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) effective in 1991. These violations were examination-based pattern and practice violations of the ECOA for the first two quarters of 1992.

Q.2. What documents (e.g., exam reports, examiner work papers or loan files) have been included in these referrals?

A.2. In these cases, CRA Performance Evaluations were included. In any case, we would provide any relevant documents to the Department of Justice with the referral and any other documents requested by the Department of Justice.

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Q.3. Please provide a copy or describe the substance of the memorandum of understanding between the financial supervisory agencies and HUD regarding FHA referrals.

A.3. A copy of the MOU is included as Attachment H. The MOU essentially requires that all FHA complaints received by any of the FFIEC member agencies or HUD be expeditiously forwarded to the other agency and that we attempt to coordinate our investigations.

Q.4. Please describe what coordination exists between your agency and the Department of Justice regarding referral of suspected fair lending violations.

A.4. The Division of Supervision is the contact point between the Department of Justice and the FDIC for such violations. The FDIC is required to forward all cases of a pattern or practice of violations to the Department of Justice. If the Department of Justice determines to proceed with a referral, the DOS cooperates through onsite investigation and/or providing access to any relevant information.

Q.5. Does a memorandum of understanding exist?

A.5. No, a MOU does not exist. The FDIC believes that FDICIA is very clear on what cases should be referred.

Q.6. What factors account for the limited number of referrals?

A.6. Prior to FDICIA, the FDIC's practice was to make referrals only in cases where corrective action was not undertaken. All ECOA and FHA cases were resolved by corrective action. FDICIA requires referrals to be made even if corrective action is undertaken.

Q.7. Is there specific staff assigned to carry out referral functions?

A.7. Yes, referrals are handled by the Chief and the staff of the Compliance and Special Review Section in the Office of Specialty Examinations and Financial Reporting, which is within the Division of Supervision.

Q.8. Who does DOJ contact within your agency regarding referrals?

A.8. The Department of Justice contact within the FDIC regarding referrals is the Assistant Director, Office of Specialty Examinations and Financial Reporting, Division of Supervision.

Q.9. How has your agency responded to DOJ's request to accompany examiners on fair lending examinations?

A.9. We have held numerous meetings with the Department of Justice. Attachment I is a September 1992 letter from FDIC to Department of Justice regarding their request. In summary, we have told the Department of Justice that we will cooperate by providing information obtained in the course of an examination in accordance with applicable laws and regulations. We are prepared to assist the Department of Justice in investigating potential violations of the FHA and ECOA. We are, in fact, currently cooperating on three such investigations.

While we believe it would be inappropriate for employees of other agencies to accompany our examiners or participate in a routine examination, we are willing to do so if the Department of Justice

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requests, and receives, the voluntary consent of the institution to do so.

Q.10. What follow-up has your agency conducted in response to the judgment in the Green mortgage discrimination case?

A.10. Our Chicago Regional office emphasized again the importance for close review of loan applications, approvals, and denials in examining for compliance with fair lending laws. The regional office also emphasized to its examiners the need to expand this review, as appropriate, when indications of apparent discrimination are found.

A fair lending examination of the institution involved was recently completed and a meeting between its management and regional office representatives is being scheduled. Based on examination findings and the results of this meeting, appropriate follow-up will take place.

Fair Lending Data Systems

Q.1. Following the lawsuits brought by civil rights groups in the 1970's, your agency now collects information, in addition to HMDA data, for fair lending enforcement purposes (see 12 CFR Chapter III, Subpart B). What data are you required to collect? What data are you permitted to collect?

A.1. As a result of the lawsuit, the FDIC established a fair lending log-sheet. The log-sheet was replaced by the HMDA Loan Application Register (LAR), effective November 4, 1991, as a result of the FDIC having conformed the log-sheet to the requirements contained in the HMDA LAR. This was done to eliminate duplicative recordkeeping for institutions subject to both rules, while providing FDIC examiners information needed to effectively monitor compliance with fair lending laws.

We are not aware of any specific prohibitions on collecting data as long as we follow the Administrative Procedures Act and receive clearance under the Paperwork Reduction Act by the Office of Management and Budget. However, we are prohibited from requiring institutions to collect data that the institution is prohibited from collecting, such as certain personal information (race, sex, marital status, etc.) prohibited under Federal Reserve Regulation B (ECOA).

Q.2. What data, in addition to HMDA data, have you in fact collected and for how many institutions?

A.2. The FDIC does not "collect" any information for fair lending enforcement beyond that required by HMDA. However, the FDIC does require that FDIC-supervised institutions request and retain certain additional data for home purchase applications for dwellings occupied or to be occupied by the applicant as a principal residence, and containing one to four units. For example, the data includes date of application, case identification (name, address, location), sex, race/national origin, and marital status (as permitted under ECOA). Additionally, institutions with an office in a PMSA or MSA that have total assets of $10 million or more, must request and retain for these applications loan type, case disposition, information on employment, income, dependents, assets, liabilities, payments, and property information. While this information is not col-

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lected by the FDIC, the data must be made available to examiners for review upon request.

Q.3. How is a determination made as to which lenders must report? Is HMDA data used to make this determination?

A.3. The HMDA specifies which institutions must report. The size of the institution, location, date, and type of loan are key points taken into account.

Boston Federal Reserve Study

Q.1. For all institutions under your jurisdiction that were included in the Boston Federal Reserve study:

Q.1a. How many fair lending compliance examinations were conducted during the time period covered by the study?

A.1a. From 1990 through 1992, the FDIC conducted 73 examinations of the institutions covered in the Boston Federal Reserve study.

Q.1b. How many violations of fair lending law were uncovered as a result of these examinations?

A.1b. Six hundred seventy seven (677) fair lending related violations were reported in these examinations.

Q.1c. What was the nature of each of these violations?

A.1c. The majority of these were of a technical nature, involving primarily recordkeeping and record retention requirements. No violations were found that involved discriminatory practices.

Q.1d. What enforcement actions, if any, were taken against institutions with violations?

A.1d. Three Memoranda of Understanding, with conditions pertaining to violations of fair lending laws, were issued. As to the other instances where violations were found, the institutions positively responded to our Boston Regional Office on suggested corrective measures regarding all deficiencies noted in their examination reports, including violations of fair lending laws.

Q.2. How have you modified examination procedures in response to the findings of the Boston Federal Reserve study?

A.2. In response to the findings of the Boston study, the FDIC's Boston Regional Office initiated a review of each of the institutions that had "exceptions" (i.e., loans that were predicted to be accepted but were rejected in the study). Of these institutions, 14 had minority applications that were "exceptions." On-site reviews were conducted in all of the 14 institutions. In each case, loan files of all of the exceptions in the institution, minority and nonminority, were reviewed in detail. We are currently in the process of reviewing the data base of every loan submitted by these institutions. We are trying to determine if it is possible to identify comparable applicants. If so, we will review these files to determine if there was any disparate treatment.

We are currently revising our Fair Housing examination procedures and have incorporated more guidance to examiners regarding the need to review comparable files as well as more guidance generally on such topics as prescreening and loan sampling. If the

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findings of our review of the 14 institutions noted above identify other areas where our procedures could be strengthened, we will do so.

Q.3. How do you plan to use statistical analysis in your future fair lending enforcement efforts?

A.3. We have no present plans to use a statistical analysis model. As noted in response to question 4, we will continue to use the HMDA data to identify potential institutions for further review.

Q.4. How will you monitor compliance for lenders that receive too few applications from minorities to make statistical analysis possible? Would it be possible to aggregate data from multiple years for those institutions?

A.4. The FDIC uses the aggregate and individual HMDA data to identify institutions that may be engaged in discriminatory lending practices. From that process, examinations are conducted with particular focus in the fair lending area. While it is theoretically possible to aggregate several years data, the statistical validity of such a process would be questionable due to changes at each institution over time such as policies, practices, underwriting standards and even personnel. Additionally, for many FDIC-supervised institutions, even doubling or tripling minority applicants sample size would still create a very small sample for analysis purposes.

Q.5. What enforcement actions, if any, have you taken against lenders referred to you by the Boston Federal Reserve as a result of the study?

A.5. Our review of the institutions involved in the Boston study is not yet complete. No enforcement actions have yet been taken. Appropriate supervisory action will be taken, if warranted, when the review is completed.

Prescreening and Related Practices

Q.1a. How do you determine whether lenders are prescreening or illegally discouraging applications from minorities?

A.1a. Proving prescreening is difficult. Usually, this is indicated by too few applications received from certain census tracts or neighborhoods. Outside contacts, such as minority brokers and realtors, can be of special assistance as a possible indicator with regard to why they may not refer customers to particular lenders. Discouraging usually begins with not encouraging—so the CRA component of the compliance examination would provide some additional indicators. HMDA data and census information cap be used to help determine prescreening and discouragement of protected groups. Through the use of this information, examiners can compare the demographics of the areas where the institution is lending against those areas where the institution is not lending. Under representation in census tracts that are largely minority would be a key indicator of possible prescreening or redlining. Examples of this type of comparison are the tables in Exhibits 1, 2, and 3 of the complaint investigation procedures included in Attachment D.

Q.1b. Do you have any exam techniques to focus on prescreening?

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A.1b. Yes, examiners are instructed to review the indicators of prescreening described in the response above (A. 1a.)

Q.1c. Is use of testers necessary for this program? If so, how should such testing be conducted?

A.1c. Testing may not be "necessary" but it is probably the most effective means of identifying prescreening. Private sector efforts, including those of institutions, would be more cost-effective and bring results more quickly. However, institutions' willingness to share the results of their own programs with the regulators may be undermined by the current requirement that the regulators refer all pattern and practice violations to the Department of Justice. That is, under existing law, if an institution finds a pattern or practice violation through testing and examiners become aware of it, even if corrective measures have been taken, we are required to make a referral to the Department of Justice.

Q.2. HMDA data consistently show low numbers of minority mortgage applications in markets with significant minority populations. When your agency has found low numbers of applications from minorities in certain markets, what surveys or other information have you collected to determine the impact of discouragement on the flow of mortgage applications?

A.2. The FDIC has not conducted any formal surveys in this regard and we are not aware of any reliable source of data or surveys to identify lenders who are illegally prescreening or discouraging applications. However, when examiners see few minority applications, in relation to the population of the area, they attempt to determine what potential demand for home mortgages is from minority households. Examiners would look for reasons for this in conducting outside contact interviews. As previously mentioned, the results of these interviews are made available to examiners and to other agencies. The Community Affairs staff would also make note of any potential problems with prescreening that they note through their outreach efforts. The result of these efforts is available to examiners through various means, including Community Reports prepared on the various Metropolitan Statistical Areas in each region. As an example, Attachment J is the Community Report for Dane County, Wisconsin. Twenty-five such reports were prepared in 1992.

Q.3. What instructions are provided to examiners to determine whether a lender is steering applicants—based on race, neighborhood, loan size or other factors—to loan products less advantageous than other products offered or to a mortgage or finance company subsidiary?

A.3. Currently, there are no specific instructions concerning steering. However, revised FHA examination procedures will have—an elaboration on the concept of steering. We anticipate these procedures to be in place within the next month.

Q.4. Are underwriting criteria examined to see if they are discriminatory? Are regulated institutions required to make the criteria public?

A.4. Examiners regularly review an institution's written lending policies. In addition, the FHA complaint investigation procedures contains a section on "Analysis of Underwriting Procedures." Inves-

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tigators are instructed to obtain a description of all factors which go into the decision that an applicant is qualified, the property is eligible and the specific terms and conditions of each loan. Some specific items the investigator is instructed to review are:

—Under what circumstances might loan-to-value, mortgage payment to income or total payments to income ratios or formula be varied?

—What factors are looked for in determining viability, stability or reliability of income?

—In the case of married applicants, if only one income is used, why?

A copy of the investigation procedures is included in Attachment D. FDIC supervised institutions are not required to make these criteria public.

Private Mortgage Insurance

Q.1. Does private mortgage insurance play a role in mortgage discrimination? How?

A.1. While there is no data to verify that private mortgage insurers (PMI) contribute to mortgage discrimination, there are some loan applications from low- and moderate-income individuals, particularly in urban neighborhoods with 2–4 unit structures. There is also a perception that as a "secondary underwriter," the PMI's do not always take into consideration unique circumstances that might provide compensating factors for a marginal applicant. Additionally, some PMI's base insurability on factors which may preclude certain neighborhoods. For example, a criteria that would require no less than 10 percent vacancy in the neighborhood would preclude many borrowers in some inner city areas from qualifying. To the extent that these neighborhoods are largely minority, this type of criteria would appear to have a role in mortgage discrimination.

One reason for concern is that a number of lenders have developed first time homeowner programs that include more liberal debt and housing expense ratios, as well as consideration of untraditional ways of verifying credit and other critical information. In some cases, lenders have resorted to "self-insurance" for these loans. The reasons for the decision to self-insure include (1) desire to reduce the cost of low and moderate income buyers by eliminating the PMI premium, (2) lack of agreement from the PMI to approve loans based on the more flexible and liberal underwriting criteria, and (3) in some recession impacted areas the withdrawal of PMI from the highest ratio loan to values (90–95 percent LTV's) for some categories of loans—typically condos and 2–4 unit structures. To the extent that these programs benefit minorities the lack of participation by PMI's is a problem.

Q.2. Should private mortgage insurers be subject to HMDA or similar disclosure requirements?

A.2. Private mortgage insurers should not be subject to HMDA since requiring PMI's to collect HMDA data would in effect double count the loans submitted to the PMI since the loan originator also collects that data. The Mortgage Insurance Companies Association (MICA) has volunteered to provide data to the regulators in connec-

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tion with their data collection. Discussions are underway as to technical issues involved, including possible duplication.

Q.3. Do examiners attempt to discover whether an institution has engaged in discrimination by steering certain groups to particular insurers or by making greater efforts to follow-up when insurance is denied to white applicants than when insurance is denied to minority applicants?

A.3. Examiners do not take specific steps to review accepted or rejected PMI loans. However, the examination procedures do provide for a sampling of accepted and rejected loans to look for any patterns of apparent radial discrimination. The FDIC is not aware of any instance where a pattern of higher PMI rejection rates for minority than similar white applicants was detected.

Non-Mortgage Related Lending Discrimination

Q.1. What data does your agency have on the prevalence of non-mortgage related lending discrimination? In which markets, other than the mortgage market, is discrimination a serious problem?

A.1. The FDIC monitors mortgage lending discrimination through the complaints it receives and the violations noted during examinations. Non-mortgage lending complaints and violations are not coded by industry. Therefore, we have no data to support the extent to which discrimination may be a problem in other markets.

Q.2. Do we need disclosure of non-mortgage related lending?

A.2. FDICIA required the Federal Financial Institutions Examination Council to revise financial institution call reports to provide for the collection of small business lending data. This change only recently has become effective and no data has been collected yet. It would be premature to discuss whether or not additional data is necessary until we have had an opportunity to review the data to be collected through this format.

Q.3. What examination techniques do you use to enforce ECOA with respect to non-mortgage related lending? Given the paucity of statistical data, what "flags" do you instruct examiners to look for to detect non-mortgage related lending discrimination?

A.3. "Flags" raised in conjunction with an examination can come from complaints against an institution concerning the lending function; a review of a sample of loan files and applications; interviews with institution personnel; and a review of lending policies, procedures and practices. In addition, the examination objectives and procedures for ECOA (Attachment A) are equally applicable to mortgage and non-mortgage related lending.

Q.4. How do these "flags" differ from those you look for to detect discrimination by mortgage lenders not falling under HMDA?

A.4. These "flags" differ little in the examination of mortgage and non-mortgage lending as pertaining to assessing compliance with ECOA.

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United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WASHINGTON, DC 20510-6075

January 15, 1993

Jonathan Fiechter
Acting Director
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552

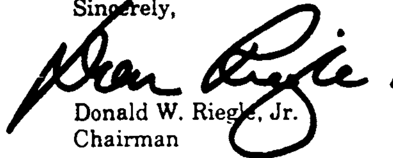
Dear Mr. Fiechter:

The Senate Committee on Banking, Housing, and Urban Affairs has tentatively scheduled a hearing to be held on Wednesday, February 24, 1993, to examine the problem of mortgage and other lending discrimination. In preparation for that hearing and in support of ongoing oversight activities, the Committee would like certain information from your agency concerning your fair lending compliance activities.

Enclosed please find a compilation of questions, the responses to which should be delivered to the Committee by Friday, February 12, 1993. Please deliver your responses to Matthew Roberts of my staff at the Dirksen Senate Office Building, Room 534, Washington, D.C. 20510.

Thank you for your cooperation.

Sincerely,



Donald W. Riegle, Jr.
Chairman

DWR/mr
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RESPONSE TO WRITTEN QUESTIONS FROM SENATOR RIEGLE BY JONATHAN FIECHTER

Compliance Structure

Q.1a. What division within your agency conducts fair lending examinations?

A.1a. We established a specialized examination program for compliance matters in January 1989. This program serves as the cornerstone of our nationwide program to examine savings associations for compliance with fair lending, consumer protection, and public interest laws and regulations. The fair lending area includes the Equal Credit Opportunity Act, Fair Housing Act, Home Mortgage Disclosure Act, and OTS nondiscrimination regulations. We also evaluate performance under the Community Reinvestment Act (CRA) as part of examinations conducted under this program. Recent improvements to the program's management structure are discussed in our response to question 2.

Our specialized examination program is comprised of several significant components. First, compliance examinations are conducted by specially-trained and career-professional staffs in our five Regional Offices. These compliance personnel have a separate career path and accreditation program (discussed in our response to question 3). Second, separate compliance examination reports are presented to a savings association's board of directors. Third, we use separate rating systems to evaluate an association's compliance and CRA performance. The rating systems provide a mechanism to trigger the frequency of subsequent examinations.

We revised the management structure of our compliance examination program in September 1992 so that we can focus more resources in the field examination process. In adopting these changes, we emphasized that compliance is a major component of the entire examination process. We conduct these examinations concurrently with safety and soundness examinations whenever practicable to improve internal coordination and to minimize examination burdens on the industry.

Q.1b. To whom within the agency do the examiners report? Do these supervisors have other responsibilities besides fair lending and/or Community Reinvestment Act compliance?

A.1b. Compliance examiners in each of our Regional Offices report to one or more "Compliance Managers." These positions are dedicated solely to the compliance function. As noted previously, the compliance function encompasses responsibility for a host of consumer protection laws and regulations; but the fair lending laws and CRA compliance comprise a significant portion of that function. Compliance Managers provide direct oversight and supervision to compliance examiners, review and approve the scope of the examinations, review complex examination reports and CRA evaluations, coordinate with examiners and senior management on matters such as enforcement actions, review and evaluate compliance examiners, and attend boards of directors meetings, as needed.

The Compliance Managers report to an "Assistant Director for Compliance." The Assistant Director for Compliance directs and manages the compliance and consumer affairs operation, reviews examination reports, reviews and evaluates Compliance Managers

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and other compliance personnel, attends boards of directors meetings as needed, and coordinates scheduling and resource needs with other Assistant Directors. In some cases, the Assistant Director has similar responsibilities for other types of examinations.

Q.2. Would a separate division devoted to fair lending and community reinvestment examinations enhance your agency's compliance efforts? Why or why not?

A.2. As indicated in our response to question 1, we already have in place a separate division for compliance examinations.

We believe that the use of specialized examiners provides an efficient and effective way to approach our compliance responsibilities. Persons who are specially trained and perform generally the same functions on a daily basis are able to assess an association's compliance much more readily than those less familiar with the intricacies of the compliance laws, and who have many other responsibilities. specialized examiners serve as a valuable resource to an association by providing advice and answering questions. Specialization can also lower the overhead costs of examinations by limiting the number of examiners who have to receive extensive training in any one area.

We believe it is unrealistic to expect examiners to be proficient in the entire range of laws, regulations and practices that encompass a financial institution's diverse array of services, products and responsibilities. The current environment of rapidly changing safety and soundness standards and increasing consumer protection legislation illustrates the need for specialization.

Q.3. Are there any structural factors (such as job classification) that preclude or impede consumer compliance examiners from being promoted to supervisory positions?

A.3. There are no structural factors that preclude compliance examiners from being promoted to supervisory positions. Two essential elements of the specialized examination program are an accreditation program for compliance professionals and a career path that is separate from, but similar to, that followed by safety and soundness examiners. One of the underlying goals of our specialized examination program is to provide career progression opportunities equal to those under any other examination function. Compliance examiners can progress to the Compliance Manager and Assistant Director positions, which is substantially similar to the career progression for safety and soundness personnel.

Trained and experienced compliance personnel are valuable resources and placing impediments in their career paths would be counterproductive.

Q.4a. How many staff personnel are allocated to fair lending enforcement?

A.4a. Our Washington and Regional Offices have 123 persons allocated to the compliance function. These persons include compliance examiners and analysts, consumer affairs specialists, managers and supervisors.

Q.4b. Approximately how much time do they spend per year on fair lending compliance work?

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A.4b. The fair lending laws and regulations are a significant component of our specialized examination program. Approximately 21 percent of the time we spent reviewing for compliance with consumer laws and regulations during examinations conducted in 1992 was devoted to fair lending work. In addition, nearly 24 percent of our time during examinations was devoted to the CRA. The remaining 55 percent was spread among other statutes such as the Truth-in-Lending Act and Bank Secrecy Act.

Q.5. What is the nature of the training for fair lending examiners?

A.5. In-depth training is provided to our compliance examiners as part of our specialized examination program. Three schools are designed specifically for compliance examiners; each includes extensive lectures, discussions and case studies on the fair lending laws and regulations.

Our Compliance I school is a two-week program for entry-level compliance examiners. The CRA and fair lending segments comprise nearly half of the school. The curriculum for that school was significantly revised in 1992 to place an even greater emphasis on the fair lending area.

Our Compliance II school is a one-week program for more experienced compliance examiners; therefore, it deals with more complex regulatory and examination issues. Approximately half of the segments are devoted to CRA and fair lending topics, with the remaining segments devoted to other advanced compliance subjects.

Our Intermediate Compliance Regulator school is a one-week program that includes rigorous case-study analysis for experienced examiners. Issues concerning CRA performance and fair lending compliance and enforcement are emphasized and interwoven throughout the curriculum during the entire week.

Formal schools are, however, only one facet of the training we provide to compliance examiners. We provide uniform guidance to examiners through our Compliance Activities Regulatory Handbook. We also participate in the training programs undertaken by the Federal Financial Institutions Examination Council (FFIEC). For example, the FFIEC is sponsoring a five-day Compliance Conference in March 1993. The agenda for that Conference includes a number of fair lending topics.

Q.6. Please provide a breakdown of the race, ethnicity, and gender of fair lending examiners and supervisory personnel by job classification.

A.6. Available data on minorities tracks African-American, Hispanic and Asian persons. We have 123 compliance examiners and analysts, consumer affairs specialists, managers and supervisory personnel allocated directly to the compliance function. Fifty-three (43 percent) are female and 70 (57 percent) are male. Thirty-seven people (or 30 percent) of our Compliance staff are members of a minority group. Twenty-eight are African-American, 5 are Hispanic, and 4 are Asian. Nineteen of the 53 female employees are minorities (36 percent); eighteen of the male employees are minorities (26 percent).

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Examination Techniques

Q.1. What instructions do you give examiners on the types of loans and the number of files that they should review in a fair lending compliance exam? How many files are sampled as part of an examination? Does the number of files sampled vary by the size of the institution or other criteria?

A.1. Our compliance examinations are conducted using a "top-down/risk focused" approach. This approach emphasizes a savings association's ability to manage its compliance responsibilities. The first step in this approach for fair lending compliance involves a comprehensive review of loan policies, underwriting standards and processing procedures, lending patterns, self-assessment efforts, staff training, and discussions with management and lending personnel. The examiner forms an initial assessment, or hypothesis, of an association's compliance based on the nature and extent of any deficiencies noted in this phase of the review. In analyzing lending patterns, our examiners place primary emphasis an identifying significant disparities associated with applicant or neighborhood characteristics such as race or racial composition. Home Mortgage Disclosure Act data are instrumental in this part of the process. Hypothesis testing and judgmental sampling are then used to review credit application files.

When our examiners reach a hypothesis regarding the possibility that one group is being treated less favorably than another, we instruct them to select a sample of at least 15 files from the group suspected to have received less favorable treatment and 15 from the group suspected to have received more favorable treatment. If there are fewer than 15 applications from either group, all files are reviewed. Examining large institutions with considerable lending activity, investigating hypotheses about different types of lending, or identifying patterns indicative of more than one type of prohibited discrimination requires either more samples or a carefully selected sample that contains a greater number of applications.

Q.2. What indicia of discrimination are examiners instructed to look for in the files (e.g., perfect minority applicants who are rejected, comparable minority and non-minority applicants who receive differential treatment, etc.)?

A.2. After formulating a hypothesis and gathering the judgmental sample of application files, our examiners generally review for evidence of overt discrimination or differential treatment that would confirm the hypothesis. This generally involves an assessment of how a savings association applied its lending standards for the files selected or how exceptions to those standards were made. Indicia of discrimination could include varying loan terms, unsupported processing time-frames, inconsistent or unreasonable requests for documentation from applicants, the loan decision process itself, the reasons for denial communicated to the applicant, or innumerable other aspects of the credit process.

Our examiners are certainly aware of the possibility that otherwise qualified applicants may be denied without a reasonable basis. The purposes of reviewing samples of application activity are to compare the experience of one group against that of another, and

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to compare the treatment of applicants from two or more groups with the lender's stated policies and standards. Our examiners do not expect the characteristics of one loan application to be identical to those of another application before they are able to draw comparisons.

Q.3. Does your agency operate on the premise that you need to find statistically significant discrimination to take enforcement action?

A.3. No. The need for formal enforcement action is determined by the substance and extent of a violation and the action that the savings association's management has already taken, or is expected to take immediately, to correct the problem. Any single instance of prohibited discrimination is significant, and our standing policy is to pursue formal enforcement action to correct the conditions resulting from such a violation, or to prevent recurrence, whenever management fails to take appropriate remedial action voluntarily. Also, please see our response to the "Enforcement Powers" questions.

Q.4. Do compliance examiners interview loan officers?

A.4. Our compliance examiners interview savings association personnel at all levels, including loan officers. Interviews with management concerning how underwriting standards have been developed and how they are applied are an integral part of the compliance examination process. These interviews also assist the examiner in evaluating the effectiveness of internal training and the extent of loan officers' knowledge of relevant requirements and prohibitions.

Q.5. Please describe the circumstances under which examiners contact credit applicants to collect consumers' opinions on how their applications were handled by bank personnel.

—and—

Q.6. What percentage of fair lending examinations include examiner outreach to credit applicants?

A.5. & A.6. Our examiners generally do not contact credit applicants or borrowers in connection with regular compliance examinations. However, we do make such contacts as part of our investigation of discrimination complaints. Under our investigation procedures, an OTS consumer affairs specialist or compliance examiner contacts, either by telephone or in person, each individual who files a complaint with OTS alleging illegal discrimination by a savings association in any aspect of a credit transaction. This allows us to obtain as much information as possible concerning the actions of the lender from the complainant's point of view.

Q.7. Please describe the circumstances under which examiners contact representatives of the business and consumer community to collect their opinions on bank treatment of credit applications.

A.7. We believe that contact with community representatives is an integral component of reaching a balanced, supportable conclusion regarding a savings association's performance under the CRA. These community contact interviews generally do not deal exclusively with issues involving a single savings association, unless it happens to be the only financial institution in the community.

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These interviews enhance the examiner's knowledge of the most pressing credit needs of the community, the institutions that are particularly receptive or unreceptive to those needs, and any indication of the presence of illegal discrimination by local lenders. An examiner may contact an individual or representative of an organization that has commented on an institution's CRA performance specifically to discuss those comments and that institution.

Since December 1990, the Federal bank regulatory agencies and the OTS have shared community contact information. The overall objective of this sharing arrangement is to increase the amount of information available from the community to assist examiners in properly evaluating performance.

We strongly encourage our examiners to conduct interviews with community organizations or other representatives of the community as a routine part of the compliance examination process. Reasons for not conducting outside interviews on a particular examination may be that the examiner has collected sufficient information through recent outside contact interviews as part of other examinations in the same community, or has received recent information from another regulatory agency.

Q.8. How frequently are community organizations contacted? How frequently are legal service agencies contacted? How frequently are members of the small business community contacted? How frequently are members of the real estate community contacted?

A.8. As indicated in our response to the previous question, our examiners usually conduct outside contact interviews as part of all compliance examinations. We are not able to provide a breakdown of actual contacts by the types of organizations that they represents. We find that most contacts fall into the following general groupings: government officials; civil rights and consumer aid groups; economic and community development organizations; private grass-roots community groups; and private individuals and businesses.

Q.9. What percentage of examinations result in specific examiner discussion of fair lending compliance problems and recommendations with a bank's board of directors? With bank management?

A.9. Virtually all of our compliance examinations involve specific discussions with management concerning fair lending compliance and administrative issues. Any performance deficiencies are discussed with management during an examination, with appropriate recommendations for corrective action provided no later than at the meeting held with the institution's chief executive officer and other senior management at the completion of on-site examination work.

More serious fair lending compliance deficiencies (*i.e.*, those reflective of poor management by the institution and requiring immediate corrective action) are also included in the written report of examination along with detailed requirements and recommendations.

Based upon CRA and Compliance ratings assigned by our examiners, we estimate that one-third of all compliance examinations conducted over the past two years have resulted in meetings between boards of directors and OTS personnel to discuss compliance

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deficiencies. We are unable to determine how many of these meetings were prompted solely by deficiencies in the fair lending area.

Q.10. What procedures do you use to monitor the quality and consistency of fair lending examinations?

A.10. National standards for our compliance examination program are contained in our Compliance Activities Regulatory Handbook. These standards range from administrative issues such as examination frequency and when OTS personnel should meet with boards of directors, to specific examination procedures for individual regulatory subjects such as compliance with the Equal Credit Opportunity Act and performance under the Community Reinvestment Act.

Each of our five Regional Offices has a quality assurance oversight system that includes periodic reviews of the compliance function. In addition, our Washington-based Specialized Programs area maintains an oversight program that focuses on the quality of examination reports and other substantive aspects of performance by our Regional Offices in their administration of the specialized compliance examination program.

Complaints and Violations

Q.1. How many complaints of ECOA and Fair Housing Act violations has your agency received each year for the past 10 years? Are these complaints investigated by the same examiner that conducted the routine compliance examination? How many have been resolved and with what resolutions?

A.1. We are providing a breakdown of complaints received and resolved since 1986, the first year for which we have data available on our nationwide automated Consumer Complaint System.

ECOA and Fair Housing Act complaints are analyzed by regional consumer affairs specialists based on our complaint guidelines (attached as Exhibit A). These guidelines require an association to provide the entire application file related to a discrimination complaint to the appropriate OTS Regional Office for analysis. If the regional office determines that an on-site investigation is required to resolve the complaint, it is usually conducted by a compliance examiner.

The Regional Consumer Affairs Manager may also request that the examination staff pay special attention to areas of an institution's operations that have generated complaints from the public at the next scheduled compliance examination. Finally, a summary of complaints is part of the record reviewed by examiners prior to establishing the scope of a compliance examination.

We investigate and resolve all discrimination complaints. You should note that the following tables report incoming complaints as of the year *received* and report disposition as of the year the complaint is *closed*. Consequently, the totals for each year do not match. For example, a certain number of discrimination complaints received in the last few months of 1992 are in the first table (complaints received) but not in the second table of complaints resolved. They will appear in our data for complaints resolved in 1993.

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Alleged Lending Discrimination Complaints by Year Received

Year	Fair Housing Complaints	Other Discrimination Complaints	Total
1986	117	80	197
1987	132	180	312
1988	96	87	183
1989	111	87	198
1990	60	128	188
1991	71	104	175
1992	97	138	235

Resolution of Alleged Lending Discrimination Complaints by Year Resolved

Type of Resolution	1986	1987	1988	1989	1990	1991	1992
Association Violation or Error	11	20	5	4	15	14	21
Association's Position Substantiated	103	182	70	97	93	108	156
Other (e.g., referred to correct regulator)	67	103	106	74	57	41	50
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Total	181	305	181	175	165	163	227

Q.2a. What distinguishes a technical violation from a substantive violation?

A.2a. The difference between technical and substantive violations is relative to particular circumstances. Technical violations are violations that are truly inadvertent, easily corrected and not indicative of a savings association's practices. Technical violations are often corrected by an association's management prior to, or shortly after, the completion of a compliance examination.

As a general principle, a substantive violation is any action or omission that interferes so significantly with the fundamental purpose of the relevant law or regulation that such purpose is effectively defeated, or is a condition which taken alone or in combination with other violations and deficiencies reflects unfavorably upon the management of an association. A violation is substantive if it has any of the following characteristics:

- It is, or results from, a systemic procedural or computational error incorporated into the routine operations of one or more offices, departments, or individual employees of the association;
- It is, or results in, a violation of a person's individual rights under the Fair Housing Act, the Equal Credit Opportunity Act, or the Fair Credit Reporting Act;

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- It triggers financial restitution to customers of the association or presents significant risk of a lawsuit for money damages, and is not an isolated, inadvertent error that occurred despite reasonable operational controls to prevent such errors; or,
- It is, or results from, a repeat of violations or deficiencies cited in the previous examination report indicating inadequate management attention to stated supervisory concerns.

Q.2b. Can an institution have technical violations and get a satisfactory Community Reinvestment Act rating? Can an institution have substantive violations and get a satisfactory CRA rating?

A.2b. Violations of the fair lending laws have a significant bearing on the CRA rating, while violations of other laws such as the Truth-in-Lending Act or the Bank Secrecy Act do not. It is possible for a savings association to receive a "satisfactory" CRA rating in the presence of a technical violation of the fair lending laws. However, our examiners attach great significance to substantive violations of the fair lending laws and regulations in reaching an overall conclusion about an association's CRA performance. Substantive violations of the fair lending laws that interfere with an individual's rights or a fundamental statutory purpose would preclude the assignment of a satisfactory CRA rating.

Q.2c. What kind of enforcement action, if any, is taken for technical violations? For substantive violations?

A.2c. We generally rely on informal enforcement tools for technical violations and both formal and informal for substantive violations. A detailed description of our enforcement tools is presented under the heading "Enforcement Powers."

Q.3a. How many ECOA and Fair Housing Act violations have been found for each of the last 10 years? Of these, how many were technical and how many were substantive?

A.3a. Our electronic data system contains detailed information on ECOA and Fair Housing Act violations identified during examinations conducted since April 1989, the date we began our separate compliance examination program. Data maintained prior to April 1989 is not citation—specific and not responsive to your question. In compiling our response, we focused on ECOA and FHA violations that meet our definition of substantive and those of material significance. Therefore, we are not reporting violations that relate to items such as internal recordkeeping.

1989

Substantive ECOA violations (*e.g.*, discouragement or denial of applicants on a prohibited basis or the use of prohibited information) numbered 32. Other procedural violations of ECOA (*e.g.*, the failure to provide timely and complete notices of action taken and the failure to collect monitoring information) totaled 1,142.

There were 2 substantive violations of the FHA. Other technical violations of FHA (*e.g.*, failure to use the Equal Housing Opportunity logo on advertisements) numbered 22.

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1990

Substantive ECOA violations numbered 26. Other procedural violations of ECOA totaled 2,772.

There were 2 substantive violations of the FHA. Other technical violations of FHA numbered 46.

1991

Substantive ECOA violations numbered 57. Other procedural violations of ECOA totaled 2,635.

There were 8 substantive violations of the FHA. Other technical violations of FHA numbered 71.

1992

Substantive ECOA violations numbered 25. Other procedural violations of ECOA totaled 4,723.

There were 12 substantive violations of the FHA. Other technical violations of FHA numbered 22.

Q.3b. How many of these violations have been resolved and how were they resolved?

A.3b. A principal goal of effective supervision is to ensure future compliance. To meet that goal, the process of resolving regulatory violations noted during a compliance examination is initiated before the completion of the examination. We find that the majority of associations are cooperative and that most violations are corrected without the need for formal enforcement action.

As violations are identified during an examination, they are brought to the attention of an association's management. Management is given the opportunity to respond to the specific issues raised by the examiner. These responses are factored into the examiner's conclusions about the association's overall compliance posture. In most cases, a responsive management team can correct technical violations or their underlying causes before the completion of the examination.

At the end of the on-site portion of an examination, the examiner conducts a closing conference with the association's management team. The objective of the closing conference is to communicate clearly the examiner's findings and recommendations and to obtain assurances from senior management regarding improvement to operating procedures to prevent violations in the future. It is also an opportunity to impress upon management the importance of compliance and CRA performance. An effective closing conference will leave management with a firm understanding of the items that will appear in the report of examination and what must be done to correct deficiencies. A meeting with an association's full board of directors is encouraged when compliance or CRA performance requires close supervisory attention.

The compliance report of examination is sent to the association's board of directors generally within 45 days of the examination completion date. The report is comprehensive in nature and details the examination findings to give the reader a thorough analysis of the integrity of the association's compliance-related systems. A subsection of the report contains detailed recommendations for future

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improvement. These recommendations may be specific to a particular law or regulation.

A letter transmits the examination report to the association's board. This letter, together with the report, is a primary enforcement tool designed to make an association's management acutely aware of the severity of any problems. It typically asks for a response from the directorate within 30 days. Supervisory personnel in our regional offices review the response to ensure that it contains detailed explanations of the actions taken to correct any violations or deficiencies. We follow-up with institution management on any weak responses or those that fail to adequately address the underlying causes of violations *via* correspondence. In some cases, we may conduct an on-site visitation to review the institution's progress toward correcting deficiencies. Our follow-up actions on particular violations are not tracked on our automated system.

A significant part of any examination is to carefully assess whether prior violations were properly corrected. If corrective actions are inadequate or not undertaken, we will not hesitate to initiate formal enforcement actions.

Q.4. What specific practices by regulated institutions and their subsidiaries that constitute illegal discrimination are set out in your regulations? Do you make any effort to disseminate to the public a list of practices that they might encounter that would be illegal? If so, how?

A.4. Our Nondiscrimination regulation (12 C.F.R. Part 528) repeats and elaborates on the basic prohibitions of the Equal Credit Opportunity and Fair Housing Acts, with detailed attention to practices associated with discouragement of applications. The regulation also contains additional prohibited bases that are not in either statute. For example, lenders subject to our jurisdiction are flatly prohibited from making credit decisions based on the age or location of a dwelling.

To assist consumers in understanding their rights and how their credit application will be evaluated, our regulations require each savings association:

- to have clearly written, nondiscriminatory loan underwriting standards, available to the public upon request at each of its offices;
- to review at least annually its underwriting standards and business practices implementing them to ensure equal opportunity in lending; and
- to inform each inquirer for credit of his or her right to file a written loan application, and to receive a copy of the association's underwriting standards.

Our regulations also contain guidelines relating to nondiscrimination in lending (12 C.F.R 571.24) to assist savings associations in developing and implementing nondiscriminatory lending policies. These guidelines address the potential discriminatory effect, for example, of requiring fluency in English, discounting overtime or part-time income, or favoring previous customers.

With respect to fair lending and compliance issues generally, our primary educational emphasis is on helping to ensure that lenders understand and carry out their statutory obligations. Whenever

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possible, we also attend and speak at meetings involving consumers, community groups or fair housing representatives to provide information about the additional rights that are available to customers of the savings associations we regulate. Further, we expect to distribute in March 1993 a brochure that summarizes our complaint procedures to consumer and community organizations.

Q.5. Over the past several years a number of highly publicized news reports have indicated evidence of fair lending problems in a number of metropolitan areas across the country (*i.e.*, Atlanta, Detroit, and Boston). What responses has your agency made to these reports?

A.5. We are aware of media accounts that point to disparities in denial rates for minority and nonminority applicants. Some of these accounts conclude that there is widespread discrimination on the basis of race in home mortgage lending. We carefully evaluate these reports and generally try to gather additional, and sometimes more accurate, information prior to reaching any firm conclusions. These articles can be useful in pinpointing certain areas of concern to be considered in our examination approach or procedures.

For example, heightened public interest during the late–1980's helped us identify fair lending and CRA as high priority components of our mission. In response to a series of news reports in 1989, we conducted a number of special nondiscrimination examinations as part of our ongoing review of mortgage loan application patterns. We first identified metropolitan areas whose aggregate data indicated the largest differences between the rejection rates for black and white mortgage loan applicants. We next identified institutions and certain of their loan decision offices for which differences in rejection rates were particularly large. As a results we targeted 35 savings associations located in 15 metropolitan areas, including Atlanta, Detroit, and Boston, for special examinations to assess compliance with the Equal Credit Opportunity and Fair Housing Acts, as well as OTS regulations.

Some of these 35 special examinations identified technical violations and some identified isolated policies, practices, or standards that may, under certain circumstances, have a disproportionate impact on the availability of credit to some classes of applicants and neighborhoods. The examinations did not, however, disclose loan policies, practices, or individual acts that involved overt discrimination on the basis of race, or discover differential treatment of credit applicants on the basis of race. Based in part on the findings of these examinations, the FFIEC-member agencies developed a pamphlet on subtle discrimination. That pamphlet was distributed to all savings associations in early–1992 (see Exhibit B).

We met with consumer and community groups in 1989 and 1990, (*e.g.*, in Atlanta), to solicit and encourage the submission of complaints of racial discrimination by savings associations against credit applicants and inquirers. These efforts produced no notable increase in the relatively low volume of fair lending complaints that we normally receive.

We issued Thrift Bulletin 25 in April 1989 (see Exhibit C) to emphasize our commitment to fair lending enforcement and to provide

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guidance to savings associations to assist them in complying with our requirements.

In December 1992 we conducted a follow-up review of credit applications denied by savings associations and their mortgage banking subsidiaries in the Boston metropolitan area. That review was prompted by the study released by the Federal Reserve Bank of Boston in October 1992. Our review included a review of documentation and discussions with lending personnel concerning every denied mortgage application identified by the FRB Boston to involve a low probability of denial. Additional information relative to our review is included in our responses to the "Boston Federal Reserve" section.

Q.6. For each of the following metropolitan areas, please provide the number of fair lending examinations conducted by your agency for every year since 1985: Atlanta, Boston, and Detroit.

A.6. Before 1989, there were no separate compliance examinations. Compliance matters such as fair lending were reviewed by generalist examiners as part of their regularly scheduled examinations. As indicated in question 1 under "Compliance Structure," we established a specialized examination program specifically for compliance matters in January 1989. Fair lending issues are examined in conjunction with other compliance matters during those examinations.

For the years 1985–1992, 216 examinations covering compliance issues, including fair lending, were conducted at institutions currently headquartered in the Atlanta, Boston, and Detroit metropolitan areas. The number of examinations that addressed fair lending compliance for each of those years is given below:

Atlanta—74 (1985—11; 1986—10; 1987—13; 1988—9; 1989—8; 1990—11; 1991—7; 1992—6).

Boston—81 (1985—9; 1986—10; 1987—19; 1988—11; 1989—7; 1990—8; 1991—8; 1992—9).

Detroit—61 (1985—6; 1986—7; 1987—16; 1988—7; 1989—2; 1990—6; 1991—11; 1992—6).

Enforcement Powers

Q.1a. What range of enforcement powers are available to your agency?

A.1a. Our policy is to ensure that prompt, fair, and firm action is taken to correct violations of the laws and regulations we enforce. We have a number of informal and formal enforcement tools available ranging from informal advice and moral suasion to formal enforcement actions, such as Cease and Desist Orders.

Informal enforcement actions used to correct violations of consumer laws and regulations include: meetings with management, meetings with boards of directors, supervisory directives, supervisory correspondence, special examinations, and requests for voluntary management changes or reorganization. The effectiveness of these informal tools is dependent, in part, on the resolve and ability of an association to bring its activities into compliance with applicable laws and regulations.

If our informal enforcement tools are not sufficient to correct a particular supervisory concern, our staff generally recommends one

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or more formal enforcement actions. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 substantially enhanced our enforcement powers. For example, we are now authorized to initiate an enforcement action for a violation of any law or regulation and we have the power to assess Civil Money Penalties.

Our Washington and Regional staffs work together closely when formal action is recommended. Formal enforcement actions that may be initiated for violations of compliance laws and regulations include: formal written "conditions" imposed in connection with the granting of applications, Supervisory Agreements, Temporary Cease and Desist Orders, Cease and Desist Orders, Civil Money Penalties, immediate or temporary suspensions of individuals during Removal and Prohibition proceedings, Removal and/or Prohibition Orders, temporary suspensions for certain criminal indictments, enforcement of orders in U.S. District Court, and injunctive actions.

Q.1b. How frequently has each power been used over the past 10 years?

A.1b. Our automated system for information concerning enforcement actions, including provisions to address compliance violations, contains information on enforcement actions from its inception in 1987 to the present. Prior to that time, data on enforcement actions was maintained manually by each of the twelve Federal Home Loan Banks, and is not available on our automated system.

Based on available data, OTS initiated 189 enforcement actions that included provisions to address compliance violations since 1987. These 189 enforcement actions include: 29 Cease and Desist Orders, 31 Civil Money Penalty assessments, 9 Supervisory Directives, 2 Director's Resolutions, 1 Memorandum of Understanding, and 117 Supervisory Agreements.

Q.2. Would any additional tools be useful?

A.2. We currently have a wide range of formal and informal enforcement tools available, and do not believe that additional ones are necessary at this time.

Referrals of Violations to HUD and Justice

Q.1. During the past 10 years, on how many occasions has your agency referred violations of ECOA to Justice and of the Fair Housing Act to HUD?

We have provided 39 fair housing complaints to HUD since we implemented the Memorandum of Understanding with HUD on June 1, 1992. When we complete our investigation of each complaint, we inform HUD of our findings regarding violations of the ECOA or OTS nondiscrimination rules.

Prior to the passage of the Federal Deposit Insurance Corporation Improvement Act in December 1991, we were authorized but not required under the ECOA to make referrals to Justice only if we were unable to obtain compliance through our own supervisory process.

The 1991 amendments to the ECOA require us to refer cases to Justice if we have reason to believe that one or more creditors has engaged in a pattern or practice of discrimination or discourage-

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ment on a prohibited basis. If we discover through a compliance examination an act, policy, or practice that represents a violation of both the Fair Housing Act and the ECOA, and we have not referred it to Justice, then we are required to notify HUD and affected credit applicants of our finding.

We have discussed the referral requirement with Justice and are finalizing internal referral guidelines and processing procedures for our staff, but have not referred any ECOA violations to Justice. We are presently reviewing several examination reports that contain ECOA violations and will soon decide which of those cases meet the statutory referral standards. We will refer cases to Justice in all appropriate instances. If we determine there are Fair Housing Act violations, we will either refer the cases to Justice or make the requisite notifications to HUD and any affected applicants.

Q.2. What documents (*e.g.*, exam reports, examiner work papers or loan files) have been included in these referrals?

A.2. We are discussing with Justice what information it would like to be included in a referral package and expect to conclude the matter soon. We intend to provide Justice at a minimum with a copy of the relevant examination reports and make available any pertinent examiner work papers.

With regard to the consumer complaints referred to HUD under the Memorandum of Understanding, we have provided complete copies of the case files.

Q.3. Please provide a copy or describe the substance of the memorandum of understanding between the financial supervisory agencies and HUD regarding Fair Housing Act referrals.

A.3. Exhibit D contains a copy of the MOU between the agencies and HUD.

Q.4. Please describe what coordination exists between your agency and the Department of Justice regarding referral of suspected fair lending violations.

A.4. As noted, we have had discussions with Justice about the referral process and are continuing to meet with them to identify the documentation they would like to see as part of a referral package.

Q.5. Does a memorandum of understanding exist?

A.5. We do not have a MOU with Justice and do not believe that one is necessary at this time. We believe that we can work together in a cooperative manner.

Q.6. What factors account for the limited number of referrals?

A.6. As indicated in our answer to question 1, the ECOA did not require until late 1991 that we make referrals and OTS believed it had sufficient authority to resolve ECOA problems on its own.

Q.7. Is there specific staff assigned to carry out referral functions?

A.7. Our Specialized Programs unit in Washington is working with designated compliance management personnel in our Regional Offices to carry out the referral requirements. Specialized Programs will also coordinate and consult with enforcement personnel in our Chief Counsel's Office on any potential referral cases, and senior staff in our Washington and Regional Operations areas.

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Q.8. Who does DOJ contact within your agency regarding referrals?

A.8. Our Deputy Assistant Director for Specialized Programs is Justice's principal contact on ECOA and Fair Housing Act referrals and other matters.

Q.9. How has your agency responded to DOJ's request to accompany examiners on fair lending examinations?

A.9. We believe we have responded positively. Our cooperation with Justice on their investigation of Decatur Federal Savings and Loan Association (Decatur) in Atlanta demonstrates that OTS and Justice can work together effectively.

At the time we began a special discrimination examination of Decatur in December 1989, Justice was in the early stages of its investigation into the mortgage lending practices of Atlanta-area financial institutions. We informed Justice of our examination and our agencies mutually agreed we would benefit from cooperating with each other.

We were very interested in learning about the statistical method Justice wanted to use in Decatur and how it might apply to our examination process as a means of improving our approach to detecting discrimination. On the other hand, Justice was very interested in learning about our examination process and how we test for discriminatory treatment of mortgage loan applicants. To our knowledge, Justice had never participated with a Federal banking regulator in a field examination and the Decatur examination offered Justice an unprecedented learning opportunity to bolster its experience level and strengthen its overall investigation.

We followed our standard discrimination detection procedures and Justice used a new, extensive statistical approach. Although we concluded our examination in March 1990, Justice continued its investigation of Decatur until May 1992. In May 1992, Justice informed Decatur of its conclusion that Decatur had violated the Fair Housing Act and the ECOA. Justice gave Decatur the opportunity to settle the matter without protracted, costly litigation. Decatur opted for this approach and a settlement agreement was reached between Decatur and Justice in September 1992.

We had several discussions with Justice while its investigation was being conducted and permitted Justice to review our examination work papers and examination report of Decatur. During informal conversations with Justice, they confirmed that our examination findings were valid based on the procedures we used.

Since the Decatur investigation, we have had several meetings with Justice and are committed to establishing a better working relationship with them. At this point, Justice has provided us with listings of institutions they have targeted for possible fair lending investigations. We are working with them to narrow these lists based on our examination experience, the market areas served by the targeted lenders (whether they are located in inner cities or suburban fringes of large MSAs), and reviews of Home Mortgage Disclosure Act data. The final listings will provide both us and Justice with a rational basis for working together to combat lending discrimination.

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Fair Lending Data Systems

Q.1. Following the lawsuits brought by civil rights groups in the 1970's, your agency now collects information, in addition to HMDA data for fair lending enforcement purposes (see 12 CFR 528.6–528.7). What data are you required to collect? What data are you permitted to collect?

A.1. From October 1980 through December 1989, we required all savings associations to maintain an on-site loan application register (LAR). The register contained information very similar to that now required by HMDA. Each savings association was also required to file a summary Data Submission Report (DSR) semi-annually with our Washington office. The DSR's summarized the disposition of mortgage and home improvement applications by the race and gender of the applicants as well as the type of census tract. After this information was summarized and analyzed by computer, the results were provided to examination and supervisory staff. Although this LAR/DSR system was developed in cooperation with the complainants in the 1977 civil rights settlement, we continued to use the system after the expiration of the settlement agreement.

Between 1980 and 1989, approximately 75 percent of our institutions were also subject to HMDA. When FIRREA expanded HMDA to closely resemble our original LAR/DSR, we revised our regulations to combine the two systems and reduce unnecessary regulatory burden. From 1990 through 1992, savings associations subject to HMDA were only required to file the HMDA Loan Application Register. However, we continued to require that all savings associations maintain on-site both the data required by post-1989 HMDA and nine additional items that we had required since 1980.

Subsequently, on January 14, 1993, we published final regulations that make savings associations subject to the same data collection requirements as other depository institutions. We found that compliance examiners were able to obtain the additional data they may need from application and loan files and that a separate collection requirement was, therefore, unnecessary.

Q.2. What data, in addition to HMDA data, have you in fact collected and for how many institutions?

—and—

Q.3. How is a determination made as to which lenders must report? Is HNDA data used to make this determination?

A.2. & A.3. Prior to 1990, we collected and aggregated DSR data from all savings associations. Now that the HMDA and the DSR are combined, only savings associations subject to HMDA are required to send their data to Washington for aggregation. We use HMDA data and any other available fair lending data to help determine the scope of an association's compliance examination, rather than to determine additional reporting requirements.

Boston Federal Reserve Study

Q.1. For all institutions under your jurisdiction that were included in the Boston Federal Reserve study:

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Q.1a. How many fair lending compliance examinations were conducted during the time period covered by the study?

A.1a. The FRB Boston study included mortgage loan application data from 119 lenders, including 14 savings associations and 5 mortgage banking subsidiaries of savings associations. The study included only data from applications taken in the year 1990. Loan application activity and lending patterns during 1990 were considered as part of 6 compliance examinations of the study participants conducted during that year.

Since January 1990, we have conducted compliance examinations of 18 of the 19 OTS-regulated lenders that participated in the study. We have examined 5 of these 18 lenders twice during this period. The only institution that we did not examine has been under the control of the Resolution Trust Corporation (RTC) since May 1991. Two of the 18 institutions that we have examined since 1990 are also now under RTC control.

In December 1992, as a follow-up to the Boston Federal Reserve study, we visited 12 Boston-area OTS-regulated lenders and reviewed actual mortgage application files that served as the basis for some of the study data. We did not treat these visits as examinations.

Q.1b. How many violations of fair lending law were uncovered as a result of these examinations? What was the nature of these violations?

A.1b. The 23 examinations conducted in 18 savings associations disclosed a total of 581 violations of fair lending rules, such as those implementing the Home Mortgage Disclosure and Equal Credit Opportunity Acts, and OTS nondiscrimination rules.

These violations involved the following:

- failure to maintain or submit complete and accurate loan application registers;
- failure to provide either complete, accurate, or
- timely notices of adverse action to credit applicants;
- failure to provide notices of incompleteness to credit applicants;
- failure to record information for monitoring purposes;
- failure to maintain appropriate records;
- failure to make available in all offices copies of loan underwriting standards; and
- failure to include the required "Equal Housing Lenders" provision in advertisements.

Q.1c. What enforcement actions, if any, were taken against institutions with violations?

A.1c. One of the institutions included in the study entered into a Supervisory Agreement that required the development of a formal written compliance program. The institution's primary compliance deficiencies were, however, in the area of compliance with the Bank Secrecy Act. Informal supervisory measures were used in the other cases.

Q.2. How have you modified examination procedures in response to the findings of the Boston Federal Reserve study?

—and—

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Q.3. How do you plan to use statistical analysis in your future fair lending enforcement efforts?

A.2. & A.3. We continue to study the FRB Boston model and consider its application to our examination process. Through the FFIEC, we have hired a consultant to provide recommendations for improving the examination process, including additional use that may be made of HMDA data and large-scale statistical analysis. We have modified the credit discrimination training that we provide as part of our Compliance Level I school to reflect our findings from the study. Accordingly, we are in the process of modifying the examination procedures contained in our examination handbook.

Q.4. How will you monitor compliance for lenders that receive too few applications from minorities to make statistical analysis possible? Would it be possible to aggregate data from multiple years for those institutions?

A.4. Institutions that receive only a few applications from minority applicants, or for loans to be secured by real estate located in predominantly minority neighborhoods, raise a suspicion of illegal prescreening. We are very interested in finding better ways to detect illegal prescreening. In the meantime, we will continue to use the most effective examination techniques available to us to identify such practices and to ensure their elimination. On this front, a greater willingness on the part of individuals and community organizations to come forward with information about credit practices and to file complaints would be helpful.

We already assess lending patterns and trends for periods of greater than, one year as part of our nondiscrimination examination procedures. We believe that it would be possible to conduct statistical analysis of lending patterns covering multiple years.

Q.5. What enforcement actions, if any, have you taken against lenders referred to you by the Boston Federal Reserve as a result of the study?

A.5. We should first clarify that the FRB Boston did not refer lenders to OTS as a result of the study. In addition, the FRB Boston did not identify any single lender that it concluded to have engaged in illegal discriminatory credit practices; nor did it identify any credit application that was denied on the basis of race, national origin, or any other prohibited consideration.

As then-Director Ryan indicated in his response to Chairman Riegle's October 27, 1992 letter, most of the applications denied by savings associations that FRB Boston identified as questionable denials involved white applicants. In fact, the denials that FRB Boston concluded to be improbable had a disproportionately high percentage of white applicants. As indicated, OTS personnel reviewed all questionable applications, both those involving minority applicants and those involving nonminority applicants. For at least one of the lenders involved, we are not prepared, at this point, to rule out enforcement action, additional fact finding, moving up the date of the next compliance examination, or making a formal referral to the U.S. Department of Justice.

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Prescreening and Related Practices

Q.1. How do you determine whether lenders are prescreening or illegally discouraging applications from minorities? Do you have any examination techniques to focus on prescreening? Is the use of testers necessary for this purpose? If so, how should such testing be conducted?

A.1. We make this determination by following the general approach identified in our answer to question 1 in the "Examination Techniques" section. The essential difference, however, is that there is no paper trail of prescreened applicants.

Systematic prescreening on the basis of race is often observable through analysis of lending data, particularly in larger institutions in metropolitan areas and those with decentralized lending operations. A combination of low application levels and high approval rates for minority applicants, and the results of interviews with customer contact personnel and other lending staff, would generally indicate the existence of racially-biased prescreening.

We find, however, that some lenders engage in undocumented prescreening of all prospective applicants, and the abnormally high approval rates for applicants of all races make the presence of racial bias more difficult to detect. Low numbers of minority applicants do not alone indicate prescreening on the basis of race, particularly where the approval rates are high for all groups and the numbers of recorded applications are correspondingly low. However, the practice of providing undocumented, verbal discouragement to prospective applicants violates Regulation B and we require immediate corrective action for those violations. All lenders are required to make a written record of each application that they receive for a home mortgage loan. Regulation B also requires lenders to provide applicants with a written notice containing ECOA-enforcement information each time the lender communicates a conclusion that the applicants do not qualify, for the credit being sought.

Our examination procedures are designed to detect systematic biases in an institution's lending behavior. They are not designed to detect every situation in which a particular lending officer may let personal bias enter into his or her contact with prospective applicants. We first determine whether an institution has in place policies, procedures, training programs, and methods of self-assessment reasonably designed to ensure that problems of racial bias are promptly identified and corrected. When our tests of policies and systems disclose that these characteristics of sound management are not present, our remaining focus is on determining compliance with key requirements of law.

Examination procedures intended to test hypotheses of differential treatment often result in the identification of violations. Both technical and substantive violations are then used as a basis for requiring a board of directors to develop an effective system of compliance management.

Some testing by our examiners is always necessary, no matter how strong an institution's compliance program initially appears to be. It is common for our compliance examiners to observe the manner in which lending personnel handle the application process with

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potential borrowers. Moreover, our examiners discuss the process with loan officers and present various fact situations that test knowledge of the fair lending laws. We remain open to exploring whether the use of trained, paired testers posing as credit applicants would provide substantially more reliable or conclusive results. Certainly, there are cases in which an examiner suspects, but has no factual basis to conclude, that an institution is prescreening applicants on the basis of race. In those cases, a more formal testing program might be useful.

Fair lending compliance is the responsibility of the financial institution engaging in the highly regulated activity of lending funds that come from insured deposits. Consistent with the extent and frequency of our examinations and other supervisory efforts, we encourage financial institutions, for the purpose of ensuring equal treatment of individuals seeking credit, to: develop special nondiscrimination training programs; provide credit counseling and group-education services; participate in mortgage review boards; conduct second reviews of all applications approved as exceptions to standards and all those denied without granting exceptions; and hire credit "shoppers" or testers.

Q.2. HMDA data consistently show low numbers of minority mortgage applications in markets with significant minority populations. When your agency has found low numbers of applications from minorities in certain markets, what surveys or other information have you collected to determine the impact of discouragement on the flow of mortgage applications?

A.2. Our efforts to supervise the thrift industry and to enforce fair lending laws and regulations have not included general studies of the flow of mortgage applications in market areas. We focus our efforts on the activities of individual lenders, which in turn involves some comparisons of the lending patterns of these individual lenders to aggregate data compiled from the activity of all lenders in those same metropolitan areas, or in smaller divisions such as neighborhoods. In addition to HMDA data, our examiners also collect information concerning the actions of other creditors in a given market by conducting outside community contact interviews. These contacts often provide our examiners with information and studies prepared by foundations, universities, and regional or local planning authorities.

Q.3. What instructions are provided to examiners to determine whether a lender is steering applicants—based on race, neighborhood, loan size or other factors—to loan products less advantageous than other products offered or to a mortgage or finance company subsidiary?

A.3. Our procedures require our examiners to determine whether application and lending patterns corresponding to applicant characteristics, or to the ethnic or racial composition of neighborhoods, reflect disproportionate uses of particular types of financing (*e.g.*, FHA-insured mortgage loans). Our examiners are also instructed to look for any evidence of the imposition of more onerous terms (*e.g.*, higher interest rates or shorter amortization schedules) corresponding to race or other prohibited characteristics. In these cases, the examiner is instructed to continue his or her investigation by inter-

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viewing front-line lending personnel to determine the kinds of instructions that they have been given.

Our examiners have not found that savings associations refer inquirers to mortgage or other credit-granting subsidiaries on a prohibited basis or on the basis of loan size. If an institution uses such entities to conduct its lending operations, then it generally does so with all products of a similar type. For example, if any applications for fixed-term mortgage loans to be secured by existing dwellings are referred to an institution's mortgage banking subsidiary, then they all are.

Q.4. Are underwriting criteria examined to see if they are discriminatory? Are regulated institutions required to make the criteria public?

A.4. In accordance with our nondiscrimination regulations, our examiners review underwriting standards to assure that they are not discriminatory *per se* or in effect and that they are clear, complete and available to the public. Savings associations are required to advise borrowers that their underwriting standards are available to the public and to provide a copy of the standards upon request.

Private Mortgage Insurance

Q.1. Does private mortgage insurance play a role in mortgage discrimination? How?

A.1. Illegal discrimination may occur in any aspect of the mortgage process. When an insurer declines to cover a mortgage loan, this generally will result in the lender's denial of the mortgage application.

Each private mortgage insurance (PMI) company has its own underwriting standards. If the standards of a PMI company are discriminatory or are applied differentially on a prohibited basis, not only are credit applicants illegally denied, but the underwriting standards of the lenders doing business with that company may also be influenced. In addition, an insurer's establishment of a "minimum insurance amount" has the same effect as a lender's establishment of a "minimum loan amount." While neither is overtly discriminatory on a prohibited basis, both are examples of standards that exclude properties and neighborhoods at the low end of a housing market.

Q.2. Should private mortgage insurers be subject to HMDA or similar disclosure requirements?

A.2. Some information about private mortgage insurance is already available in the HMDA data base. The HMDA loan/application form provides a code for "mortgage insurance denied" as a primary reason for denial. Although recording the reason for denial is optional for all other HMDA reporters, savings associations are required to complete this field. Consequently, we already have some information on the effect that private mortgage insurance has on the credit-granting process that we use during our examinations.

Q.3. Do examiners attempt to discover whether an institution has engaged in discrimination by steering certain groups to particular insurers or by making greater efforts to follow-up when insurance

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is denied white applicants than when insurance is denied to minority applicants?

A.3. Our examiners should be alert to any discriminatory practices, including those identified in your question. However, a review of the standards of different private mortgage insurers is not a significant focus of our compliance examinations. Our examiners do review whether an association provides any differential treatment on the basis of race or other prohibited considerations, whether that treatment involves a greater effort to secure needed documentation, to assemble or characterize that credit request for the approval decision, or to more actively pursue approval either internally or from an insurer. As indicated in the answers to questions 1 and 2 in the "Examination Techniques" section, the exact procedures used by our examiners are influenced to a great degree by the association's lending patterns.

Non-Mortgage Related Lending Discrimination

Q.1. What data does your agency have on the prevalence of non-mortgage related lending discrimination? In which markets other than the mortgage market is discrimination a serious problem?

A.1. As noted throughout our responses, we are concerned about any form of credit discrimination, regardless of loan type. Although, the lending activity of savings associations is based primarily on home mortgages, our examiners review for compliance with fair lending laws and regulations as they relate to an association's overall product mix. Our examination data collection system does not categorize fair leading violations on the basis of loan type.

To the extent that an association makes non-mortgage loans, examiners review the association's lending practices using procedures established to determine its compliance with ECOA, as implemented by Regulation B. Since Regulation B applies to all credit transactions regardless of their nature, the ECOA examination procedures encompass all loan types.

Q.2. Do we need disclosure of non-mortgage related lending?

A.2. As stated previously, the associations we regulate primarily provide mortgage credit. The volume of non-mortgage loans (*e.g.*, small business and consumer loans) comprise relatively small percentages of most associations' overall loan portfolios. Consequently, the lack of loan registers to track non-mortgage related transactions is not a major impediment. We believe our examiners can perform the necessary reviews with available loan records.

Q.3. What examination techniques do you use to enforce ECOA with respect to non-mortgage related lending? Given the paucity of statistical data what "flags" do you instruct examiners to look for to detect non-mortgage related lending discrimination?

—and—

Q.4. How do these "flags" differ from those you look for to detect discrimination by mortgage lenders not falling under HMDA?

A.3. & A.4. The examination approach described in our response to questions 1 and 2 under "Examination Techniques" applies equally to types of credit other than home mortgage loans. A thorough fair lending review begins with an evaluation of lending policies, proce-

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dures, underwriting guidelines, the adequacy of training, and self-assessment efforts. The review also includes detailed interviews and discussions between an examiner and a savings association's senior management, compliance officer, internal auditor, lending officers, and other personnel responsible for the association's compliance with fair lending laws and regulations.

Based upon this review, an examiner develops various hypotheses about an association's treatment of credit applicants and its level of compliance. These hypotheses are proved or disproved by analyzing judgmental samples of accepted and rejected credit files. Our examiners may not have available data concerning the race of applicants for non-mortgage loans; however, they do have access to information concerning consumer complaints, and our examiners should be alert to evidence of differential treatment on any prohibited basis. Illegal discrimination may be reflected in instructions given to lenders, processing time-frames, approval procedures, documentation required, loan fees and terms, or how standards and exceptions are applied.

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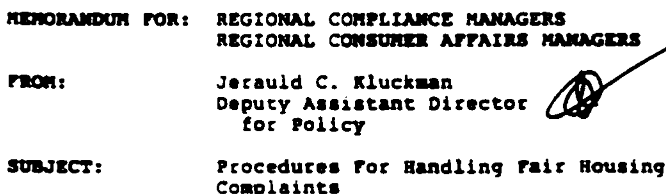
Office of Thrift Supervision
Department of the Treasury

Exhibit

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6000

May 18, 1992



MEMORANDUM FOR: REGIONAL COMPLIANCE MANAGERS
REGIONAL CONSUMER AFFAIRS MANAGERS

FROM: Jerauld C. Kluckman
Deputy Assistant Director
for Policy

SUBJECT: Procedures For Handling Fair Housing Complaints

PURPOSE

This memorandum establishes procedures for the Office of Thrift Supervision to implement a Memorandum of Understanding ("MOU") between the U.S. Department of Housing and Urban Development ("HUD") and the member agencies of the Federal Financial Institutions Examination Council ("FFIEC"). This also serves to reaffirm and clarify existing OTS procedures for processing and handling fair housing complaints. This memorandum supersedes any previous guidelines governing the handling of fair housing complaints.

BACKGROUND

The Fair Housing Amendments Act of 1988 ("the Act") and its implementing regulations explicitly require administrative coordination between HUD and federal agencies having regulatory authority over financial institutions.

In order to further promote the intent and requirements of the Act, HUD and member agencies of the FFIEC recently adopted the attached MOU (Attachment A). Pertinent procedural excerpts from HUD's implementing regulation (24 CFR 103) are also attached (Attachment B). Please consult these documents as needed in conjunction with this memorandum.

OTS PROCEDURES FOR FAIR HOUSING COMPLAINTS

1. OTS Procedures for Incoming Mail

Complaints covered by the Act should be identified immediately upon receipt and be distinguished from other discrimination complaints which are in no way dwelling-related. Both categories of discrimination complaints should be distinguished from other complaints that do not involve discrimination at all.

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Many complaints covered by the Act will also be covered by OTS nondiscrimination regulations or other laws and regulations, such as the Equal Credit Opportunity Act, implemented by Regulation B. However, if

-the complaint alleges discrimination based on race, color, religion, national origin, sex, familial status or handicap; and

-the transaction described is dwelling-related or dwelling-secured (all home equity loans are covered by the Act);

you should follow the procedures below for fair housing complaints.

Complaints should be acknowledged within three business days. The acknowledgment letter should inform the complainant of his/her rights under the Act. Whenever appropriate, the letter should also indicate if the allegations may also involve other laws or regulations administered by OTS. The MOU provides for such initial identification of issues by the financial regulatory agency. The acknowledgment letter should also advise the complainant that copies of the complaint and acknowledgment letter are being forwarded to HUD in accordance with the MOU. (See Model Letter Attachment C.)

A copy of the complaint and acknowledgment letter should be forwarded immediately to:

Office for Fair Housing and Equal Opportunity
HUD, Room 5100
451 Seventh St., SW
Washington, DC 20410

Att: Director, Office of Investigation

A copy should also be sent promptly to Consumer Programs in Washington, which will be the key contact for HUD in tracking and coordinating fair housing complaints.

When Consumer Programs receives a complaint from HUD, in accordance with the MOU, it will promptly forward the complaint to the appropriate region for investigation and response. The region should immediately acknowledge receipt to the HUD contact above, so that HUD fair housing personnel know who is investigating the complaint on behalf of OTS and the MOU requirements are fulfilled. The region should also send an acknowledgment to the complainant within three business days. See Model Letter Attachment D.)

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2. OTS Investigation Procedures

Upon receipt from any source of a fair housing complaint involving a savings institution, the OTS region should promptly undertake an investigation. Every effort should be made to compile and review all relevant information within 30 days from receipt of the complaint. At any stage during investigation of a fair housing complaint, regional consumer affairs staff may consult Consumer Programs personnel.

Review each complaint to determine all issues raised and to identify any other regulatory problems. After determining the issues, initial complaint codes should immediately be entered for each issue identified. For nationwide tracking purposes, the first code should always be Fair Housing Act, in accordance with the revised complaint codes. A comment should be added if more than three codes are required. After the complaint is resolved, the code(s) should be reviewed to assure that all regulatory issues have been properly documented.

The region's first communication with the institution should request the institution's complete file regarding the complainant's loan application or other transaction. The initial communication should also request specific responses to each of the complainant's allegations. In addition, complaint specialists should request any other information or material that appears pertinent and helpful from initial review of the incoming complaint. Ask the institution to respond within two weeks. Whenever you have a substantive conversation with the institution about the case, prepare a brief memorandum for the file.

As in all cases of alleged discrimination, regional staff should interview the complainant by telephone or in person in order to obtain as much information as possible. The interview should be conducted within two weeks after receipt of the complaint. Whenever the complaint specialist obtains information from the complainant by telephone or personal interview, the specialist should prepare a summary for the complainant's file.

If the complaint specialist later needs additional documentation or information from the complainant, he or she should contact the complainant, by telephone or in writing, stating clearly what is needed and providing a reasonable date by which the information is needed.

After obtaining all relevant information from the complainant and the association, make a prompt determination regarding whether or not an on-site investigation is needed to resolve the complaint. If an on-site investigation is needed, the consumer specialist should promptly communicate

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with the regional compliance manager, indicating the approximate length of time needed to conduct the investigation, the specific questions that require answers, and the specific information or documentation that will contribute to resolution.

3. Coordination with HUD

Subject to OTS policies and procedures and the requirements of Section 4 of the MOU, OTS personnel should make every effort to cooperate with HUD personnel who may be interested in the same complaint. Requests for consultation or joint investigation should be granted whenever feasible. When Washington staff receives requests directly from HUD for consultation or joint investigation, the requests will be promptly referred to the region for its consideration.

Throughout the investigation and resolution of fair housing complaints, OTS regional staff should consult with HUD fair housing staff whenever such consultation may expedite and enhance OTS or HUD implementation of their fair housing responsibilities.

Any HUD request for OTS records must be made in writing and in a manner consistent with applicable laws and regulations, including the Right to Financial Privacy Act and the Privacy Act. To the extent permitted by law, OTS will make every effort to provide information which is relevant and necessary to HUD's fair housing investigation. Regional transmission of such records should always be accompanied by a letter from OTS specifying the materials transmitted and the purposes for which they may be used. (See model letter Attachment E.) In conjunction with each HUD request for information from OTS, HUD and OTS will agree upon the time frame for providing the information to HUD.

The member agencies of the FFIEC have reserved the right to receive reimbursement from HUD for any costs in excess of $500 incurred in providing information or documentation. If regional staff determines they have incurred such costs exceeding $500, and believes HUD should be billed in the specific situation, they should provide a memorandum describing the costs to Consumer Programs.

4. Guidelines for Disposition of All Discrimination Complaints

a. Principles

The region's final response to the complainant should address all issues raised by the complainant and include an explanation of the conclusion(s) reached. If no violation of law or regulation has occurred, the letter should indicate the same and state the reasons for the conclusion.

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If the findings fail to prove or disprove the complaint, the complainant should be advised of his/her rights to pursue the matter through other channels and OTS should explain that our inability to substantiate the charges does not foreclose the complainant's right to pursue other courses of action.

If the institution takes corrective action prior to the close-out letter, the complainant should be advised of the action taken by the institution.

If it is determined that violations of pertinent fair lending laws and regulations appear to be present, the complainant should be informed of this determination and advised what action the institution has been instructed to take in relation to the complainant, in accordance with OTS nondiscrimination enforcement guidelines.

If in the course of investigation of any complaint, policies or practices inconsistent with nondiscrimination laws or regulations are discovered, the regional office should request remedial action whether or not the policies and practices are directly related to the complaint and whether or not the specific issues raised by the complaint are sustained. These matters, as well as any findings of a pattern or practice, should be referred to Regional Compliance Programs for further disposition and/or referral in accordance with such guidance as OTS may provide.

b. Timeframes and Procedures

In most cases, complaints should be resolved within 30 days after the receipt of the complaint. If the 30 day time limit cannot be met, the region should send one or more interim responses to the complainant and Consumer Programs should be informed of any such unavoidable delay prior to the 45th day after receiving the complaint. Complaints involving on-site examinations should be resolved within no more than 60 days from receipt of the complainant's letter and interim letters should be sent to the complainant.

Once a complaint is resolved, the regional office should immediately provide a copy of the final response to the HUD Fair Housing contact above. The file should not be sent to HUD. Instead, a copy of the complete file, including the correspondence with HUD, should be sent in a timely manner to Consumer Programs, to assist in its review of fair housing complaint procedures.

The MOU also requires HUD to notify OTS expeditiously of its determinations and actions with respect to institutions regulated by OTS. Whenever Consumer Programs receives such notification from HUD, it will immediately advise the

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appropriate region.

6. Implementation

These procedures take effect May 30, 1992. Any problems in implementation should be brought to the attention of Consumer Programs, so they can be discussed during quarterly consultations with HUD as provided in the MOU.

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Exhibit B

Home Mortgage Lending and Equal Treatment

A Guide for Financial Institutions

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Office of Regulatory Activities

Exhibit

Thrift Bulletin

Handbook: Compliance Activities
Subjects: Nondiscrimination

Section:

April 19,

Disparities in Mortgage Lending

Summary: The Federal Home Loan Bank System is firmly committed to the vigorous enforcement of the fa[ir] lending laws in this country. This Bulletin re-emphasizes the affirmative obligations of thrift institutions to he[lp] meet the credit needs of their communities in a nondiscriminatory manner and summarizes the Federal Hom[e] Loan Bank Board's program for ensuring nondiscriminatory treatment of loan applicants.

For Further Information Contact:
The FHLBank District in which you are located or the Compliance Programs Division of the Office of Regulatory Activities, Washington, DC.

Thrift Bulletin 25

Equal access to the credit markets by all people is both an economic and social good, in addition to being the law of the land. Discrimination has no place in this society and affirmative efforts of thrift institutions to assure that they do not engage in discriminatory practices, either intentionally or unintentionally, is vital to assure equal and fair treatment.

Background

A review of the information in the Data Submission Reports that thrift institutions compile from their Loan Application Registers pursuant to 12 CFR 528.6 shows that, in most cases, minority applicants are rejected for home mortgage loans more frequently than nonminorities. The Board is concerned about the disparities reflected in the data. While the data alone does not prove discrimination by the industry or by individual institutions, any disparities in the data must be fully explored by both examiners and thrift institutions.

Obligations of Thrift Institutions

Under the Community Reinvestment Act and associated Board regulations, thrift institutions have an affirmative obligation to help meet the credit needs of their entire communities on a nondiscriminatory basis, consistent with safe and sound operation. In addition, thrift institutions are subject to a number of other laws and regulations, such as the Equal Credit Opportunity Act, that prohibit lending discrimination.

Thrift institutions should examine, at least annually, their own policies, procedures, lending activity and data, including their written underwriting standards and the practices implementing them, to be sure that no illegal discriminatory lending practices could result. As part of this review, institutions should analyze the Data Submission Reports they submit and the Loan Application Registers to help determine the cause of any lending disparities. Data compiled under the Home Mortgage Disclosure Act should also be carefully analyzed. Furthermore, thrift institutions should conduct reviews of their own compliance with the nondiscrimination laws and regulations. To assist in conducting internal reviews, the manual "Compliance: A Self Assessment Guide", which was prepared and distributed to every thrift institution in July 1988, can be consulted.

Federal Home Loan Bank Board Initiatives

The Board has a number of programs underway to ensure that institutions comply with the non[dis]crimination laws and regula[tions]. First, the Board recently appro[ved a] specialized examination pro[gram] for the compliance area [which] involves the use of a separate ex[ami]nation force of specially-trained [per]sonnel to conduct compliance e[xam]inations. The decision to appro[ve a] separate compliance examin[ation] program reaffirms the Board's c[om]mitment to assuring that thrift [man]agement complies with its respo[nsi]bilities under applicable [...] requirements and standards of [pru]dent management. As part of [this] program, examiners will rou[tinely] analyze the Data Submission Re[port] information as part of each exam[ina]tion and make any additional i[nves]tigations deemed necessary.

The Board has developed an ex[ami]nation handbook devoted e[xclu]sively to examining and ensur[ing] compliance with the consumer [pro]tection laws and regulations, [the] Community Reinvestment Act, [and] other public-interest laws suc[h as] the Bank Secrecy Act. This h[and]book should be in the hand[s of] every thrift institution and e[very] examiner involved in review[ing] compliance issues in the near fu[ture].

Furthermore, the Board is monit[or]ing thrifts whose previous Data S[ub]mission Reports indicated wi[de] disparate trends involving race [and] census tract income levels. In c[on]junction with the Federal H[ome] Loan Banks, targeted visits to t[hese] thrifts will be conducted, using

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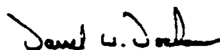
Thrift Bulletin

Data Submission Reports as the basis for the examination. Examiners will analyze thoroughly the lending policies and procedures of these thrifts. Any instances of illegal discrimination that arise in connection with these investigations will be subject to the full extent of our supervisory and enforcement authority.



— Darrel W. Dochow, Executive Direc

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Exhibit

MEMORANDUM OF UNDERSTANDING BETWEEN DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT AND THE FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL (FFIEC) MEMBER AGENCIES

1. Purpose

This Memorandum of Understanding (MOU) is a set of procedures for coordination and cooperation in the investigation of complaints that allege a violation of the Fair Housing Act (FHAct).

The Department of Housing and Urban Development (HUD) is responsible for administering the FHAct and investigating the FHAct complaints it receives. The agencies that are members of the FFIEC (member agencies) also have statutory and regulatory responsibility for investigating and resolving complaints alleging illegal discrimination in residential real estate-related transactions by the financial institutions they regulate (regulated institutions). HUD and the member agencies agree to coordinate their efforts with regard to the FHAct to: a) assure nondiscrimination in residential real estate-related transactions by the regulated institutions, b) minimize duplicative Federal efforts, and c) reduce the burden on the public.

Nothing in this MOU shall be deemed to address interagency coordination except in connection with investigations of complaints undertaken by HUD and/or the member agencies pursuant to the FHAct. HUD's investigations shall not be deemed to constitute "examinations" of regulated institutions.

This MOU does not apply to complaints that name a member agency as a respondent.

2. Notification of Complaint Receipt

Complaint First Received by a Member Agency: Upon receipt of a complaint that appears to allege a violation of the FHAct, that is, involves an allegation of discrimination based on race, color, religion, national origin, sex, familial status or handicap in a residential real estate-related transaction by a regulated institution, the appropriate member agency (i.e., the primary regulator of the regulated institution) will expeditiously provide a copy of the complaint to the designated contact in HUD's national office for Fair Housing and Equal Opportunity. At the same time, the member agency will inform the complainant by letter of his or her rights under the FHAct, as well as other pertinent statutes or regulations, and advise the complainant that copies of this letter and the complaint are being provided to HUD. A copy of this letter will accompany the complaint provided to HUD.

Following receipt of a complaint forwarded by a member agency, HUD will expeditiously send the member agency a letter acknowledging receipt.

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<u>Complaint First Received by HUD</u>: Upon receipt of a FHAct complaint against a regulated institution, HUD will expeditiously provide the headquarters of the appropriate member agency with a copy of that complaint. At the same time, HUD will inform the complainant that copies of this letter and the complaint are being provided to the appropriate member agency.

Following receipt of a complaint forwarded by HUD, the member agency will expeditiously acknowledge receipt and advise HUD whether the allegations in the complaint involve or may involve laws or regulations, other than the FHAct, administered by the member agency.

3. <u>Coordination in Processing FHAct Complaints</u>

Upon receipt of a complaint alleging a violation of the FHAct involving a regulated institution, both HUD and the appropriate member agency will coordinate the initiation of appropriate investigation(s) and processing of the complaint pursuant to their respective regulations and procedures. HUD will, as in all other complaints, provide the respondent (the regulated institution) with adequate notice of the investigation and of any records needed from the respondent. At the same time, HUD will notify the member agency in advance of the dates, times and places of any on-site investigations and will provide an opportunity to participate. If member agency participation is not feasible, HUD may consult with the agency regarding investigative approaches.

To the extent permissible under their policies and procedures, HUD and the member agencies will attempt to coordinate their investigations of complaints that allege a violation of the FHAct. In undertaking their respective investigations, HUD and the member agencies will consider each other's regulations, policies and procedures, including the statutory and regulatory deadlines governing HUD actions.

4. <u>Information Requests</u>

HUD requests to member agencies for their records shall be made in writing and in a manner which is consistent with any applicable laws and regulations, including the Right to Financial Privacy Act and the Privacy Act. When HUD makes a request in writing for a member agency to provide nonpublic information that the member agency maintains with respect to the lending practices of a regulated institution or group of regulated institutions it regulates, the member agency will make every effort to provide that information which is relevant and necessary to HUD's FHAct investigation, to the extent permissible by law. (HUD understands that examination reports, working papers and other examination-related documents are the property of the member agencies and will, therefore, make its requests for those documents only to the member agencies and not to the regulated institutions involved in the investigation.) The member agencies reserve the right to receive reimbursement from HUD for any costs in excess of $500 incurred in providing this information. HUD and the member agencies recognize that certain Federal laws, including the Right to Financial Privacy Act and the Privacy Act,

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as well as agency regulations and policies governing confidentiality and nondisclosure, may limit their ability to publicly release information received from each other. Therefore, the parties agree that if the agency receiving information (otherwise governed by such laws, regulations and policies) believes that release of such information is necessary and essential to effect compliance with the FHAct, the General or Chief Counsels of the two agencies will confer, prior to any public release of the information. With regard to publicly available data, the member agency will advise HUD of their location and the procedures to obtain access to them. Time frames for responding to requests will be agreed upon between the two agencies on a case-by-case basis.

5. Determinations and Decisions

With regard to HUD processing of FHAct complaints against regulated institutions, HUD will expeditiously notify the headquarters of the member agency of:

A. the reason for closing the complaint (and will provide the member agency with a copy of any conciliation agreement); or

B. the HUD determination of whether there is reasonable cause to believe there has been a violation of the FHAct; and

- any election by the complainant or respondent to have a charge heard in Federal district court, or

- the issuance of a final decision after an administrative hearing.

With regard to member agency processing of complaints involving both the FHAct and one or more member agency-administered laws or regulations, the member agency will expeditiously notify HUD of its determination or other reason for closing the complaint.

6. Implementation

This MOU becomes effective not later than 180 days after it is signed by all parties. Prior to the effective date, HUD and the member agencies will each establish internal procedures for implementation. HUD and the member agencies will provide each other with copies of these procedures.

HUD will provide the member agencies at least annually with a list of regulated institutions that were named as respondents in complaints filed during the preceding twelve-month period. At least annually, the member agencies will provide HUD with current lists of the institutions they regulate to enable HUD to notify the appropriate member agency when HUD receives a complaint against a regulated institution.

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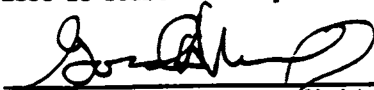
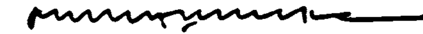
HUD and the member agencies agree to confer quarterly and to meet at least annually to assess the implementation of this MOU.



Date

Name : Gordon H. Mansfield
Title: Asst. Sec. for Fair Housing and Equal Opportunity
Agency: Department of Housing and Urban Development



11-15-91
Date

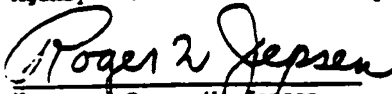
Name : Robert L. Clarke
Title: Comptroller of the Currency
Agency: Comptroller of the Currency

Date

Name : John P. LaWare
Title: Member, Board of Governors
Agency: Board of Governors of the Federal Reserve System

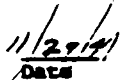
Date

Name : T. Timothy Ryan
Title: Director
Agency: Office of Thrift Supervision



Date

Name : Roger W. Jepsen
Title: Chairman
Agency: National Credit Union Administration



Date

Name : William Taylor
Title: Chairman
Agency: Federal Deposit Insurance Corporation

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DONALD W RIEGLE JR MICHIGAN CHAIRMAN

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STEVEN B HARRIS STAFF DIRECTOR AND CHIEF COUNSEL
LAMAR SMITH REPUBLICAN STAFF DIRECTOR AND ECONOMIST

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WASHINGTON, DC 20510-6075

January 15, 1993

Stephen R. Steinbrink
Acting Comptroller
Office of the Comptroller of Currency
250 E Street, S.W.
Washington, D.C. 20219

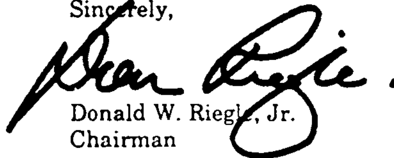
Dear Mr. Steinbrink:

The Senate Committee on Banking, Housing, and Urban Affairs has tentatively scheduled a hearing to be held on Wednesday, February 24, 1993, to examine the problem of mortgage and other lending discrimination. In preparation for that hearing and in support of ongoing oversight activities, the Committee would like certain information from your agency concerning your fair lending compliance activities.

Enclosed please find a compilation of questions, the responses to which should be delivered to the Committee by Friday, February 12, 1993. Please deliver your responses to Matthew Roberts of my staff at the Dirksen Senate Office Building, Room 534, Washington, D.C. 20510.

Thank you for your cooperation.

Sincerely,



Donald W. Riegle, Jr.
Chairman

DWR/mr
enc.

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RESPONSE TO WRITTEN QUESTIONS FROM SENATOR RIEGLE BY STEPHEN R. STEINBRINK

LENDING DISCRIMINATION QUESTIONS

Compliance Structure

Q.1. What division within your agency conducts fair lending examinations? To whom within the agency do the examiners report? Do these supervisors have other responsibilities besides fair lending and/or Community Reinvestment Act compliance?

A.1. The Office of the Comptroller of the Currency (OCC) is in the midst of far-reaching changes with regard to the matters raised by these questions.

At present, OCC examiners working in approximately duty discrimination examinations and the lending discrimination component of routine compliance examinations. These examiners also perform commercial examinations. All these activities are carried out under the direction of our six district offices. The chain of supervision within which the examiners currently work is responsible for both safety and soundness and compliance (including fair lending) aspects of bank supervision.

After a thorough review, the OCC recently decided to replace this arrangement with compliance examiners specializing in consumer matters, including nondiscrimination (among other consumer protections) and compliance with the Community Reinvestment Act (CRA). Compliance examiners will be commissioned national bank examiners who progress through a compliance career ladder. Their work will be supported by generalist assistant and associate examiners and supervised by compliance managers.

The overall guidance for the compliance program will continue to come from the OCC's Compliance Management Department.

We expect the new compliance program to be substantially operational by early 1994.

Q.2. Would a separate division devoted to fair lending and community reinvestment examinations enhance your agency's compliance efforts? Why or Why not?

A.2. The OCC does not have special "fair lending examiners" currently, but is starting to implement a program that will include specialized consumer examiners who will examine for lending discrimination and CRA compliance, along with other consumer protections.

We anticipate that the new specialist examiners in our compliance program will significantly improve our compliance efforts in the fair lending and community reinvestment areas. Specialist examiners should be more effective in their assessments of national banks' compliance with laws and regulations, including fair lending laws, than are generalist examiners.

Q.3. Are there any structural factors (such as job classification) that preclude or impede consumer compliance examiners from being promoted to supervisory positions?

A.3. There will be no structural barrier to the promotion of compliance specialist examiners to supervisory positions in the new compliance program.

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Q.4a. How many staff personnel are allocated for fair lending enforcement?

A.4a. The OCC annually devotes approximately 200 FTEs to direct compliance supervision. Each OCC district office supplements its core of generalist examiners with a limited number of Consumer/CRA/Retail experts who devote a large portion of their time to supporting the district's activities to identify lending discrimination and examine for CRA compliance.

Beginning in 1994, there will be between 100 and 150 commissioned examiners devoted solely to compliance supervision. They will be supported by compliance technicians and by assistant/associate national bank examiners who will perform both safety and soundness and consumer compliance examinations.

Two fair lending specialists in OCC headquarters work full-time on matters related to lending discrimination enforcement, focusing on residential lending. Another specialist in headquarters devotes a substantial portion of his time to Equal Credit Opportunity Act (ECOA) issues.

These specialists participate directly in lending discrimination reviews of national banks, provide technical assistance to examiners conducting compliance examinations, offer training to OCC examiners, develop examination techniques and strategies for detecting discrimination, facilitate the flow of evidence of possible discrimination to HUD and DOJ and coordinate investigative activities with those agencies, and produce guidance to help the industry prevent illegal discrimination.

Q.4b. Approximately how much time do they spend per year on fair lending compliance related work?

A.4b. We do not record separately the time devoted to examining for compliance with nondiscrimination and consumer protection laws, but reviewing bank lending activities to identify discrimination is a required component of compliance examinations. In 1991, about six percent (199 work years) of our work years was devoted directly to compliance. This was about 14 percent of supervisory time. About 26 percent of that time was devoted to CRA compliance. We are compiling 1992 figures and will forward them shortly.

Our district offices report that the lending discrimination portion of a routine compliance examination of a community bank takes one examiner one week or longer, for a regional bank, it takes two or more examiners two weeks or longer to examine for lending discrimination.

Q.5. What is the nature of the training for fair lending examiners?

A.5. Presently, examiners attend a five-day District Consumer Compliance Examination Techniques School. Six and one-half hours of this school are devoted to ECOA and the Fair Housing Act (FHAct)—including a case study that encompasses loan file review—and an additional eight hours are devoted to community reinvestment and home mortgage disclosure requirements.

Prerequisite to this school is an eight-module computerized tutorial introducing various consumer topics, including Truth in Lending, CRA, Regulation B, Regulation CC, Regulation E, Regulation DD, Bank Secrecy Act, and regulations concerning residential mortgage lending. Students must complete and pass tests on each

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of these modules before attending the classroom instruction. The average time to complete this tutorial is about 36 hours.

We also conduct specialized training for senior examiners who spend the vast majority of their time performing compliance examinations at the largest national banks. At the specialized compliance training seminars in 1992, the lead attorney in, the Justice Department's lending discrimination investigation in Atlanta advised the examiners in methods to conduct inquiries into possible mortgage lending discrimination and described the approaches and findings from the Atlanta investigation. The director of the systemic housing discrimination investigation program for the U.S. Department of Housing and Urban Development (HUD) also made presentations.

We also have offered several times, and continue to develop, a day-long training module on residential lending discrimination. The module reflects such recent developments as the Justice Department's consent order in Atlanta and the Federal Reserve Bank of Boston's recent study, as well as feedback from our current field-testing of innovative examination techniques to identify discrimination. The module is designed both to offer technical guidance and to make certain that senior examiners and others understand the effects of racial discrimination and the importance of enforcing civil rights laws. (See Enclosure A, Training Agendas.)

As a result of our new program for compliance examinations, including specialist examiners, we are re-evaluating all of our compliance training. This is proceeding concurrently with the re-evaluation of lending discrimination training for all financial regulators that is being carried out by a contractor for the Federal Financial Institutions Examination Council (FFIEC). We will revise, as appropriate, existing compliance training programs and develop new and updated ones.

Q.6. Please provide a breakdown of the race, ethnicity, and gender of fair lending examiners and supervisory personnel by job classification.

A.6. As explained in the responses to the previous questions under this heading, OCC does not presently have examiners or supervisors devoted solely to fair lending. Enclosures B and C are charts showing the distribution, by pay grade, race, ethnicity, and gender, of all examiners and the total OCC work force.

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OFFICE OF THE COMPTROLLER OF THE CURRENCY
DISTRIBUTION OF EXAMINERS BY PAY PLAN, GRADE LEVEL, GENDER, AND RACE
AS OF PAYROLL PERIOD 9226 ENDING JANUARY 9, 1993

PAY PLAN	GRADE LEVEL	TOTAL EXAMINERS	MALES (BY RACIAL CODE)* A	B	C	D	E	TOTAL MALES	FEMALES (BY RACIAL CODE)* A	B	C	D	E	TOTAL FEMALES
OC	08	205	0	6	3	7	117	133	0	1	3	0	68	72
OC	09	420	0	10	17	8	215	250	1	6	16	2	145	170
OC	10	452	4	6	25	14	217	266	1	8	28	11	138	186
OC	12	391	1	3	19	9	204	236	0	4	13	10	128	155
OC	13	41	0	0	1	4	12	17	0	0	3	0	21	24
OC	14	500	5	5	21	16	301	348	2	2	15	7	126	152
OC	15	67	0	2	2	1	39	44	0	0	3	0	20	23
OC	16	272	2	2	7	6	189	206	0	1	11	5	49	66
OC	17	281	1	2	9	1	223	236	0	1	5	1	38	45
OC	18	59	0	1	0	0	52	53	0	0	0	0	6	6
OC	19	37	0	0	2	0	29	31	0	0	1	0	5	6
OC	20	20	0	0	0	1	16	17	0	1	0	0	2	3
OC	21	2	0	0	0	0	1	1	0	0	0	0	1	1
OC	22	10	0	0	0	0	10	10	0	0	0	0	0	0
OC	24	8	0	0	0	0	7	7	0	0	0	0	1	1
OC	25	2	0	0	0	0	1	1	0	0	0	0	1	1
PAY PLAN TOTALS		2,767	13	37	106	67	1,633	1,856	4	24	98	36	749	911
AGENCY TOTALS		2,767	13	37	106	67	1,633	1,856	4	24	98	36	749	911

* RACIAL CODES: A=AMERICAN INDIAN, B=ASIAN, C=BLACK, D=HISPANIC, E=WHITE

PRODUCED BY: HUMAN RESOURCES DIVISION, PERSONNEL SYSTEMS & ANALYSIS
REFERENCE: CTC028.P0923.EASY.CNTL(HRSTATS2)
SOURCE: TREASURY INTEGRATED MANAGEMENT INFORMATION SYSTEM (TIMIS)

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1/29/93 OFFICE OF THE COMPTROLLER OF THE CURRENCY

DISTRIBUTION OF EMPLOYEES BY PAY PLAN, GRADE LEVEL, GENDER, AND RACE
AS OF PAYROLL PERIOD 9226 ENDING JANUARY 9, 1993

PAY PLAN	GRADE LEVEL	TOTAL EMPLOYEES	MALES (BY RACIAL CODE)* A	B	C	D	E	TOTAL MALES	FEMALES (BY RACIAL CODE)* A	B	C	D	E	TOTAL FEMALES
GG	11	2	0	0	1	0	0	1	0	1	0	0	0	1
PAY PLAN TOTALS		2	0	0	1	0	0	1	0	1	0	0	0	1
OC	01	13	0	0	1	1	0	2	0	0	8	1	2	11
OC	03	18	0	0	1	0	3	4	0	0	6	0	8	14
OC	04	12	0	0	2	0	2	4	0	0	4	0	4	8
OC	05	129	0	0	5	1	7	13	0	4	50	2	60	116
OC	06	141	0	1	7	1	3	12	0	3	50	7	69	129
OC	07	50	0	0	15	0	6	21	1	0	14	4	10	29
OC	08	358	0	6	10	10	126	152	1	4	62	3	136	206
OC	09	477	0	10	19	8	221	258	1	8	38	2	170	219
OC	10	521	4	6	31	15	222	278	1	9	49	12	172	243
OC	11	15	0	0	1	0	2	3	0	1	5	0	6	12
OC	12	478	1	6	21	9	233	270	1	7	22	10	168	208
OC	13	126	0	0	8	4	50	62	0	2	9	1	52	64
OC	14	555	5	7	25	17	330	384	2	3	18	7	141	171
OC	15	115	0	4	3	2	63	72	1	1	7	0	34	43
OC	16	307	2	2	7	7	207	225	0	2	14	5	61	82
OC	17	342	1	3	13	1	252	270	0	2	5	1	64	72
OC	18	69	0	1	0	0	59	60	0	0	1	0	8	9
OC	19	54	0	0	2	0	40	42	0	0	3	0	9	12
OC	20	31	0	0	0	1	24	25	0	2	0	0	4	6
OC	21	3	0	0	0	0	2	2	0	0	0	0	1	1
OC	22	16	0	0	0	0	14	14	0	0	0	0	2	2
OC	23	4	0	1	0	0	2	3	0	0	0	0	1	1
OC	24	9	0	0	0	0	8	8	0	0	0	0	1	1
OC	25	5	0	0	0	0	3	3	0	0	0	0	2	2
PAY PLAN TOTALS		3,848	13	47	171	77	1,879	2,187	8	48	365	55	1,185	1,661
AGENCY TOTALS		3,850	13	47	172	77	1,879	2,188	8	49	365	55	1,185	1,662

* RACIAL CODES: A=AMERICAN INDIAN, B=ASIAN, C=BLACK, D=HISPANIC, E=WHITE

PRODUCED BY: HUMAN RESOURCES DIVISION, PERSONNEL SYSTEMS & ANALYSIS
REFERENCE: CTC028.P0923.EASY.CNTL(HRSTATS1)
SOURCE: TREASURY INTEGRATED MANAGEMENT INFORMATION SYSTEM (TIMIS)

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Examination Techniques

Q.1a. What instructions do you give examiners on the types of loans and the number of files that they should review in a fair lending compliance exam?

A.1a. This month we will issue interim procedures on examining for racial and ethnic discrimination in residential lending, including procedures for selection of application and loan files. These procedures are "interim" while we continue field testing, which was begun last year, and while we await the result of the review of all of the financial regulators' fair lending examination techniques by a consultant hired by the FFIEC. A description of the forthcoming examination procedures, which focus on conventional home purchase loans, is enclosed. (See Enclosure D.)

In banks with substantial minority loan denials, examiners will review all denied minority applicants for a specific time period, or selected minority applicants based on patterns in reasons for denial or other suspicious circumstances (as shown on the HMDA Loan/Application Register (HMDA-LAR)). Examiners also will review as many approved white applications as needed to learn what kinds of accommodations, exceptions, and assistance customarily are given by the bank. This will typically mean reviewing four to five times as many white approved files as minority denied files. From this basis, the examiner can judge whether any minority applicants were denied similar advantageous treatment.

In banks with few minority loan denials, the examiner may adapt the forthcoming examination procedures to other than racial/ethnic distinctions (for example, gender or marital status), or may use the approach stated in the current *Comptroller's Handbook for Compliance (Handbook).*

As provided in the *Handbook,* at the initial level of inquiry, the examiner judgmentally selects a sufficient number of application and loan files to learn whether the bank follows its own procedural safeguards to prevent discrimination. While this approach is suitable for measuring compliance with specific, explicit requirements on individual loan and application files (such as many stated in ECOA concerning impermissible inquiries by lenders, signature requirements, etc.), it is less useful in identifying patterns of disparate treatment for different groups of applicants. The next edition of the *Handbook* will place principal emphasis on comparing the pattern of actual treatment of applicants as called for in the forthcoming examination procedures for residential lending discrimination.

Q.1b. How many loan files are sampled as part of an examination?

A.1b. The answer to the previous question describes sampling under the forthcoming examination procedures for residential lending discrimination, which eventually will be incorporated in a revised Compliance Handbook.

The current *Compliance Handbook* gives the examiner discretion—for the first level of review—to select an "appropriate" number of files to learn whether and how well the bank implements its own compliance program. These are to be selected from those that the bank has used for its own internal review. Then, if there is reason to lack confidence in the bank's safeguards or otherwise sus-

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pect discrimination, the Handbook directs the examiner to a table that states minimum *additional* numbers of accepted, rejected, and withdrawn loan and application files to be reviewed. The guidance provides that, for real estate loans, from 14 to 26 files should be reviewed (depending on the size of the bank) evenly divided between a control group and a prohibited basis group. Minimums also are provided for commercial loans and other consumer loans.

Q.1c. Does the number of files sampled vary by the size of the institution or other criteria?

A.1c. In the forthcoming examination procedures for residential lending discrimination, the minimum number of files sampled varies by the number of minority denials and the overall number of applications. Examiners will choose files based on specific factors or characteristics, rather than simply a random sample. In the current *Handbook's* approach the number of files varies by size of institution.

Q.2. What indicia of discrimination are examiners instructed to look for in the files (*e.g.*, perfect minority applicants who are rejected, comparable minority and nonminority applicants who receive differential treatment, etc.)?

A.2. The forthcoming procedures focus on whether the application process ended similarly for minority and nonminority applicants with equivalent qualifications and whether the bank gave them equivalent levels of assistance and accommodation in the course of the process. Commencing with an off-site review of the HMDA-LAR, in part to identify comparable files for review, those procedures direct the examiner to focus on anomalies that may indicate possible illegal discrimination—for example, disproportionately more rapid or more frequent denials of minority applications for reasons that usually warrant more extensive consideration.

For file review itself, examiners will use Residential Lending Comparative Analysis Worksheets designed to capture not only conspicuous qualifications, such as qualifying ratios, but also data on compensating, alternative, or explanatory factors that the lender has discretion to deem evidence, of creditworthiness. The existence of these discretionary conditions is a "red flag" for our examiners.

The forthcoming procedures include a four-page attachment listing discretionary and subjective aspects of residential lending with high potential for unequal quality of service. They also contain a five-page questionnaire for interviewing a bank's chief underwriter so that the examiner fully understands the bank's standards and procedures. (All the referenced materials that support those procedures are included with their description in Enclosure D.)

Our traditional examination techniques have not included inquiries into the subtle, dynamic aspects of the lending process in which discriminatory influences now are believed most likely to play a role. Our traditional approach had been devised partially in response to the often-heard allegations that well-qualified minority applicants frequently were denied loans. The recent findings in Boston and Atlanta suggest that well-qualified minority applicants in fact obtain loans at about the same rate as well-qualified nonminority applicants, a finding that is consistent with HMDA data that now have shown for two years that minority applicants

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are twice as likely to get a loan as to be denied one. These facts in turn explain, to some degree, why examination approaches oriented toward well-qualified applicants have failed to identify violations.

Q.3. Does your agency operate on the premise that you need to find statistically significant discrimination to take enforcement action?

A.3. No. In accordance with ECOA, we refer matters to the Justice Department or notify HUD of possible violations when we find "reason to believe" there may have been a violation. The information supporting "reason to believe" a violation has occurred may be documents (including those in loan files), credible observations by parties and other individuals, or valid statistical analysis. Referral for enforcement does not require establishing a pattern or practice of violations, but may be baked on isolated situations.

We regard "reason to believe" to exist when a reasonable person might conclude from credible information in hand (or might conclude from additional information that appears likely to be obtained through further investigation) that:

- One or more of the lender's policies is overtly discriminatory on a prohibited basis;
- There is disparate treatment by the lender on a prohibited basis and, after request, the lender cannot produce a credible, legitimate, nondiscriminatory explanation; or
- A policy of the lender produces a disparate effect on a prohibited basis, and, after request, the lender has not justified the policy with business reasons or—if it has provided justification—cannot demonstrate that there were no less-discriminatory alternatives.

It is not necessary for purposes of referral to the Justice Department or HUD that the evidence conclude that discrimination has occurred. There is "reason to believe" if a reasonable person reviewing the available evidence could reach a defensible conclusion that discrimination had occurred, or that its occurrence was likely to be proven through further investigation.

When we find a "reason to believe" that discrimination may have occurred and contact HUD or the Justice Department, we coordinate further investigation and enforcement activities with those agencies rather than proceed independently. Should enforcement activities by the OCC become appropriate, they would be carried out in accordance with our Policy Statements on Enforcement of the Equal Credit Opportunity and Fair Housing Acts. A copy is enclosed, though we expect a substantially revised Joint Policy Statement to be issued before long by all the financial regulatory agencies. (See Enclosure E.)

Q.4. Do compliance examiners interview loan officers?

A.4. For effective file review, we believe the key bank employee to interview is the one most knowledgeable about underwriting standards. The forthcoming examination procedures for residential lending discrimination direct the examiner to interview the chief underwriter very early in the examination. A five-page questionnaire attached to those procedures poses numerous straightforward questions about the bank's procedures and standards, but also many questions that are likely to involve complicated answers. These—

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which chiefly concern exceptions, compensating factors, and the lender's responses to problems in the transaction—are designed to help the examiner understand how discretion, flexibility, creativity, and other dynamic elements operate in the loan process.

If the examiner finds apparent disparate treatment or unaccountable decisions, then the loan officer who handled the transactions in question becomes an important source of information and would be interviewed.

The current *Compliance Handbook* directs the examiner to interview the bank's compliance staff (using detailed questionnaires) and "first contact" personnel. (See Enclosure F, Internal Control Questionnaire and Compliance Review Function Questionnaire.) This will be a secondary focus under the new procedures.

Q.5. Please describe the circumstances under which examiners contact credit applicants to collect consumers' opinions on how their applications were handled by bank personnel.

A.5. The forthcoming examination procedures for residential lending discrimination advise that in certain situations it may be advantageous for examiners to meet with applicants and borrowers. Examiners will consider this in planning examinations of institutions targeted because of strong suspicions of illegal discrimination. One situation in which we envision that contacts with customers might be valuable is when differential treatment of consumer loan applicants is apparent but the race of the customers must be ascertained to establish whether race is involved. Another situation is when a denied minority application file raises questions about the quality of advice, assistance, etc., the bank provided that can only be answered by the applicant.

However, we are still developing guidelines to address the privacy concerns and other sensitive aspects of contacts with customers who have not in fact alleged wrongdoing by the bank or communicated in any way with the OCC. Until we do so, examiners will only contact customers on a case-by-case basis in consultation with our Fair Lending Specialists.

Q.6. What percent of fair lending examinations include examiner outreach to credit applicants?

A.6. Contact with credit applicants has not been a component of our fair lending examinations. The new procedures, however, emphasize the potential value of such contacts in future examinations.

Q.7. Please describe the circumstances under which examiners contact representatives of the business and consumer community to collect their opinions on bank treatment of credit applications.

A.7. Consumer and community groups should be contacted by examiners routinely in connection with CRA examinations. Typically, however, those inquiries concern the overall level of service to the community rather than handling of particular applications.

We have requested the community organization ACORN to forward lending discrimination complaints to us. Since ACORN advised its mortgage counselors of that interest in August 1992, the organization has forwarded two complaints to the OCC.

As a general practice, however, the OCC has not contacted consumer and local organizations in connection with examinations

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for lending discrimination. However, the new procedures on residential lending discrimination advise that community and fair lending groups and local government agencies concerned with civil rights or the lending industry may have information or experiences that will help focus on-site activities on specific customer groups, specific procedures and standards, and even individual transactions (if the groups or agencies have been contacted by dissatisfied customers). We plan to develop guidelines for such contacts, which will encourage that practice.

Business groups typically have not been contacted in connection with the OCC's fair lending activities, though they are contacted in connection with CRA reviews. Most interest in possible illegal credit discrimination has focused on residential lending, with regard to which local business persons are not the best contacts. Therefore, our forthcoming procedures on residential lending discrimination do not call for contacts with local businesspersons.

Q.8a. How frequently are community organizations contacted?

A.8a. See answer to previous question.

Q.8b. How frequently are legal service agencies contacted?

A.8b. Like other outside groups, legal service agencies typically have not been contacted in connection with the OCC's fair lending activities. However, the forthcoming procedures direct examiners planning lending discrimination examinations to consider contacting state or local government agencies that enforce banking or civil rights laws and that receive lending discrimination complaints, as well as local private civil rights groups that receive lending discrimination complaints.

Q.8c. How frequently are members of the small business community contacted?

A.8c. See answer to question 7.

Q.8d. How frequently are members of the real estate community contacted?

A.8d. Although recent practice has been not to contact these sources in connection with examining for lending discrimination, the forthcoming examination procedures state that appropriate types of organizations to contact may include housing counseling services and minority real estate agents and brokers or those working in minority neighborhoods.

Q.9. What percent of exams result in specific examiner discussion of fair lending compliance problems and recommendations with a bank's board of directors? With bank management?

A.9. At the conclusion of an examination, it is the OCC's practice for examiners to discuss with the bank's management any apparent violations of law, regulations, or rulings and any significant internal control deficiencies; to recommend corrective action for deficiencies cited; and to obtain the bank's commitment to specific actions to correct the deficiencies.

This was the standard practice for the targeted lending discrimination examinations carried out in 1992. Because no substantive violations were identified in these examinations, the discussions

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covered technical compliance with fair lending requirements and recommendations for avoiding potential lending discrimination.

Meetings with directors are less common than meetings with management. Following our targeted lending discrimination examinations in 1992, one district reported meetings with directors occurred in 10 of 16 examinations. Another district sent letters to boards of directors informing them of examination findings.

Q.10. What procedures do you use to monitor the quality and consistency of fair lending exams?

A.10. The OCC's district offices assess the adequacy and effectiveness of bank supervision activities within their districts. This includes the lending discrimination element of compliance examinations.

In addition, selected examinations are subjected to review by experienced field examiners from other districts. Examinations of different types and for different sizes of institutions are selected. They examine work papers but can also contact the examiners who did the examination.

Our new procedures for examining for residential lending discrimination provide that copies of reports for all examinations based on suspicions of illegal discrimination will be forwarded to our fair lending specialists in Washington.

Complaints and Violations

Q.1. How many complaints of ECOA and Fair Housing Act violations has your agency received each year for the past 10 years? Are these complaints investigated by the same examiner that conducted the routine compliance examination? How many have been resolved and with what resolutions?

A.1. The following table shows the disposition of written consumer complaints alleging illegal discrimination received and resolved for the years 1988 through 1992. Comparable information on consumer complaints received prior to 1988 is not currently available. (See Enclosure G for definitions of these resolutions from the *Comptroller's Manual for Consumer Complaints.*) Most of these complaints involved non-residential credit, particularly credit cards.

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	1988	1989	1990	1991	1992
Withdrawn	3	7	8	10	29
Bank Error	4	4	4	12	7
Bank legally correct	147	117	104	79	116
Communication Problem	5	7	9	7	11
Referral to other Agencies	2	4	2	3	3
Information Provided	7	14	15	8	10
Settled by Mutual Consent	7	5	6	4	3
Violation of Regulation B	3	2	3	3	4
Other violation			1	1	
In or for litigation		1	6	5	1
Factual Dispute	7	6	6	4	10
Total Complaints Alleging Illegal Discrimination	185	167	162	136	194

Along with the other financial regulators, the OCC in 1992 implemented a Memorandum of Understanding (MOU) with HUD to exchange complaints received that allege illegal residential lending discrimination. Since this agreement became effective in May 1992, we have forwarded approximately 50 such complaints to HUD. The 1992 data in the table above do not reflect this because we have not yet implemented a data field for complaints that are not closed upon referral. Complaints covered by the MOU remain open at both HUD and the OCC. Over half of these complaints involved racial or national origin discrimination. One investigation, in which OCC examiners participated, resulted in a $10,000 settlement. Several complainants have instructed us not to proceed after they received loans following the filing of their complaints.

Our complaints are not typically investigated by examiners. They are handled by consumer complaint specialists in the district offices. Procedures we are now finalizing to implement the MOU will assign a more substantial role to examiners in investigating residential lending discrimination complaints.

Q.2a. What distinguishes a technical violation from a substantive violation? Can an institution have technical violations and get a satisfactory Community Reinvestment Act rating? Can an institution have substantive violations and get a satisfactory CRA rating?

A.2a. The *Comptroller's Handbook for Consumer Examinations* states that "substantive violations are violations of statutory or regulatory requirements intended to implement the major intent of a law. Those violations may result in adverse impact on the consumer, either financially or through inadequate disclosure of a significant requirement of law or regulation." This definition covers failure to provide adequate adverse action notices, which, therefore, are included in the substantive violations column in the answer to Question 3.a. in this section.

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If a national bank is discriminating in its lending process, it should not receive a satisfactory CRA rating. If, in an isolated instance, it failed to provide an applicant with a required adverse action notice (a substantive violation according to our definition), it could receive a satisfactory CRA rating if it was helping meet community credit needs. A national bank may have technical violations of fair lending laws or regulations and still have a satisfactory CRA rating.

Q.2b. What kind of enforcement action, if any, is taken for technical violations? For substantive violations?

A.2b. Generally, with regard to enforcement by the OCC, more serious violations require retrospective action to correct the conditions resulting from the violations and prospective action to make sure it doesn't happen again. For less serious violations, the bank is required to act prospectively to prevent the violation from recurring. (See Enclosure E, Enforcement Policy Statements.)

The ECOA requires or authorizes a regulator to involve HUD or DOJ based on distinctions in the type of violations, though it does not use the terms "substantive" or "technical." OCC must refer to the Justice Department any pattern or practice of disparate treatment in credit transactions made, on an ECOA-prohibited basis. Any isolated violations of ECOA *may* be referred to the Justice Department. If the conduct in question violates the FHAct and is not referred to Justice for a related ECOA violation, notice of the apparent violation must be provided to HUD. Our forthcoming examination procedures for residential lending discrimination and earlier guidance (see Enclosure H, Examining Bulletin 92–2) reflect these distinctions.

Q.3a. How many ECOA and Fair Housing Act violations have been found for each of the last 10 years?

A.3a. By "violations," the OCC means a condition of apparent noncompliance with legal requirements for which the bank was requested to undertake corrective action. If these violations were resolved through voluntary corrective actions or enforcement actions, there was no need for adjudicative proceedings.

The following table shows the total number of ECOA and FHAct violations, the total number of substantive violations (including both instances of illegal disparate treatment and serious procedural problems such as failure to provide proper adverse action notices), the number of technical violations, and the total number of violations involving disparate treatment on a prohibited basis (given in the column under the list of statutory citations under which they are entered in our database).

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Year	Total Violations	Substantive Violations	Technical Violations	Violations of 42 USC 3605 12 CFR 202.4 12 CFR 202.5(a) 12 CFR 202.6(b)(1) 12 CFR 202.6(b)(2)
1983	312	120	192	12
1984	325	138	187	5
1985	276	129	147	8
1986	458	137	321	16
1987	530	156	374	7
1988	705	163	542	10
1989	806	129	677	18
1990	835	119	716	13
1991	1,209	171	1,038	12
1992	1,205	171	1,034	16

Q.3b. Of these, how many were technical and how many were substantive?

A.3b. For each year since 1983, the number of technical violations is indicated in the answer to the previous question.

Q.3c. How many of these violations have been resolved and how were they resolved?

A.3c. All violations have been resolved without adjudication. As noted earlier, the definition of "substantive" includes failures to provide adequate adverse action notices and other requirements of ECOA that do not necessarily involve discrimination on a prohibited basis.

Prior to 1992, the OCC could refer isolated apparent violations of ECOA—even if substantive—to the Justice Department *only* if the OCC was unable to secure compliance. During that period, referral of cases involving a pattern or practice of violations was not required. Our database does not indicate whether any of the violations from that period involved patterns or practices.

Amendments to ECOA, which became effective in 1992, now require referral of patterns or practices of violations to the Justice Department. In 1992, none of the 16 violations involving discrimination on a prohibited basis constituted a pattern or practice. ECOA also now requires that violations of the FHAct be referred to HUD if not referred to the Justice Department. None of the 16 violations involved residential lending. All 16 instances of discrimination on a prohibited basis involved either transactions not covered by the FHAct (such as credit cards) or prohibited bases unique to ECOA (such as age or marital status).

For these 16 violations, the OCC's Policy Statement on Enforcement of the Equal Credit Opportunity and Fair Housing Acts ensures that the rights of credit applicants are protected by requiring creditors to take action to correct the results of certain, more serious past violations of the ECOA and FHAct, as well as taking action to be in compliance in the future. (See Enclosure E.) Subsequent examinations ensure that the corrective actions have been

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taken and that they have been successful in achieving compliance. Most banks voluntarily take appropriate corrective action. If they do not, the OCC has, and will use, its full administrative enforcement powers to ensure that appropriate corrective action is taken, including referring isolated ECOA violations to the Justice Department when appropriate.

Q.4. What specific practices by regulated institutions and their subsidiaries that constitute illegal discrimination are set out in your regulations? Do you make any effort to disseminate to the public a list of practices that they might encounter that would be illegal? If so, how?

A.4. The OCC does not have a general nondiscrimination regulation. It is unambiguous that the prohibitions described in the Federal Reserve Board's Regulation B (implementing ECOA) and 24 CFR Part 100 (HUD's regulation implementing the FHAct) apply to national banks. These regulations are so explicit in describing prohibited practices that a separate OCC regulation would largely be redundant.

Our forthcoming examination procedures will include a list of illegal practices in residential lending reflecting the HUD and Federal Reserve Board's regulations. When incorporated into the OCC's revised *Compliance Handbook*, the list will be available to the industry.

As a regulator, we have directed the major thrust of our educational efforts toward the industry rather than the public. However, we do provide inquiring consumers a large range of pamphlets describing their fair lending and other rights (for example, "Home Mortgages: Understanding the Process and Your Rights," "A Guide to Business Credit and the Equal Opportunity Act," and "Facts for Consumers: Equal Credit Opportunity"). (See Enclosures I, J, and K.)

With regard to educating the industry, we participated in developing the FFIEC's pamphlet, "Home Mortgage Lending and Equal Treatment," which we distributed to national banks in 1992. It focuses particularly on lending standards and practices that may have unintended discriminatory effects. (See Enclosure L.) Also, as the enclosed banking circular illustrates, the OCC has been quick to communicate directly to OCC-regulated institutions the implications of the Boston Federal Reserve Bank's study and of the Justice Department's settlement in Atlanta. (See Enclosure M, BC–263.) We also have taken the lead in conveying this information to the lending industry generally. (See Enclosure N (article from *The American Banker*).)

Moreover, we have acted not only to inform the industry about legal requirements but to dispel myths that frustrate efforts to prevent discrimination. For example, the enclosed letters to *The American Banker* and *Forbes* challenge, respectively, the view that financial incentives inevitably drive out discriminatory practices and the view that equal loan default rates for racial groups is evidence of the absence of discrimination. (See Enclosures O and P.)

Q.5. Over the past several years a number of highly publicized news reports have indicated evidence of fair lending problems in a number of metropolitan areas across the country (*i.e.,* Atlanta, De-

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troit, and Boston). What responses has your agency made to these reports?

A.5. As noted above, we already have communicated to the lending industry what we believe are the key lessons from the 1992 investigations in Atlanta and Boston, and also devised examination procedures that we, believe are responsive to the insights from that research.

We have closely analyzed studies released in 1991 of racial patterns in mortgage lending by local organizations in Los Angeles, Chicago, and Washington, D.C. We also are familiar with the earlier research by the *Atlanta Constitution,* Federal Reserve Bank of Boston, and Boston Redevelopment Authority, as well as that by the *Detroit Free Press.*

While all these pre-1992 studies provided valuable information of a general kind, the key distinction between them and the recent efforts of the Federal Reserve Bank of Boston and the Justice Department is that the earlier studies offered virtually no insights as to how discrimination might be occurring. No procedures, standards, products, etc., were isolated as associated with the racial disparities. This was frustrating to us because the studies gave no clues regarding how we should re-focus our examination efforts.

Some of the more sophisticated studies recognized their limitations. For example, the 1989 study by the Federal Reserve Bank of Boston stated that it was impossible to tell whether the source of the racial pattern was the housing market or the mortgage market. Similarly, the Western Center on Law and Poverty, author of the massive and detailed 1991 study prepared for the City of Los Angeles, acknowledged that it lacked the evidence to conclude that the racial disparities it documented stemmed from illegal acts. The Center characterized the data as showing "racially disparate lending," and emphasized that "this term is not synonymous with the term 'redlining'."

Similarly, in its March 1992 followup on its Pulitzer Prize-winning 1988 series, "The Color of Money," the *Atlanta Constitution* used a much different tone from the original series. The original series virtually ignored the possibility that legitimate factors might at least partially explain the racial differential. The new series acknowledged that the absence from the HMDA data of applicants' financial information other than income made it impossible to tell whether particular loan decisions were justified. The new series used the simple descriptive terms "gap" and "disparity" instead of alleging "discrimination" and "redlining," which were terms frequently employed by the authors of the earlier series.

In sum, we have followed very closely the research of recent years, but the pre-1992 studies—as their own authors often acknowledged—offered little guidance for detecting lending discrimination in specific transactions. In contrast, the latest findings from Boston and Atlanta offer such insights, and we have moved quickly to act on them.

Q.6. For each of the following metropolitan areas, please provide the number of fair lending examinations conducted by your agency for every year since 1985: Atlanta, Boston, Detroit.

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	Atlanta	Boston	Detroit
1985	2	1	5
1986	2	1	7
1987	2	2	6
1988	3	2	4
1989	4	2	3
1990	5	4	2
1991	3	2	3
1992	6	4	4

NOTE: The Boston data do not includo information on three banks that were doclared insolvent during this period.

Enforcement Powers

Q.1. What range of enforcement powers are available to your agency and how frequently has each power been used over the past 10 years?

A.1. The OCC's general supervisory authority empowers it to adjudicate whether there has been noncompliance with any law the OCC is charged with enforcing, including nondiscrimination laws. Describing cease-and-desist proceedings 12 USC 1818(b) states:

> If . . . any . . . institution . . . is violating or has violated . . . a law, . . . the agency may issue and serve upon the party a notice of charges . . . and . . . fix a time and place at which a hearing will be held to determine whether an order to cease and desist therefrom should issue. . . . [I]f upon the record made at any such hearing, the agency shall find that any violation has been established, the agency may issue . . . an order to cease and desist . . . and, further, to take affirmative action to correct the conditions resulting from any such violation or practice.

Such proceedings have not been instituted in connection with violations of ECOA and the FHAct.

Q.2. Would any additional tools be useful?

A.2. We believe the authority cited above is sufficient to compel banks to comply with nondiscrimination requirements. We recognize, however, that the breadth of relief for victims of illegal discrimination that can be secured through our authority is narrower than the relief that HUD and DOJ may secure for victims pursuant to explicit provisions of the FHAct and that the Justice Department may secure for violations of ECOA. We consequently are emphasizing coordination with those agencies.

Referrals of Violations to HUD and Justice

Q.1. During the past 10 years, on how many occasions has your agency referred violations of ECOA to Justice and of the Fair Housing Act to HUD?

A.1. A "pattern or practice" referral by the OCC to the Justice Department was made in 1990. In this case, a bank had used promotional materials that contained racial comments. The Justice Department contacted the bank, which then stopped using the materials. We have no record of any other referrals related to lending discrimination.

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Prior to the FDIC Improvement Act, the OCC could refer *isolated* apparent violations of ECOA to the Justice Department, but only if the OCC was unable to secure compliance. The OCC was able to secure compliance in such situations, which precluded referral.

The FDIC Improvement Act (FDICIA) amended ECOA (effective December 19, 1991) for referring matters to the Justice Department or notifying HUD of an apparent violation. Answers to Question 3 of the Examination Techniques section and Question 2b of the Complaints and Violations section describe the conditions established by FDICIA for such referrals. Those answers also describe the OCC's standards for implementing those provisions.

There have been no such referrals since these provisions became effective. We have notified our examiners of these requirements, and are prepared to make referrals as called for if we should find reason to believe that violations have occurred. With increasing frequency, examiners on compliance examinations have been contacting the fair lending specialists in our Compliance Management Department to discuss whether specific situations constitute violations. During the past year, we have consulted the Justice Department several times to discuss facts discovered by our examiners that might indicate discrimination. In each instance, however, we and the Justice Department reached the conclusion that referral was not appropriate given the evidence.

We have taken substantial steps to guarantee effective working relationships with the Justice Department and HUD. Both of our fair lending specialists, who were hired in the last two years, were senior housing discrimination investigators for HUD immediately prior to joining the OCC, and in that capacity had worked with the Justice Department on lending discrimination enforcement matters. Both HUD and the Justice Department have reviewed our proposed standards and procedures for forwarding evidence of apparent discrimination to them.

Although we haven't yet referred violations of ECOA to Justice and of the Fair Housing Act to HUD under the recent amendments to ECOA, during the past year, we and the other financial regulators have implemented an agreement with HUD to exchange complaints that allege residential lending discrimination. As a result, we have forwarded about 50 such complaints to HUD. One has resulted in a $10,000 settlement. OCC examiners participated in that investigation. HUD has informed us that it has settled a number of lending discrimination complaints, but has yet to find "reasonable cause" to conclude that any complaint of racial discrimination in lending involved a violation.

Q.2. What documents (*e.g.*, exam reports, examiner work papers or loan files) have been included in these referrals?

A.2. Our forthcoming procedures on residential lending discrimination provide that when a district office concludes there is reason to believe illegal discrimination has occurred, it must forward to the Compliance Management Department (1) a recommendation that the matter be referred to the Justice Department or that HUD be notified; (2) a summary report describing the district office's inquiry, the evidence, and its significance; (3) copies of the relevant

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documents; and (4) if the possible violations are procedural, a description of the district office's efforts to secure compliance.

Those procedures will direct the district offices to make a reasonable effort to identify individuals affected by any apparent discrimination. This information also would be conveyed to the Compliance Management Department. If the documents are voluminous, the district office would consider whether they would better be presented in abstracted or tabular form.

Q.3. Please provide a copy or describe the substance of the memorandum of understanding between the financial supervisory agencies and HUD regarding Fair Housing Act referrals.

A.3. Enclosure Q is the Memorandum of Understanding and the letter by which we conveyed copies of it to our district offices.

Q.4. Please describe what coordination exists between your agency and the Department of Justice regarding referral of suspected fair lending violations.

A.4. The OCC and the Department of Justice are coordinating their activities on both a formal and informal basis. The Justice Department has reviewed, without objection, our proposed procedures to implement our referral obligations under ECOA. (These are summarized in the enclosed description of our forthcoming procedures on residential lending discrimination.) Also, both of the OCC's fair lending specialists have had experience coordinating lending discrimination enforcement investigations with the Justice Department.

We have discussed a number of situations involving possible discrimination informally with attorneys at the Justice Department. We believe such early consultation is in the best interest of all parties, including possible discrimination victims, and we have worked to create an interagency relationship that makes both sides comfortable with informal consultation.

OCC representatives have met with representatives of the Justice Department approximately a dozen times in the past 12 months to discuss techniques for detecting lending discrimination. Moreover, at two OCC seminars for senior compliance examiners during 1992, the lead attorney in the Justice Department's lending discrimination investigation in Atlanta advised examiners how to conduct inquiries into possible lending discrimination and described the approaches and findings from the Justice Department's Atlanta investigation.

Q.5. Does a memorandum of understanding exist?

A.5. A very sketchy MOU signed in 1977 by the Justice Department, HUD, and the regulators calls for the financial regulatory agencies and the Justice Department mutually, at their discretion, to refer to each other cases "reflecting possible discrimination." (See Enclosure R.) The recent amendments to ECOA regarding referrals make the 1977 MOU largely irrelevant as to DOJ. Our current level of cooperation with DOJ, in fact, is far more extensive than the 1977 MOU provides. With regard to HUD, the 1977 MOU has been supplanted by the, 1991 MOU.

Q.6. What factors account for the limited number of referrals?

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A.6. We believe that lending discrimination occurs and must be addressed seriously. We have said so unambiguously in Congressional testimony delivered well before the results of the latest investigations in Atlanta and Boston were reported. (See Enclosure S.) At the same time, the rarity with which it has bean reported results from at least two factors.

First, inappropriate examination techniques have not detected it. As we acknowledge in the answers to Questions 1a and 2 in the Examination Techniques section and Questions 1 and 4 in the Fair Lending Data Systems section, the examination procedures that we have heretofore employed were based on the premise that discrimination largely consisted of well-qualified minority applicants being denied loans. This emphasis reduced the potential for examiners to detect less obvious forms of discrimination that affect marginally-qualified minority applicants (which may well be unintentional). This is the kind of discriminatory treatment identified in the recent study by the Federal Reserve Bank of Boston and in the Justice Department's recent settlement with an Atlanta lender.

This premise was widely held. That probably accounts, in significant part, for the fact that in recent years virtually no one has been able to secure hard evidence to support lending discrimination enforcement actions or lawsuits, even in the wake of intense publicity about racial gaps in mortgage lending.

Second, although some portion of minority loan denials appears to result from discriminatory treatment, most minority loan denials reflect lenders' equal application of legitimate lending procedures and standards. This is the conclusion, for example, of the Boston Fed's study, even though that study also documented the existence of illegal discrimination. This was also the conclusion of studies by the New York State Banking Department and the Atlanta Mortgage Consortium focusing on individual applications. Such legitimate loan denials are not an appropriate basis for enforcement activity.

Q.7. Is there specific staff assigned to carry out referral functions?

A.7. The two fair lending specialists located in Washington have this responsibility.

Q.8. Who does DOJ contact within your agency regarding referrals?

A.8. The Deputy Comptroller for Compliance Management has been involved during the past year in virtually every contact with the Justice Department concerning lending discrimination. We anticipate that, in the future, routine referral activities will be carried out by the fair lending specialists.

Q.9. How has your agency responded to DOJ's request to accompany examiners on fair lending examinations?

A.9. As the enclosed letter illustrates, the OCC is continuing to discuss the possibility of joint investigation with the Justice Department. (See Enclosure T.) The letter broaches several possible alternative forms of cooperation.

Fair Lending Data Systems

Q.1. Following the lawsuits brought by civil rights groups in the 1970's, your agency now collects information, in addition to HMDA

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data, for fair lending enforcement purposes (see 12 CFR Chapter 1, Part 27). What data are you required to collect? What data are you permitted to collect?

A.1. The Fair Housing Home Loan Data System (FHHLDS) was established in 1979 by 12 CFR Part 27, to provide a data collection system to assist us in determining national bank compliance with fair lending laws.

FHHLDS requires each bank that receives 50 or more home loan applications a year (based on the preceding year) to record and maintain information about each application on a home loan activity form. Banks that have not received 50 or more applications in the last year but receive in excess of four home loan applications per month in any current quarter must begin completing the monthly home loan activity form the following quarter. The monthly home loan activity form includes data on the number of applications received, the number closed, the number rejected, and the number withdrawn.

If an examiner determines that statistical analysis prior to examination is warranted, a national bank with sufficient application volume (at least 75 home loan applications in the preceding year) may be asked to submit additional information on individual loans, including the terms of loans made, the income and monthly debt service of the applicant (so that housing cost and total debt ratios can be calculated) and location and value of property (so loan-to-value ratios can be calculated). That choice of data elements reflects assumptions that (1) minorities might be likely to receive loans on less favorable terms, (2) banks might have double standards for the three ratios, and (3) racial and/or geographic redlining might be the basis for discrimination and be linked to under appraisals.

We believe, however, that the FHHLDS needs to be overhauled for several reasons. It fails to collect certain data that lenders use in making credit decisions, most notably information on credit history; it duplicates the data collection requirements of HMDA—in some cases, with less detail; and our statistical analyses of the data have, to date, been of negligible advantage in selecting loan files for review.

We are now evaluating whether it is possible to construct a more relevant statistical analysis using HMDA data supplemented with data on credit history. A proposed revision to the regulation is under consideration. It would require banks to report reasons for loan denial in their HMDA data, and update their HMDA-LARs within 30 days of taking action on a residential mortgage loan application. It would also eliminate, pending the development of a more relevant statistical analysis, the need for banks to retain data other than the HMDA data.

We believe the two additional HMDA requirements (more timely updating of the HMDA-LARs and required reporting of reasons for denial) would significantly enhance our ability to carry out effective fair lending examinations, quite apart from the eventual decision regarding FHHLDS statistical analyses. Indeed, our forthcoming examination procedures on residential lending discrimination stress analysis based on the HMDA-LAR and reasons for denial.

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Q.2. What data, in addition to HMDA data, have you in fact collected and for how many institutions?

A.2. No additional data beyond the FHHLDS data described in the answer to the previous question have been collected. The number of banks required to fill out the monthly home loan activity form varies from year to year and our records do not contain information on this number.

Q.3. How is a determination made as to which lenders must report? Is HMDA data used to make this determination?

A.3. The FHHLDS regulation, 12 CFR 27, makes the recordkeeping requirement applicable to all national banks that received 50 or more home loan applications in the preceding calendar year. At present, an institution's HMDA data are not related to the question of whether it is subject to the FHHLDS.

Q.4. In November of 1991, your agency announced that it was stargeting institutions with large HMDA disparities and institutions from metropolitan areas with large HMDA disparities for more detailed examinations. How did you select these institutions? What special procedures have you used in these examinations? What violations have you found?

A.4. There were two lists of banks. The first list included banks with 25 or more black and Hispanic applicants and a black or Hispanic rejection rate at least double that for white applicants. The second list consisted of banks with 350 or more applicants, of whom less than one percent were either black or Hispanic.

The second list was provided for the information of examiners, but with minimal expectation that they would be able, to determine whether illegal actions were deterring potential minority applicants. The bank examination process is inherently unsuited to detect discrimination prior to application. (This is further described in the section below on pre-screening.)

Nevertheless, there were attempts to address these concerns. For example, one district determined that marketing and loan application volumes were particularly weak for four of the listed banks. The district asked management of the four banks to determine the effectiveness of their marketing and business strategies for residential lending and the adequacy of their application activity and market share as reflected in the HMDA data. The district plans to use these responses (which have not been received) to evaluate whether marketing strategies result from business strategies and plans or lack of consideration of the impact of narrow advertising.

With regard to banks with disparities in denial rates, the initial examinations carried out in the 1992 initiative followed procedures in our *Compliance Handbook*. As described in the answer to Question 1a in the Examination Techniques section above, the *Handbook* stresses evaluation of the bank's internal compliance activities and nondiscrimination controls, and is weak on comparative analysis for disparate treatment. While this round of examinations was in progress, we began to field test approaches to upgrade and promote the use of comparative analysis. Most of the examinations did undertake some form of comparative analysis, though generally not with the thoroughness and sophistication we now believe necessary.

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The new examination procedures for residential lending discrimination will guide the 1993 round of lending discrimination examinations. Some of the approaches we field tested (and are incorporating in those procedures) in fact anticipated the results from the Boston Fed's study and of the Justice Department in its Atlanta investigation. We will issue final procedures in a revised *Handbook* after further field testing and after the FFIEC's consultant has reviewed all the agencies' lending discrimination examination procedures.

For our six districts, the lists of banks with large denial rate disparities totaled approximately 220. Of those, about 15 had very recent compliance examinations, so the district offices did not schedule an examination based on the targeting. An equal number of institutions failed, merged, or became subject to a different regulator (for example, by conversion to state charter). The remaining banks have received or are scheduled to receive some form of additional supervisory attention as a result of being targeted. On-site examinations have been completed in approximately 100 banks. Over 25 more on-site reviews are scheduled or in progress. Off-site reviews (such as scrutiny of self-analyses solicited from the bank) were conducted for the remaining institutions.

The examinations identified only technical violations such as the HMDA-LAR not being properly maintained, monitoring information on race of applicants not being gathered, etc.

Examiners met routinely with bank management to discuss their findings. They discussed correction of the technical violations. Often, they made recommendations for improving the bank's monitoring systems, documentation, and other aspects of internal compliance efforts. They met with boards of directors considerably less often, though in one district this occurred in 10 of 16 examinations. In another district, examiners in charge at four banks discussed with management and boards of directors the nationwide developments regarding fair lending, including the study by the Federal Reserve Bank of Boston.

Boston Federal Reserve Study

Q.1. For all institutions under your jurisdiction that were included in the Boston Federal Reserve study:

Q.1a. How many fair lending compliance examinations were conducted during the time period covered by the study?

A.1a. Six OCC-regulated institutions were included in the study, one of which was declared insolvent in 1991. Two of the institutions were examined for fair lending during the period covered by the study.

Q.1b. How many violations of fair lending laws were uncovered as a result of these examinations?

A.1b. One institution was cited for three technical violations of fair lending laws.

Q.1c. What was the nature of each of these violations?

A.1c. The violations consisted of isolated instances of recording denials as withdrawals on the Monthly Home Loan Activity Report, issuing nonspecific or misleading adverse action notices, and failing

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to disclose to consumers that denials were based on information obtained from a credit reporting agency.

Q.1d. What enforcement actions, if any, were taken against institutions with violations?

A.1d. Corrective action commitments were obtained from the management of the institution, and a follow-up examination was conducted later in the year to ensure that the commitments had been fulfilled and were successful in preventing additional violations.

Q.2. How have you modified examination procedures in response to the findings of the Boston Federal Reserve study?

A.2. The forthcoming examination procedures referred to in many of the answers to questions above are designed to address the forms of discrimination hypothesized by the Federal Reserve Bank of Boston (Boston Fed). We had begun to devise and field test these techniques approximately six months before the Boston Fed's study was released, based on perceptions and observations conveyed to us by the Justice Department derived from its Atlanta investigation.

We have not incorporated statistical analysis into our forthcoming examination procedures. When we requested the applicant data on which the Boston Fed's study was based, we learned that "none of the OCC institutions was large enough to perform-any individual analysis." Nationwide, few institutions have the loan volume to support useful statistical analysis.

Nevertheless, we are now evaluating whether it is possible to construct a statistical analysis using HMDA data supplemented with data on credit history as part of our assessment of the Fair Housing Home Loan Data System (FHHLDS), which is described in more detail in our answer to question 1 of the section on Fair Lending Data Systems.

Q.3. How do you plan to use statistical analysis in your future fair lending enforcement efforts?

A.3. As described in the previous answer, we are evaluating whether it is possible to construct a statistical analysis using HMDA data supplemented with data on credit history.

However, we expect the use of statistical analyses to be rare. For example, we understand that a minimum of 200 applications, of which no less than 50 must be from the specified minority racial group, is needed to produce reliable conclusions using the Federal Reserve Bank of Boston's approach. Because different types of loans (purchase, refinance, etc.) have significantly different requirements, those application volumes are minimums for the *specific type* of loan to be examined. For purchase loans, for example, the 1990 HMDA data indicated that only about 90 national banks had the requisite volume needed to analyze disparate treatment of black applicants; the total was about 120 for Hispanic applicants. In sum, this form of statistical analysis is unsuitable for the vast majority of national banks.

Furthermore, we believe that a properly conceptualized and conducted comparative file review, as required by our forthcoming examination procedures for residential lending discrimination, will uncover the same discriminatory lending practices that a statistical analysis approach will, both faster and at far less expense.

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Q.4. How will you monitor compliance for lenders that receive too few applications from minorities to make statistical analysis possible? Would it be possible to aggregate data from multiple years for those institutions?

A.4. If a statistical analysis approach is used, we are not aware of anything that would preclude aggregating data for multiple years, as the Department of Justice did in the Atlanta case. Care would have to be taken to account for any changes in the lending criteria during the aggregate period.

In addition, we plan to use and further develop the approach described in our new examination procedures for residential lending discrimination. Those techniques do not require the volume of minority applications necessary for statistical analyses.

We disagree with the suggestion in the Federal Reserve Bank of Boston's study that examinations cannot hope to detect illegal discrimination. During our meetings with the Justice Department, we were informed that it had acquired considerable evidence of disparate treatment through review of the Atlanta lender's files, quite apart from its statistical analysis. We expect to be able to do the same.

Q.5. What enforcement actions, if any, have you taken against lenders referred to you by the Boston Federal Reserve as a result of the study?

A.5. Upon completion of the study, the OCC obtained from the Federal Reserve Bank of Boston detailed data on personal, economic, and property characteristics for 307 applications for residential mortgage loans from the six OCC-regulated institutions included in the study. We also obtained a listing of what the Boston Fed characterized as "improbable denials" at each institution. The Boston Federal Reserve, however, did not refer any lender to the OCC as a result of its study.

We carefully reviewed the data for each institution for indications of possible disparate treatment on the basis of race or ethnicity. One institution had been declared insolvent prior to the release of the results of the study. One institution received no applications from minorities (one application from a white was an improbable denial), and another approved the applications of all its minority applicants (two whites were listed as improbable denials). The fourth institution had one white and one black listed as improbable denials; the fifth had five whites and three blacks listed as improbable denials. Our review of the detailed data on all transactions at the latter two institutions determined that there were no indications of disparate treatment on the basis of race or ethnicity.

The sixth institution had five blacks listed as improbable denials, and our initial review of the detailed data revealed several instances of possible disparate treatment on the basis of race. Therefore, in November 1992, we conducted an on-site examination of the 47 applications at this bank that had been included in the study.

The examination revealed that information on two of the black applicants had been miscoded in the Boston Fed's database. Instead of being denied by the bank, they had been approved and, because of high loan-to-value ratios, submitted to a Private Mortgage

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Insurance (PMI) company. The PMI company denied the applications. One was denied because a debt-to-income ratio acceptable to the bank was considered too high; the other because the condominium he was seeking to purchase was located in a building that was 37.5 percent commercial space.

Of the three remaining improbable denials of applications from blacks at that institution, one had housing expense and debt-to-income ratios significantly higher than the bank's criteria and a poor credit history; one had housing expense and debt-to-income ratios significantly higher than the bank's criteria and the appraisal of the property revealed a major structural defect that rendered it uninhabitable; and the third applicant's property was appraised at $13,000 less than the loan amount sought. No whites were approved by the bank under circumstances similar to these. All of the instances of apparent disparate treatment based on race, therefore, were explained by legitimate, nondiscriminatory factors.

In addition, all of the files were reviewed to determine if there were differences, based on race, in the level or quality of assistance given to applicants. No such differences were apparent.

During the examination, we noted one isolated instance of probable discrimination based on handicap. However, the action occurred beyond the statute of limitations under the FHAct so no action could be taken other than counseling the bank.

Pre-Screening and Related Practices

Q.1a. How do you determine whether lenders are prescreening or illegally discouraging applications from minorities?

A.1a. Under our Fair Housing Home Loan Data System, a bank may be required to maintain an Inquiry/Application Log if:

- there is reason to believe the bank may be prescreening applicants on a prohibited basis;
- complaints have been made indicating that the bank's home lending practices are, or may be, discriminatory; or
- analysis of HMDA data indicates a pattern of significant variation in the number of home loans between census tracts with similar incomes and home ownership levels differentiated only by race or national origin.

We have not determined that any national banks have engaged in illegal prescreening, however. Examiners are rarely in a position to observe illegal treatment of creditseekers before they apply, and there are rarely documents in banks that reveal such practices.

Q.1b. Do you have any exam techniques to focus on prescreening?

A.1b. Our *Compliance Handbook* calls for the following steps to detect illegal prescreening:

- Analyze the distribution of loans and other information to determine whether there is:
  —little or no lending activity in minority or racially mixed neighborhoods or commercial areas;
  —concentrations of credit in certain areas;
  —a disproportionately low level of rejected applications, an inordinately high level of withdrawn applications, and/or a high

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percentage of protected class members among the withdrawn applications.

- If any of the above conditions exist, determine whether the bank:
  - —has application policies or procedures designed to discourage or that have the effect of discouraging persons from applying for credit on a prohibited basis. If no formal policies exist, interview loan officers and determine what application process is used;
  - —has selective marketing practices;
  - —has selective branch locations and services;
  - —has procedures authorizing reviews of applicant financial data or property characteristics by other than loan officers prior to formally submitting an application, to determine eligibility;
  - —determines creditworthiness or eligibility on the basis of information obtained from telephone conversations, particularly from questions concerning property location;
  - —uses pre-arranged questions;
  - —uses persons outside of the bank to refer or advise applicants.
- Determine how an application is made and processed, and what records are maintained by considering:
  - —where applications are obtained and submitted;
  - —whether there is an application or appraisal fee, its amount, when and how often it is paid, and under what conditions it is waived or refunded;
  - —whether there is anyone authorized to review the applicant's financial data or property characteristics, before the application is formally submitted, to determine eligibility. If so, determine how it is done, who is so authorized, and whether any record is kept of applications not ultimately submitted, and whether the practice occurs even though it is not formally authorized;
  - —what information is available to applicants by phone and whether any pre-qualification or prescreening is done;
  - —what information an inquirer is asked to give, if he or she calls on the telephone for information, and whether the property address is asked and why;
  - —under what circumstances persons are told that loans are not being made in certain areas;
  - —where an application is submitted (i.e., forwarded to a central loan department or processed by the branch).
- Interview "first contact" personnel to learn whether any information is available to applicants by telephone that would allow prequalification or prescreening.

We suspect, however, that a lender that intends to discriminate prior to application could readily conceal that prescreening from an examiner.

Q.1c. Is use of testers necessary for this purpose? If so, how should such testing be conducted?

A.1c. Testing is the most promising method of which we are aware to detect illegal pre-application discrimination. Many of its proponents, however, have not acknowledged that testing in the lending area has formidable difficulties absent from the sales and rental spheres where testing has proved valuable.

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First, discrimination in lending is unlikely to involve simple untruths that a tester can expose. Unlike landlords or real estate sales persons, lenders rarely claim that they "just made the last loan an hour ago," or that "someone else applied earlier than you" or "someone else offered more than you." Lending testers will encounter subtle, multi-faceted behavior, which means that multiple—perhaps many—tests are needed to confirm differences in treatment.

Increasing the frequency, however, immediately raises the second problem, risk of detection as more tests are run. For example, lending testers often have described "sale by owner" transactions so as not to have to involve real estate brokers in fabricating their identities, but tested lenders have become suspicious upon encountering a number of such relatively rare transactions in a short period.

A third problem concerns analysis of results. The largest and best-known lending testing pilot program to date, in Louisville, Kentucky, concluded that because "[l]enders do not appear to discriminate . . . blatantly[,] . . . test results are not readily susceptible to statistical analysis." The Louisville study recommended a "more qualitative approach." We agree, but this makes interpretation problematically more subjective.

Perhaps the greatest limitation is that testing is lawful *only* in the pre-application phase of the loan process. The tester cannot confirm whether the lender would in fact have rejected the application because it is illegal for anyone to submit a falsified credit application. One alternative is to submit "test" applications from persons whose actual (not falsified) qualifications are similar, as has been recommended by Professor George Galster. We believe it would be difficult to recruit testers with similar authentic qualifications, but the approach nevertheless offers some potential.

In sum, testing is no panacea but it is promising, and we continue to track developments. We hope to receive, for example, information from HUD about the results of lending testing pilot programs that it has funded in recent years.

Q.2. HMDA data consistently show low numbers of minority mortgage applications in markets with significant minority populations. When your agency has found low numbers of applications from minorities in certain markets, what surveys or other information have you collected to determine the impact of discouragement on the flow of mortgage applications?

A.2. We have not conducted surveys to learn the causes of low levels of minority applications, but we have encouraged lenders' efforts to make minorities aware that they may seek and obtain credit. "Discouragement" has both an attitudinal and an objective component, and we have tried to address both.

First, we have encouraged lenders to reach out to historically underserved groups with special efforts that might overcome discouragement arising from actual or perceived historical exclusion. This occurs chiefly as part of our efforts to promote CRA compliance.

Second, we are attempting to identify and remove impediments of the type documented in the few, small testing programs to date. These have found that minority testers were given partial information, quoted stricter requirements, steered toward particular pro-

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grams, and otherwise subtly obstructed in ways that were not apparent until their experiences were compared to white testers.

Because these subtle practices are not always recognized as discriminatory by their victims in isolation, surveys of creditseekers are unlikely to elicit revealing information. This perception is corroborated by the fact that very few complaints are filed alleging "discouragement." If creditseekers felt that they had been treated improperly, they would file complaints. Of the approximately 50 complaints that we have forwarded to HUD, very few involved discouraging a prospective applicant on the basis of race or national origin.

Q.3. What instructions are provided to examiners to determine whether a lender is steering applicants—based on race, neighborhood, loan size or other factors—to loan products less advantageous than other products offered or to a mortgage or finance company subsidiary?

A.3. The *Compliance Handbook* calls for examiners to interview "first contact" personnel to learn whether applicants are directed to particular loan officers or loan products based on specific criteria such as property location or any prohibited basis. Steering to a mortgage or finance company subsidiary typically occurs at the pre-application stage. The answers to Questions 1.b and 1.c of this section discuss pre-application discrimination.

Q.4. Are underwriting criteria examined to see if they are discriminatory? Are regulated institutions required to make the criteria public?

A.4. The examiners review underwriting criteria and look for policies that are overtly discriminatory or that may have a disparate effect. The *Handbook* calls for examiners to determine—by reviewing the bank's policies and procedures, and/or interviews with management—if there are guidelines or standards with potential disparate impact along prohibited lines relating to:

- applicant eligibility requirements;
- collateral (property) eligibility requirements;
- appraisal standards;
- income ratios, stability, reliability, and/or source requirements;
- loan-to-value requirements; or
- other criteria.

The extensive underwriter interview in our forthcoming examination procedures for residential lending discrimination takes a more searching approach. It is designed to reveal discretionary aspects of the underwriting criteria so that the examiner can analyze whether these are applied even-handedly.

Private Mortgage Insurance

Q.1. Does private mortgage insurance play a role in mortgage discrimination? How?

A.1. We are aware of assertions that it does. For example, we are familiar with the allegations and defenses in *Briceno v. United Guaranty Residential Insurance Co.* (concerning a minimum loan amount requirement) and of other discrimination lawsuits and administrative complaints naming private mortgage insurance (PMI)

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companies. These cases were not adjudicated, so the evidence was not fully developed and we cannot comment on the merit of the allegations.

The current HMDA reporting format permits a lender to report that the inability to obtain PMI was a reason for denying the loan. The aggregate HMDA data have shown that denial of PMI caused only a very small proportion of minority loan denials. However, the role of PMI may be understated, because we have found that some banks report for HMDA the substantive problem named by the PMI company, and not the PMI denial itself. We are trying to learn how prevalent this problem may be, and are alerting examiners to the question.

Q.2. Should private mortgage insurers be subject to HMDA or similar disclosure requirements?

A.2. We have no opinion on this issue. Such requirements would not assist us in determining whether banks are in compliance with nondiscrimination laws.

Q.3. Do examiners attempt to discover whether an institution has engaged in discrimination by steering certain groups to particular insurers or by making greater efforts to follow-up when insurance is denied to white applicants than when insurance is denied to minority applicants?

A.3. A major thrust of the examination procedures we have been field testing in the past year and are now implementing is the level of effort exerted by the lender to qualify an applicant. This includes attempts to persuade an insurer that the loan is viable. For example, this was specifically evaluated in our followup to the Boston Fed's recent study of mortgage lending discrimination in Boston. We found that the lender under suspicion in fact had made significant efforts to qualify applicants for PMI without regard to race.

We have not found evidence that groups have been steered to particular insurers. However, this has not been a specific focus of our examinations.

Non-Mortgage Related Lending Discrimination

Q.1. What data does your agency have on the prevalence of non-mortgage related lending discrimination? In which markets, other than the mortgage market, is discrimination a serious problem?

A.1. We treat instances of possible discrimination in consumer lending with great seriousness as we encounter them, but we lack aggregate data to describe the prevalence of discriminatory practices in consumer loan markets. We are not aware of studies of consumer lending comparable to the research that has been undertaken on possible discrimination in residential lending.

Q.2. Do we need disclosure of non-mortgage related lending?

A.2. The investigation of possible discrimination in consumer lending could be facilitated if racial, national origin, gender, marital status, and age information was recorded on the loan application, as is now required by ECOA for residential transactions.

This would be useful even if the information were not aggregated and reported. Requiring the lender to obtain (but not report) monitoring information might be a viable middle position that makes

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it possible to analyze possible discrimination in consumer lending without unduly burdening the industry.

Q.3. What examination techniques do you use to enforce ECOA with respect to non-mortgage related lending? Given the paucity of statistical data, what "flags" do you instruct examiners to look for to detect non-mortgage related lending discrimination?

A.3. For a number of years, our *Compliance Handbook* has directed examiners to look for specific practices that would violate explicit requirements of ECOA. These aspects of ECOA chiefly concern gender and marital status discrimination, and apply equally to mortgage and consumer lending. For example, ECOA prohibits lenders from requiring a woman's husband to co-sign for a loan and bars inquiries about a female applicant's childbearing intentions. If any underwriting standards, forms, etc., used by the bank contain references to such restrictions, that would be a "red flag" of an ECOA violation.

Apart from these explicit provisions, comparative treatment of applicants is also a focus in our consumer lending reviews, to the degree that the applicant's class can be identified. For these classes of applicants, the same "red flags" that serve in comparative analysis in residential lending by and large also apply in consumer lending.

OCC examiners compare the application outcomes for similarly qualified applicants of differing gender, marital status, and age, although this has not been done as consistently or in as sophisticated a fashion as we now believe necessary. We expect that the comparative analysis techniques we are now implementing with regard to mortgage lending will also be used in consumer lending (though without an emphasis on racial and ethnic comparisons).

Q.4. How do these "flags" differ from those you look for to detect discrimination by mortgage lenders not falling under HMDA?

A.4. As previously noted, ECOA contains many explicit prohibitions. These also apply to residential lending and serve as "red flags" with regard to gender, marital status, and age discrimination.

Even if a mortgage lender is not covered by HMDA, it still must obtain monitoring information on the applicant's race and national origin (plus gender, marital status, and age). When the lender aggregates and reports these data under HMDA, the examiner can readily identify minority and white files to compare on-site. If HMDA does not apply, this identification can still be done more laboriously file by file. For consumer loans, identification of applicants by race is extremely difficult.

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Mortgage Lending in Boston: Interpreting HMDA Data

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MORTGAGE LENDING IN BOSTON: INTERPRETING HMDA DATA

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The authors are grateful to the many persons who contributed to this study. Early discussions within the Boston Fed with Bob Augusta and Allen DeYoung of the Examination Department and Patricia Allouise of the Legal Department contributed greatly to the design and strategy. Members of the Consumer Advisory Council of the Board of Governors, bankers, and underwriters provided insights on the workings of the mortgage lending market. The other supervisory agencies, including the OCC, the FDIC, OTS, and HUD, provided strong support for undertaking the survey. Martha Bethea and Glenn Canner of the Board staff greatly facilitated getting the survey launched. Once the questionnaires were returned, numerous super interns and research assistants provided months of assistance under the able management of Betsy Morgan. Special thanks go to interns Janet Feldstein and Virginia Genao, to research assistants Thomas Miles, Faith Kasirye, and Meeta Anand, and to Computer Liaison staff Mary Chamberlain, Luci Rexroad, and Diane Stanevicz, and to consultant Anne Kinsella. Two drafts were read by experts within the Federal Reserve including Paul Calem of the Philadelphia Fed, Brian Cromwell of the San Francisco Fed, Mark Sniderman of the Cleveland Fed, and Glenn Canner: their comments and suggestions were invaluable. Robert Avery of Cornell University also provided useful comments on an early draft. John F. Kain of Harvard University, representatives of the other Federal supervisory agencies, and Fannie Mae and Freddie Mac provided extensive and insightful comments on a revised version of the study. Joan Poskanzer edited and re-edited the document. Finally, the authors wish to thank all those financial institutions who responded to the questionnaire, making this study possible.

The Home Mortgage Disclosure Act (HMDA) data for 1990, which were released in October 1991, showed substantially higher denial rates for black and Hispanic applicants than for white applicants. These minorities were two to three times as likely to be denied mortgage loans as whites. In fact, high-income minorities in Boston were more likely to be turned down than low-income whites. The 1991 HMDA data, which are being released currently, show a similar pattern.

This pattern has triggered a resurgence of the debate on whether discrimination exists in home mortgage lending. Some people believe that the disparities in denial rates are evidence of discrimination on the part of banks and other lending institutions. Others, including lenders, argue that such conclusions are unwarranted, because the HMDA data do not include information on credit histories, loan-to-value ratios, and other factors considered in making mortgage decisions. These missing pieces of information, they argue, explain the high denial rates for minorities.

Because the applicant and loan characteristics collected under HMDA are indeed limited, the Federal Reserve Bank of Boston, with the support of the other supervisory agencies, asked financial institutions operating in the Boston Metropolitan Statistical Area (MSA) to provide additional information on the financial and employment variables that lenders have indicated are relevant to the mortgage lending decision. This information was requested for all applications for conventional mortgage loans made by blacks and Hispanics in 1990 and for a random sample of 3,300 applications made by whites. Substantial lender cooperation resulted in a very good response rate and high-quality data. The additional data, combined with Census information on neighborhood characteristics, were used to develop a model of the determinants of mortgage lending decisions in the Boston area. This model was then employed to test whether race was a significant factor in the lending decision once financial, employment, and neighborhood characteristics were taken into account.

The results of this study indicated that minority applicants, on average, do have greater debt burdens, higher loan-to-value ratios, and weaker credit histories and they are less likely to buy single-family homes than white applicants, and that these disadvantages do account for a large portion of the difference in denial rates. Including the additional information on applicant and property characteristics reduces the disparity between minority and white denials from the originally reported ratio of 2.7 to 1 to roughly 1.6 to 1. But these factors do not wholly eliminate the disparity, since the adjusted ratio implies that even after controlling for financial, employment, and neighborhood characteristics, black and Hispanic mortgage applicants in

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the Boston metropolitan area are roughly 60 percent more likely to be turned down than whites. This discrepancy means that minority applicants with the same economic and property characteristics as white applicants would experience a denial rate of 17 percent rather than the actual white denial rate of 11 percent. Thus, in the end, a statistically significant gap remains, which is associated with race.

The information gathered in this survey provides some insight into how this outcome emerges. Many observers believe that no rational lender would turn down a good application because the applicant is a minority. The results of this survey confirm this perception; minorities with unblemished credentials are almost (97 percent) certain of being approved. But the majority of borrowers are not perfect, and lenders have considerable discretion over the extent to which they consider these imperfections as well as compensating factors.

To take just one example, two key standards for selling mortgage loans in the secondary market are the "obligation ratios," which relate the applicant's housing expense to total income and total debt burden to total income. Secondary market guidelines suggest benchmarks of 28 percent and 36 percent, respectively, although they go on to add that "a lender may use a higher ratio . . . when there are fully documented compensating factors . . ." (Fannie Mae 1992, p. 654). More than one-half of the applications in this sample exceeded one of these benchmarks, and lenders approved and sold into the secondary market some loans with ratios in excess of 36 percent and 44 percent, respectively.

The secondary market's flexibility in this area undoubtedly increases the general availability of mortgage funds for both minorities and whites. Moreover, this willingness to lend to imperfect borrowers is justified: historically, residential mortgages have been very safe investments. The difficulty is that unless primary market lenders apply the flexibility in a nondiscriminatory manner, minority applicants will not benefit to the same degree as white applicants. The results of this study suggest that for the same imperfections whites seem to enjoy a general presumption of creditworthiness that black and Hispanic applicants do not, and that lenders seem to be more willing to overlook flaws for white applicants than for minority applicants.

The preponderance of flawed applicants and the significant discretion accorded lenders have important implications for the efficacy of bank examinations for compliance with the fair lending laws. Since the bulk of applications contain some flaws, most denials will appear legitimate by some objective standard. Moreover, this study found that denied black/Hispanic applications on average have poorer objective qualifications than denied white applications; that is, as measured by the median value, denied minorities had lower income and wealth, higher obligation and loan-to-value ratios, and worse credit histories than denied whites. If these patterns hold true elsewhere, a systematic bias in mortgage lending is very difficult to document at the institution level, particularly when the number of minority applications is small, as it is in the vast majority of institutions. It becomes apparent only when many applications are aggregated. As the supervisory agencies themselves have already recognized, under existing examination procedures, examiners can be expected to uncover only the most flagrant abuses.

I. The Boston Area and the Boston Fed's 1989 Study of Mortgage Lending

Boston is the 8th largest metropolitan statistical area in the nation, with a population in 1990 of 2.9 million.[1] The area comprises more than 100 politically distinct cities and towns. The largest of these communities is the City of Boston, with a population of 574,000. Boston is an old city with long-established neighborhoods, many of which are defined along ethnic and racial lines. The communities surrounding the Boston were founded many years age and their development has taken varied paths. Some are lightly populated, almost exclusively residential communities. Others function as small cities in their own right, as well as suburbs to the City of Boston.

About 15 percent of the Boston area population is minority (Table 1). As can be seen from the map, the minority population, especially the black population, is concentrated in the City of Boston and surrounding communities. Seventy percent of blacks live in the City, where they make up 24 percent of the population. Within the City, blacks also tend to be very concentrated; many live in neighborhoods where more than 50 percent of the population is black. The Hispanic population tends to live in the area's smaller cities as well as in the City of Boston. Both blacks and Hispanics are underrepresented in the more residential, suburban communities.

[1] Boston is considered a primary metropolitan statistical area (PMSA), meaning it falls within an even larger agglomeration called a consolidated metropolitan statistical area (CMSA). The Boston CMSA is the seventh largest in the nation and stretches north into New Hampshire.

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Table 1
Characteristics of the Boston Primary Metropolitan Statistical Area

Area	Total Population 000s	Percent Distribution by Race			
		White[a]	Black[a]	Hispanic	Other[a]
Boston PMSA	2,870.7	85.0	6.8	4.5	3.7
City of Boston	574.3	59.0	23.8	10.8	6.4
Other Central City[b]	299.9	80.0	7.1	7.5	5.4
Not in Central City	1,996.5	93.2	1.9	2.2	2.7

[a]Not of Hispanic origin.
[b]Cambridge, Framingham, Lynn and Waltham. Only Cambridge borders the City of Boston.

Source: U.S. Bureau of the Census, 1990 Census of Population and Housing.

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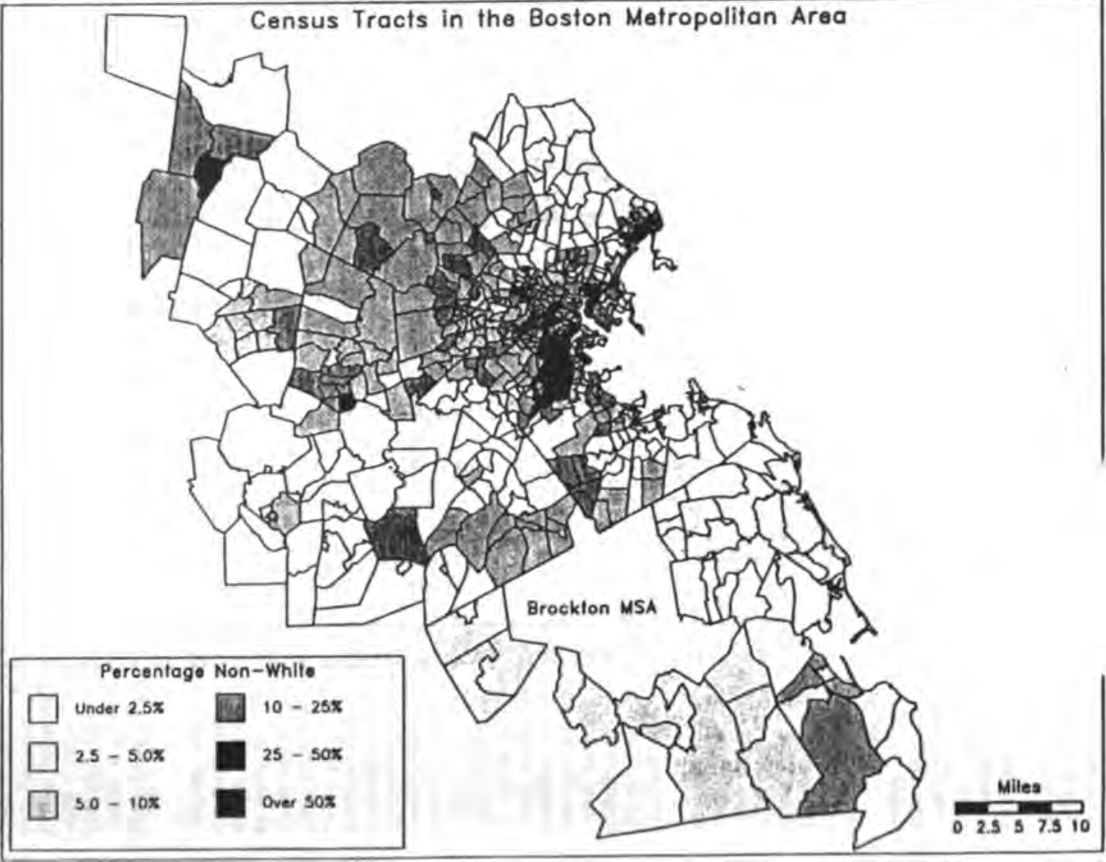

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A relatively small proportion of the Boston PMSA housing stock is in single-unit structures and a relatively large fraction is made up of properties with two to four units. Single-unit properties are especially scarce, and two- to four-unit properties are most common in the City of Boston and some of the small cities. This pattern may have some bearing on mortgage lending decisions, because evaluating an application to purchase a property with more than one unit requires an assessment of the stream of rental income that will be generated by the additional units.

In 1989, the Federal Reserve Bank of Boston examined the pattern of mortgage lending in the City of Boston and concluded that housing and mortgage credit markets were functioning in a way that hurt black neighborhoods (Bradbury, Case, and Dunham 1989). The number of mortgage originations relative to the owner-occupied housing stock was 24 percent lower in black neighborhoods than in white neighborhoods, after taking account of economic variables such as income, wealth, and other factors.[2] The study, however, could not distinguish between discrimination in the housing market and discrimination in the mortgage market. From the available data, it was not possible to sort out the precise role played by lenders, as opposed to buyers, sellers, developers, realtors, appraisers, insurers, and others. Thus, a possible interpretation of the earlier study was that fewer mortgages were made in black neighborhoods because people in black neighborhoods did not buy houses as frequently as residents of white neighborhoods and therefore did not apply for as many mortgages.

The results of this study do not suffer from this ambiguity. Instead of analyzing the location of mortgage loans, this study explores the factors affecting the decision to approve or deny mortgage applications. In other words, it bypasses the contention that blacks and Hispanics never enter the doors of financial institutions and looks at what happens to individuals after they are inside the institution and actually apply for a mortgage loan. Such a study is possible because amendments to HMDA in 1989 required that lenders report not only the location of loans actually made but also the sex, race, and income of individual applicants and whether the application was approved or denied.[3] Thus, 1990 was the first year for which information was available about the applicant as well as the property and about applications that were denied as well as approved. The new data changed the focus of concern from "redlining," that is, differential treatment by lenders based on location of a property, to discrimination, that is, differential treatment of applicants based on race or other personal, rather than economic, characteristics.[4]

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[2]The results were consistent with some earlier studies that have found evidence of redlining (Avery and Buynak 1981; Dedman and others 1988; Gabriel and Rosenthal 1991). Three other studies, however, found no conclusive evidence that redlining had been practiced by lenders (Benston, Horsky, and Weingartner 1978; Cannery Gabriel, and Woolley 1991; Schafer and Ladd 1981). The different results from these studies appear to depend on the definition of redlining used by the researcher. Studies that characterized redlining in terms of the amount of lending in a particular area were more likely to find evidence of redlining. Others that looked at differences in the terms of mortgage loans across neighborhoods found no conclusive evidence of redlining.

[3]The Home Mortgage Disclosure Act was enacted in 1975 in response to concerns voiced by community activists that banks had demarcated areas in cities where they were unwilling to make mortgage loans. The legislation required that banks report the number of mortgage loans made by location of property. These data, however, were never particularly useful in evaluating banks' performance, since standards were not available against which to evaluate bank lending patterns nor was information available on individual applicants.

[4]Although HMDA did not provide information on mortgage applications until 1990, three major studies of applications data were conducted in the late 1970's. In 1977, the Comptroller of the Currency and the Federal Deposit Insurance Corporation sponsored a nationwide survey to determine what economic characteristics were important in bank lending decisions and whether race or sex entered into the determination (Black, Schweitzer, and Mandell 1978). Based on an analysis of roughly 5,000 completed returns, the researchers found that race played a statistically significant, although not particularly large, role in the lending decision.

In 1981, the MIT-Harvard Joint Center for Urban Studies published an extensive study of mortgage lending decisions in New York and California; one portion of this study focused on individual applications (Schafer and Ladd 1981). Mortgage application data were provided by state-regulated savings and loans in California and all state-regulated commercial banks, mutual savings banks, and savings and loans in New York. Based on the information included in a very large sample of loans, the authors determined that blacks had a much greater chance of denial than white applicants with equivalent socioeconomic, property, and neighborhood characteristics.

The third study was conducted in 1978 by the Federal Home Loan Bank Board (King 1980). Examiners collected data for 4,776 mortgage applications in a special examination of federally insured savings and loan associations in Miami, San Antonio, and Toledo. The study found statistically significant evidence that black and Hispanic applicants were more likely to be denied

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II. The Mortgage Lending Decision

In order to determine whether race plays a role in the lending decision, it is necessary first to account for all the economic factors that might bear on the financial institution's decision. If relevant economic variables are not considered and they vary across racial groups, then a rational and legitimate decision to deny a mortgage may appear to be based on race. For example, if minority applicants have poorer credit records than whites, minorities will be rejected at a higher rate than whites. If credit information is not included in the analysis, the higher minority denial rate would appear to be discrimination even if race were never considered by the lender. The only way to determine whether lenders' decisions are influenced by race is to include in a model all the economic variables that are available to the lender and that might cause a loan to be denied, and then test to see whether race is still a significant and important factor in the decision.

The Mortgage Application Process

The mortgage application and approval procedure is complex and far from mechanical. It generally consists of three steps—a quick review of the application for viability, verification of the information and an appraisal of the property, and an evaluation of the numbers and consideration of any "compensating factors."

An applicant who has decided to purchase a property selects a lender, based on proximity, attractiveness of rates and fees, or some other factor, and fills out a standard loan application form, such as Fannie Mae Form 1003. This can be done at the lender's site, by mail or via telephone, or by a mortgage broker at the applicant's home. The information contained on the application is used by the intake person or the loan officer to make an immediate decision as to the ultimate viability of the loan. If the loan does not appear viable, the lender may make its credit decision at that time and deny the application. This initial review process saves some borrowers application fees, but also represents the first level of discretion in the process.[5]

If the lender believes that the applicant has a reasonable chance of approval, the process enters a more comprehensive stage. The lender attempts to verify the information to ensure that the applicant has the financial ability and inclination to repay the loan, and sufficient liquid funds for a down payment and closing costs. Verification of employment provides some assurance about both the adequacy of the income and the likelihood of continuation of the current employment. A credit history report may provide some information about the applicant's commitment to paying debts. A verification of bank deposits indicates whether liquid assets are sufficient; this step also provides some information about whether a gift, grant, or loan, rather than savings, serves as the down payment.

If the information on the application is verified, the lender will take a hard look at the numbers, such as the ratios of monthly housing expense to income and total obligations to income. These ratios are important indicators of the ability to sell the mortgage in the secondary market. Secondary market purchasers, such as Fannie Mae and Freddie Mac, use 28 percent and 36 percent, respectively, as maximum guidelines for these ratios, but these are guidelines, and subject to considerable discretion on the part of the lender. Assuming the application is still viable, the lender will proceed with an appraisal and calculate the loan-to-value ratio. The secondary market uses 80 percent as a threshold for loan to value, but with private mortgage insurance higher ratios are permitted.

At this point, the lender is in a position to approve or deny the loan. If the credit history is clean, the applicant has a good supply of cash, all the debt and loan-to-value ratios are within the guidelines, and the property is a single-family home in a desirable neighborhood, the decision is relatively easy and, indeed, the application could probably be analyzed and approved by a computer. However, few (less than 20 percent) borrowers are without blemish and, therefore, lenders are left considerable room for subjectivity and discretion. To offset negatives, lenders can use a host of "compensating factors." For example, to compensate for high debt-to-income ratios, lenders might note a large down payment, a good record of carrying high housing expenses, a strong propensity to save and a high level of liquid assets, and an

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than comparable white applicants. The researchers speculated that differences in credit histories might have contributed to this result, but lacked the data to test this hypothesis.

[5] This paragraph describes the appropriate form of an initial review, which involves the completion of an application and an explicit denial or encouragement by the lender. Examiners, however, are very concerned about the prevalence of informal prescreening where applicants are discouraged from even filing a formal application or are not provided with the adverse action notice, which is required by law when the informal process is pursued to the point where the lender, in fact, makes a credit decision.

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excellent potential for future earnings based on education and training. Similarly, to compensate for credit history problems, lenders might be willing to accept favorable letters from creditors, extenuating circumstances such as an adverse judgment in a civil suit, or simply prior life circumstances that have changed for the better. In other words, many flawed loan applications can be brought to a viable status and even made eligible for sale in the secondary market.

A MODEL OF MORTGAGE LENDING

The information gathered and analyzed in the mortgage application process can be used to model the mortgage lending decision. Because little is known about the relationship between applicant characteristics and actual loan performance, any model must by necessity explain what lenders actually consider when making their decisions rather than what they ought to consider.

Mortgage lenders are assumed to maximize the expected profit of the institution. This goal requires that financial institutions attempt to minimize the probability and costs of default associated with each mortgage loan.[6] This means that the probability of a lender denying a mortgage application P(D) is a function of the applicant's ability to carry the loan (F), the risks of default (R), the potential loss associated with default and foreclosure (L), and the terms of the loan (T). Although these factors are listed separately, they are all interrelated; for example, an applicant's ability to carry a loan depends on the terms of the loan. If the lender's judgment is influenced by the race or other personal characteristics of the applicant (C), that will also affect the likelihood of denial. That is, $P(D) = f(F,R,L,T,C)$.

The original HMDA data include only one piece of economic information about the applicant—namely, income. Income alone actually has less explanatory power than one might expect, because lower-income borrowers usually buy lower-priced homes. Moreover, as the discussion above suggests, many other variables affect the mortgage lending decision. Thus, the Federal Reserve Bank of Boston attempted to augment the 1990 HMDA report by gathering information on 38 additional variables. These variables were selected on the basis of numerous conversations with lenders, underwriters, and others familiar with the lending process. Most of the variables come from standard loan application forms; several are taken from credit reports and a few from lenders' worksheets. The following is a brief summary of the major groupings of variables.

Ability of Applicant to Support Loan. The original HMDA data did not include information on two financial concepts—obligation ratios and wealth—that could have considerable bearing on the applicant's ability to carry and repay the mortgage loan. "Obligation ratios," which measure proposed housing expenses relative to income and total debt payment obligations relative to income, indicate whether the applicant can afford the mortgage more clearly than income alone. In addition, because the secondary market has established guidelines for these ratios and because today most mortgages are sold in the secondary market, lenders must be concerned about how the obligation ratios affect the loans' marketability.

Economists contend that wealth may also be important to the lender's decision, since substantial wealth can make debt repayment easy even when income is low and obligation ratios are high. Not only can wealthy individuals spend down their wealth, but also liquid assets can be a cushion that prevents a temporary job loss or other income disruption from resulting in a mortgage default. Bankers and other lenders who were consulted said, however, that the available wealth information is not very reliable, and, for this reason, they tend to place little weight on wealth, with the exception of verifiable liquid assets. Nevertheless, information was collected on total assets and total liabilities, as well as liquid assets.

Risk of Default. Two groups of variables—one relating to applicants' reliability as borrowers and one pertaining to the stability of the applicants' income—were collected in order to capture the possibility that the applicants' circumstances might change and their commitment or ability to repay the loan might decline.

RELIABILITY OF BORROWER: Lenders state that they place considerable weight on applicants' credit histories in judging their commitment to meeting mortgage obligations. The contention is that past behavior may signal creditworthiness in the future; some people may be more responsible about credit obligations than others and,

[6] Maximizing expected profit requires maximizing the difference between the return on mortgage lending and the cost of funds to the lender. In the case of home mortgages, however, applications are usually either rejected or accepted at the market interest rate. Given expectations of inflation, the market rate should generate a profit on loans that fulfill monthly payment commitments. Thus, the primary task facing the lender is avoiding default and any associated losses. Even if the lender sells the loan on the secondary market, default remains a concern, as the purchaser can return the loan to the originator. At a minimum, secondary market buyers will not continue to buy from lenders whose loans frequently default.

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therefore, less likely to default. Loan underwriters tend to view certain elements of the credit report as more important than others. For example, failure to meet previous mortgage commitments is said to be viewed more seriously than a late credit card payment. Likewise, public record of default, foreclosure, or bankruptcy is considered especially damaging to the borrower. This study constructed a concise outline of the prospective borrower's past creditor relationships that provides substantial detail about different credit categories.

STABILITY OF INCOME: Mortgage application forms devote considerable space to questions concerning the labor force status of the applicant. In addition to earnings, the lender collects information on industry, profession, seniority, years in this type of employment, age, and education. These questions are aimed at determining how easily the applicant will be able to carry the mortgage not only now, but also over an extended period. This information was used to calculate a rough estimate of the probability that the applicant will become unemployed.[7] If, because of differences in education and skills or labor market discrimination, minorities are concentrated in jobs that have a higher risk of unemployment, then unstable incomes could be the reason for denials that appear to be attributable to differential treatment in the lending decision. Only by explicitly including a variable representing the probability of becoming unemployed is it possible to distinguish discrimination in the mortgage market from effects related to race in the rest of the economy.

Similarly, the earnings of the self-employed are thought to be more variable than the earnings of those employed by others. Increased variance of future income increases the riskiness of the loan. Thus, whether or not the applicant is self-employed may bear on his ability to get a mortgage loan.

Potential Default Loss. While credit history and employment stability provide information about the possibility of default, several other variables collected provide some indication of the magnitude of the loss should default and foreclosure occur. These variables include the loan-to-value ratio, the availability of private mortgage insurance, and neighborhood characteristics that might affect the stability of the value of the mortgaged property.

LOAN-TO-VALUE RATIO: The study collected information on the appraised value of the home; from these appraised values, loan-to-value ratios were calculated to measure the borrower's equity in the property. Loan to value ratios are potentially important indicators of both the risk of default and the magnitude of a potential loss in the event of foreclosure. The more equity borrowers have in their properties, the less likely that declining property values will cause them to abandon their homes to the lender. A larger cushion also protects lenders from loss.

PRIVATE MORTGAGE INSURANCE: Since some of the loss associated with default can be absorbed by insurers of mortgage loans, the survey collected information on whether applicants applied for private mortgage insurance and whether their application was approved or denied. To the extent that an applicant applies for and receives private mortgage insurance, the potential loss to the lending institution is reduced. More important, the secondary market will not accept a mortgage loan that has a loan-to-value ratio in excess of 80 percent without private mortgage insurance protection. Thus, any applicant with a high-loan-to-value ratio who is refused private mortgage insurance is likely to be denied the loan. As will be discussed later, the fact that the insurers are basing their decisions on the same factors as the lenders makes it difficult to determine the appropriate treatment of private mortgage insurance in a model of mortgage lending.

STABILITY OF VALUE: Because of a variety of neighborhood features, inner-city properties are often thought to carry a higher risk of capital loss than properties in other areas. While the appraised value should reflect expectations that the property will rise or decline in value, it may not capture the uncertainties surrounding these expectations. Risk-averse lenders will avoid loans with the same expected probability and costs of default but higher variability of potential losses. As a result, lenders could be economically motivated to avoid investing in areas that are perceived to be risky.

Some researchers have included a separate variable for each Census tract in their analysis to standardize for neighborhood characteristics. This approach has serious drawbacks when minorities are heavily concentrated in a few Census tracts because the racial composition of the tract as well as the race of the applicant may be rel-

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[7] A more sophisticated approach is also being investigated, which builds on the job clustering work by Gittleman and Howell (1992) and the information on individual spells of unemployment, given age, seniority, education level, and experience, from the University of Michigan's Panel Study of Income Dynamics. The simpler approach adopted for this study, which uses 1989 unemployment rates in the Boston area for the major industrial groups, does, however, capture the concept and also has the advantage of incorporating the local unemployment situation.

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evant in the lending decision. A better approach is to estimate directly the risk associated with the value of property in different tracts. For this study, the measure adopted was the ratio of rent to the value of the rental housing stock in the Census tract where the property is located, which can be calculated from Census data. To compensate investors for the higher risk, the same amount of capital invested in an area with greater potential for loss should generate a higher stream of earnings.

Loan Characteristics. In order to isolate the effect of race on the lending decision, it is necessary to hold constant the characteristics of the loan. The sample was limited to conventional mortgages because FHA and VA loans are uncommon in the Boston metropolitan area.[8] The follow-up survey secured additional information on the duration of the loan, for example 15 years or 30 years; whether the interest rate was fixed or adjustable; and whether the application was made under a program designed for low-income individuals. The survey also asked whether the property was a single-family home, a condominium, or a building with two to four units.

Personal Characteristics. The original HMDA data included information on the sex and race of the applicant and co-applicant. The follow-up survey requested data on age, marital status, and the number of dependents. Age could be an indicator of future earnings potential, as earnings tend to rise with age over the average person's working life. Similarly, lenders could be interested in the number of dependents, because the more dependents for any given level of income, the less money the applicant is likely to have available to carry the loan.

III. Survey Design and Results

It may be helpful to say a few words about how the sample was designed and how the data were collected before looking at the results. Because the high denial rates for minorities prompted the survey and because only 1,200 blacks and Hispanics applied for mortgages in Boston in 1990, the goal was to collect information on every black and Hispanic applicant. A sample of 3,300 whites was chosen to identify those characteristics that result in rejections when race is not a factor; this information provides a base against which to assess the extent to which race contributes to the high rejection rate for minority applicants. To determine the cause of rejections among whites requires that the sample include a sufficient number of white rejections; since the white rejection rate is only 11 percent, a large number of white applicants was required.

Practical considerations required limiting the institutions surveyed to those that had received at least 25 mortgage applications from borrowers of all races. This reduced the pool of applications only slightly, but cut the number of institutions to be contacted from 352 to 131. The Boston Fed sent each of the 131 lending institutions a survey document in the form of an expanded HMDA register. The register contained the identification number and the HMDA data that the institution had originally submitted for all its black and Hispanic applicants and for the random sample of white applicants selected by the Federal Reserve Bank of Boston.[9] For each applicant, 38 additional pieces of information were requested.

Final Sample

A high degree of cooperation by lenders and considerable follow-up resulted in a very high response to the survey, as can be seen in Table 2.[10] The largest part of the divergence between the survey as designed and the responses submitted by the

[8] In the Boston metropolitan area in 1990 only 4 percent of all home-purchase applications (only 4.5 percent of applications by blacks and 3.5 percent of applications by Hispanics) were for government-backed mortgages. Thus, the conventional mortgage represented the norm in Boston for blacks, Hispanics, and whites.

[9] The sample of applications by whites was selected randomly rather than matched with black and Hispanic applications by institution or key borrower characteristics, because matching would have required prejudging the causes of rejection and precluded an evaluation of the role that the variables used in the matching process played in determining rejection rates.

[10] The institutions participating in the survey were requested to keep track of the expenses they incurred in supplying the information. Only sixteen of the 131 institutions responded with estimates of the hours devoted to the survey or with dollar expenditure figures. According to these estimates, the time required to supply all the information for a single loan averaged about an hour and the dollar cost averaged $30 per loan, a figure generally consistent with the hourly estimate. These costs are probably indicative of those experienced by the other lenders participating in the survey. Applying these estimates to the entire sample indicates that approximately 4,500 hours were expended in complying with this survey request and that the total dollar cost was $135,000.

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institutions was caused by the closing of some banks that had been significant lenders in 1990. A second source of difference was that lenders, in the process of providing additional data, checked their earlier entries and made corrections. In one of the more notable examples, 51 applications that a suburban bank had coded as Hispanic on its original HMDA submission were found to be white. Some institutions were simply unable to locate all their loan files.

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Table 2
Comparison of Final Sample with Original HMDA 1990 Reports, Boston MSA

Source	Total Number of Applications	White		Black/Hispanic	
		Number	Percent Denied	Number	Percent Denied
Original HMDA Reports[a]	18,838[a]	16,019	11.0	1,210	30.7
Survey Design	4,443	3,300	11.0	1,143	30.4
Survey Response[a]	4,153[a]	3,123	11.4	1,013	27.6
Final Sample	3,062	2,340	10.3	722	28.1

[a]Includes applicants of races other than white, black, or Hispanic.
Note: The survey response (4,153) falls short of the survey design (4,443) because of the closing of some banks that had been significant lenders in 1990, the inability of some lenders to find some loan files, and corrections to earlier submissions. The final sample (3,062) falls short of the survey response (4,153) because some loans had missing data (618), some were withdrawals (232), some were refinancings (200) or for nonresidential property (24) that lenders had originally coded as home purchase mortgages, and some applicants proved to be neither white, black, or Hispanic (17).

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The survey response was further refined to derive a sample of completed applications for conventional loans for the acquisition of residential property. This required eliminating any application that, upon review, was for refinancing as opposed to home purchase or for the acquisition of nonresidential as opposed to residential property, and any application with missing data for one of the key variables. In addition, the decision was made to exclude applications that were withdrawn.

Some experts have suggested that withdrawals may be hidden rejections. That is, in the process of verifying an application, the lender could encourage the applicant to withdraw rather than be rejected. However, applicants might withdraw for a host of other reasons. In particular, the property might fail an inspection report or the buyer might simply get cold feet. Withdrawals accounted for roughly 8 percent of both black/Hispanic and white applications. An examination of the pattern of withdrawals in the sample revealed, at most, a weak link to race or creditworthiness. Since retaining withdrawals in the study would have complicated the econometric presentation that fellows and produced uninteresting results, they are not included in the sample. Despite the reduction in the number of applicants in the final sample, the pattern of denial rates is fairly close to that reported in the original HMDA data.

The pattern of lending by type of institution is also very similar to that reported for the original HMDA data. In both cases, applications are split relatively evenly between depository institutions and mortgage companies; this is true for blacks/Hispanics as well as for whites (Table 3).

Table 3. Institutions Providing Mortgage Loans and Denial Rates, Final Sample

Institution	Total Applications		White Applications		B/H Applications	
	Number	Percent Denied	Number	Percent Denied	Number	Percent Denied
Banks, Thrifts, and Credit Unions	1,638	14.0	1,265	9.6	373	28.6
Mortgage Companies	1,424	15.1	1,075	11.1	349	27.5
Subsidiaries	1,297	15.3	979	11.3	318	27.7
Independents	127	12.6	96	8.3	31	25.8
Total	3,062	14.5	2,340	10.3	722	28.1

Values of Key Variables

The values of key variables collected in the follow-up survey are presented in Table 4 for black/Hispanic applicants and white applicants, both approved and denied. (Appendix Table A1 presents values for the complete list of variables.) These data and all subsequent analyses combine applications by blacks and Hispanics. Both blacks and Hispanics had substantially higher denial rates than whites and the number of applications by Hispanics was too small to analyze separately. Moreover, statistical tests confirmed that the independent variables affected the probability of denial for the two groups similarly.

The data show that black and Hispanic applicants in the Boston area differ from white applicants in a number of ways. These differences tend to support arguments that the higher denial rates experienced by minorities are attributable, at least in part, to financial characteristics, credit histories, and other economic factors. As reported in other surveys, black and Hispanic applicants have considerably less net wealth and liquid assets than whites. Black and Hispanic applicants also tend to have poorer credit histories than whites.

Blacks and Hispanics in Boston are substantially more likely than whites to be purchasing a two- to four-family home. The higher proportion of two- to four-family

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homes among denied applicants, for whites as well as for blacks and Hispanics, suggests that lenders perceive more risk associated with financing the purchase of such properties. Blacks and Hispanics also make lower down payments and have higher loan-to-value ratios than whites. Since the secondary market will not accept a mortgage with a loan-to-value ratio in excess of 80 percent without mortgage insurance, minorities apply more frequently for private mortgage insurance.

Blacks and Hispanics have lower incomes than white applicants. They also purchase less costly homes, however, so their obligation ratios are similar. Supporting the view that obligation ratios rather than incomes are the critical variable is the fact that the median income of white applicants whose loans were approved was virtually the same as the median income of applicants whose loans were denied; in the case of minority applicants, the median income of denied applicants actually slightly exceeded the median income of those whose loans were approved.

Table 4
Key Characteristics of Mortgage Applicants, by Race and Loan Disposition

Variable	White		Black/Hispanic	
	Approved	Denied	Approved	Denied
Ability to Support Loan				
Housing Expense/Income (percent)[a]	26.0	26.6	26.0	28.0
Total Debt Payments/Income (percent)[a]	33.0	37.0	34.0	38.0
Net Wealth ($)[a]	93,000	75,000	39,000	33,000
Monthly Income ($)[a]	4,666	4,471	3,333	3,600
Liquid Assets ($)[a]	38,000	28,000	19,000	15,500
Risk of Default				
Percent with Poor Credit History[b]	14.6	38.9	23.4	51.5
Probability of Unemployment	3.2	3.2	3.2	3.2
Percent Self-Employed	12.0	22.4	7.5	7.4
Potential Default Loss				
Loan/Appraised Value (percent)[a]	77.3	83.1	85.0	90.0
Rent/Value in Tract (percent)	4.6	4.9	7.3	8.9
Percent Applied for Private Mortgage Insurance	21.6	17.1	42.2	26.6
Percent Denied Private Mortgage Insurance[c]	.7	75.0	1.3	82.5
Loan Characteristics				
Percent Purchasing Two- to Four-Family Homes	7.7	18.3	24.8	34.4
Percent Fixed-Rate Loans	68.6	62.8	60.6	69.6
Percent 30-Year Loans	85.9	83.3	91.1	91.3
Percent in Special Loan Programs	12.6	16.1	40.6	40.3
Personal Characteristics				
Age[a]	34.0	35.0	36.0	36.0
Percent Married	63.0	53.2	53.7	55.0
Percent with Dependents	37.6	39.9	52.6	52.2

[a]Median value.
[b]Poor credit defined as having more than two late mortgage payments or delinquent consumer credit histories (more than 60 days past due) or bankruptcies or other public record defaults.
[c]Base is those applying for private mortgage insurance.
See Appendix Table A1 for complete list of variables.

IV. The Role of Race in the Mortgage Lending Decision

While the data in Table 4 suggest that financial and other differences between black/Hispanic and white applicants account for a large part of the disparity in mortgage denial rates, determining whether race plays an independent role, and how great a role, requires statistical techniques that hold these characteristics constant. This can be done by estimating an equation which makes the probability of

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being denied a mortgage loan a function of obligation ratios, wealth variables, credit histories, and other factors thought to affect the mortgage decision. Race is then added to the equation to determine whether it has any independent effects after the other factors have been taken into account.

REGRESSION RESULTS

Table 5 presents the results of a logit regression using the equation that most closely represents the model discussed earlier. Many other equations were also estimated, in order to test the robustness of these results and to incorporate variables used in previous studies or thought to be important to the mortgage lending decision. A sample of these additional equations is presented in Appendix B, and it confirms the stability of the results.[11]

The first column of Table 5 reports the coefficient associated with each variable. The "t-statistic" in parentheses indicates the statistical significance of the coefficient; a t-statistic in excess of 2 means that the coefficient is statistically significant. With the exception of wealth, all the variables in the equation have a statistically significant impact on the probability of denial.

[11] As discussed earlier, little is known about the link between applicant characteristics and loan performance; thus, the results describe what lenders actually consider in their decision to approve or deny a loan, but these are not necessarily the factors that would provide the best predictions of repayment or default.

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Table 5
Determinants of Probability of Denial of Mortgage Loan Application

Variable	Coefficient (t-Statistic)	Impact of Variable on Probability of Denial[a] (Percent)
Constant	-6.61 (-17.0)	
Ability to Support Loan		
Housing Expense/Income	.47 (3.2)	33.9
Total Debt Payments/Income	.04 (6.6)	33.0
Net Wealth	.00008 (1.1)	4.5
Risk of Default		
Consumer Credit History	.33 (9.8)	37.2
Mortgage Credit History	.35 (3.0)	11.4
Public Record History	1.20 (7.0)	113.7
Probability of Unemployment	.09 (3.3)	11.4
Self-Employed	.52 (2.8)	35.1
Potential Default Loss		
Loan/Appraised Value	.58 (3.2)	11.5
Denied Private Mortgage Insurance	4.70 (9.6)	596.0
Rent/Value in Tract	.68 (3.5)	9.3
Loan Characteristics		
Purchasing Two- to Four-Family Home	.58 (3.6)	42.4
Personal Characteristics		
Race	.68 (5.0)	56.0
Number of Observations	3062	
Percent of Correct Predictions[b]	89	

[a]For variables entered as 0 or 1 (see the notes to this table), the increase in the probability of denial associated with the variable. For continuous variables, the increase in the probability of denial associated with a change in the variable equal to one standard deviation.
[b]The number of applicants with a probability of denial greater than 50 percent who were denied, plus the number of applicants with a probability of approval greater than 50 percent who were approved, as a percent of the total sample.

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Notes to Table 5

Dummy Variable Definitions:

Variable		Definition
Housing Expense/Income	= 1	if greater than .30.
	0	otherwise
Total Debt Payments/Income	=	value of question #46
Net Wealth	=	value of question #36 less question #38
Consumer Credit	= 1	if no "slow pay" account (code 1 in question #43)
	= 2	if one or two slow pay accounts (code 2)
	= 3	if more than two slow pay accounts (code 3)
	= 4	if insufficient credit history for determination (code 0)
	= 5	delinquent credit history with 60 days past due (code 4)
	= 6	serious delinquencies with 90 days past due (code 5)
Mortgage Credit	= 1	if no late payments (code 1 in question #42)
	= 2	if no payment history (code 0)
	= 3	if one or two late payments (code 2)
	= 4	if more than two late payments (code 3)
Public Record	= 1	if any public record of credit problems (codes 1, 2, 3, 4 in question #44).
	0	otherwise
Probability of Unemployment	=	1989 Massachusetts unemployment rate for applicant's industry
Self-Employed	= 1	if self-employed
	0	otherwise
Loan/Appraised Value	=	value of loan amount divided by question #38
Percent Denied Private Mortgage Insurance	=	derived from question #53
Rent/Value in Tract	=	rental income divided by estimate of value of rental property from Census
Two to Four-Family Homes	= 0	if purchasing a single-family or a condo.
	= 1	if purchasing a two to four-family home
Race	= 1	if applicant was black or Hispanic.
	= 0	otherwise

Means and Standard Deviations:

Variable	Mean	Standard Deviation
Total Debt Payments/Income	33.46	11.26
Net Wealth ($)	230,160	979,245
Consumer Credit History	2.16	1.70
Mortgage Credit History	1.75	.53
Probability of Unemployment	3.82	2.07
Loan/Appraised Value	.77	.33
Rent/Value in Tract	09	.23

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The importance of the variables to the denial decision cannot be interpreted solely from the t-statistics or from the coefficients themselves, but rather depends on the values of the variables in the equation. Thus, the second column presents a measure of the impact of each variable on the probability of denial. For variables that have values of 0 or 1, such as self-employed, the figures in the second column represent the increase in the probability of denial associated with having that particular characteristic. That is, the probability of denial increases 35 percent for a person who is self-employed.[12] Since the average denial rate for the sample as a whole is 14.5 percent, the probability of denial for the average applicant who happens to be self-employed would be roughly one-third greater than the average, or 19.6 percent. For continuous variables, such as the total obligation ratio, the figures in the second column represent the increase in the probability of denial associated with a one standard deviation change in that variable. That is, if the total obligation ratio rises 11 percentage points (one standard deviation), the probability of denial increases by 33 percent.

Ability of Applicant to Support Loan. As expected, the results confirm that high obligation ratios increase the probability of having a loan application denied. Because the two obligation ratios tend to move together, that is, an applicant with a high housing expense ratio generally also has a high ratio of total debt payments to income, it is difficult to sort out precisely the relative importance of the two ratios. Suffice it to say that these measures are crucial to the lending decision. As discussed above, one standard deviation increase in the total obligation ratio raises the probability of denial by 33 percent.

Economists have long argued that perhaps one of the reasons that minorities are denied mortgage loans more frequently than whites is that they have less wealth. The net wealth coefficient is not statistically significant, however, a result that supports lenders' claims that they do not place much weight on wealth.[13] As reported in Appendix B, liquid assets also do not appear to affect the probability of denial, although they are cited in secondary market guidelines as a compensating factor and are frequently mentioned by lenders as an important consideration. The answer may be that liquid assets are frequently used for the down payment and therefore their effect is captured by the loan-to-value ratio. Prescreening may also exclude people without enough cash to settle.

Risk of Default. Credit information was categorized by the severity of the problem in the consumer, mortgage, and public records areas; the precise definitions can be found in the notes to Table 5. The results show clearly that an increase in credit problems raises the probability of having the loan denied. A problem in the public records area, such as a bankruptcy, raises the probability of denial 114 percent.[14] Thus, if an applicant with average characteristics of the sample had a bankruptcy, this person's probability of denial would roughly double from 14.5 percent to 31.0 percent.

Instability of income, whether stemming from a higher likelihood of becoming unemployed or from being self-employed, increases the probability of denial. Self-em-

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[12] Logit regressions are particularly suited to modelling discrete outcomes, such as approval or denial. However, the resulting equations are nonlinear and, therefore, calculating the impact of changes in variables is more complicated than in the more familiar ordinary least squares and other linear regression forms. In deriving the impact values reported in Table 5, the first step is to determine the probability of denial in the absence of a particular characteristic, such as being self-employed. This requires determining for each non-self-employed applicant the probability of denial based on the coefficients of the equation reported in Table 5. These estimated probabilities for each applicant are then averaged to get a single figure for the group. The second step is to add to each non-self-employed applicant's probability of denial the impact of being self-employed (the coefficient 0.52 multiplied by 1). These new probabilities are averaged. The figure reported in the second column is the percent difference between the average probability of denial for the non-self-employed with the self-employment effect and the probability for the non-self-employed without it.

For a continuous variable, such as the total obligation ratio, the procedure is slightly different. In this case, the first step is to determine the estimated probability of denial for each applicant in the sample, and then average the probabilities. The second step is to add one standard deviation to the total obligation ratio for each applicant, recalculate the estimated probabilities of denial, and average the probabilities. As before, the value reported in the second column is the percent difference between these two average probabilities.

[13] An equation was also estimated including income, liquid assets, and the ratio of base to total income as alternative measures of the applicant's ability to carry a loan. None of these variables has a statistically significant effect on the probability of being denied; the results can be found in Appendix Table B1.

[14] An alternative characterization of credit history, which treats the credit information as individual dummies rather than as semi-continuous variables, is presented in Appendix Table B2. The results are fully consistent with those in Table 5.

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ployment has by far the larger effect, however, raising the probability of denial by 35 percent.[15]

Potential Default Loss. A high loan-to-value ratio raises the probability of denial, but the effect is relatively small. This result occurs because virtually all applicants with loan-to-value ratios over 80 percent must secure private mortgage insurance. Thus, as shown in Table 5, the denial of private mortgage insurance virtually precludes attaining a mortgage. It should be noted, however, that very few applicants were turned down for private mortgage insurance. The large impact, therefore, means that those who were turned down were very unlikely to get a mortgage, not that denial of private mortgage insurance was the most important reason to be denied a mortgage loan.

The appropriate way to treat private mortgage insurance was a difficult decision, because these insurers consider the same information provided the financial institutions. Thus, in one sense, they could be considered simply another lender and the mortgage insurance variable omitted from the equation. On the other hand, insurers could be viewed as outside the direct lending market, and, to the extent that their denials fell disproportionately on minorities, excluding a variable representing denial of mortgage insurance from the equation would ascribe to lenders differential treatment occurring elsewhere in the system. For this reason, the denial of mortgage insurance was included in the equation.

Since the treatment of private mortgage insurance is controversial, it should be noted that excluding private mortgage insurance from the equation has little impact on the coefficients of the other variables; the exception, not unexpectedly, is the loan-to-value ratio, which takes on somewhat greater importance in the absence of private mortgage insurance (Appendix Table B4). Similarly, estimating the equation excluding those applicants who were denied private mortgage insurance has little impact on the basic results; again the exception is the loan-to-value ratio.[16]

Finally, the theoretical construct to standardize for the riskiness of the neighborhood in which the property was located entered the equation with the expected sign and was statistically significant. That is, the greater the rent-to-value ratio, which attempts to measure the variability of housing value from tract to tract, the greater the likelihood the applicant will be denied a mortgage loan.[17] An equation was also estimated that included a dummy variable for each of the more than 500 tracts in the sample—the ultimate exercise in controlling for neighborhood characteristics. The inclusion of those additional variables has a modest impact on most of the other coefficients in the original equation; the exception is the coefficient on race, which increases (Appendix Table B9).[18]

Loan Characteristics. The loan characteristic that turned out to be important is whether the applicant was applying for a mortgage for a two- to four-family home.[19]

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[15] An equation was estimated that also included years on the job and the presence of a co-signer. Secondary market guidelines request documentation for applicants who have been on the job less than two years, and the presence of a co-signer reduces the risk of default. The results, which can be seen in Appendix Table B3, have the expected signs, but neither variable has a statistically significant effect on the probability of denial.

[16] In terms of the determinants of private mortgage insurance itself, nearly all the variables included in the mortgage loan decision equation, including race, appear to be relevant. The effect of race disappears, however, with the addition of information about the racial composition of the tract in which the applicant is purchasing the property (Appendix Table B5).

[17] Equations were also estimated with several alternative indicators of the risk of loss arising from the property's location (Appendix Table B6); these include vacancy rates, the appreciation in housing values, and a dummy for tracts with more than 30 percent minority population. These variables do not alter the basic equation appreciably. It appears that although blacks and Hispanics tend to reside in minority areas, they are not being denied mortgages because of where they live. Minorities living in white areas are also denied mortgages at higher rates.

The foreclosure rate by tract was also included in the basic equation as a measure of neighborhood risk, but its coefficient was statistically insignificant and it had no impact on the race coefficient (Appendix Table B7). It should be noted that most of the neighborhoods with large minority populations do not have high rates of foreclosure (Appendix Table B8).

[18] The race coefficient might increase for two reasons. First, the racial composition of the tract affects the denial rates for both white and minority applicants. For whites the denial rate increases from 10 percent in predominantly white tracts to 16 percent in tracts with 30 percent or more minority population; the comparable figures for minority applicants are 25 percent and 33 percent, respectively. Since white applicants are hurt relatively more by buying property in minority tracts, excluding tract information could artificially raise the denial rate for white applicants and reduce the effect of being a minority on the probability of denial. Including the tract information, therefore, raises the coefficient on race. The second possible explanation is that tracts vary by many characteristics other than race, and many predominantly white tracts may simply have poor quality housing and other factors that affect the risk of the loan.

[19] The duration of the loan and whether the rate was fixed or variable were also tried, but proved not to add any information. The results of this exercise are shown in Appendix Table

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Financial institutions clearly are less willing to make loans on two- to four-family housing that involves rental arrangements. The positive coefficient says that if the property is a multi-unit dwelling, the probability of denial rises 42 percent.

Personal Characteristics. The only personal characteristic that appears to enter into the loan denial decision is the race of the applicant.[20] The positive and statistically significant coefficient suggests that after accounting for obligation ratios, wealth, credit histories, stability of the applicants' incomes, loan-to-value ratios, private mortgage insurance, and neighborhood characteristics, the race of the applicant still plays a role in the lender's decision to approve or deny the loan. Thus, for an individual with average white economic characteristics and minority race, the probability of denial increases 56 percent.

Evaluation of the Results. A logical question is "How good are these results?" This question can be broken into four parts. The first pertains to the robustness of the results with regard to race; the second pertains to the broader issue of how much of the variability in approval and denial rates is explained by the equation; the third relates to whether the results can be explained by variations in underwriting standards among lenders; and the fourth relates to the pervasiveness of the behavior captured in the equation.

With regard to the race variable, nearly every equation that was estimated had virtually the same coefficient and degree of statistical significance. As shown by the supplementary equations reported in Appendix B, adding variables to the equation reported in Table 5 had little impact on the coefficient of race or for that matter on most of the other coefficients in the equation.[21] In short, the effect of race on the probability of denying a loan application was consistently positive, large, and statistically significant.[22]

Robustness of the race coefficient in and of itself does not fully answer the question of how much credibility should be given to these results. If important variables that differed by race were missing from the analysis, the race variable could be picking up their effect. Two responses address the issue of omitted variables. First, the survey included every variable mentioned as important in numerous conversations with lenders, underwriters, and examiners and no reviewer suggested any other economic factor that should be included in the equation.

Second, the variables included in the equation do a good job of explaining the decision to approve or deny. Although no simple measure of "goodness of fit" exists for equations that estimate the probability of an action, the explanatory power of the equation can be assessed. The first column of Table 6 reports actual denial rates for applicants in the survey by total obligation ratio; that is, the denial rate for very good credits (obligation ratios 36 percent or lower) is 9.9 percent and for poor credits (obligation ratios in excess of 40 percent) is 38.8 percent. The second column reports the denial rates predicted by the equation for each group. For the good credits, the equation performs remarkably well, predicting 10.6 percent compared with the actual of 9.9 percent. The results for the denial rates for poor credits are also quite good, 32.3 percent compared to the actual of 38.8 percent.

B10. Also tried were whether the loan was applied for under a special program and whether a gift or a grant contributed to the down payment; the latter slightly reduced the probability of denial, but had little impact on the rest of the basic equation.

[20] The age, sex, marital status, and number of dependents do not affect the probability of having a loan application denied (Appendix Table B11).

[21] Various interaction terms were tested to examine whether a combination of certain variables was essential to the mortgage lending decision. Interaction between the loan-to-value ratio and the obligation ratios and credit history variables, as well as the interplay between the obligation ratios and the credit variables were all tested. Only the loan-to-value ratio and consumer payments interaction term was statistically significant. The importance of this variable, however, derived solely from its severe collinearity with the consumer payments index; the consumer payments variable becomes insignificant when this interactive term is included, and the correlation between the two variables is 0.9. None of these interactive terms affected the race coefficient or its statistical significance. Finally, some non-linearity in the obligation ratios and the loan-to-value ratio was examined, but it did not improve the fit of the equation or change any of the results for the other variables.

[22] As shown in the correlation matrix (Appendix Table B14), multicollinearity between any two independent variables is not affecting the results.

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Table 6
Explanatory Power of the Regression Equation

Total Obligation Ratio	Denial Rates			
		Predicted from Equation Based on		
	Actual Sample	Full Model	Original HMDA Data[a]	Key Variables[b]
36 percent or lower	9.9	10.6	14.0	12.4
Between 36 percent and 40 percent	14.4	16.2	15.2	16.2
Greater than 40 percent	38.8	32.3	16.2	22.9

[a]Equation includes race, sex, and income of the applicant and the loan amount.
[b]Key variables add to the original HMDA data a dummy when the ratio of housing expense to total income exceeds 30 percent, a measure of the applicant's consumer payment credit history, and the applicant's loan-to-value ratio.

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In order to have a better sense of how good the equation results are, it is useful to compare the predictions with those that emerge from an equation using only information from the original HMDA data—namely, race, sex, and income of the applicant and loan amount. As shown in the third column of Table 6, these four variables produce a flat distribution of predicted denial—rates, explaining none of the difference between good and poor credits. In other words, the additional variables included in the full model explain a lot compared to the basic HMDA data. To provide just one more point of comparison, the last column shows the predicted denial rates from an equation that adds only three additional variables to the original HMDA data—a dummy for a ratio of housing expense to total income in excess of 30 percent, consumer payment credit history, and loan-to-value ratio. This equation begins to pick up some of the tilt in denial rates as applicants move from poor to good credits, but a substantial gap remains between actual and predicted rates.

Third, the question arises about the pervasiveness of the results. That is, does the impact of race come from a single large institution operating in a discriminatory manner or is the practice widespread? To test whether race was consistently an important factor in the mortgage lending decision, the sample was divided into large lenders and small lenders. Large lenders, which accounted for only 5 percent of the institutions, received exactly 50 percent of minority applications; the other 50 percent of minority applications were distributed among the remaining 95 percent of the institutions. Separate equations were then estimated for the two sub-samples. The results indicate that the model is stable across institutions of vastly different size, and that race is an important explanatory factor in mortgage lending decisions among both small and large lenders (Table 7). In short, the results represent a widespread phenomenon, not just the behavior of a single institution.

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Table 7
Determinants of Probability of Denial for Lenders

Variable	Coefficient (t-Statistic) Small Lenders	Large Lenders
Constant	-6.59	-7.53
	(14.1)	(9.6)
<u>Ability to Support Loan</u>		
Housing Expense/Income	.50	.39
	(2.5)	(1.7)
Total Debt Payments/Income	.04	.07
	(4.6)	(5.3)
Net Wealth	.0001	-.0001
	(1.7)	(0.5)
<u>Risk of Default</u>		
Consumer Credit History	.36	.30
	(7.7)	(6.2)
Mortgage Credit History	.35	.27
	(2.4)	(1.3)
Public Record History	1.07	1.65
	(4.7)	(5.8)
Probability of Unemployment	.13	.03
	(3.7)	(0.7)
Self-Employed	.41	.94
	(1.8)	(3.1)
<u>Potential Default Loss</u>		
Loan/Appraised Value	.39	1.54
	(2.0)	(2.9)
Denied Private Mortgage Insurance	4.96	4.50
	(7.7)	(5.9)
Rent/Value in Tract	.38	1.02
	(1.2)	(3.7)
<u>Loan Characteristics</u>		
Purchasing Two- to Four-Family Home	1.16	-.09
	(5.3)	(0.4)
<u>Personal Characteristics</u>		
Race	.51	.68
	(2.6)	(3.4)
Number of Observations	1968	1094
Percent of Correct Predictions[a]	92	87

[a]The number of applicants with a probability of denial greater than 50 percent who were denied, plus the number of applicants with a probability of approval greater than 50 percent who were approved, as a percent of the total sample.

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Finally, even though the variables in Table 5 standardize for applicant and property characteristics, the argument remains that minorities may be treated the same as whites within any given institution, but may simply frequent institutions with tougher lending standards. To test this hypothesis, a "tough" lender variable was added to the basic equation. This variable was constructed by estimating the equation for white applicants only and including a separate dummy variable for each lender, and then designating specific lenders as "tough" based on the coefficients of the lender dummies. The inclusion of this variable, however, had virtually no effect on the coefficients of the other variables and the variable itself was statistically insignificant (Appendix Table B12). This result was not unexpected given that most lenders conform to secondary market guidelines. Including separate dummy variables for all institutions in the sample alters the coefficients slightly, but does not change the basic results.

This assessment shows that the results presented in Table 5 merit serious consideration. The coefficient of the race variable is stable and always statistically significant; it is difficult to think of omitted variables linked with race, that could be biasing the race coefficient; and the overall equation does a very good job of explaining the variation in denial rates. Moreover, the equation is describing widespread behavior, not simply that of a single large institution or of particular types of institutions, and variation in lending standards does not appear to explain the results.

An Alternative Approach

Estimating an equation that includes an explicit measure for race is not the only way to test whether race is an important factor in the mortgage lending decision. An equally good alternative is to estimate an equation for white applicants and then plug in the obligation ratios, loan-to-value ratio, credit history, and other values for each black/Hispanic applicant to calculate that applicant's probability of denial. The resulting discrepancy between the actual minority denial rate and the estimated minority denial rate based on the white equation can be interpreted as the effect of race on the mortgage lending decision.

The equations estimated separately for white and black/Hispanic applicants are reported in Appendix Table B13 and the results of estimating the probability of denial based on the white equation are shown in Table 8. If blacks/Hispanics had their own characteristics, that is, high obligation ratios, weaker credit histories, higher loan-to-value ratios, and less likely to buy a single-family home, but were treated by lenders like whites, their average denial rate would be 20.2 percent rather than the actual 28.1 percent experienced by minority applicants. In other words, economic, property and neighborhood characteristics explain much of the higher minority denial rate, but 7.9 percentage points remain unexplained.

Table 8
Probability of Black/Hispanic Denials Based on White Experience

Characteristics and Experience	Denial Rates (percent)
Actual Denial Rate for Blacks/Hispanics in Sample	28.1
Denial Rate for Blacks/Hispanics with Black/Hispanic Characteristics but White Experience	20.2
Denial Rate for Blacks/Hispanics with White Characteristics but Black/Hispanic Experience	18.2
Actual Denial Rate for Whites in Sample	10.3
Addendum: Ratios of Black/Hispanic to White Denial Rates	
Actual (28.1/10.3)	2.7
Based on Black/Hispanic Characteristics (28.1/20.2)	1.4
Based on White Characteristics (18.2/10.3)	1.8

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If the 7.9 percentage point discrepancy is attributed to the effect of race on the lending decision, this amount can be added to the white denial rate to estimate the racial impact starting from the white base. That is, the third line in Table 8 shows what the denial rate would have been for black and Hispanic applicants if they had white obligation ratios, loan-to-value ratios, credit histories, and other characteristics but were treated by lenders like minorities. Thus, even if minorities had all the economic and property characteristics of whites, they would have experienced a denial rate of 18.2 percent, 7.9 percentage points more than the actual white denial rate of 10.3.

Some ambiguity arises when these various denial rates are used to characterize the ratio of minority to white denial rates. If the ratio is calculated using black/Hispanic characteristics, the ratio is 1.4 to 1; if white characteristics are used, the ratio is 1.8 to 1. The 1.8 to 1 ratio is the appropriate comparison with the 2.7 to 1 ratio of unadjusted denial rates, since both use the white experience as the base.

The important point, however, is that the ratios bracket the 56 percent increase in the probability of denial for minority applicants reported in Table 5. This confirmation of the earlier results lends additional support to their credibility.

VI. Conclusions

This study has examined one avenue through which differential treatment could affect minorities' access to credit and opportunities for home ownership. It found that black and Hispanic mortgage applicants in the Boston area were more likely to be turned down than white applicants with similar characteristics.

It is important to clarify the limited focus of this analysis; it abstracts from discrimination that may occur elsewhere in the economy. For example, if minorities are subject to discrimination in education or labor markets, they will have lower incomes and their applications may reflect higher obligation ratios, greater loan-to-value, or poorer credit history. Similarly, if blacks and Hispanics are discouraged from moving into predominantly white areas, they will limit their search to neighborhoods sanctioned for minorities. These tend to be older central cities with high—density housing, such as two- to four-family homes. Denial of a mortgage loan application on the basis of either these economic or property characteristics would not be considered discriminatory for the purposes of this study.

Even within the specific focus of conventional lenders, the reported measure of the hurdles faced by minorities should be placed in perspective; differential treatment can occur at many stages in the lending process. For example, minorities may be discouraged from even applying for a mortgage loan as a result of a prescreening process. Similarly, if white applicants are more likely than minority applicants to be "coached" when filling out the application, they will have stronger applications than similarly situated minorities. In this case, the ratios and other financial information in the *final* application, which were the focus of this analysis, may themselves be the product of differential treatment. This study does not explore the extent to which coaching occurs, but rather focuses on the impact of race on lenders' decisions regarding the final applications received from potential borrowers.

The results of this study indicate that race does play a role as lenders consider whether to deny or approve a mortgage loan application. The impact of race is substantially less than indicated by the original 1990 HMDA data, which showed that black and Hispanic applicants for mortgages in the Boston metropolitan area in 1990 were turned down at a rate 2.7 times that for white applicants. As it turns out, the higher denial rate for minorities in Boston is accounted for, in large part, by their having higher loan-to-value ratios and weaker credit histories than whites. They are also more likely to be trying to purchase a two- to four-unit property rather than a single-family home. Nevertheless, after taking account of such factors, a substantial gap remains.

A black or Hispanic applicant in the Boston area is roughly 60 percent more likely to be denied a mortgage loan than a similarly situated white applicant. This means that 17 percent of black or Hispanic applicants instead of 11 percent would be denied loans, even if they had the same obligation ratios, credit history, loan to value, and property characteristics as white applicants. In short, the results indicate that a serious problem exists in the market for mortgage loans, and lenders, community groups, and regulators must work together to ensure that minorities are treated fairly.

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APPENDIX A

Attachment 1

FEDERAL RESERVE SYSTEM—FOLLOW-UP TO 1990 HOME MORTGAGE DISCLOSURE ACT (HMDA) REPORTS

INSTRUCTIONS FOR COMPLETING LOAN/APPLICATION REGISTER (LAR)

Our records indicate that your institution listed (XX) applications from blacks and Hispanics in your 1990 HMDA Report; all of their identification numbers and basic HMDA information are reproduced in Attachment 4, the Loan/Application Register. As a control group, we have randomly selected (XX) white applicants; the information for the white applicants also appears in the Register. Although this information is taken directly from your submissions, it would be useful for you to check it for accuracy.

In addition, please review "Reasons for Denial" (column 19), and if you have not already included the reasons, please enter that information at this time. The reasons should conform to Attachment 2, Regulation B, Form C–1 "Sample Notice of Action Taken and Statement of Reasons" (Adverse Action Notice). The reasons (up to three) should be entered on the Register, from left to right in the space provided.

Thirty-eight questions, listed below, have been added to the Register. All requested information should be provided from the loan documentation as of *the date of decision* for the loan. Please enter the requested data for each of the (XXX) applicants on the expanded Register. If any of the requested information was not collected, put "X" in the column.

A. Data from Residential Loan Application (Fannie Mae Form 1003), see sample on Attachment 3. Note: Information for loan applications which were approved should come from the standard loan application. Some of the requested information for denials may have to be obtained from other documentation in the loan folder.

Column 20: Number of units in property purchased; 21: Applicant age—(A) Applicant. (C) Co-applicant. 22: Years of school—(A) Applicant. (C) Co-applicant. 23: Marital status (use codes below)—(A) Applicant. (C) Co-applicant. Codes: (M) Married. (U) Unmarried (includes single, divorced and widowed). (S) Separated. 24: Number of dependents—(A) Applicant. (C) Co-applicant. 25: Years employed in this line of work (NE if not employed)—(A) Applicant. (C) Co-applicant. 26: Years employed on this job (NE if not employed)—(A) Applicant. (C) Co-applicant. 27: Self-employed (Y or N)—(A) Applicant. (C) Co-applicant. 28: Position/title (NE if not employed)—(A) Applicant. (C) Co-applicant. 29: Type of business (NE if not employed)—(A) Applicant. (C) Co-applicant. 30: Base employment monthly income (in dollars)—(A) Applicant. (C) Co-applicant. 31: Total monthly income (in dollars)—(A) Applicant. (C) Co-Applicant. 32: Proposed monthly housing expense (in dollars). 33: Purchase price (in thousands). 34: Other financing (in thousands).

For the next four columns, sum applicant and co-applicant information if separate statements were completed.

Column 35: Liquid assets (in thousands). 36: Total assets (in thousands). 37: Total nonhousing monthly payments (in dollars). 38: Total liabilities (in thousands).

B. Data Relating to Credit History

Column 39: List the number of commercial credit reports in the file. 40: Did the applicants' credit history meet your loan policy guidelines for approval? (Y or N). 41: List the number of separate consumer credit lines on the credit report. 42: Credit history—Mortgage payments (see instructions, next page). 43: Credit history—Consumer payments (see instructions, next page). 44: Credit history—Public records (see instructions, next page).

C. Obligation Ratios (from lender worksheets)

Column 45: Debt-to-income ratio (housing expense/income). 46: Debt-to-income ratio (total obligations/income).

D. Loan Characteristics

Column 47: Fixed or adjustable rate (F or A). 48: Term of loan (months). 49: If the loan application was for a special (e.g. low income) loan program, please provide the name of the program. 50: Appraised value (in thousands). 51: Type of Property Purchased—Codes: (1) Condominium; (2) Single family; (3) 2-4 family. 52: Was private mortgage insurance sought? (Y or N). 53: Was private mortgage insurance approved? (Y or N). 54: Did a gift or a grant account for any part of the down payment? (Y or N; answer N if not known). 55: Did someone, other than the co-applicant, co-sign this application? (Y or N).

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E. Unverifiable Information

Column 56: Type of information on the application which could not be verified—(0) Not applicable (all verifiable); (1) Credit references; (2) Employment; (3) Income; (4) Residence; (5) Other.

F. Underwriting Information

Column 57: List total number of times application was reviewed by the underwriter before the final loan decision was made.

INSTRUCTIONS FOR COMPLETING COLUMNS #42–44

Enter the number that best describes the credit history (from the commercial credit report) of the applicant(s). Note that these columns should be completed *regardless* of the loan disposition or your answer to #40.

CREDIT HISTORY CODES—Mortgage Payments (Column 42):

0—no mortgage payment history.
1—no late mortgage payments.
2—one or two late mortgage payments.
3—more than two late mortgage payments.

CREDIT HISTORY CODES—Consumer Payments (Column 43): Note: Consider consumer payment history for previous two years only.

0—Insufficient credit history or references for determination.
1—no "slow pay" or delinquent accounts, but sufficient references for determination.
2—one or two "slow pay" account(s) (each with one or two payments 30 days past due).
3—more than two "slow pay" accounts (each with one or two payments 30 days past due); or one or two chronic "slow pay" account(s) (with three or more payments 30 days past due in any 12-month period).
4—delinquent credit history (containing account(s) with a history of payments 60 days past due).
5—serious delinquencies (containing account(s) with a history of payments 90 days past due).

CREDIT HISTORY CODES—Public Records (Column 44):

0—no public record defaults.
1—bankruptcy.
2—bankruptcy *and* charge-offs.
3—one or two charge-off(s), public record(s), or collection action(s), totalling less than $300.
4—charge-off(s), public record(s), or collection action(s) totalling more than $300.
5—information not considered.

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Appendix Table A
Values of Variables Collected on Follow-Up Survey, Boston MSA

Loan Application Register No.	Characteristic	Approved and Denied Applicants: White	Black/Hispanic
20	Median number of units in property purchased	1	1
21	Median age of applicant	34	36
	co-applicant	29	28
22	Median years of school of applicant	16	16
	co-applicant	12	12
23	Percent of applicants married	61.9	54.1
	co-applicants	82.2	72.3
24	Median number of dependents of applicant	0	1
25	Median number of years in line of work: applicant	9	7
	co-applicant	6	5
26	Median number of years on current job: applicant	4	4
	co-applicant	3	3
27	Percent of applicants self-employed	13.1	7.6
	co-applicants	5.8	1.8
28	Position/title	n.a.	n.a.
29	Type of business	n.a.	n.a.
30	Median base monthly income of applicant ($)	3,250	2,400
	co-applicant ($)	754	1,123
31	Median total monthly income of applicant ($)	3,658	2,725
	co-applicant ($)	910	1,176
32	Median proposed monthly housing expense ($)	1,300	1,154
33	Median purchase price ($)	160,000	139,000
34	Percent with other financing	3.5	8.2
35	Median value liquid assets ($)	37,000	18,000
36	Median value total assets ($)	121,000	48,000
37	Median total nonhousing monthly payments ($)	300	292
38	Median value total liabilities($)	14,000	8,000
39	Median number of commercial credit reports on file	1	1
40	Percent meeting credit history guideline for approval	98.6	76.5
41	Median number of credit lines on report	12	9
42	Percent with more than two late mortgage payments	1.0	.8
43	Percent with delinquent consumer credit accounts	16.0	26.8
44	Percent with some public record defaults	6.2	15.3
45	Median obligation ratio (housing expense/income)	26.0	27.0
46	Median total obligation ratio (total obligations/income)	33.1	35.0
47	Percent of loans with fixed rates	67.9	63.2
48	Percent of loans with 30-year terms	85.0	90.7
49	Percent of loans in special loan programs	13.0	40.5
50	Median appraised value of property ($)	165,000	142,000
51	Type of property		
	Percent single-family	68.1	39.1
	Percent condominium	23.0	33.3
	Percent 2-4 family	8.9	27.6
52	Percent seeking private mortgage insurance	20.7	36.8
53	Percent approved for private mortgage insurance	19.0	30.0
54	Percent with a gift or grant account used as part of the down payment	16.8	10.4
55	Percent with co-signer on application	3.4	4.0
56	Percent with unverifiable information	4.9	11.0
57	Percent reviewed more than once by underwriter	*	*

n.a. = not applicable
*Number of responses was too small to be meaningful
Note: Percentage base for each item does not include applicants for whom information was missing.

APPENDIX B

ALTERNATIVE SPECIFICATIONS OF THE PROBABILITY OF DENIAL OF THE MORTGAGE APPLICATION

Alternative specifications of the probability that a mortgage application will be denied are presented in this appendix. The additional variables are based on the model of mortgage lending outlined in the text and the suggestions of experienced researchers in this field. The primary conclusion is that the equation whose results are shown in Table 5 of the text is very robust. Adding more variables has little effect on the coefficients of most of the "basic" variables listed in Table 5. Of particular importance to the conclusions drawn from this analysis, race continues to have a statistically significant effect on the probability of being denied a mortgage after the additional variables have been taken into account.

Ability to Support Loan

Table B1 compares the basic equation from Table 5 with an equation incorporating additional measures of the applicant's ability to support the loan. As can be seen, the coefficients of most of the basic variables are affected only modestly by the addition of income, liquid assets, and the ratio of base income to total income. The coefficient for race remains almost the same. In both this equation and those that follow, changes in sample size may account for some of the changes in coefficients.

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None of the additional variables has a statistically significant influence on the probability of being denied a mortgage. As noted in the text, people with lower incomes tend to buy lower-priced homes and, thus, the obligation ratio is a better indicator of the financial constraints on the borrower. It is more surprising that liquid assets do not reduce the probability of denial, especially as liquid assets are cited in Fannie-Mae's secondary market guidelines as a factor that can compensate for other weaknesses in the application.

Risk of Default

Credit History. Two alternative characterizations of the mortgage history and consumer credit history variables are presented in Table B2. In the equation in Table 5, the progression of credit problems is pre-specified as described in the table notes. In Table B2 a dummy variable represents each credit history code and the regression is allowed to determine the weights attached to each code. The base for both mortgage and consumer credit history is no late payments; thus, the dummy variables measure the increase in the probability of denial from.this standard. As can be seen, the regression produces a ranking very similar to that specified in the credit variables in Table 5; a log likelihood test indicates that one cannot reject the hypothesis that the coefficients of the credit variables are the same as assumed in the specification in Table 5. Perhaps the most interesting result from the finer breakdown is confirmation that borrowers with insufficient consumer credit history to make a determination of their payment record face a higher probability of being denied a mortgage than borrowers with some late payments. The finer breakdown of credit history does not alter the coefficients of the other variables, including race.

The third equation appearing in Table B2 adds a dummy variable for those applicants with a prior mortgage payment history to the basic equation. The reasoning was that borrowers who already owned a home might be more likely to have their applications approved; however, the variable provides no additional information beyond that contained in Table 5.

Seniority and Co-signer. In Table B3 the applicant's years on the job and the presence of a co-signer are added to the basic equation. While frequent job changes could be a sign of upward mobility, they may also indicate a higher risk of unemployment. The applicant may be unable to hold a position or may be limited to jobe where the last hired is the first fired. Fannie Mae guidelines require additional documentation for applicants who have been at their current job less than two years. The presence of a co-signer reduces the risk of default, since the co-signer's financial strength as well as the applicant's stands behind the loan.

Although the signs are as expected, the additional variables do not have a statistically significant effect on the probability of a mortgage application being denied and the coefficients of most of the basic variables do not change very much. Again, the race coefficient remains large and statistically significant. Replacing years on the job with a dummy variable indicating the applicant had more than two years on the job produced similar results.

Potential Default Loss

Private Mortgage Insurance. As discussed in the text, the appropriate treatment of private mortgage insurance is unclear. If race enters into the insurance decision, the inclusion of a variable representing the denial of insurance will understate the difficulties that minorities face in securing mortgages, since the effect of race on the ability to get insurance and, therefore, to get a mortgage would be subsumed in the mortgage insurance variable. Accordingly, Table B4 shows the effect of omitting this variable. Also shown is an equation in which all mortgage applicants who were denied mortgage insurance are omitted from the sample. In both cases, the coefficients for the other variables, including race, are similar to those in Table 5. These results suggest that the probability of denial facing minority applicants is not substantially understated by including the mortgage insurance variable in the basic equation.

Table B5 presents two equations that relate the denial of private mortgage insurance to the economic characteristics gathered for this study. Controlling for the characteristics in the basic equation, minority applicants are more likely to be denied private mortgage insurance than white applicants. Adding a variable for the racial composition of the census tract in which the property is located, however, causes the racial coefficient to become statistically insignificant. These equations must be viewed with caution, since the number of observations is much smaller than in the other equations and since the variables collected for this study were not gathered for this purpose.

Location. Table B6 adds to the equation in Table 5 several indicators of the risks of loss arising from the property's location. In the basic equation, the riskiness of the neighborhood is represented by the ratio of rental income to the value of the

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rental housing stock in the relevant census tract. While this measure is justified by theory and the results in Table 5 are as predicted, lenders may rely on, other indicators of neighborhood risk, such as vacancy rates or the appreciation in housing prices in the tract. A dummy variable indicating that minorities comprise more than 30 percent of the tract population is also included. Although the racial composition of the neighborhood is not an appropriate criterion for lending decisions, it was routinely considered in appraisals and lending policies until the 1970's.

As can be seen, adding these variables does not alter the basic equation appreciably. In particular, the coefficient for race remains significant after taking account of the racial composition of the neighborhood. Although blacks and Hispanics in the Boston area tend to live in minority neighborhoods, they are not being denied mortgages solely because of where they live. Blacks and Hispanics seeking to buy homes in predominantly white areas also face a higher risk of being denied mortgages than comparably situated whites.

Foreclosures. Some researchers have suggested the foreclosure rate as a measure of neighborhood risk. This has considerable intuitive appeal, since the lender's objective is to minimize the probability and costs of foreclosure. The direction of causality is ambiguous, however. A high foreclosure rate could be the result of lenders' reluctance to make loans in a neighborhood as well as a cause of such reluctance. Homeowners who fall behind in their mortgage payments will not be able to get out from under their troubles by selling their properties if prospective buyers cannot get loans.

Foreclosures were very infrequent in the Boston area until 1990 and, thus, lenders making decisions in 1990 did not have much foreclosure history to guide them. Since foreclosure is a lengthy process, however, lenders might have had some knowledge of foreclosures that were in the works. If so, it did not affect their decision making. As can be seen from Table B7, the effect of the tract foreclosure rate on the probability of being denied a mortgage was insignificant.

Table B8 shows the pattern of foreclosures in the planning districts of the City of Boston along with the racial composition of the districts. The districts with the very highest foreclosure rates were predominantly white. Foreclosure rates in predominantly minority areas ranged from high (Mattapan) to quite low (South End).

Tract Dummy Variables. As a final test of whether the coefficient on race might be representing lenders' concerns about the location of the property, a dummy variable was used to represent each of the more than 500 census tracts in which applicants were attempting to purchase homes. This is a crude approach. It provides no indication of why lenders might deny mortgages in a particular area, and if minorities tend to be concentrated in particular neighborhoods it risks attributing rejections that are influenced by the applicant's race to location. Nevertheless, as can be seen from Table B9, the inclusion of dummy variables for each census tract actually increased the coefficient for the race variable.

Loan Characteristics

Table B10 adds more loan characteristics to the basic equation. As before, these do not change the coefficients for the basic variables. Whether the rate was fixed or variable had no effect on the probability of denial. The effect of longer loan terms also was not statistically significant. The presence of a gift or grant reduced the probability that the loan would be denied, and the effect approached statistical significance.

Gifts are intended to give the borrower sufficient funds for the down payment. Since the loan-to-value ratio has already been included in the equation, it is not obvious why a gift would increase the likelihood of approval. Perhaps it implies access to the resources of a parent or some other source of financial strength.

Applications that were not made under special programs were denied more frequently, but the effect was not statistically significant. Many of these special programs are offered by the Massachusetts Housing Finance Agency. These are intended to encourage lending to lower-income and minority borrowers and to first-time home buyers. Another large group consisted of First-Time Homebuyer programs offered by various banks.

Personal Characteristics

Additional personal characteristics do not alter the basic results (Table B11). The age, sex, and number of dependents of the applicant have no significant effect on the probability of denial. The variable representing marital status approached statistical significance, with applicants who were not married facing a higher probability of being denied a mortgage, other things equal.

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Lender Standards

The equations in Table B12 attempt to take account of differential lender standards. It has been suggested that black and Hispanic applicants go disproportionately to institutions that have higher than average credit standards and, therefore, higher denial rates for both whites and minorities. This is a controversial hypothesis, since it implies that minority mortgage applicants act against their own best interest; alternatively, the institutions with higher denial rates may be more aggressive in soliciting minority applications.

A "tough" lender variable was constructed by estimating the basic equation with a dummy variable for each lender over the sample of white applicants only. The coefficients of these dummies were then used to create a dummy variable indicating that the lender had "tough" standards and the equation was estimated over the entire sample of applicants. As can be seen from Table B12, the "tough" lender variable is not statistically significant and does not alter the results. The inclusion of separate dummy variables for each lender when the equation is estimated over the entire sample does reduce the coefficient of the race variable; but it remains large and statistically significant.

Separate Equations for White and Minority Applicants

An implicit assumption underlying the equation in Table 5 is that lenders treat white and minority applicants the same except for their race. In other words, lenders accord the same weights to credit history, obligation ratios, location risk, and all the other characteristics of white and minority applicants. An alternative possibility is that lenders assess the creditworthiness of minorities quite differently than they do that of whites, so credit history or obligation ratios are viewed differently if the applicant—is black or Hispanic.

To test this possibility, the basic equation from Table 5 was run with and without the race variable and separately for white applicants and for black and Hispanic applicants. The four equations are shown in Table B13. Comparing the residuals of the white and minority equations with those of the equation excluding the race variable produces a chi-squared of 37.2 compared to a critical value of 23.7. This result implies that lenders do not treat whites and minorities the same, but does not indicate whether the source of the difference lies in the constant or in the coefficients of the other independent variables. The race variable in the basic equation allows the constant to differ for minority and white applicants. When the separate white and minority equations are compared with the basic equation, the chi-squared is 12.8 compared to a critical value of 22.7. Thus, the hypothesis that lenders treat blacks and whites the same, except for race, cannot be rejected.

Correlation Matrix

Table B14 presents a matrix showing the correlations among the variables used in the basic equation. As can be seen, multicollinearity between any two independent variables is not driving the results, because no two variables are strongly correlated.

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Appendix Table B1
Alternative Specifications of Probability of Mortgage Denial
Ability to Support Loan

Variable[a]	Basic Equation Coefficient (t-Statistic)	Coefficient (t-Statistic)
Constant	-6.61	-6.17
	(-17.0)	(-13.0)
Ability to Support Loan		
Housing Expense/Income	.47	.47
	(3.1)	(3.1)
Total Debt Payments/Income	.06	.06
	(6.6)	(6.2)
Net Wealth	.00008	-.000005
	(1.1)	(-.03)
Income		.000013
		(.8)
Liquid Assets		.0002
		(.7)
Base Income/Total Income		-.33
		(-1.7)
Risk of Default		
Consumer Credit History	.33	.33
	(9.8)	(9.8)
Mortgage Credit History	.35	.33
	(3.0)	(2.8)
Public Record History	1.28	1.28
	(7.0)	(7.0)
Probability of Unemployment	.09	.09
	(3.3)	(3.4)
Self-Employed	.52	.56
	(2.8)	(3.0)
Potential Default Loss		
Loan/Appraised Value	.58	.60
	(3.2)	(3.2)
Denied Private Mortgage Insurance	4.70	4.73
	(9.6)	(9.6)
Rent/Value in Tract	.68	.67
	(3.5)	(3.5)
Loan Characteristics		
Two- to Four-Family Home	.58	.57
	(3.6)	(3.4)
Personal Characteristics		
Race	.68	.70
	(5.0)	(5.1)
Number of Observations	3042	3030
Percent Correct Predictions[b]	89	89

[a] See notes to Appendix Tables following Appendix Table B14, for variable definitions and sources.
[b] The number of applicants with a probability of denial greater than 50 percent who were denied, plus the number of applicants with a probability of approval greater than 50 percent who were approved, as a percent of the total sample.

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Appendix Table B2
Alternative Specifications of Probability of Mortgage Denial
Risk of Default - Credit History

Variable	Basic Equation Coefficient (t-Statistic)	Coefficient (t-Statistic)	Coefficient (t-Statistic)
Constant	-6.61 (-17.0)	-6.04 (-17.1)	-6.68 (-16.4)
Ability to Support Loan			
Housing Expense/Income	.47 (3.1)	.46 (3.0)	.48 (3.2)
Total Debt Payments/Income	.04 (6.6)	.05 (6.7)	.04 (6.5)
Net Wealth	.00008 (1.1)	.00007 (1.0)	.00007 (1.0)
Risk of Default			
Consumer Credit History	.33 (9.8)		.33 (9.8)
Mortgage Credit History	.35 (3.0)		.38 (3.0)
Public Record History	1.20 (7.0)	1.22 (7.1)	1.20 (7.0)
Consumer: Insufficient History		1.55 (5.8)	
Consumer: One or Two Slow Accounts		.62 (3.4)	
Consumer: More than Two Slow Accounts		.94 (3.9)	
Consumer: Delinquencies		1.32 (6.6)	
Consumer: Serious Delinquencies		1.65 (8.5)	
Mortgage: No History		.30 (1.8)	
Mortgage: One or Two Late		.73 (1.9)	
Mortgage: More than Two Late		1.12 (2.4)	
Mortgage: Prior History			.09 (.5)
Probability of Unemployment	.09 (3.3)	.09 (3.2)	.09 (3.3)
Self-Employed	.52 (2.8)	.51 (2.7)	.51 (2.7)
Potential Default Loss			
Loan/Appraised Value	.58 (3.2)	.60 (3.2)	.58 (3.2)
Denied Private Mortgage Insurance	4.70 (9.6)	4.73 (9.6)	4.70 (9.6)
Rent/Value in Tract	.68 (3.5)	.64 (3.2)	.68 (3.5)
Loan Characteristics			
Two-to-Four-Family Home	.58 (3.6)	.58 (3.6)	.58 (3.6)
Personal Characteristics			
Race	.68 (5.0)	.67 (4.8)	.69 (5.0)
Number of Observations	3062	3062	3062
Percent Correct Predictions	89	89	89

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Appendix Table 83
Alternative Specifications of Probability of Mortgage Denial
Risk of Default - Years on Job; Co-signer

Variable	Basic Equation Coefficient (t-Statistic)	Coefficient (t-Statistic)
Constant	-6.61 (-17.0)	-6.62 (-16.3)
Ability to Support Loan		
Housing Expense/Income	.47 (3.1)	.44 (2.9)
Total Debt Payments/Income	.04 (6.6)	.05 (6.4)
Net Wealth	.00008 (1.1)	.0001 (1.3)
Risk of Default		
Consumer Credit History	.33 (9.8)	.33 (9.9)
Mortgage Credit History	.35 (3.0)	.31 (2.6)
Public Record History	1.20 (7.0)	1.23 (7.1)
Probability of Unemployment	.09 (3.3)	.09 (3.4)
Self-Employed	.52 (2.8)	.55 (3.0)
Years on Job		-.003 (-.3)
Presence of Co-signer		-.55 (-1.5)
Potential Default Loss		
Loan/Appraised Value	.58 (3.2)	.59 (3.2)
Denied Private Mortgage Insurance	4.70 (9.6)	4.73 (9.6)
Rent/Value in Tract	.68 (3.5)	.74 (3.7)
Loan Characteristics		
Two-to-Four-Family Home	.58 (3.6)	.60 (3.6)
Personal Characteristics		
Race	.68 (5.0)	.71 (5.1)
Number of Observations	3062	2997
Percent Correct Predictions	89	89

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Appendix Table B4
Alternative Specifications of Probability of Mortgage Denial
Default Loss - Private Mortgage Insurance

Variable	Basic Equation Coefficient (t-Statistic)	Coefficient (t-Statistic)	Excluding PMI Denials* Coefficient (t-Statistic)
Constant	-6.61 (-17.0)	-6.57 (-17.4)	-6.61 (-16.9)
Ability to Support Loan			
Housing Expense/Income	.47 (3.1)	.44 (3.2)	.48 (3.2)
Total Debt Payments/Income	.04 (6.6)	.05 (7.1)	.04 (6.5)
Net Wealth	.00008 (1.1)	.00005 (.7)	.00008 (1.1)
Risk of Default			
Consumer Credit History	.33 (9.8)	.31 (9.8)	.33 (9.9)
Mortgage Credit History	.35 (3.0)	.35 (3.1)	.34 (2.9)
Public Record History	1.20 (7.0)	1.17 (7.1)	1.19 (7.0)
Probability of Unemployment	.09 (3.3)	.09 (3.5)	.09 (3.2)
Self-Employed	.52 (2.8)	.44 (2.5)	.51 (2.7)
Potential Default Loss			
Loan/Appraised Value	.58 (3.2)	.75 (3.4)	.62 (3.2)
Denied Private Mortgage Insurance	4.70 (9.6)		
Rent/Value in Tract	.68 (3.5)	.60 (3.1)	.68 (3.5)
Loan Characteristics			
Two-to-Four-Family Home	.58 (3.6)	.64 (4.2)	.59 (3.6)
Personal Characteristics			
Race	.68 (5.0)	.71 (5.5)	.69 (5.0)
Number of Observations	3062	3062	2983
Percent Correct Predictions	89	88	89

*Sample excludes applicants denied private mortgage insurance.

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Appendix Table 85
Factors Affecting Probability of Private Mortgage Insurance Denial

Variable	Coefficient (t-Statistic)	Coefficient (t-Statistic)
Constant	-7.31 (-5.6)	-7.30 (-5.6)
<u>Ability to Support Loan</u>		
Housing Expense/Income	.44 (1.3)	.43 (1.3)
Total Debt Payments/Income	.07 (4.0)	.07 (3.8)
Net Wealth	-.0004 (-.7)	-.0004 (-.7)
<u>Risk of Default</u>		
Consumer Credit History	.20 (2.7)	.20 (2.7)
Mortgage Credit History	-.08 (-.2)	-.13 (-.3)
Public Record History	1.02 (2.5)	1.02 (2.5)
Probability of Unemployment	.07 (1.0)	.06 (1.0)
Self-Employed	.63 (1.1)	.64 (1.1)
<u>Potential Default Loss</u>		
Loan/Appraised Value	1.53 (1.9)	1.72 (2.1)
Rent/Value in Tract	-1.13 (-.8)	-1.78 (-1.0)
Minority Population Share		.55 (1.4)
<u>Loan Characteristics</u>		
Two-to-Four-Family Home	.55 (1.7)	.52 (1.6)
<u>Personal Characteristics</u>		
Race	.59 (2.0)	.34 (1.0)
Number of Observations	723	723
Percent Correct Predictions	90	90

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Appendix Table B6
Alternative Specifications of Probability of Mortgage Denial
Potential Default Loss - Tract Characteristics

Variable	Basic Equation Coefficient (t-Statistic)	Coefficient (t-Statistic)
Constant	-6.61	-6.92
	(-17.0)	(-15.9)
Ability to Support Loan		
Housing Expense/Income	.47	.47
	(3.1)	(3.0)
Total Debt Payments/Income	.04	.05
	(6.6)	(6.6)
Net Wealth	.00008	.00008
	(1.1)	(1.1)
Risk of Default		
Consumer Credit History	.33	.34
	(9.8)	(9.7)
Mortgage Credit History	.35	.34
	(3.0)	(2.7)
Public Record History	1.20	1.19
	(7.0)	(6.7)
Probability of Unemployment	.09	.10
	(3.3)	(3.4)
Self-Employed	.52	.58
	(2.8)	(3.1)
Potential Default Loss		
Loan/Appraised Value	.58	.59
	(3.2)	(3.1)
Denied Private Mortgage Insurance	4.70	4.64
	(9.6)	(9.3)
Rent/Value in Tract	.68	.66
	(3.5)	(3.1)
Housing Units Boarded Up		-.02
		(-1.2)
Housing Units Vacant		-.004
		(-.3)
Housing Value Appreciation		.0009
		(1.6)
Minority Population Share (>30 Percent)		.08
		(.3)
Loan Characteristics		
Two-to-Four-Family Home	.58	.63
	(3.6)	(3.7)
Personal Characteristics		
Race	.68	.62
	(5.0)	(3.9)
Number of Observations	3062	2788
Percent Correct Predictions	89	89

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Appendix Table B7
Alternative Specifications of Probability of Mortgage Denial
Potential Default Loss - Foreclosure Rate

Variable	Basic Equation Coefficient (t-Statistic)	Coefficient (t-Statistic)
Constant	-6.61 (-17.0)	-6.64 (17.1)
<u>Ability to Support Loan</u>		
Housing Expense/Income	.47 (2.8)	.47 (3.1)
Total Debt Payments/Income	.06 (6.6)	.06 (6.6)
Net Wealth	.00008 (1.1)	.00008 (1.1)
<u>Risk of Default</u>		
Consumer Credit History	.33 (9.8)	.33 (9.8)
Mortgage Credit History	.35 (3.8)	.35 (3.0)
Public Record History	1.20 (7.0)	1.22 (7.1)
Probability of Unemployment	.09 (3.3)	.09 (3.3)
Self-Employed	.52 (2.8)	.53 (2.9)
<u>Potential Default Loss</u>		
Loan/Appraised Value	.58 (3.2)	.58 (3.2)
Denied Private Mortgage Insurance	4.70 (9.6)	4.70 (9.6)
Rent/Value in Tract	.68 (3.5)	.61 (3.1)
Foreclosures/Owner-occupied Units		0.41 (1.4)
<u>Loan Characteristics</u>		
Two-to-Four-Family Home	.58 (3.6)	.55 (3.3)
<u>Personal Characteristics</u>		
Race	.68 (5.0)	.67 (4.9)
Number of Observations	3062	3062
Percent Correct Predictions	89	89

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Appendix Table 8B
Foreclosure[a] Rates and Racial Composition of City of Boston Planning Districts
Percent

Planning District	Foreclosures[a] as a Percent of Owner-Occupied Units	Total Foreclosures as a Percent of Total Housing Units	Percent Black and Hispanic in Population
East Boston	.37	.40	18.9
South Boston	.34	.37	1.9
Mattapan	.33	.37	94.5
Charlestown	.32	.35	2.1
Fenway/Kenmore	.26	.32	17.6
South Dorchester	.18	.23	46.7
North Dorchester	.18	.16	36.8
Allston/Brighton	.18	.18	15.5
Jamaica Plain	.17	.18	43.2
Roxbury	.16	.23	90.2
Back Bay/Beacon Hill	.14	.29	5.5
West Roxbury	.14	.15	3.2
South End	.13	.17	52.3
Central	.12	.13	7.0
Hyde Park	.07	.08	27.1
Roslindale	.05	.05	18.1
City of Boston	.27	.22	34.3

[a]Foreclosures are for the years 1988 through 1990.

[b]All sellers are persons; commercial entities are excluded.

Source: Foreclosures were supplied by Banker & Tradesman; housing units are from 1990 Census of Population and Housing.

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Appendix Table 69
Alternative Specifications of Probability of Mortgage Denial
Potential Default Loss - Tract Dummy Variables

Variable	Basic Equation Coefficient (t-Statistic)	Coefficient (t-Statistic)
Constant	-6.61	*
	(-17.0)	
Ability to Support Loan		
Housing Expense/Income	.47	.63
	(3.1)	(3.3)
Total Debt Payments/Income	.06	.06
	(6.6)	(6.4)
Net Wealth	.00008	.00005
	(1.1)	(.6)
Risk of Default		
Consumer Credit History	.33	.47
	(9.8)	(8.3)
Mortgage Credit History	.35	.57
	(3.0)	(2.1)
Public Record History	1.20′	1.69
	(7.0)	(7.0)
Probability of Unemployment	.09	.13
	(3.3)	(3.6)
Self-Employed	.52	.46
	(2.8)	(1.9)
Potential Default Loss		
Loan/Appraised Value	.58	.81
	(3.2)	(2.5)
Denied Private Mortgage Insurance	4.70*	5.68
	(9.6)	(8.9)
Rent/Value in Tract	.68	-829.7
	(3.5)	(-13.9)
Census Tract		*
Loan Characteristics		
Two-to-Four-Family Home	.58	.54
	(3.6)	(2.6)
Personal Characteristics		
Race	.68	.93
	(5.0)	(4.1)
Number of Observations	3062	3062
Percent Correct Predictions	89	n.a.*

* Constant is included in the dummy variables for the census tracts. These are not shown because they are so numerous.
*The large number of variables in this equation required a more powerful computer and the regression package available did not calculate percent correct predictions.

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Appendix Table 810
Alternative Specifications of Probability of Mortgage Denial
Loan Characteristics

Variable	Basic Equation Coefficient (t-Statistic)	Coefficient (t-Statistic)
Constant	-6.61 (-17.0)	-6.57 (-11.8)
Ability to Support Loan		
Housing Expense/Income	.47 (3.1)	.49 (3.2)
Total Debt Payments/Income	.04 (6.6)	.05 (6.7)
Net Wealth	.00008 (1.1)	.00007 (1.0)
Risk of Default		
Consumer Credit History	.33 (9.8)	.33 (9.8)
Mortgage Credit History	.35 (3.0)	.38 (3.2)
Public Record History	1.20 (7.0)	1.20 (6.9)
Probability of Unemployment	.09 (3.3)	.08 (3.0)
Self-Employed	.52 (2.8)	.53 (2.8)
Potential Default Loss		
Loan/Appraised Value	.58 (3.2)	.62 (3.4)
Denied Private Mortgage Insurance	4.70 (9.6)	4.81 (9.7)
Rent/Value in Tract	.68 (3.5)	.70 (3.6)
Loan Characteristics		
Two-to-Four-Family Home	.58 (3.6)	.61 (3.7)
Fixed-Rate Loan		-.13 (-1.0)
Not a Special Loan Program		.23 (1.4)
Term of Loan		-.0009 (-.8)
Gift or Grant in Down Payment		-.32 (-1.9)
Personal Characteristics		
Race	.68 (5.0)	.73 (5.2)
Number of Observations	3062	3055
Percent Correct Predictions	89	90

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Appendix Table 811
Alternative Specifications of Probability of Mortgage Denial
Personal Characteristics

Variable	Basic Equation Coefficient (t-Statistic)	Coefficient (t-Statistic)
Constant	-6.61	-6.88
	(-17.0)	(-13.4)
Ability to Support Loan		
Housing Expense/Income	.47	.46
	(3.1)	(3.0)
Total Debt Payments/Income	.04	.05
	(6.6)	(6.8)
Net Wealth	.00008	.00008
	(1.1)	(1.1)
Risk of Default		
Consumer Credit History	.33	.33
	(9.8)	(10.0)
Mortgage Credit History	.35	.35
	(3.0)	(2.9)
Public Record History	1.20	1.18
	(7.0)	(6.8)
Probability of Unemployment	.09	.09
	(3.3)	(3.3)
Self-Employed	.52	.52
	(2.8)	(2.8)
Potential Default Loss		
Loan/Appraised Value	.58	.63
	(3.2)	(3.3)
Denied Private Mortgage Insurance	4.70	4.70
	(9.6)	(9.5)
Rent/Value in Tract	.68	.66
	(3.5)	(3.4)
Loan Characteristics		
Two-to-Four-Family Home	.58	.58
	(3.6)	(3.6)
Personal Characteristics		
Race	.68	.65
	(5.0)	(4.7)
Age		.006
		(.9)
Sex		-.21
		(-1.2)
Number of Dependents		.04
		(.6)
Marital Status (Not Married = 1)		.27
		(1.8)
Number of Observations	3062	3027
Percent Correct Predictions	89	89

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Appendix Table B12
Alternative Specifications of Probability of Mortgage Denial
Lender Standards

Variable	Basic Equation Coefficient (t-Statistic)	Coefficient (t-Statistic)	Coefficient (t-Statistic)
Constant	-6.61	-6.65	*
	(-17.0)	(16.9)	
<u>Ability to Support Loan</u>			
Housing Expense/Income	.47	.47	.47
	(3.1)	(3.1)	(2.8)
Total Debt Payments/Income	.06	.06	.05
	(6.6)	(6.6)	(6.4)
Net Wealth	.00008	.00008	.00007
	(1.1)	(1.1)	(.7)
<u>Risk of Default</u>			
Consumer Credit History	.33	.33	.39
	(9.8)	(9.8)	(10.0)
Mortgage Credit History	.35	.36	.40
	(3.0)	(3.1)	(3.1)
Public Record History	1.20	1.20	1.51
	(7.0)	(7.0)	(7.3)
Probability of Unemployment	.09	.09	.08
	(3.3)	(3.3)	(2.7)
Self-Employed	.52	.52	.67
	(2.8)	(2.8)	(3.2)
<u>Potential Default Loss</u>			
Loan/Appraised Value	.58	.59	.67
	(3.2)	(3.2)	(3.2)
Denied Private Mortgage Insurance	4.70	4.70	4.85
	(9.6)	(9.6)	(8.8)
Rent/Value in Tract	.68	.68	.56
	(3.5)	(3.5)	(2.6)
<u>Loan Characteristics</u>			
Two-to-Four-Family Home	.58	.58	.64
	(3.6)	(3.6)	(3.5)
<u>Lender</u>			
Tough Lender		.09	
		(.5)	
Lender Dummy			*
<u>Personal Characteristics</u>			
Race	.68	.68	.54
	(5.0)	(5.0)	(3.4)
Number of Observations	3062	3062	3061
Percent Correct Predictions	89	89	91

* Constant is included in the dummy variables for the lenders. These are not shown because they are so numerous.

Appendix Table B13
Alternative Specifications of Probability of Mortgage Denial

Variable	Basic Equation Coefficient (t-Statistic)	No Race Coefficient (t-Statistic)	White Coefficient (t-Statistic)	Black and Hispanic Coefficient (t-Statistic)
Constant	-6.61	-6.56	-6.22	-7.33
	(-17.0)	(-17.0)	(-14.6)	(-7.6)
Ability to Support Loan				
Housing Expense/Income	.47	.51	.44	.46
	(3.1)	(3.4)	(2.3)	(1.9)
Total Debt Payments/Income	.06	.05	.06	.07
	(6.6)	(6.6)	(4.9)	(4.8)
Net Wealth	.00008	.00005	.00008	-.0002
	(1.1)	(.7)	(1.3)	(-.5)
Risk of Default				
Consumer Credit History	.33	.35	.32	.33
	(9.8)	(10.6)	(7.5)	(6.1)
Mortgage Credit History	.35	.39	.28	.63
	(3.0)	(3.3)	(2.1)	(2.5)
Public Record History	1.28	1.27	1.33	1.07
	(7.0)	(7.6)	(5.9)	(4.0)
Probability of Unemployment	.09	.08	.09	.08
	(3.3)	(2.8)	(3.0)	(1.4)
Self-Employed	.52	.46	.65	.15
	(2.8)	(2.5)	(3.1)	(.4)
Potential Default Loss				
Loan/Appraised Value	.58	.63	.56	.79
	(3.2)	(3.1)	(2.9)	(1.2)
Denied Private Mortgage Insurance	4.78	4.71	5.00	4.12
	(9.6)	(9.7)	(8.0)	(5.3)
Rent/Value in Tract	.68	.74	.55	.98
	(3.5)	(3.9)	(2.1)	(3.0)
Loan Characteristics				
Two-to-Four-Family Home	.58	.76	.78	.38
	(3.6)	(4.8)	(3.4)	(1.7)
Personal Characteristics				
Race	.68			
	(5.0)			
Number of Observations	3062	3062	2340	722
Percent Correct Predictions	89	89	92	81

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Appendix Table B14
Correlation Matrix

	1 RACE	2 HEXP	3 DTOI	4 NETW	5 CONSPAY	6 MORTPAY	7 PUBREC	8 UR	9 LTV	10 Rent	11 PMI	12 2 to 4	13 SELF
1 Race	1.00												
2 Housing Expenses/Income	.06	1.00											
3 Total Debt Payments/Income	.07	.37	1.00										
4 Net Wealth	-.00	-.03	-.00	1.00									
5 Consumer Credit History	.20	.01	.06	-.03	1.00								
6 Mortgage Credit History	.14	.06	.06	-.11	.15	1.00							
7 Public Record History	.14	.05	.10	.01	.31	.07	1.00						
8 Probability of Unemployment	-.05	-.01	.03	-.01	-.02	.03	.01	1.00					
9 Loan/Appraised Value	.14	.04	.00	-.07	.05	.12	.05	-.01	1.00				
10 Rent/Value in Tract	.10	-.02	-.02	.04	.03	.02	.02	.001	.02	1.00			
11 Denied Private Mortgage Insurance	.10	.05	.00	-.03	.07	.05	.07	.01	.15	-.0003	1.00		
12 Two- to Four-Family Home	.23	-.01	.01	-.01	.07	.06	.04	.05	.07	.11	.09	1.00	
13 Self-Employed	-.07	-.003	.02	.12	-.02	-.05	.02	.16	-.03	-.03	-.02	.03	1.00

Number of Observations: 3062

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Variable Definitions and Sources

Question numbers refer to the questions listed in Appendix A.
Data from lenders' HMDA reports were supplied by the lenders as
part of their normal Home Mortgage Disclosure Act filing.

Variable	Definition
Dependent Variable	= 1 if applicant was denied a mortgage 0 if application was accepted
Housing Expense/Income	= 1. if greater than .30, 0 otherwise (from question #45)
Total Debt Payments/Income	= value of question #46
Net Wealth	= value of question #36 less question #38
Income	= sum of applicant and co-applicant total monthly income (question #31)
Liquid Assets	= value of question #35
Base Income/Total Income	= applicant and co-applicant base income relative to total income (derived from questions #30 and #31)
Consumer Credit History	= 1 if no "slow pay" account (code 1 in question #43) = 2 if one or two slow pay accounts (code 2) = 3 if more than two slow pay accounts (code 3) = 4 if insufficient credit history for determination (code 0) = 5 delinquent credit history with 60 days past due (code 4) = 6 serious delinquencies with 90 days past due (code 5)
Mortgage Credit History	= 1 if no late payment (code 1 in question #42) = 2 if no payment history (code 0) = 3 if one or two late payments (code 2) = 4 if more than two late payments (code 3)
Public Record	= 1 if any public record of credit problems (codes 1,2,3,4 in question #44) 0 otherwise
Consumer: Insufficient History	= 1 if code 0 in question #43; 0 otherwise
Consumer: One or Two Slow Accounts	= 1 if code 2 in question #43; 0 otherwise
Consumer: More than Two Slow Accounts	= 1 if code 3 in question #43; 0 otherwise
Consumer: Delinquencies	= 1 if code 4 in question #43; 0 otherwise
Consumer: Serious Delinquencies	= 1 if code 5 in question #43; 0 otherwise
Mortgage: No History	= 1 if code 0 in question #42; 0 otherwise
Mortgage: One or Two Late	= 1 if code 2 in question #42; 0 otherwise
Mortgage: More than Two Late	= 1 if code 3 in question #42; 0 otherwise
Mortgage: Prior History	= 1 if code was not 0 in question #42; 0 otherwise
Probability of Unemployment	= 1989 Massachusetts unemployment rate for applicant's industry (from question #29) Unemployment rates from U.S. Bureau of Labor Statistics, <u>Geographic Profile of Employment and Unemployment, 1989</u>
Self-Employed	= 1 if applicant was self-employed 0 otherwise (from question #27)
Years on Job	= value for applicant for question #26
Presence of Co-signer	= 1 if affirmative response to question #53 0 otherwise

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Variable		Definition
Loan/Appraised Value	=	value of loan amount from original HMDA report divided by question #50
Denied Private Mortgage Insurance	= 1 0	if negative response to question #53 otherwise
Rent/Value in Tract	=	rental income divided by value of rental housing stock in census tract in which property was located. Derived from U.S. Bureau of the Census, 1990 Census of Population and Housing, Summary Tape File 3 (1990 Census)
Housing Units Boarded Up	=	percent of housing units in census tract in which property was located that were boarded up Source: 1990 Census
Housing Units Vacant	=	percent of housing units in census tract in which property was located that were vacant Source: 1990 Census
Housing Value Appreciation	=	percent change in the median value of owner-occupied housing between 1980 and 1990 in the census tract in which in which the property was located Source: Derived from 1990 Census and 1980 Census of Population and Housing, Summary Tape File 3
Minority Population Share (>30 Percent)	= 1 0	if minorities comprise more than 30 percent of the tract population otherwise Source: 1990 Census
Foreclosure Rate	=	total foreclosures divided by owner-occupied housing units Source: Foreclosures from Banker & Tradesman; housing units from 1990 census
Census Tract Dummy Variable (for each tract)	= 1	if property was located in census tract; 0 otherwise
Two- to Four-Family Homes	= 1 0	if purchasing a two- to four-family home otherwise (question # 51)
Fixed-Rate Loan	= 1 0	if fixed rate otherwise (question #47)
Not a Special Loan Program	= 1 0	if not applying under a special loan program otherwise (question #49)
Term of Loan	=	value from question #48
Gift or Grant in Down Payment	= 1	if affirmative response to question #54; 0 otherwise
Lender Dummy Variable (for each lender)	= 1	if application made to lender; 0 otherwise
Race	= 1 = 0	if applicant was black or Hispanic, otherwise (lenders' HMDA report)
Age	=	applicant age from question #21
Sex	= 1 0	if applicant was male otherwise (lenders' HMDA report)
Number of Dependents	=	number of applicant's dependents (question # 24)
Marital Status	= 0 1	if applicant was married otherwise (question #23)
Tough Lender	= 1 0	if lender had a high denial rate for white applicants, as described in Appendix B otherwise

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Native Action nets $ 4 million lending goal

By Jerry Reynolds
Today Staff

COLSTRIP, Mont. — The Community Reinvestment Act becomes coin of the realm this month in Indian country, when the Northern Cheyenne Tribal Council is expected to ratify an agreement between the community group Native Action and First Interstate BancSystem of Montana.

First Interstate is a bank holding company based in Billings, Mont. The agreement commits its subsidiary bank in the border town of Colstrip to an agenda that can help end the dearth of economic development loans on the reservation, said Gail Small, president of Native Action.

In mounting the CRA challenge to a merger application, Ms. Small identified capital scarcity as "probably the number one economic development issue facing our community."

The agreement commits First Interstate Bank of Colstrip to a lending goal of $4 million over five years in new housing, agricultural, business and consumer loans on the reservation. The bank has agreed to "good faith efforts" in originating the loans at competitive interest rates. In 1992, Ms. Small said, the bank has already extended $400,000 in credit to the reservation — more than three times its loan volume there in previous years, she added.

The lending goal was a difficult negotiating point, but Native Action insisted on it. "You need some method of evaluation," Ms. Small said. "Are you making progress? ... The lending goal is critical."

Tom Scott, president and chief executive officer of First Interstate, said the real test of the agreement will be what happens next.

"The only way it will be successful at all is if there's cooperation," he said.

But in terms of giving "teeth" to the CRA, the jury is already in on the Native Action challenge.

The Community Reinvestment Act is designed to encourage bank lending to low- and moderate-income groups. Native Action's challenge led to a Federal Reserve Board of Governor's vote against the merger request, based on bank non-

Photo by John Warner

Gail Small, president of Native Action.

compliance with CRA guidelines. The board's vote, the first of its kind in Indian country and one of a handful anywhere, took place a year ago today.

First Interstate filed its merger application with the Federal Reserve Board in December 1989. Earlier in the year, Wyoming had liberalized its financial laws to permit interstate banking. First Interstate took advantage of the law to merge its Colstrip bank with a Wyoming affiliate. Both holding companies are owned in common.

First Interstate BancSystem controlled deposits totaling $530 million, with assets of $629 million, making it the third-largest commercial banking organization in Montana. The Wyoming affiliate, Commerce BancShares, was the fourth-largest banking company in that state, controlling $236 million in deposits and with assets of $280 million. Merging the two would end duplication of functions and increase profitability, First Interstate contended.

But the banking giants had underestimated a little-known law, the Community Reinvestment Act. In an amendment to the dead letter of CRA law that had been on the books since 1977, the U.S. Congress in 1989 mandated disclosure of bank CRA ratings as a reaction to the

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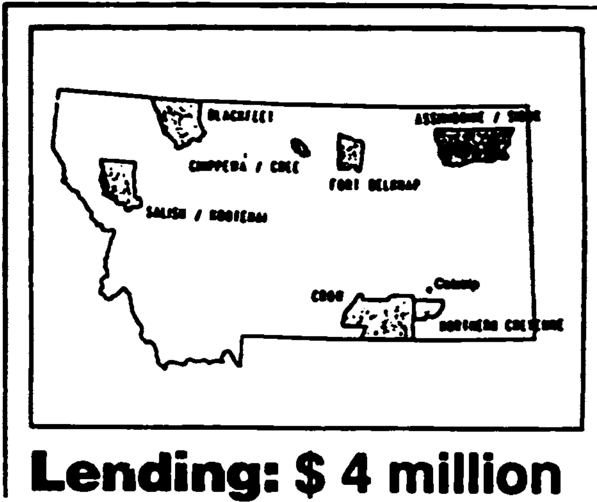

Lending: $ 4 million

Savings and Loan crisis that was then entering its final tailspin. Newspaper investigations in Atlanta, Boston and elsewhere, proving racial discrimination against blacks in bank lending, also helped force Congress' hand.

Native Action filed its challenge in January 1990, contending the Colstrip bank gets a majority of Northern Cheyenne deposits yet was making a "pitiful" few loans to the reservation's estimated 5,000 tribally enrolled residents.

After Native Action made its protest to the Federal Reserve, the Colstrip bank reduced its lending area, in effect "red lining" the reservation 15 miles to the south. Still later in the year, according to the affidavit of Suzanne Trusler, president of the Northern Cheyenne Chamber of Commerce in Lame Deer, Mont., Mr. Scott told a meeting of the chamber he would withdraw a grant he had earlier offered unless Native Action withdrew its challenge.

Native Action maintained its protest. The bank eventually took retroactive measures to improve its credit services on the reservation, but it had already received less than satisfactory CRA compliance ratings. In ruling against the merger, the Federal Reserve noted that credit practices consistent with CRA should be established well in advance of a bank's regulatory applications.

After almost three years of often confrontational negotiations, Mr. Scott called the newly inked agreement a framework for cooperative efforts to build up the economy of the Northern Cheyenne Indian Reservation.

"There will hopefully be a lot of good that will come out of the agreement we signed," he said. "... There's no reason to beat each other up if there's work that needs to be done."

The cost to First Interstate of the merger denial and subsequent negotiation process was "too painful" to compute just yet, he said. "It would be in excess of $100,000, I'm sure."

In return for good faith compliance with its commitments, First Interstate won agreements from four community groups not to file protests with federal regulatory agencies against any of its future applications for the term of the agreement, which is five years.

In addition to establishing a lending goal, the agreement targets a broad array of other credit needs on the Northern Cheyenne Reservation.

■ A liaison committee will meet at least every three months to monitor how the goals of the agreement are being met. Committee members will discuss difficulties, and identify and develop strategies to overcome them, "including but not limited to the development of a program of credit counseling services."

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■ The bank will try to increase participation in government agency lending programs that target low- and moderate-income people, such as Bureau of Indian Affairs guaranteed loans, the Small Business Administration cash-injection plan, Farmers Home Administration and Veterans Administration.

Ms. Small said such programs are sometimes "about the only way you can get loans on reservations."

■ The bank will provide technical assistance for small business entrepreneurs on the reservation, as well as responding to technical assistance needs identified by the liaison committee, and assisting with the cost of technical consultants.

■ The bank must continue to seek and consider qualified Northern Cheyennes for employment and management training.

■ Credit worthiness will continue to be a major factor in the bank's lending policy, as at most banks. But it will not be the only factor, and income criteria will be relaxed to include public assistance, self-employment, part-time and seasonal work, land-lease contracts and other forms of documentable revenue.

■ Banking services aimed at low- and moderate-income customers will continue to be developed. The Colstrip bank recently announced plans to install an automatic teller machine in Lame Deer, Mont., pending federal approval.

■ The bank will make good faith efforts to retain at least one tribal member on its board of directors. The current tribally enrolled board member is Clara Spotted Elk. Mr. Scott credited her with "really opening my eyes" to the fine points of reservation credit needs after a long spell of confrontational stalemate.

Though the agreement was signed by six parties, Ms. Spotted Elk said the go-ahead had to come from Mr. Scott, as president and CEO of the bank holding company.

Parties to the agreement are Native Action, the Northern Cheyenne Tribal Council, the Northern Cheyenne Area Chamber of Commerce, the Northern Cheyenne Livestock Association, First Interstate Bank of Colstrip and First Interstate BancSystem of M[illegible]

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Are S.D., Nebraska banks 'red lining'?

By Jerry Reynolds
Today Staff

RAPID CITY — The Community Reinvestment Act maps of seven border town banks draw lines around the Pine Ridge and Rosebud Reservations from east to west.

According to the banks and the federal regulating agencies that examine them for CRA compliance, the lines are color-neutral. But they seem red enough t Native Action's Gail Small. Native Action spearheaded a successful challenge to a large Montana bank holding company's merger plan and Ms. Small said an organized CRA protest could be in order for Lakota tribes as well.

"They need to be moving on these issues," she said.

"Red lining" refers to a bank practice of denying loans in low-income areas. The Community Reinvestment Act of 1977 required banks to meet the credit needs of low- and moderate-income groups in their lending area. Congress stiffened the law in 1989 to require public delineations of the lending area, public CRA statements, a public CRA file, and public disclosure of CRA compliance ratings.

Among the border town banks whose Community Reinvestment Act files the *Indian Country Today* examined, seven exclude Pine Ridge or Rosebud from their delineated lending areas. They are First National Bank of Chadron, Neb.; Blackpipe State Bank of Martin, S.D.; and the Abbott Banks in Chadron, Gordon, Merriman, Cody, and Valentine, Neb.

Loan officers at each of these banks said they have loans out on the reservations. Each claimed a strong commitment to non-discriminatory lending practices and said they take good loans where they find them.

"It's too competitive not to," said Tom Willnerd, senior vice president of the Abbott Bank in Chadron, which has a lending area extending to Oelrichs, S.D., but not east of there to Pine Ridge. " ... By no means do those lines indicate where we stop at."

But the question posed by CRA is not whether banks should make the good loans that come to them. The

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question is whether they are seeking ways to serve people who may not fit the standard bank definiton of a good loan prospect, said Elaine Dudley, deputy director of the Office of Indian Housing in Washington, D.C.

The banks in question do not have to expand credit services to Pine Ridge or Rosebud because they are not within their delineated lending communities.

■ Jerry Beagle, chief CRA compliance officer for the Abbott Banks, said in a telephone interview that he didn't know why the lending area of each branch bank stops at the reservation borders, anywhere from 18 to 60 miles away depending on the bank's location.

Minutes of the main Alliance bank's CRA committee meetings state that Mr. Beagle went into detail about what the CRA map should include. An hour after he had forgotten the details, executives in all the branch banks had them a their fingertips. Loan volume, the number of loans in their given geographic areas, had been the determining factor.

"How those delineations are done is by our loan volume, it's as simple as that," said Marvin Larabee, assistant vicepresident of the Abbott Bank in Valentine.

Jan Lallman at the Abbott Bank in Cody added, "When we delineated these, we went by our volume. Those lines don't limit you whatsoever."

Community Reinvestment Act advisors indicated the bank should delineate by concentration of loan customers, Mr. Willnerd said. He explained the Chadron branch's extension to Oelrichs by a concentration of ranch customers there.

He also said the bank has encountered no difficulty in tribal court with the loans it has made on Pine Ridge. "I got more problems in bankruptcy court than I've got up there."

The Abbott Bank group participates in loan programs for low- and moderate-income customers through the Small Business Administration and the Farmers Home Administration (a major agricultural bank, it's an approved lender for the latter). The only experience the bank has had in Bureau of Indian Affairs guaranteed loans is in the Plains Inn project, executive vice-president Darrell Raum said. The project calls for a hotel and conference center complex that would run tours to the Pine Ridge Reservation and employ 50 percent Native Americans.

The project marks the only appearance of Indians in the bank's CRA file. Mr. Raum said the Plains Inn project is still alive and the Abbott Bank is still "actively involved."

■ Randy Langemier, vice president of the First National Bank in Chadron, said the bank's shrinking delineation is due to advice that CRA examiners don't approve the perfect circles of previous banking practice. So the bank squared its circle to include all of Dawes County, Neb., and none of Pine Ridge to the north.

The bank surveyed reservation banking needs at a Feb. 10 meeting in Pine Rid[illegible] ith Mike Graham and Rob[illegible] [illegible]mer of the tribal treasury and tax offices.

"T[illegible] [illegible] was that we know we n[illegible] [illegible] Native Americans in [illegible]

DONALD W. RIEGLE, JR., MICHIGAN, CHAIRMAN
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United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WASHINGTON, DC 20510-6075

March 9, 1993

Jonathan Fiechter
Acting Director
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552

Dear Mr. Fiechter:

On Wednesday, February 24, the United States Senate Committee on Banking, Housing, and Urban Affairs held a hearing on mortgage and other lending discrimination at which the Committee received testimony from representatives of various community organizations and agencies involved in monitoring the lending practices of financial institutions.

The testimony presented a disturbing picture of persistent discriminatory conduct by financial institutions and a shocking pattern of failed enforcement by the financial institutions supervisory agencies.

There was widespread agreement from all witnesses that the recent study by the Boston Federal Reserve conclusively demonstrated that African-Americans and Latinos have a significantly more difficult time getting mortgage credit simply because of their race or ethnicity. Nonetheless, testimony by Federal Reserve Governor LaWare and others made clear that the banking regulators rarely uncover racial discrimination in their examinations and that they have rarely, possibly never, imposed civil monetary penalties for such discrimination.

The hearing testimony revealed that discrimination and ineffective enforcement are national problems. The Committee received testimony that, in several specific instances, the banking regulators have failed to find discrimination when evidence of such discrimination has been sufficient to prompt substantial legal settlements in civil actions.

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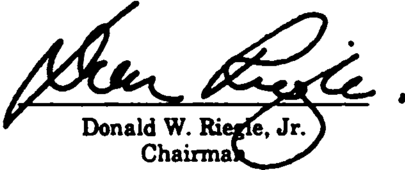
In addition, lending to African-Americans and Latinos is at appallingly low levels. HMDA data reveal that the flow of mortgage lending to minority neighborhoods and individuals is significantly lower than the flow to white neighborhoods and individuals.

We urge you to investigate this disturbing performance record and to take action to ensure that the financial institutions subject to your supervision are in fact complying with community reinvestment and fair lending laws.

Sincerely,



Donald W. Riegle, Jr.
Chairman

Alfonse D'Amato
Ranking Republican

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Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6590

April 5, 1993

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter of March 9, 1993, regarding lending discrimination. In that letter, you urge the Office of Thrift Supervision (OTS) to investigate our record of performance and to take action to ensure that the financial institutions we regulate are complying with community reinvestment and fair lending laws.

I share your concerns about discriminatory lending practices. While OTS already has an extensive compliance program in place, we can do better. Former Director Timothy Ryan's responses to your letters of October 14 and October 27, 1992, along with our response to your January 15, 1993 letter describe the current OTS compliance program. This letter describes a new three-part plan we will implement to combat lending discrimination in the savings and loan industry.

First, we will improve our discrimination detection techniques in our fair lending examinations. Second, we will ensure that referrals are made to the U.S. Department of Justice, as appropriate, and that we use effective measures, including formal enforcement actions, to address noncompliance. Third, we will work with the industry and other interested groups to prevent discrimination through education.

1) Improve the Compliance Examination Process

Our fair lending examination procedures need to be revised to take full advantage of our recent experience and of the Home Mortgage Disclosure Act (HMDA) data. The conclusions of the Federal Reserve Bank of Boston study on mortgage discrimination and the results of the Department of Justice investigation of Decatur Federal Savings and Loan Association raise important questions about the effectiveness of our current examination approach. Clearly, more sophisticated anti-discrimination examination techniques are in order.

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To improve our examination approach, we will:

- o expand and improve our compliance training curricula through the development of an advanced compliance examiner training school on credit discrimination;
- o explore other discrimination detection techniques, such as testing, for their possible application to our examination approach by working with civil rights experts, the Department of Justice, and the Department of Housing and Urban Development; and
- o support the Federal Financial Institution Examination Council's effort to review and improve the fair lending examination process, including ways to better use HMDA data to identify key lending disparities and potential problems that should receive intensified examination emphasis.

2) <u>Strengthened Fair Lending Enforcement</u>

Our fair lending enforcement efforts need more emphasis. We must successfully communicate to our staff the importance of aggressively enforcing the fair lending laws.

To strengthen our fair lending enforcement efforts, we will:

- o ensure that OTS staff receives adequate guidance and support in the use of available OTS formal enforcement actions, including civil money penalties, for fair lending violations; and
- o implement new internal procedures to ensure that appropriate cases are referred to the Department of Justice under the Equal Credit Opportunity Act (ECOA).

Using these new procedures, we have recently made a referral for ECOA violations to the Department of Justice.

3) <u>Enhance Industry Education and External Communications</u>

OTS will play a larger role in educating the industry about specific lending standards and practices that may cause discrimination. The debate and discussion in the fair lending area is increasingly not about overt discrimination, but about subtle discrimination and seemingly neutral practices that have the effect of discriminating on a prohibited basis, such as race. We will take the initiative to work with the industry, community groups, and other interested parties to enhance industry education and communications.

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We will:

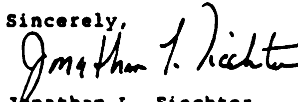
- consider regional fair lending schools for thrift institution executives on a cost recoupment basis that focus on regulatory fundamentals as well as subtle lending practices that impede the ability of low-income and minority individuals to obtain credit;

- hold periodic meetings with various community organizations to discuss consumer and fair lending issues, and to share ideas on ways to improve fair lending efforts; and

- improve communications with Congressional staff to inform them about our compliance programs and keep them apprised of our efforts in the fair lending area.

We believe this is an ambitious agenda that targets the right issues and tackles them head-on. We have asked the other financial regulatory agencies if they would have any interest in moving forward with us on any of these initiatives. We would be pleased to brief you or your staff in more depth about our efforts.

Sincerely,



Jonathan L. Fiechter
Acting Director

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United States Senate

COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS

WASHINGTON, DC 20510-6075

March 9, 1993

Stephen R. Steinbrink
Acting Comptroller
Office of the Comptroller of Currency
250 E Street, S.W.
Washington, D.C. 20219

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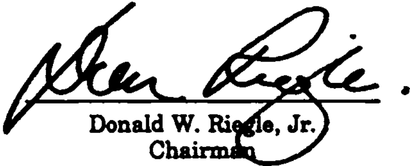
We urge you to investigate this disturbing performance record and to take action to ensure that the financial institutions subject to your supervision are in fact complying with community reinvestment and fair lending laws.

Sincerely,



Donald W. Riegle, Jr.
Chairman

Alfonse D'Amato
Ranking Republican

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Comptroller of the Currency
Administrator of National Banks

Compliance Management
250 E Street, SW
Washington, D.C. 20219

March 23, 1993

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510-6075

Dear Mr. Chairman:

Thank you for your March 9, 1993 letter, jointly signed by Senator D'Amato, urging me to take action to ensure that the financial institutions supervised by the Office of the Comptroller of the Currency (OCC) are complying with community reinvestment and fair lending laws.

In my February 18, 1993 response to your request for information for the Committee on Banking, Housing and Urban Affairs' hearing on mortgage and other lending discrimination, I provided detailed information on efforts by the OCC to ensure that supervisory examinations of national banks will detect any unlawful discrimination. These efforts include:

- Revising our supervisory structure to provide for specialized examiners, supervisors and managers for compliance matters, including fair lending and community reinvestment.
- Revising our fair lending examination procedures to focus on the comparative file analysis necessary to detect subtle differences in treatment on a prohibited basis.
- Refining our techniques for analyzing Home Mortgage Disclosure Act (HMDA) data to target banks for fair lending examinations.
- Recommending changes in the information collected on the Fair Housing Home Loan Data System (FHHLDS) to allow us to better focus our fair lending examinations.

I assure you that the OCC is committed to vigorous enforcement of fair lending and community reinvestment statutes. We are mindful of the perceived shortcomings in the manner in which these statutes have been implemented in the past. We will continue to review our policies and procedures and to take steps necessary to ensure that the important goals of these statutes are furthered and achieved in the future. We will keep you informed of any new efforts we develop.

Sincerely,

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DONALD W. RIEGLE, JR., MICHIGAN, CHAIRMAN

PAUL S. SARBANES, MARYLAND
CHRISTOPHER J. DODD, CONNECTICUT
JIM SASSER, TENNESSEE
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STEVEN B. HARRIS, STAFF DIRECTOR AND CHIEF COUNSEL
HOWARD A. MENELL, REPUBLICAN STAFF DIRECTOR

United States Senate

COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

March 9, 1993

The Honorable Alan Greenspan
Chairman
Board of Governors
Federal Reserve System
Constitution Avenue and 20th Street
Washington, D.C. 20551

Dear Chairman Greenspan:

On Wednesday, February 24, the United States Senate Committee on Banking, Housing, and Urban Affairs held a hearing on mortgage and other lending discrimination at which the Committee received testimony from representatives of various community organizations and agencies involved in monitoring the lending practices of financial institutions.

The testimony presented a disturbing picture of persistent discriminatory conduct by financial institutions and a shocking pattern of failed enforcement by the financial institutions supervisory agencies.

There was widespread agreement from all witnesses that the recent study by the Boston Federal Reserve conclusively demonstrated that African-Americans and Latinos have a significantly more difficult time getting mortgage credit simply because of their race or ethnicity. Nonetheless, testimony by Federal Reserve Governor LaWare and others made clear that the banking regulators rarely uncover racial discrimination in their examinations and that they have rarely, possibly never, imposed civil monetary penalties for such discrimination.

The hearing testimony revealed that discrimination and ineffective enforcement are national problems. The Committee received testimony that, in several specific instances, the banking regulators have failed to find discrimination when evidence of such discrimination has been sufficient to prompt substantial legal settlements in civil actions.

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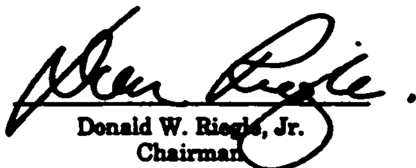
In addition, lending to African-Americans and Latinos is at appallingly low levels. HMDA data reveal that the flow of mortgage lending to minority neighborhoods and individuals is significantly lower than the flow to white neighborhoods and individuals.

We urge you to investigate this disturbing performance record and to take action to ensure that the financial institutions subject to your supervision are in fact complying with community reinvestment and fair lending laws.

Sincerely,



Donald W. Riegle, Jr.
Chairman

Alfonse D'Amato
Ranking Republican

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

April 5, 1993

The Honorable Donald W. Riegle
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter of March 9, 1993, in which you express concern about issues raised in your recent hearings related to racial discrimination in mortgage lending. I share your concern about this important issue and can assure you that fair lending issues have been receiving - and will continue to receive - a great deal of attention from the Board.

As you know, we have taken a number of steps to improve our enforcement efforts - but we can do more. We are reassessing our examination techniques and training, exploring sophisticated computer systems to make maximum use of HMDA data, expanding our civil rights and consumer education resources and actively assisting and prodding the industry to improve its response to this problem. My colleagues on the Board with direct responsibility in the area have used numerous occasions to speak publicly about the need to ensure equal access to credit for all of our nation's citizens. In this regard, I thought you might be particularly interested in the enclosed speech given by Governor LaWare last week.

We are, of course, also troubled by information from the Federal Reserve Bank of Boston study and a Department of Justice consent agreement that shows that disparate treatment based on race exists in our country with respect to mortgage credit. But one thing that is important to keep in mind, as the Boston study indicates, is that it is very difficult to detect illegal credit discrimination through the examination process. The fact that it took the Justice Department several years to develop a case of credit discrimination against one financial institution supports that notion. Nonetheless, we believe that both the Justice and Federal Reserve efforts have provided new insights into this problem and the Board and the FFIEC have already begun using that information to strengthen the enforcement of fair lending laws.

Thank you for sharing the results of the Committee's hearings with me. Please be assured that the Board recognizes the importance of fair lending compliance to the Congress and the country.

Sincerely,

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ADDRESS BY JOHN P. LaWARE TO THE BANK ADMINISTRATION INSTITUTE'S 1993 BANK AUDIT, COMPLIANCE AND SECURITY CONFERENCE

Detecting and Eliminating Possible Discrimination in Financial Institutions

March 30, 1993

I appreciate the opportunity to speak to you today about a topic that is receiving much attention from community groups, the Congress, and the regulators. That topic is discrimination in mortgage lending—or, more specifically, as your program notes, "detecting discrimination in mortgage lending."

I can't imagine a topic that embodies more controversy and affects more people that this one. This nation was founded on the idea that all of us have certain rights and certain freedoms. While the Pilgrims may not have had home ownership at the top of their list, home ownership certainly is part of the American dream today.

Lately, mortgage lending discrimination has become a leading attention getter in the press. Numerous magazine and newspaper articles, and even television programs, have focused on this issue. In turn, these articles have raised the public's perception of mortgage discrimination as a national problem. And, lately, the Congress has held several hearings on this issue. I don't think I have to tell you what happens when the Congress and the public perceive a problem that is not being adequately addressed. More regulation is usually the solution that first comes to mind.

More regulation, however, does not have to be the solution. In fact, I'm not sure that more regulation will solve the problem. I believe that it is up to us, regulators and lenders alike to find the solution. We must take a hard look at what we are doing to eradicate discriminatory practices. We have to start now. I can assure you that if banks and regulators do not take action, then the Congress will take it for us. I also assure you that any action the Congress may mandate will probably be more expensive in the long run than action you yourself design for your institution.

The conference brochure indicates that my presentation will focus on HMDA data as a means of detecting mortgage discrimination. Frankly, I don't believe the HMDA data tell the whole story, or even most of it. Taken alone, these data will neither prove nor disprove discrimination. The data will, however, point out areas for further investigation. Going beyond the data is the challenge for all of us.

First, let me say that I certainly do not presume to have all the answers. I believe, however, that there are things that compliance and audit professionals can do to eliminate discrimination in your institution. Many of them cost little to implement, but will yield dividends in the future. As I see it, there are three main areas or ideas. The first involves setting up a fair lending framework within your bank. Once the initial framework is established, reviewing what your bank is actually doing and taking steps to correct identified problems, should follow naturally.

Detecting and eliminating discrimination, whether intentional or not, takes special effort. Before you can achieve this goal, you have to make the message loud and clear that discrimination will not be tolerated. You have to make a statement and it should come from the "top of the house." Does your bank have a mission statement that incorporates fair treatment to all applicants? Do all of your employees, from the teller in the lobby to the telephone operator in the back room, know about the bank's position on discrimination? Do your policies and procedures make it clear that discrimination will not be tolerated?

Last month, I testified on behalf of the Federal Financial Institutions Examination Council, or the FFIEC, before the Senate Banking Subcommittee. My testimony focused on what the agencies are doing to combat and eliminate discrimination in mortgage lending. In that testimony, I enunciated a mission statement of sorts for the Federal Reserve's position on mortgage discrimination. I'd like to read it you.

> "Parity in how applications are considered, without regard to race, sex or other prohibited bases, is absolutely essential in our country. Let no one have any misunderstanding on the point. Racial discrimination, no matter how subtle and whether intended or not, cannot be tolerated. Simply stated, excluding any segment of our society from fundamental economic opportunities, such as home ownership and equal access to credit, is morally repugnant and illegal. Moreover, it robs the lending industry and our economy of growth potential. I can assure you that the Board is committed to vigorously enforcing fair housing laws."

If your bank doesn't have such a position statement on discrimination, adopt one. If it does have such a statement, tout it. Send it to your employees and your customers. Advertise it in the bank's lobby and in statement stuffers. Get out the message that discrimination has no part in your organization. Establishing an anti-

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discrimination policy in the minds of every employee and customer will set the framework for a program in which discrimination is not tolerated.

As a corollary to this, you have to educate your employees. Overt discrimination is easy to find. But that is the rarity. Today's challenge is to find the more subtle forms of discrimination, which include the treatment of some customers slightly differently than others. That type of discrimination is much more difficult to uncover.

If confronted, most of us would state that we do not harbor biases about certain races or income groups. While we may genuinely think this is the case, we may unconsciously treat some individuals with more respect, courtesy, or even offers of help than others. Providing sensitivity training may be an answer if that is the case. That special training may help attune employees to cultural differences and unconscious behavior patterns. Sensitivity training, then, is another means of providing a statement that discrimination will not be tolerated. I know of one large bank that recently provided sensitivity training to over 600 employees as part of its CRA program. Increasing employee awareness of cultural differences, especially those employees with public contact, will demonstrate your bank's concern.

I think it goes without saying that all financial institutions should review their loan policies to make sure that they are free from bias against any particular racial group. I believe that area is one you should look at, but one I'm not going to dwell on. But, after you assure yourself that your loan policies are without bias, you should look at how those policies are working in practice to satisfy yourself that they do not result in unjustifiable disparities in treatment among your customers and potential customers. One place to start is your bank's HMDA data. The data will tell you where and to whom you are lending. It will also enable you, in a very rough way, to compare how your bank is treating similarly situated applicants.

Reviewing HMDA data periodically will help ensure that your bank is kept abreast of how new products or changes in advertising and outreach efforts effect your mortgage lending. If a change in advertising triggers a corresponding increase in lending, it will show up in your periodic HMDA reviews. Likewise, if a new product does not generate new loans, the data will reflect this as well. Learning about a problem early will allow you to correct for it and improve your lending performance during the year. And always, keep top management and board members abreast of what the HMDA reviews are telling you.

When you look at where your loans are made, compare your loan distribution with your bank's community delineation. Are any areas underserved? Are any areas excluded? If segments of your community are being left out, find out why. Figure out what you can do to ensure that these areas receive credit. Is there an advertising problem? Are credit products advertised in media which reach all segments of the bank's market? Or are credit products marketed in media that reach only a portion of the market?

When you find weaknesses in the data, take action to improve the profile. Long term sustainable solutions are best, but the results may take time to materialize. Be patient. If you have not served some markets, it may take time to become a familiar player. Successful business development efforts don't happen overnight as all bankers know. For example, suppose you decide to offer a new loan product to attract low- and moderate-income or minority individuals. Once you decide to offer a new product, target your marketing effort. Establish a dialog with community groups, particularly these in the minority community, and let them know about the new product. Don't rely entirely on the media. Get out there and talk to people and press the flesh.

The HMDA data will help you determine whether your bank is offering credit to applicants without regard to race. But, you will have to do a lot of work beyond the data itself. Here's what I mean.

The HMDA data show who is applying for mortgage and home improvement loans and who is, and is not, getting them. If you receive few loan applications, you need to find out why. Is it an advertising problem? Is it an outreach problem? Does the bank need to focus more outreach efforts to solve the problem? Or is the low application rate from minorities or others an indication of discrimination in the prescreening process? Receiving few loan applications from minority applicants may indicate that the bank is discouraging applications, or reflect some other problem. For example, some applicants may feel intimidated by the bank or the application process itself. If this is the case, working with or through community or other organizations may increase applications from the targeted group.

In many cases, the quality of a marketing effort is more important than the quantity. If your bank is spending money for minority or low-income advertising programs, but is not receiving applications, then there may be another problem at work. You may have advertising that does not reach or appeal to the group you're aiming at. Does your advertising reflect the community you are targeting? Are all

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of the faces on your advertisements white, or do they represent the cultural diversity of the community? Do you need the assistance of a community group to help target your marketing effort? Some banks have found it beneficial to work with community groups, such as a church group or other community organization, to promote a particular loan program.

If minorities are not applying for special programs, maybe the programs don't fit their needs. I recently heard of a bank that had expanded its advertising budget in an attempt to attract more minority applicants to a new home improvement product. Despite these budgeted increases, however, no new loan customers appeared. After consulting with a community group, the bank discovered that its minimum loan amount was too high. In short, it did not meet the credit needs of the group targeted.

Another area for investigation is credit underwriting standards. As part of your review, you should examine specific underwriting policies for requirements that may be unrelated to risk or repayment performance. Sometimes these standards may unduly effect a certain segment of the community.

No one advocates lenders sacrificing safety and soundness, in their pursuit of low-income and minority lending. However, when a mortgage underwriting standard is explained as "we've always done it this way," it shouldn't be surprising that some people will ask lenders, "couldn't there be another way of looking at it?" Today there are many innovative and successful lending programs that reflect new and different underwriting standards.

Test policies and practices by saying, "How does this underwriting standard help me evaluate risk? Is there an alternative that will achieve the same result?" For example, how is the applicant's credit history evaluated? What payments do you look at? Credit reports may not show payment histories that are important to many. For example, credit reports do not typically include rent and utility payments, which can be used as an indication of an applicant's ability and willingness to support a mortgage.

How do you evaluate an applicant with numerous job changes? Are there different criteria which predict creditworthiness and allow individuals to obtain a home? Minimum standards for the size or age of a house, off street parking or the number of bedrooms may exclude residents from urban communities with older homes from the mortgage market. But those factors may be of little significance to the soundness of the loan.

As a double check on credit process and underwriting standards, you might consider having a second or a management review of the bank's loan denials. This second review is another way to ensure that all applicants get at least an even chance at obtaining credit. Fob example, in some banks, a senior loan official or group of officials conduct a second review of all denied loan applications. This review checks for unfair treatment of applicants and also whether any loans could be made using different loan criteria or if the loans were structured slightly differently. Sometimes, the second review results in a loan origination. In one of the most successful programs of this type, the reviewing officer is a minority female, and over time the new loans put on as a result of her review have had negligible losses.

While not a method for detecting discrimination, participation in mortgage review boards demonstrates a bank's willingness to "go the extra mile" to give a potential homeowner a second chance. For these boards, representatives from a group of banks gather to review denied mortgage applications. Each bank accepts a few of the denied loans when the review shows that the loans can be made. Participation on mortgage review boards and the use of committees to review internally denied loans makes a positive statement about the bank's commitment to the community. Loan experience gained from this participation may indicate ways in which the bank's underwriting standards could be adjusted to attract more creditworthy minorities.

You can also look at the HMDA data to satisfy yourself that you give all applicants an equal chance to qualify for credit. As you know, when the 1990 HMDA data was released, it showed disparities between white and minority applicants nationwide. Last October, the Federal Reserve Bank of Boston released a study based on mortgage lending in Boston which focused on that data. The study showed that black and Hispanic applicants were denied loans two to three times as often as their white counterparts. To augment the HMDA data, the Federal Reserve Bank launched an expansive review of the specific data behind these loans, and focused on additional information contained in the loan files, but not in the HMDA data, for the entire Boston market.

The results were disheartening. The study found that individuals with no credit blemishes received credit, no matter what their color. But, few of the applicants were perfect. Most of the loan applicants had some credit problem which could have

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been used to deny the loan. And the study found that "for the same imperfections whites seem to enjoy a general presumption of creditworthiness that black and Hispanic applicants do not, and that lenders seem to be more willing to overlook flaws for white applicants than for minority applicants."

For example, a white applicant may have been given the chance to explain a credit problem, while a minority applicant may not. Or, a white applicant may have been steered to a different type of loan, or asked to put down a larger percentage in order to qualify for the loan where a minority applicant was not.

The Boston study points up the need to look at how your bank handles credit applicants. What kind of "coaching" do loan officers initiate? How are applicants with less than perfect credit records treated? Are procedures written? Do all applicable staff understand them? If procedures are unwritten, this may be the time to put them in writing. The goal is evenhanded treatment for all applicants. To ensure this treatment for all applicants, consider giving your loan officers a script to use for potential customers. Mandatory coaching for *all* denied applicants may help many to qualify.

If you think there is a possibility of uneven treatment, alert top management and the Board of Directors. Tell management and the Board your findings and recommendations. Disparity in applicant treatment is apparently not uncommon, despite the existence of fair lending laws. Assuring identical treatment for all applicants should improve results.

The Federal Reserve Board has a Consumer Advisory Council composed of members from the banking industry, academia, and consumer groups. At last year's March meeting, several of the consumer representatives related stories about subtle, but inconsistent treatment between minority and white testers shopping for credit. The differences ranged from a black female not even being asked to sit down for a loan interview to a loan officer telling the applicant that the bank did not offer credit for mortgages under $40,000 and to "try the bank down the street," even though this type of credit was included on the institution's CRA statement. The subtle differences of treatment of applicants cited in the Consumer Advisory Council testimony and the findings of the Boston study support the need for banks to examine their treatment of all applicants.

Along these lines, one approach that I support is the use of credit "shoppers." Your board may want to consider authorizing the use of "shoppers" to visit various branch offices posing as mortgage applicants to test the bank's actual credit practices. Different treatment of similar applicants is cause for concern. If your credit shoppers are treated differently for no apparent reason, it is a red flag. Is it racial? Is the practice widespread, or limited to one office. Does the treatment reflect the bank's policy? What remedies can the bank prescribe for correcting the difference in treatment? Report the detailed findings to your Board. They need to know and to be part of the solution.

Later in this conference, someone from the Department of Justice will speak on the Decatur Federal case, but I thought I would offer some thoughts on it also. Decatur Federal is a savings and loan headquartered in Atlanta and one of the largest home mortgage lenders in that area. In the fall of 1992, the Department of Justice issued a consent decree against Decatur Federal, charging the S&L with discriminating against black homebuyers. This order is the first of its kind issued against a savings and loan, or any financial institution, for that matter.

Although Decatur Federal had received satisfactory CRA examinations and had never been accused of discriminatory practices, disparities in HMDA lending patterns triggered the Justice Department's review. A team from Justice entered Decatur in 1991 and reviewed mortgage loan applications which were rejected between January of 1988 and May of 1992. From its in-depth review, Justice concluded that Decatur had "engaged in a pattern or practice of discriminating against prospective black homebuyers." Contributing to this case were the facts that the bank:

—excluded sections of Atlanta inhabited by black residents in its community delineation;
—made no HMDA loans to black individuals;
—closed branches when black populations reached 85 percent and opened new branches in white neighborhoods;
—excluded black advertising media directed toward the black community;
—subjected black applicants to stricter loan standards than white applicants; and
—rejected black applicants at a higher rate than white applicants.

The Justice Department's consent decree requires that the savings and loan not only pay $1 million in damages to those discriminated against, but also take steps to correct the deficiencies I mentioned. The work done by the Justice Department was intense and time consuming. As part of this investigation, Justice reviewed

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credit files and compared white accepted applicants with black rejected applicants. Altogether, it took the Justice Department three years to investigate. As an outgrowth of that experience, Justice now has proven investigative procedures to use in other institutions.

This gets me to my point. The Justice review of Decatur was the first of its kind. Further reviews are planned. You may have heard about the "200 bank list." This is a list that Justice compiled based on denial rates and low minority applications volume noted in HMDA data.

To date, there has been no decision on which or how many of these institutions will receive a "Decatur" type investigation. Knowing that Justice, as well as community groups and other banks, are looking at your HMDA data should be an incentive for you to look at it first, determine which areas need additional study, and correct the deficiencies noted. No one here believes that having the Justice Department investigate a bank is the most effective, or least costly way to root out discrimination in the industry. The most effective way is to have individual banks find and eliminate problems within their own institutions. I want to say here, that from a management perspective, the steps you take to address these issues should be no different from other actions that you are currently taking to ensure that your bank's other strategies and plans are being carried out in an effective and profitable manner.

In closing, I'd like to say that loan customers of all colors are valuable to every financial institution, especially today. To find and eliminate possible discrimination, you first have to take a stand against it. You have to let your employees and customers know that it will not be tolerated in your organization. You have to set the framework so that everyone within your institution and everyone who comes in contact with it knows that you are a fair and equitable lender.

Discrimination is illegal and morally repugnant. It is also bad business. It robs the individual of his dignity, to say nothing of his chance to own his own home. It also robs the bank of a chance to make a loan and a profit. And who among you is not interested in adding to the bottom line? I urge all of you to look hard at your bank and eliminate any and all mortgage lending discrimination. Thank you.

70-832 (840)

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