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Preface

The *Federal Reserve Bulletin* was introduced in 1914 as a vehicle to present policy issues developed by the Federal Reserve Board. Throughout the years, the *Bulletin* has been viewed as a journal of record, serving to provide the public with data and research results generated by the Board.

Authors from the Board's Research and Statistics, Monetary Affairs, International Finance, Banking Supervision and Regulation, Consumer and Community Affairs, Reserve Bank Operations, and Legal divisions contribute to the content published in the *Bulletin,* which includes topical research and analysis and quarterly "Legal Developments."

Starting in 2004, the *Bulletin* was published quarterly rather than monthly. In 2006, in response to the increased use of the Internet—and in order to release articles and reports in a more timely fashion—the Board discontinued the quarterly print version of the *Bulletin* and began to publish the contents of the *Bulletin* on its public website as the information became available. All articles, orders on banking applications, and enforcement actions that were published in the online *Bulletin* in 2011 are included in this print compilation.

The tables that appeared in the Financial and Business Statistics section of the *Bulletin* from 1914 through 2003 were removed and published monthly as a separate print and online publication, the *Statistical Supplement to the Federal Reserve Bulletin,* from 2004 to 2008. Effective with the publication of the December 2008 issue, the Federal Reserve Board discontinued both the print and online versions.

The majority of data published in the *Statistical Supplement* are available elsewhere on the Federal Reserve Board's website at www.federalreserve.gov. The Board has created a webpage that provides a detailed list of links to the most recent data on its site and links to other data provided by the Federal Reserve Bank of New York, the U.S. Treasury, and the Federal Financial Institutions Examination Council.

Online access to the *Bulletin* is free. A free e-mail notification service (www.federalreserve.gov/generalinfo/subscribe/notification.htm) is available to alert subscribers to the release of articles and orders in the *Bulletin,* as well as press releases, testimonies, and speeches. The notification message provides a brief description and a link to the recent posting.

- *Federal Reserve Bulletin*: www.federalreserve.gov/pubs/bulletin
- Data sources for the tables in the discontinued *Statistical Supplement to the Federal Reserve Bulletin*: www.federalreserve.gov/pubs/supplement/statsupdata/statsupdata.htm
- Subscribe to e-mail notification service: www.federalreserve.gov/generalinfo/subscribe/notification.htm

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Designing Disclosures to Inform Consumer Financial Decisionmaking: Lessons Learned from Consumer Testing

Jeanne M. Hogarth and Ellen A. Merry of the Board's Division of Consumer and Community Affairs prepared this article.

The Federal Reserve Board has studied ways to improve the information and materials—including required disclosures—that consumers draw on when they purchase and use financial products and services. As part of its regulatory development process, the Board has used qualitative and quantitative research methods in controlled environments to create new disclosures and to test them for their ability to enhance consumer understanding of a wide range of financial products and services. The goal has been to develop disclosures that consumers can understand and use to help them make financial decisions that align with their personal circumstances.

Key Findings

This article provides an overview of results from some of the Board's consumer testing projects. The results reveal some lessons learned, suggest potential best practices for consumer disclosure content and presentation, and highlight challenges involved in crafting effective disclosures for financial products. The following are key findings from the testing:

- **Disclosure language should be plain but meaningful.** When reading disclosure documents, consumers are best served by terms that are straightforward. Small wording changes can significantly improve consumer understanding, but for some content, communicating the intended meaning may be difficult even with the use of plain language.
- **Thoughtful design can make disclosures more usable.** Carefully designed visual elements in disclosures, such as titles, headings, tables, charts, and typography can increase consumers' willingness to read disclosures and can aid their ability to navigate and understand them.
- **Contextual information can improve comprehension and usability.** Context, or a "frame," for information on a disclosure can help readers understand both specific content in the disclosure as well as its overall message. It can also help consumers better comprehend how to use the information.
- **Achieving a neutral tone can be challenging.** Although disclosures often strive for a neutral tone to avoid "steering" consumers in one direction over another, achieving neutrality is difficult.
- **Creating disclosures may involve creating a choice structure.** In some cases where choice options are not specified in the law, establishing the structure may be part of creating the disclosure.
- **Standardizing disclosure can be challenging.** Standardization can be beneficial, but finding terms that are truly standard across all contexts can be difficult, and consumers may

need to be alerted when a "standard term" has a different meaning than the one they may be familiar with.

- **What works in print may not work online.** Disclosure design needs to take into account the possibilities and limitations of alternative delivery channels.
- **"Less is more" often remains true.** Too much information can overwhelm consumers or distract their attention from key content.

The Role of Financial Product Disclosures in Consumer Protection

Disclosure has long been a fundamental component of consumer protection policy in financial services.[1] For example, in 1968, Congress passed the Truth in Lending Act (TILA), which requires that lenders provide consumers with disclosures about rates and terms for mortgages, credit cards, and a variety of other consumer loans. A number of other laws also feature consumer disclosures as a central element, including the Real Estate Settlement Procedures Act, the Consumer Leasing Act, the Electronic Fund Transfer Act, and the Truth in Savings Act. Over time, these laws have been amended and new requirements have been added. Indeed, recent federal legislation has required the revision or addition of disclosures through provisions of the Mortgage Disclosure Improvement Act, the Higher Education Opportunity Act, the Helping Families Save Their Homes Act, and the Credit Card Accountability Responsibility and Disclosure (Credit CARD) Act.

Congress has delegated authority to implement these and other consumer protection laws to the Board and other agencies. The Board's Division of Consumer and Community Affairs (DCCA) has developed disclosures in connection with a number of these laws. These efforts are one component of DCCA's overall mission to develop regulations, policies, and programs designed to inform and protect consumers; to enforce federal consumer protection laws; to strengthen market competition; and to promote access to banking services in historically underserved markets.

In 2010, Congress further acknowledged the importance of protecting and informing consumers in their financial transactions by passing the Dodd-Frank Wall Street Reform and Consumer Protection Act, which created an independent Consumer Financial Protection Bureau (CFPB). The act consolidates under the CFPB most of the disclosure and rulemaking responsibilities for consumer credit and deposit products that previously were carried out by the Board and other federal agencies and gives the bureau other responsibilities for consumer protection in financial services.[2]

While many financial service firms provide product information in the absence of mandatory disclosure requirements, the presence of these requirements imposes common standards of terminology, presentation, and calculation of relevant figures that can aid consumers in making comparisons between products and providers. Indeed, in the early 1960s, disclosures for interest rates on consumer credit products were primarily governed by state law, and multiple standards were in use by lenders. One of the aims of TILA was to create a common, national standard for disclosing the cost of credit.[3]

Models of information search in economics posit that consumers will seek product information and comparison shop as long as they perceive a marginal benefit from these activi-

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[1] Thomas A. Durkin and Gregory Elliehausen (2011), *Truth in Lending: Theory, History, and a Way Forward* (New York: Oxford University Press).

[2] Many of pieces of the Dodd-Frank Act relating to the CFPB went into effect on July 21, 2011.

[3] Durkin and Elliehausen, *Truth in Lending: Theory, History, and a Way Forward.*

ties; benefits can take the form of lower prices or better value, as each consumer defines it.[4] In an ideal marketplace, if complete information were available at no cost to all participants, fully informed consumers would make decisions that are optimal for their financial situations and lifestyles and, at the same time, enable markets to function efficiently.[5] While engineering this ideal marketplace is not feasible in the real world, disclosures that make product pricing and features more transparent can reduce search costs, potentially improving outcomes for those consumers who shop. Furthermore, search on the part of some consumers may lead to a more competitive marketplace as financial service providers adjust product features and reduce prices to attract informed customers.

Consumer decisions are affected not only by the broad context of the consumer's economic, social, cultural, and political environment but also by more personal psychological and socioeconomic factors.[6] For example, research on consumer search for financial products shows that finding ways to motivate consumers to shop, seek out, and pay attention to information disclosures is a significant challenge. Many consumers seeking mortgages and credit cards do not appear to shop among possible offerings.[7] Nor is it clear that many consumers understand how to shop in financial markets or even what they should look for or how to correctly use the information available. For example, there is evidence that consumers have problems processing information in financial markets just as they do in other markets (for example, the nutrition and health care markets).[8] In addition, individual differences in experience, expertise, and self-confidence affect how consumers process information.[9]

Although findings like these showing differences and limits in consumer information processing are not new, such issues have received increased attention in policy discussions. In part, this may be a response to an increase in the complexity of financial product decisions. In some cases, the features and risks of a new product may be more challenging to understand than the "old model." For example, an adjustable rate mortgage loan with multiple monthly payment options is likely to be a more complex product than a fixed rate mort-

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4 George. J. Stigler (1961) "The Economics of Information," *Journal of Political Economy*, vol. 69 (June), pp. 213–25, www.jstor.org/stable/1829263; Pauline M. Ippolito (1988), "The Economics of Information in Consumer Markets: What Do We Know? What Do We Need to Know?" in E. Scott Maynes, ed., *The Frontier of Research in the Consumer Interest* (Columbia, MO: The American Council on Consumer Interests), pp. 235–63.

5 For a discussion on the promotion of economic efficiency and other goals that have been suggested for the Truth in Lending Act, see Durkin and Elliehausen, *Truth in Lending: Theory, History, and a Way Forward.* Disclosures have other uses beyond their role in the shopping process; for example, they provide a legal record of the transaction.

6 See, for example, George Katona (1951) *Psychological Analysis of Economic Behavior* (New York: McGraw Hill) and Sandra J. Huston (2010) "Measuring Financial Literacy," *Journal of Consumer Affairs*, vol. 44 (2), pp. 296–316, http://onlinelibrary.wiley.com/doi/10.1111/j.1745-6606.2010.01170.x/pdf.

7 Jinkook Lee and Jeanne M. Hogarth (1999), "Returns to Information Search: Consumer Mortgage Shopping Decisions," *Financial Counseling and Planning Journal*, vol. 10 (1), pp. 49–66, http://6aa7f5c4a9901a3e1a1682793cd11f5a6b732d29.gripelements.com/pdf/vol1015.pdf; and Jinkook Lee and Jeanne M. Hogarth (2001), "Consumer Information Search for Home Mortgages: Who, What, How Much and What Else?" *Financial Services Review,* pp. 277–93, www2.stetson.edu/fsr/abstracts/vol_9_num3_p277.pdf.

8 Jinkook Lee and Jeanne M. Hogarth (1999), "The Price of Money: Consumers' Understanding of APRs and Contract Interest Rates," *Journal of Public Policy and Marketing*, vol. 18 (Spring), pp. 66–76, www.jstor.org/stable/30000509; Alan Levy, Sara B. Fein, and Raymond E. Schucker (1996), "Performance Characteristics of Seven Nutrition Label Formats," *Journal of Public Policy and Marketing*, vol. 15 (Spring), pp. 1–15, www.jstor.org/stable/30000331; and Judith H. Hibbard, Paul Slovic, and Jacqueline J. Jewett (1997), "Informing Consumer Decisions in Health Care: Implications from Decision-Making Research," *The Milbank Quarterly*, vol. 75 (3), pp. 395–414, http://onlinelibrary.wiley.com/doi/10.1111/1468-0009.00061/pdf.

9 John W. Payne, James R. Bettman, and Eric Johnson (1993), *The Adaptive Decision Maker* (New York: Cambridge University Press); Douglas A. Hershey and David A. Walsh (2000), "Knowledge versus Experience in Financial Problem Solving Performance," *Current Psychology*, vol. 19 (Winter), pp. 261–92; and Cäzilia Loibl, Soo Hyun Cho, Florian Diekmann, and Marvin T. Batte (2009), "Consumer Self-Confidence in Searching for Information," *Journal of Consumer Affairs*, vol. 43 (1), pp. 26–55, http://onlinelibrary.wiley.com/doi/10.1111/j.1745-6606.2008.01126.x/pdf.

gage loan with a single, constant payment. However, decisionmaking can also be affected by having a larger number of options available from which to choose.[10] In the current era of complex financial markets and products, being well-informed can be a costly and possibly daunting task, even for those with substantial education.

Research in psychology, marketing, and behavioral economics has highlighted not only the possible limitations of disclosure but also new opportunities for its use. For example, research shows that the way in which choices are structured or presented can change the likelihood that consumers will select them. One implication is that as policymakers confront decisions about the proper presentation of disclosure, they may face choices about whether disclosure should be "neutral" in presenting product options or should promote or discourage a consumer's selection of certain products or features. Some argue that if design matters, no truly "neutral" presentation of choices exists.[11] This raises the question of which features should be promoted, as the desirability of some features depends on their fit with a particular consumer's personal situation.

While these behavioral insights are increasingly a part of the policy discussion and debate, the statutory disclosure requirements and the longstanding goals of increased transparency and competition in markets also continue to motivate policymakers to improve the effectiveness of disclosures. The task for policymakers and regulators is to implement disclosure standards that have the potential for being timely, comprehensible, and useful in consumer decisionmaking and that take into account the associated costs and benefits for all market participants.

Efforts to Craft Effective Disclosures

Testing Efforts in the United States

Beginning in 1996, the Board conducted consumer focus groups to help inform the content, language, and layout of disclosures for vehicle leases, mortgages, payroll cards, and electronically delivered disclosures. In 2004, in collaboration with other federal agencies, the Board instituted a more rigorous consumer testing program, using focus groups, cognitive interviews, usability testing, and quantitative validation surveys to inform disclosure development for privacy notices (see **box 1** for a compendium of Federal Reserve Board testing reports). The Board used a similar research design for its work on credit cards. In more recent years, the Board has used cognitive interviews in developing disclosures for mortgages, home equity lines of credit, reverse mortgages, private student loans, bank overdraft services, and remittances. This article focuses primarily on results from the Board's work on mortgages and credit cards, and its interagency work on privacy notices.

Other U.S. federal financial regulators also have used qualitative and quantitative testing when developing disclosures. For example, the interagency project on privacy notices mentioned above included six federal agencies.[12] In addition, the Department of Housing and Urban Development (HUD) conducted extensive qualitative and quantitative testing before

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[10] For example, see Sheena S. Iyengar and Emir Kamenica (2010), "Choice Proliferation, Simplicity Seeking, and Asset Allocation," *Journal of Public Economics*, vol. 94, pp. 530–39, www.sciencedirect.com/science/article/pii/S0047272710000290.

[11] See, for example, the discussion of choice architecture in Richard H. Thaler and Cass R. Sunstein (2008), *Nudge: Improving Decisions about Health, Wealth, and Happiness* (New Haven: Yale University Press).

[12] In addition to the Board, the Federal Deposit Insurance Corporation, Federal Trade Commission, National Credit Union Administration, Office of the Comptroller of the Currency, and the Securities and Exchange Commission participated in the interagency research project on privacy notices. The Office of Thrift Supervision joined the research project for the quantitative testing phase.

Box 1. Compendium of Consumer Testing Reports

Reports outlining the findings of the consumer testing sponsored by the Federal Reserve Board over the last few years are available online. Reports on interagency testing efforts are also available for download. These reports are listed below by type of disclosure. Visit the links to view specific reports.

Banking Services and Payments

Review and Testing of Overdraft Notices (2008), www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a6.pdf

Design and Testing of Overdraft Disclosures: Phase Two (2009), www.federalreserve.gov/newsevents/press/bcreg/bcreg20091112a4.pdf

Design and Testing of Regulation CC Funds Availability Clauses, Disclosures, and Notices (2010), www.federalreserve.gov/newsevents/press/bcreg/bcreg20110302a_summary_findings.pdf

Design and Testing of Remittance Disclosures (2011), www.federalreserve.gov/econresdata/bcreg20110512_ICF_Report_Remittance_Disclosures_(FINAL).pdf

Credit Cards

Design and Testing of Effective Truth in Lending Disclosures (2007), www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf

Design and Testing of Effective Truth in Lending Disclosures: Findings from Experimental Study (2008), www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a8.pdf

Design and Testing of Effective Truth in Lending Disclosures: Findings from Qualitative Consumer Research (2008), www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a7.pdf

Mortgages

Consumer Testing of Mortgage Broker Disclosures (2008), www.federalreserve.gov/newsevents/press/bcreg/20080714regzconstest.pdf

Design and Testing of Truth in Lending Disclosures for Closed-End Mortgages (2009), www.federalreserve.gov/boarddocs/meetings/2009/20090723/Full%20Macro%20CE%20Report.pdf

Design and Testing of Truth in Lending Disclosures for Home Equity Lines of Credit (2009), www.federalreserve.gov/boarddocs/meetings/2009/20090723/Full%20HELOC_Macro%20Report.pdf

Design and Testing of Periodic Statements for Home Equity Lines of Credit, Disclosures about Changes to Home Equity Line Credit Limits, and Disclosures about Credit Protection Products (2010), www.federalreserve.gov/newsevents/press/bcreg/bcreg20100816_MacroBOGReportOtherDisclosures(7-10)(FINAL).pdf

Design and Testing of Truth in Lending Disclosures for Rescission Notices (2010), www.federalreserve.gov/newsevents/press/bcreg/bcreg20100816_MacroBOGReportRescission(7-10)(FINAL).pdf

Design and Testing of Truth in Lending Disclosures for Reverse Mortgages (2010), www.federalreserve.gov/newsevents/press/bcreg/bcreg20100816_Reverse_Mortgage_Report_(7-28)_(FINAL).pdf

Design and Testing of Escrow Disclosures (2011), www.federalreserve.gov/newsevents/press/bcreg/bcreg20110223b3.pdf

continued on next page

Box 1.—*continued*

Privacy Notices

Evolution of a Prototype Financial Privacy Notice: A Report on the Form Development Project (2006), www.ftc.gov/privacy/privacyinitiatives/ftcfinalreport060228.pdf

Mall Intercept Study of Consumer Understanding of Financial Privacy Notices: Methodological Report (2008), www.ftc.gov/privacy/privacyinitiatives/Macro-Report-on-Privacy-Notice-Study.pdf

Consumer Comprehension of Financial Privacy Notices: A Report on the Results of the Quantitative Testing (2008), www.ftc.gov/privacy/privacyinitiatives/Levy-Hastak-Report.pdf

Financial Privacy Notice: A Report on Validation Testing Results (2009), www.ftc.gov/privacy/privacyinitiatives/validation.pdf

Web-Based Financial Privacy Notice Final Summary Findings Report (2009), www.ftc.gov/privacy/privacyinitiatives/WebbasedNoticeFinalSummaryReport.pdf

Student Loans

Consumer Research and Testing for Private Education Loans: Report of Findings (2009), www.federalreserve.gov/newsevents/press/bcreg/bcreg20090311a8.pdf

Consumer Research and Testing for Private Education Loans: Final Report of Findings (2009), www.federalreserve.gov/newsevents/press/bcreg/bcreg20090730a2.pdf

finalizing revised versions of the Good Faith Estimate (GFE) and HUD-1 mortgage disclosures.[13] And as a part of its rulemaking process, the Federal Trade Commission (FTC) has conducted quantitative testing of opt-out disclosures for prescreened credit card solicitations and used testing to inform disclosure rules for nonfinancial products such as health claims in food advertising and energy usage labeling for appliances.[14] The Securities and Exchange Commission (SEC) has conducted qualitative testing of disclosures for mutual fund sales fees, broker conflict of interest, and summary mutual fund prospectuses.[15] In addition, the agency has provided guidance on creating plain-English disclosure documents for investors.[16]

[13] For a summary of HUD's testing, see Kleimann Communication Group, Inc. (2008), *Summary Report: Consumer Testing of the Good Faith Estimate Form (GFE),* prepared for the Department of Housing and Urban Development, Office of Policy Development and Research (February), www.huduser.org/publications/pdf/Summary_Report_GFE.pdf. Additional reports from HUD's testing of the GFE can be found at www.huduser.org/portal/publications/hsgfin/goodfaith.html#pdf.

[14] Manoj Hastak (2004), *The Effectiveness of "Opt-Out" Disclosures in Pre-Screened Credit Card Offers,* report submitted to the Federal Trade Commission (September), www.ftc.gov/reports/prescreen/040927optoutdiscprecreenrpt.pdf; Joseph Farrell, Janis K. Pappalardo, and Howard Shelanski (2010), "Economics at the FTC: Mergers, Dominant-Firm Conduct, and Consumer Behavior," *Review of Industrial Organization* (November 3). The FTC has also conducted research on mortgage disclosures that has informed regulations developed by the Board and HUD. See James M. Lacko and Janis K. Pappalardo (2004), *The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment*, Staff Report (Washington: FTC, Bureau of Economics, February), www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf; and James M. Lacko and Janis K. Pappalardo (2007), *Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms*, Staff Report (Washington: Federal Trade Commission, Bureau of Economics, June), www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf.

[15] Siegel & Gale, LLC and Gelb Consulting Group, Inc. (2004), *Results of In-Depth Investor Interviews Regarding Proposed Mutual Fund Sales Fee and Conflict of Interest Disclosures*, report to the Securities and Exchange Commission (November 4), www.sec.gov/rules/proposed/s70604/rep110404.pdf; and Abt SRBI, Inc. (2008), *Final Report: Focus Groups on a Summary Mutual Fund Prospectus*, prepared for the Securities and Exchange Commission (May), www.sec.gov/comments/s7-28-07/s72807-142.pdf.

[16] Office of Investor Education, Securities and Exchange Commission (1998), *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* (Washington: SEC, August), www.sec.gov/pdf/handbook.pdf.

Testing Efforts in Other Countries

Testing—both that conducted by government agencies and by industry groups—has also played a role in informing disclosure policies in other countries.

In the United Kingdom, consumer research carried out by the Financial Services Authority (FSA) includes studies to inform disclosure policy decisions and to evaluate the usefulness of mandatory disclosures for consumers of financial products.[17] For example, since the mid-1990s, the FSA (and a predecessor agency, the Personal Investment Authority) has required financial institutions to provide a "Key Features Document" as a disclosure. In a 2007 report examining firms' implementation of the requirements, the FSA reviewed a sample of these Key Features Documents against a set of criteria relating to conduct of business rules (or "Treating Customers Fairly" outcomes) and FSA principles for business.[18] It found that only about 15 percent of documents met the established criteria. The review notes that consumer "testing of product literature was uncommon." In a follow-up study two years later, the FSA found some improvement among the same set of sample documents.[19] It was not clear whether these improvements were due to any consumer testing, but the FSA "encourage[d] all firms to test the quality of their documents." It also noted that the review focused on the Key Features Documents and might not reflect a consumer's experience with the full set of documents and marketing materials available to them in the decisionmaking process.

Canada also has used testing to help develop plain-language disclosure documents. In 2008, the Financial Consumer Agency of Canada conducted qualitative testing of a proposed credit card application form in an effort to improve disclosure documents for consumers. The agency assessed the application using four key criteria: relevance, perceived ease of comprehension, motivation to read the document, and comprehension.[20] Although the test document met the key criteria, consumers identified supplemental information that they wanted to see on a website. The agency's report also recommended including some numerical examples wherever figures or interest rates were mentioned to help improve the document.

In Australia, an industry group conducted testing in an effort to improve consumer understanding of disclosure information. In particular, the Association of Superannuation Funds of Australia sponsored a study of product disclosure statements for superannuation funds.[21] While the study focused on fee disclosures for two hypothetical investment accounts, the results showed substantial misunderstanding among participants not just of fees but also of other information in the disclosures. The report included recommendations

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[17] Reports from consumer research carried out by the FSA can be found at www.fsa.gov.uk/pages/Library/research/Consumer/index.shtml.

[18] The Treating Customers Fairly outcome (number3) used was "Customers are provided with clear information and are kept appropriately informed before, during, and after the point of sale." The FSA principle (number7) used was "A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading." See Financial Services Authority (2007), *Good and Poor Practices in Key Features Documents* (London: FSA, September), www.fsa.gov.uk/pubs/other/key_features.pdf.

[19] Financial Services Authority (2009), *Supplementary Annex to Good and Poor Practices in Key Features Documents* (London: FSA, April), www.fsa.gov.uk/pubs/other/kfd_annex.pdf.

[20] Les Études de Marché Créatec (2008), *Qualitative Testing of Proposed MasterCard Plain Language Application Form* (Ottawa: FCAC, May), www.fcac-acfc.gc.ca/eng/resources//PDFs/2008PlainLanguage-eng.pdf.

[21] Superannuation funds are retirement funds that blend a compulsory employer contribution with an employee co-contribution.

concerning the use of tables, formatting and layout, jargon, and the importance of testing consumer comprehension in "getting disclosure right."[22]

Federal Reserve Board Consumer Testing Methods

Financial information can be complex and intimidating to many people. Identifying the information consumers do not understand can help pinpoint where a disclosure document is unclear and how it can be improved. As part of its regulatory development process, the Federal Reserve Board has conducted consumer testing that relies on qualitative and quantitative methods in controlled environments to help create and test new disclosure standards. These tests focus primarily on consumers' recognition of key features and comprehension of the information contained in disclosures—and, to a limited extent, on the usability of disclosures in decisionmaking—in order to improve the overall effectiveness of disclosures.

Qualitative Studies

Much of the Board's consumer testing has involved qualitative research techniques, such as focus groups and cognitive interviews, to identify why and how consumers make decisions and what information they use in the decisionmaking process. A focus group usually involves six to ten participants, while a cognitive interview is conducted with one or two participants at a time (e.g., a couple who made a financial decision together). Focus groups allow participants to share thoughts and experiences, which often produce insights and ideas that single participants would not have thought of by themselves. Interviews, on the other hand, are useful for testing knowledge, usability of the materials, and planned behaviors, and are less subject to influence of the presence or opinions of other people. Both of these qualitative research methods can be useful for collecting background information on participants' experiences with products, shopping behavior, general knowledge, and preferences.

Participants are recruited from the databases of market research facilities and typically include people who have experience with a product or who are currently shopping for that product. Recruitment is designed to select participants across a range of demographic characteristics. Sample sizes for qualitative testing are typically small, and statistical representativeness is not possible with a limited number of participants. In addition, in order to obtain the most useable input from a small sample, potential participants who may be highly knowledgeable about the topic (e.g., they work in the financial services industry) or others who have difficulty articulating their thoughts or experiences are often excluded. Including a quantitative validation phase in the study design can help determine whether the changes based on findings from the small samples used in qualitative testing actually result in improvements when tested with a larger and statistically representative sample of the population.

Cognitive and usability interviews are particularly useful when developing disclosures, because they capture the participant's ability to identify or use information on the disclosure in development as well as provide a window into the thought processes and reactions that contribute to consumers' understanding of the information. Generally, the interviews conducted in support of the Board's disclosure development have been conducted in rounds of seven to ten interviews. Although these samples are small, consistent patterns of

[22] Aging Agendas Social Policy Consultants (2004), *Superannuation Fees Disclosure Consumer Testing Report,* prepared for the Association of Superannuation Funds of Australia (January), www.superannuation.asn.au/ArticleDocuments/116/AgeingAgendas&ASFA_SuperFeesDisclosure.pdf.

responses do emerge. One study reports that 80 percent of usability problems are uncovered with five participants and 90 percent with ten.[23] When a number of participants fail to notice information or find content confusing, these findings can inform design and wording changes for the next round of interviews. Design and testing proceed iteratively with attempts to improve the form in each round until a workable disclosure is developed.

Each round of interviews has a research goal. Interviewers follow a script, asking participants to complete several different exercises. They may present the participant with a scenario to provide a context for the disclosure that is being tested. For example, the scenario for a TILA mortgage disclosure might be "Imagine you recently applied for a mortgage, and three days later, you receive this form in the mail." In a "think aloud" exercise, participants are given a document and are asked to read through it with a particular scenario or task in mind while noting aloud what they notice and questions they have. This exercise allows researchers to make numerous observations about the participant's experience with the document: what the participant noticed first, the order in which they approached the information, whether they turned to subsequent pages or skipped content, what content was clear to the participant and what was confusing, and whether the content prompted some sort of reaction—positive or negative.

The interviewer also leads participants through a set of questions and tasks that require the participant to use certain information on the document and, in some cases, explain their answers. For example, to explore whether participants notice and comprehend information on a mortgage prepayment penalty, the script may include a series of questions like "Imagine that you won the lottery and wanted to pay off this loan after only one year. Do you think ABC Bank would charge you a fee if you decided to pay off the loan? How large do you think this fee might be?"

The interviewer works from a script developed to address the research questions that are the focus of the testing and with attention to phrasing questions objectively. However, the option of deviating from the script is one of the advantages of the qualitative interview methodology. The ability to follow up on particular responses provides additional information about a participant's understanding or reasoning process. It also sets a more conversational tone for the interview, which may help some participants feel more comfortable in interacting with the content in the form and, thus, in providing more open and expansive answers to interview questions.

Quantitative Studies

Unlike focus groups or individual interviews, consumer surveys can be used to assess whether alternative disclosure designs can improve consumer comprehension by a statistically significant amount. The statistical objectives of quantitative studies, such as consumer surveys, require a larger number of participants than focus groups and individual interviews and consistent adherence by the interviewer to the survey protocol.

To date, the Board has implemented consumer surveys through a standard mall intercept methodology in a variety of locations across the country.[24] Participants were recruited from public areas of the mall based on a series of screening questions and directed to a self-contained research office where they completed the interview. Interviews generally lasted

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[23] Robert Virzi (1992), "Refining the Test Phase of Usability Evaluation: How Many Subjects Is Enough?" *Human Factors*, vol. 34, pp. 457–86.

[24] For example, the Board's credit card surveys took place in Dallas, Texas; Detroit, Michigan; Los Angeles, California; Seattle, Washington; Springfield, Massachusetts; St. Louis, Missouri; and Tallahassee, Florida, over a period of four weeks in September 2008. A total of 1,022 consumers were interviewed.

about 15 minutes. A computer-assisted interview program captured participants' responses. Traditionally, market researchers have used mall intercept protocols to test visual stimuli in a controlled setting. Because surveys can take place simultaneously at malls across varying geographies, data collection can take place quickly. However, this method also has some limitations: It is not a probability sample and mall customers may not reflect the general population.[25]

The quantitative studies are guided by a set of key research questions to assess the impact of the disclosure document. Both the privacy and credit card notice surveys were designed as factorial experiments, which allow researchers to test the effects of different factors (for example, different wording and different design layouts as well as the interaction of wording and layout) on consumers' comprehension of the information in the disclosure.[26] The goal of the privacy notice study was to test whether the form design helped consumers understand the information in the form (a knowledge component) and whether consumers knew what to do as a result of reading the form (a behavior component). In addition, the study sought to gauge whether consumers' attitudes toward sharing were influenced by the disclosure format and whether consumers' planned behaviors were consistent with their stated preferences. In contrast, the credit card survey focused only on the knowledge component.

In cases where the quantitative study highlights potential improvements to the form, additional rounds of qualitative testing or a brief qualitative validation study may be needed.

Lessons Learned from Board Testing

The Board's qualitative and quantitative studies of disclosures highlighted a number of elements that can influence how well consumers understand a disclosure's content and whether consumers will actually read and use it.

Disclosure Language Should Be Plain but Meaningful

Small wording changes can significantly affect how a consumer understands important financial product concepts. However, some concepts remain impenetrable for consumers despite attempts to explain them in simple terms.

Tests of mortgage disclosures in different parts of the country showed, for example, that terms may have different meanings depending on a consumer's geographic location. The mortgage disclosure forms initially used the term "escrow," which participants in California understood to mean the mortgage closing event itself. In other locations, however, participants understood this term to mean taxes and insurance included as a part of the monthly mortgage payment. Thus, in the new payment tables on mortgage disclosure

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[25] Scott M. Smith and Gerald S. Albaum (2005), *Fundamentals of Marketing Research* (Thousand Oaks, CA: Sage Publications).

[26] Alan Levy and Manoj Hastak (2008), *Consumer Comprehension of Financial Privacy Notices: A Report on the Results of the Quantitative Testing* (December 15), prepared for the Interagency Notice Project (see note 12 for a listing of the agencies involved in the project), www.ftc.gov/privacy/privacyinitiatives/Levy-Hastak-Report.pdf; and Macro International Inc. (2008), *Design and Testing of Effective Truth in Lending Disclosures: Findings from Experimental Study* (December 15), report submitted to the Board of Governors of the Federal Reserve System, www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a8.pdf.

forms, the phrase "taxes and insurance" has been added next to the word "escrow" to make the meaning of the term clearer.[27]

In an example from tests of credit card disclosures, some consumers misinterpreted the term "default rate," which is a term used in the past by some issuers to refer to the APR charged on an account after the cardholder makes a late payment or exceeds the credit limit. In testing, some participants interpreted "default rate" to mean the normal rate—like the default setting on a computer.[28] The language "penalty APR" better conveyed the intended concept, so the new credit card rules now require the use of this term in disclosures. Results from the credit card testing also showed that the term "finance charge" was not meaningful to consumers with respect to credit card accounts. Participants understood these costs better when they were described as "fees" and "interest"; therefore, this terminology is now required on credit card periodic statements.

Striving for plain language doesn't always translate into shorter disclosures. For example, Board researchers tried several ways to explain credit card "grace period"—how long a consumer has to pay the bill in full each month to avoid paying interest on purchases once the billing cycle closes. Some participants thought the term referred to the time they had *after the payment due date* before a late fee would be charged. After testing, the model disclosures were modified to use the language "how to avoid paying interest on purchases" instead of "grace period."

In testing of current mortgage disclosures, many consumers could correctly answer that the lender would charge them a penalty for paying off the loan before a certain date, but a number thought the penalty would not apply if they refinanced the loan or sold the house. Thus, the revised disclosures proposed by the Board in August 2009 included language explicitly stating that the penalty could apply "if you pay off your loan, refinance, or sell your home" within a particular period.

Some terms, such as the "effective APR" for credit cards, have defied any plain-language efforts. The effective APR was required on periodic statements for credit cards with cash advance, balance transfer, or foreign currency transactions. The effective APR differs from the "interest-only" APR on credit card solicitations and account opening statements for credit cards in that the effective APR includes both interest and certain fees (for example, a cash advance fee of $3). Incorporating the fee with the interest paid on the transaction creates an effective APR that is generally higher than the interest-only APR disclosed in the solicitation and account opening documents. The effective APR was meant to create a "teachable moment" for consumers, since the effective APR could be 50 percent or more. Testing revealed that participants often confused the effective APR with the more familiar interest-only APR for credit cards or simply ignored it because they could not understand it. Because of the confusion generated by the two APRs, the Board's final rules for credit card disclosures removed the effective APR and now only require the disclosure of the usual, interest-only APR on account statements in combination with separate information on the amount of fees in the billing cycle.

[27] Macro International Inc. (2009), *Design and Testing of Truth in Lending Disclosures for Closed-End Mortgages* (July 16), report submitted to the Board of Governors of the Federal Reserve System, www.federalreserve.gov/boarddocs/meetings/2009/20090723/Full%20Macro%20CE%20Report.pdf.

[28] Macro International Inc. (2007), *Design and Testing of Effective Truth in Lending Disclosures* (May 16), report submitted to the Board of Governors of the Federal Reserve System, www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf; and Macro International Inc. (2008), *Design and Testing of Effective Truth in Lending Disclosures: Findings from Qualitative Consumer Research* (December 15), report submitted to the Board of Governors of the Federal Reserve System, www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a7.pdf.

Thoughtful Design Can Make Disclosures More Usable

Elements such as titles, tables, charts, typographic styles, and use of shading can help consumers move through a document and aid their comprehension of products and services, but sometimes even these aids come with limitations that must be considered.

In the case of privacy notices, consumers who saw a table that outlined the company's information-sharing practices and consumer rights related to those practices performed substantially better than those who saw the same content laid out in prose. In the course of the Federal Reserve credit card consumer testing project, presentations that separated fees and interest charges helped consumers understand these different elements in their bills; however, there was no difference in understanding between consumers who saw transactions grouped by type (purchases, cash advances, and balance transfers) and those who saw a chronological listing of transactions regardless of type.

While it is likely that icons and color could also help consumers recognize product features and navigate around documents, the Board's testing to date has not included these design elements. One challenge with relying on color to convey the content of a mandatory disclosure is the potential loss in clarity in situations where disclosures would be delivered by fax or printed in black and white. Furthermore, the disclosures developed by the Board have been implemented by regulation as model forms that serve as a safe harbor for creditors who follow them rather than as required forms. Thus, as a practical matter, creditors have latitude in design choices as long as their disclosures comply with the requirements set out in the regulation.

In addition to helping consumers identify information and navigate through a document, design decisions can affect participants' willingness to read a document. For example, when reviewing the Federal Reserve's "Consumer Handbook for Adjustable Rate Mortgages,"[29] a number of participants commented that while the content seemed helpful, they would be unlikely to read through it because of its length (36 pages). Also, early in the development of revised mortgage disclosures, participants were shown information on mortgage payments in both graph and table formats. While some responded positively to the graph, most preferred the table. One participant indicated that because he assumed information presented graphically would be difficult to understand, he would not look at it.

Contextual Information Can Improve Comprehension and Usability

Language and design can aid comprehension and usability, but a disclosure document has more meaning when a consumer understands how the information relates to his or her personal circumstances. Contextual information can help a consumer interpret particular items on a disclosure as well as the overall purpose of the disclosure.

Setting Context for Individual Elements

The Board's testing of consumer understanding of the APR for mortgages illustrates the relevance of context for interpreting particular elements of disclosures. The APR on a mortgage can be useful to consumers when comparing similar mortgage offerings because it incorporates many upfront loan costs—along with the payments over the life of the loan—into a single, "comparison-friendly" cost measure.

[29] This publication is available on the Board's website at www.federalreserve.gov/pubs/arms/arms_english.htm.

However, as testing participants in the Board's mortgage project described their past mortgage-shopping experience, about half indicated that they only contacted one mortgage broker or lender in the process of getting their loan. Even those who did shop with several lenders or brokers usually applied for a loan from only one provider. Thus, in practice, many people may not have the context provided by multiple loan offers to use the APR on a mortgage offer they receive as a comparison tool.

Consumer behavior research has shown that when consumers make a choice considering only one option, they compare it to the reference information they have available.[30] Testing participants have shown little understanding of the APR, and typically evaluate loan offers using information on the form that they can interpret more easily and that may be most relevant to them, such as monthly payment, interest rate, and closing costs. The revised mortgage disclosure forms proposed in August 2009 included a graphic showing the APR in relation to APRs on similar loans offered to borrowers with excellent credit (**example 1**). This context was intended to provide consumers with information they could use to evaluate the offer they received, even if they did not have multiple offers to compare. Nonetheless, even with the graphic, testing participants still had difficulty understanding the APR. As this example illustrates, making required disclosure content meaningful to consumers can be challenging.

Setting Context for the Whole Form

When multiple items appear in each disclosure, consumers seek a whole-to-part way of organizing all the information put in front of them.[31] Therefore, it is important to include contextual information that aids consumers in understanding the overall message of a disclosure document as well as the individual parts.

Take the case of privacy notices, for example. Initial testing found that many participants did not understand why they were receiving the privacy disclosure form. To help orient consumers to the purpose of the notice, the final form included the information that the notice would address in the form of questions. Creating a title ("What does ABC Bank do with your personal information?"), using a set of labels (Why? What? How?), and including a set of frequently asked questions provided a context to help consumers understand why they were receiving the notice and how to use the information.[32] The table in the privacy notice provided the whole-to-part frame for consumers. Consumers could see all the possible reasons for which financial institutions could potentially share their information (the whole) and the way or ways in which their particular financial institution shares (the parts).

Because the knowledge and previous experience that people bring when reading a form can both help and hinder their understanding of what they read, contextual information can also aid consumers in interpreting the form content. A consumer with some knowledge of a specific product, or of the general workings of financial markets, may be better able to comprehend disclosures. However, prior knowledge that is incorrect or irrelevant may also lead participants to misunderstand or misinterpret information on a form.

[30] Christopher K. Hsee and France Leclerc (1998), "Will Products Look More Attractive When Presented Separately or Together?" *Journal of Consumer Research*, vol. 25 (2), pp. 175–86.

[31] Kleimann Communication Group, Inc. (2006), *Evolution of a Prototype Financial Privacy Notice: A Report on the Form Development Project* (February 28), submitted to the FTC, www.ftc.gov/privacy/privacyinitiatives/ftcfinalreport060228.pdf.

[32] The privacy notice form developed by the agencies received the 2010 ClearMark Award from the Center for Plain Language.

For example, in the testing of overdraft notices, some participants were aware of optional overdraft plans offered by banks.[33] Some of these plans allow customers to sign up to link their checking account to a savings account or a line of credit so that the individual's payments would be covered if the checking account were overdrawn. Some participants familiar with these optional plans interpreted the disclosure as being about those plans. However, the overdraft notice was not primarily about optional overdraft plans that involved a link to another account, but rather about the bank's standard practices for covering overdrafts without such a plan. Banks may cover some types of payments for customers who overdraw their accounts, and may charge fees for doing so, even when the customer has not signed up for a plan.

The final model disclosure for overdrafts begins by explaining the difference between standard overdraft practices (the primary subject of the disclosure) and optional overdraft plans that are available. This introductory text provided a context for consumers to understand the overall message of the form and markedly improved comprehension of the content both for participants who had no understanding of overdrafts and those who were familiar with overdraft plans that involved linking to other accounts. However, even with this improvement in understanding of the standard overdraft practices, some participants continued to misinterpret the disclosure because of their personal experiences with the optional plans.

"Framing" Information to Inform Choice

The preceding examples illustrate how the contextual information on a form can help readers understand particular content and the overall message of the disclosure. In addition, supplementary information and explanations can help "frame" decision options so that consumers understand possible implications of their choices.

The Board's consumer testing for credit cards included a static disclosure of how long it would take to pay off a balance of $1,000 at 17 percent APR, making only minimum payments (about seven years). The Board did not require that credit card companies disclose how long it would take consumers to pay off their actual credit card balances. However, in the Credit CARD Act passed in May 2009, Congress required credit card companies to disclose not only how long it would take to pay off the consumer's actual balance but also how much consumers would have to pay in order to pay off the balance in three years.

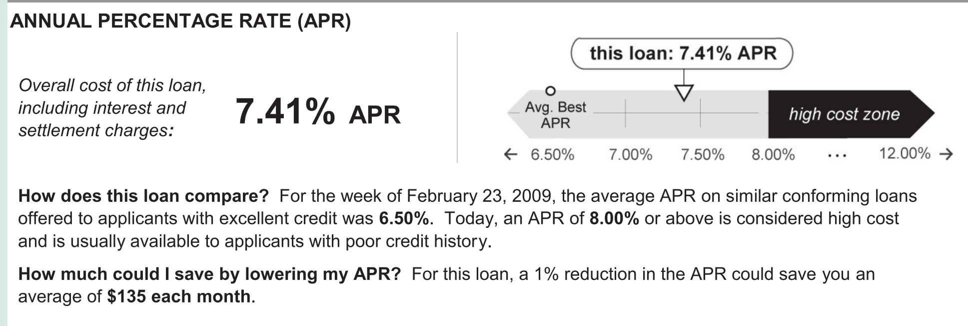
While these particular payment scenarios required by the Credit CARD Act were not a part of the Board's consumer testing, results from the testing of the static disclosure described above suggest they may provide a useful "frame of reference" for consumers in making decisions about monthly payment. In fact, for many participants in the credit card testing, seeing how long it would take to pay off a credit card balance was an insightful moment. However, other participants said that they would never just make the minimum payment.

Such differences in responses are not surprising because some consumers may not think certain information applies to them. Prior research on consumer use of and attitudes toward credit cards found that 7 percent of survey respondents reported that they "hardly ever" made more than the minimum payment on their credit card, while about 35 percent

[33] Macro International Inc. (2008), *Review and Testing of Overdraft Notices* (December 8), report submitted to the Board of Governors of the Federal Reserve System, www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a6.pdf.

Example 1. APR Graphic from Board's 2009 Proposed Rules for Home-Secured Credit

To help establish a context for consumers to better understand the APR, revised mortgage disclosure forms proposed by the Board in 2009 included a graphic showing the APR in relation to APRs on similar loans offered to borrowers with excellent credit.[1]


ANNUAL PERCENTAGE RATE (APR)

Overall cost of this loan, including interest and settlement charges: **7.41% APR**

How does this loan compare? For the week of February 23, 2009, the average APR on similar conforming loans offered to applicants with excellent credit was **6.50%**. Today, an APR of **8.00%** or above is considered high cost and is usually available to applicants with poor credit history.

How much could I save by lowering my APR? For this loan, a 1% reduction in the APR could save you an average of **$135 each month**.

[1] In the Board's 2009 proposal for the APR graphic, the "average best APR" was defined as the average prime offer rate. The "high cost zone" was defined by the HOEPA threshold for higher-priced loans; for first liens, this threshold is 1.5 percentage points above the average prime offer rate for a comparable transaction. For details on how the average prime offer rate is constructed, see www.ffiec.gov/ratespread/newcalchelp.aspx#4.

"hardly ever" pay their balances in full.[34] Differences in payment behavior are likely to imply different degrees of interest among consumers in information about estimated repayment times. Indeed, survey and experimental evidence on the effect of including a minimum payment on credit card bills showed this information did not affect the behavior of those who paid in full. However, the size of partial payments were reduced when the minimum payment was included, suggesting that the minimum payment may act as a psychological "anchor" for some consumers making less than the full payment.[35] Individual differences like these are one of the challenges regulators face in determining what content should be required on disclosures.

In contrast to a product like a credit card that consumers may use frequently, much of the financial management associated with mortgage loans occurs infrequently, when a consumer buys a home or decides to refinance. However, even with mortgages, month-to-month decisions about payments can add up to generate savings—or problems—over time. Indeed, ensuring an understandable presentation of information on the effects of monthly payment decisions is an element of the Board's proposed disclosures for "payment option" mortgages. These products give consumers a choice of several possible monthly payments. The minimum payment option typically covers none of the principal and only some of the interest. As a result, the loan amount can rise if the consumer makes minimum payments because any unpaid interest is added to the principal balance. Eventually, these loan contracts require repayment of both principal and interest. Consumers who routinely make minimum payments can be subject to considerable payment shock in the future when the required payment increases to begin repayment of the loan's principal.

The Board proposed a disclosure for payment option mortgages to be included with the monthly statement for these loans. The disclosure gives the amount of the minimum

[34] Thomas A. Durkin (2000), "Credit Cards: Use and Consumer Attitudes, 1970–2000," *Federal Reserve Bulletin* (September), pp. 623–34, www.federalreserve.gov/pubs/bulletin/2000/0900lead.pdf.

[35] Neil Stewart (2009), "The Cost of Anchoring on Credit Card Minimum Payments," *Psychological Science*, vol. 20, pp. 39–41.

required payment, as well as other payment options that may be available, such as a payment that covers only the interest, and the fully amortizing payment that covers interest as well as principal. The proposed model form also included information on the effects of making the different payments—e.g., that the minimum payment would increase the loan balance and result in significantly higher payments in the future. This proposed model is similar to an illustration issued by the federal financial institutions supervisory agencies.[36] All testing participants who viewed the disclosure form understood that they had multiple payment choices for the loan, and that there were consequences for selecting the different payments. Most understood the implications of making the minimum payment included increasing their loan balance and having to make larger payments in the future.

Clearly, effective disclosure of complex products and decisions requires careful thinking about how the individual pieces of information relate to the whole and about what additional contextual information consumers might require in order to correctly interpret—and effectively use—the information provided by the disclosure.

Achieving a Neutral Tone Can Be Challenging

Disclosures have historically been intended to present “just the facts”: They should not steer the consumer in one direction or the other. However, as “choice architecture”—the idea that the way options are presented influences what people choose—has entered the policy discussion, policymakers recognize that few presentations of information may be truly neutral.

Some aspects of choice architecture are set by statute, and others may be left to the discretion of the agency with implementing authority. Within the framework set by statute, the goal for presentation of information may still be a disclosure that does not steer consumers, yet sometimes maintaining a neutral tone can be challenging for regulators.

Experiences from the Privacy Notice Project

For the interagency privacy notice project, the choice architecture is set by statute and is structured so that the consumers’ information will be shared unless they opt to limit the sharing (**example 2**).[37] The goal of the notice is to, first, inform consumers about the information-sharing practices of their financial institutions and, second, discuss their choices for limiting information sharing without steering the individual toward a particular decision. The testing focused on using factual wording, objective presentation, and neutral words. In each round of testing, interviewers listened for comments, reactions, and perceptions from consumers that indicated areas of potential bias in the notice. The iterative testing process led the agencies to incorporate design elements (for example, the Why? What? and How? frame and the table format) and language that resulted in a final notice designed to be clear and neutral.

The situation where firms that did not share information and, therefore, did not offer an opt out was a challenge—that is, there was nothing to opt out of, since the institution did not share. In early rounds of testing, consumers reacted negatively to seeing the question “Can you limit this sharing?” answered by “No.” Consumers who preferred not to have their information shared judged institutions that did not share less favorably than they did

[36] Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, and National Credit Union Administration (2006), “Proposed Illustrations of Consumer Information for Nontraditional Mortgage Products,” *Federal Register*, vol. 71 (October 4), pp. 58672–78, http://edocket.access.gpo.gov/2006/pdf/06-8479.pdf.

[37] Gramm-Leach-Bliley Act, 15 U.S.C. 6801–6809.

Example 2. Interagency Privacy Notice Disclosure Form

Through successive rounds of testing, the interagency privacy notice project team developed a disclosure form for institutions to use in informing consumers about their information-sharing practices and to highlight consumers' choices for limiting the information shared by the institution. This sample (from page 1 of the form) illustrates the final design elements and language included in the notice.

FACTS	WHAT DOES MARS BANK DO WITH YOUR PERSONAL INFORMATION?
Why?	Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.
What?	The types of personal information we collect and share depend on the product or service you have with us. This information can include: ▪ Social Security number and income ▪ account balances and payment history ▪ credit history and credit scores When you are no longer our customer, we continue to share information about you as described in this notice.
How?	All financial companies need to share customers' personal information to run their everyday business—such as to process transactions, maintain customer accounts, respond to court orders and legal investigations, and report to credit bureaus. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons Mars Bank chooses to share; and whether you can limit this sharing.

Reasons we can share your personal information	Does Mars Bank share?	Can you limit this sharing?
For our everyday business purposes— to process your transactions, maintain your account, and report to credit bureaus	Yes	No
For our marketing purposes— to offer our products and services to you	Yes	No
For joint marketing with other financial companies	No	We don't share
For our affiliates' everyday business purposes— information about your transactions and experiences	No	We don't share
For our affiliates' everyday business purposes— information about your creditworthiness	No	We don't share
For our affiliates to market to you	No	We don't share
For nonaffiliates to market to you	No	We don't share

Contact Us	Call 1-800-898-9696 or go to www.marsbankco.com/privacy

institutions that shared but offered an opt out (in some cases, even if consumers exercise all opt outs, institutions could still share some information). In subsequent rounds, the "No" was replaced with "We don't share," and more consumers understood that they did not need to opt out of information sharing with these institutions.

Creating a Disclosure May Involve Creating a Choice Structure

The right for consumers to limit the sharing of their personal information disclosed in the privacy notices was established by statute as an opt-out choice. However, the law does not always prescribe the options consumers must be offered or how those options are to be structured. Creating simpler or more straightforward disclosures may not be feasible if the

underlying choice options vary significantly across the market or are inherently complicated.

In cases where the choice options are not standardized by law, the Board may decide to use its authority to create a standard by regulation. As noted earlier, the choice architecture of how options are presented can affect consumer decisionmaking. In addition, establishing this underlying structure may be a part of creating or improving a disclosure.

Experiences from the Bank Overdraft Disclosure Project

In the case of overdraft disclosures, the regulations establishing the choice structure for overdraft coverage of different types of transactions were based on information about consumer preferences. In the testing of disclosures for banks' standard overdraft practices, participants were asked questions about their preferences about how banks handle different types of overdrafts as well as about sample overdraft disclosures. Many indicated that they would like their bank to cover overdrafts for checks; automated clearinghouse and recurring automatic payments, such as mortgage and car loans; and other regular bills. However, the majority did not want the bank to cover overdrafts on ATM transactions and point-of-sale debit card purchases (referred to in the final disclosure as "everyday debit card transactions"). For these latter transaction types, consumers often preferred that the bank decline the transaction instead of covering it and charging them a fee. In addition, when asked whether they would prefer to have the right to opt out of automatic overdraft coverage for ATM and point-of-sale debit card transactions, or to opt in to having overdrafts on these transactions covered by the bank, most indicated they preferred to opt in—in other words, that the default option would be *not* to have these transaction covered.

Reflecting consumer preferences in the disclosure design required not only development of disclosures but also issuance of complementary rules to standardize bank practices regarding overdrafts. Because banks varied in how they treated overdrafts on different types of transactions, the Board developed rules requiring that overdraft coverage for ATM and everyday debit transactions, when available, be offered as an opt-in choice for consumers.

Standardizing Disclosure Can Be Challenging

Standardization can be beneficial in helping consumers locate and understand information on disclosures. However, customization may more effectively highlight characteristics of different products or alert consumers when a familiar piece of information may have a different meaning.

Standardization across Financial Product Lines

Results from early testing of credit card disclosures revealed how standardization can help consumers recognize disclosures. Early in the testing of credit card solicitations, participants looked for the "Schumer Box"—a required table containing certain key information in credit card solicitations. Because participants recognized and were comfortable with this tabular presentation device, it was retained in the redesigned credit card disclosures. In addition, some of the proposed early disclosures for mortgages and home equity lines of credit (HELOCs) use a similar design. While these design similarities are subtle, some have suggested a more well-defined "nutrition label" for financial products.[38] Ideally, if information could be presented using a standard, and relatively limited, set of concepts and design

[38] Susan E. Woodward (1998), "Regulatory Capture at the U.S. Securities and Exchange Commission," paper prepared for the Milken Institute Conference on Capital Markets (March 16), http://mail.sandhillecon.com/pdf/RegulatoryCapture.pdf.

elements, this would support learning over time, and a "transfer of learning" as consumers encounter the same type of information for different products.

Another example of disclosure standardization across financial product types is the requirement for product providers to disclose the "year-to-date" amount of fees and interest paid in required and proposed disclosures for checking accounts, credit cards, and home equity lines of credit. If consumers have more than one of these products, they will begin to recognize and become comfortable with the standardized "year-to-date" box approach to disclosure of fees and interest charges.

Departing from Standardization to Highlight Product Characteristics

Nevertheless, while the idea of using common design and information elements across financial disclosures is both appealing and potentially beneficial, the variety and complexity of financial products presents challenges for standardizing disclosures.

For example, consider the case of disclosing payments on closed-end mortgage products. In the past, TILA mortgage disclosure regulations required a standardized payment table that included all the required monthly payments due under the terms of the transaction (**example 3**). For adjustable rate mortgages (ARMs), future payments were disclosed under the assumption that the underlying index on which the rate was based would remain constant over time at its initial value. Under this disclosure regime, a 30-year ARM that adjusted once a year and started at the fully indexed rate (i.e., there was no discount or premium associated with the starting rate) might result in disclosure indicating 360 identical payments. A 30-year fixed rate mortgage could also have had a disclosure that showed 360 identical payments. However, in reality, the payment on the ARM loan would likely have changed over time, while the payment on the fixed rate loan would not. The disclosures in this case would have been very standardized, yet would have failed to reveal important differences in the potential payments and net costs to the consumer.

The revised payment tables for closed-end mortgages that lenders will be required to give to consumers (as of October 2011, **example 4**) are differentiated for several different types of mortgages in an effort to highlight the features that should be most relevant for consumer decisionmaking for that product. Proposed payment tables for fixed-rate mortgages are simpler, since the principal and interest payment remains the same; for more complex ARM products such as the hybrid ARM example included here, the proposed payment table includes additional information on (1) the maximum rate and payment during

Example 3. Old TILA Payment Table for 3/1 Hybrid ARM

In the past, TILA mortgage disclosures included a standardized payment table listing the required monthly payments due under the terms of the loan. For adjustable rate mortgages (ARMs), future payments were disclosed under the assumption that the underlying index on which the rate would be based remained constant over time at its initial value. However, as the example below illustrates, the table did not clearly show the potential difference in the required payment if interest rates were to change.

Payment Schedule: Payments will be due monthly

Number of Payments	Amount of Payment	Payments Begin
36	$ 1,564.94	04/01/2010
323	$ 1,607.07	04/01/2013
1	$ 1,605.09	03/01/2040

Example 4. New TILA Payment Table for 3/1 Hybrid ARM

New payment tables for closed-end mortgages informed by the Board's consumer testing of mortgage disclosures are adapted to accommodate different products. For ARMs like the one in the sample below, the table that lenders will be required to give consumers (as of October 2011) includes information on the maximum rate and payment; the payment table for a fixed rate mortgage may only have a single column if the payment does not change.

INTEREST RATE AND PAYMENT SUMMARY

	INTRODUCTORY Rate & Monthly Payment (for first 3 years)	**MAXIMUM during FIRST FIVE YEARS** (Mar. 2015)	**MAXIMUM EVER** (as early as Mar. 2017)
Interest Rate	4.75%	8.75%	10.75%
Principal + Interest Payment	$1,564.94	$2,286.12	$2,662.14
Est. Taxes + Insurance (Escrow)	$433.33	$433.33	$433.33
Total Est. Monthly Payment	**$1,998.27**	**$2,719.45**	**$3,095.47**

Introductory Rate Notice
You have a discounted introductory rate of 4.75% that ends after 3 years.
In the fourth year, even if market rates do not change, this rate will increase to 5.00%.

the first five years of the loan, and (2) the maximum rate and payment over the term of the loan.

The Impact of Differing Legal Requirements on Standardization Efforts

Sometimes the transfer of learning that occurs through standardized disclosure proves beneficial; at other times, it can be confusing or potentially misleading. Consider the case where financial products are governed by multiple statutes with multiple requirements. For example, credit and debit cards may carry the same logo, but they are governed by different laws (TILA and the Electronic Fund Transfer Act, respectively) that have different disclosures and different consumer protections (e.g., different liability limits). Consumers who "transfer" lessons learned from owning one card product to the ownership of another would be making decisions based on wrong assumptions. In some cases, the Board chose to use distinctly "nonstandard" language in order to highlight differences in financial products. For example, in consumer leasing disclosures, the Board uses the terms "capitalized cost reduction" and "rent charge" rather than "down payment" and "finance charge" to differentiate the terms of a vehicle lease from those of a vehicle loan.

Thus, while creating and maintaining consistency across disclosures for different products is beneficial, at times consumers may need to be alerted when a standard or familiar piece of information has a different meaning for another product. Furthermore, as products become more innovative and more complex, and as new parties become part of the regulatory scene (for example, the Federal Communications Commission in the case of mobile banking), designing meaningful disclosures will become increasingly difficult.

What Works in Print May Not Work Online

The Board's research found that what works for a recipient of a print disclosure may not work when transferred to another recipient's "screen of choice," be it a computer monitor

or a mobile device.[39] Changing the delivery channel for consumer disclosures may mean revising the format and being willing to modify content.[40] In the case of web presentations of disclosures, the three-dimensional nature of the Internet can enable consumers to link to more detailed information, allowing for education on the product. But getting consumers to notice and then click on key links can be as challenging as getting them to interact with the paper disclosure.

Conventional wisdom has it that consumers will read hard-copy print but scan web pages, so web designers have learned to write for "scannability." However, there is growing evidence that consumers are transferring their web page scanning techniques to print media. Thus, print disclosures are beginning to incorporate some of the elements of web page design—for example, grouping information, using graphics (boxes and bullets), and writing in "chunks" rather than prose.

"Less Is More" Often Remains True

While additional content helps comprehension in some cases, sometimes less is more. Too much information can overwhelm consumers or distract their attention from key content. It may be better to focus on a handful of elements rather than "full disclosure."

For example, when redesigning the disclosure box for credit cards, the disclosures quickly became focused on rates and fees. Other information that had been in the box—for example, balance calculation methods—was moved to an area below the box.

In the first three rounds of testing of HELOC disclosures, furthermore, many participants misunderstood the historical payment examples in the current application disclosure.[41] Many participants did not realize that the example showed what payments on a $10,000 loan would have been under actual historical rates. Some thought the example showed a hypothetical future scenario of what might happen to rates and payments and did not see the example as useful because they did not think it provided any information about their loan. Others erroneously thought that the example showed their loan and that the payments would be their exact monthly payments. Even when the table was explained, participants who had originally misunderstood the example still did not think the information provided was useful. Some participants who understood the example indicated that what they found valuable was seeing how much the index had varied over time because this gave them information that helped them evaluate the likelihood the interest rate could reach its maximum in the future. Based on these findings, the revised HELOC application disclosure proposed by the Board did not include the historical example. Instead, the form included the range of the value of the index over a 15-year period in a section for "Historical Change in Interest Rate" to provide the most important information from the historical example.

In the Board's testing of overdraft notices, a few participants gave incorrect answers to questions about how the bank would handle overdrafts because they focused on a paragraph that explained limited exceptions (that is, when the bank might pay certain types of transactions that overdrew the account, even though the bank's standard practice was to

[39] Thus far, the Board has not ventured into disclosure design for smart phones.

[40] Kleimann Communication Group, Inc. (2009), *Web-Based Financial Privacy Notice Final Summary Findings Report* (October 29), submitted to the FTC, www.ftc.gov/privacy/privacyinitiatives/WebbasedNoticeFinalSummaryReport.pdf.

[41] Macro International Inc. (2009), *Design and Testing of Truth in Lending Disclosures for Home Equity Lines of Credit* (July 16), report submitted to the Board of Governors of the Federal Reserve System, www.federalreserve.gov/boarddocs/meetings/2009/20090723/Full%20HELOC_Macro%20Report.pdf.

decline such transactions). Because the discussion of the technical exceptions appeared to distract some participants from the more important concepts in the disclosure, this paragraph was dropped from the final required language. Instead, the final required disclosure states that "If we do not authorize and pay an overdraft, your transaction will be declined." In simplifying the text to state the standard practice and not the exception, the disclosure sacrificed some technical accuracy to focus attention on the more important information in the disclosure.

Challenges, Caveats, and the Need for Additional Research

If disclosure revisions serve their intended purposes—transparency and consumer protection—consumers will make better decisions for their personal circumstances in actual financial services transactions. The implicit assumption underlying the testing approaches used in the projects described in this article is that better performance by consumer testers in recognizing, comprehending, and using the disclosures in a controlled setting, with their attention focused on the document and the task at hand, will be correlated with improved consumer decisionmaking in the real world. This correlation is not a given, however, and questions remain about how the findings from testing might apply in practice.

While the focus here is on the efficacy of disclosure, such discussion cannot be divorced from the consideration of other complementary policies. Failure—or limited success—with disclosures may point to the need for other approaches, not just more or better disclosure. For example, other types of policies that may complement or supplement disclosures include regulations affecting the timing of disclosure delivery, or the pairing of disclosure with other information interventions (e.g., education, counseling); regulations on seller incentives or behaviors; prohibitions or restrictions on product offerings; and enforcement mechanisms on sellers to promote compliance with regulations. Disclosure is most usefully viewed as one component of a larger strategy that employs other policy tools and education efforts to improve decisions and outcomes for consumers. (See **box 2** for a fuller discussion of tools and strategies beyond disclosure.)

Measurement and Methodology

Making Distinctions between Good Decisions and Good Outcomes

One challenge in determining the real-world impact of changes in disclosures is the problem of observing and evaluating decisions. In a controlled environment, a researcher can control the options presented. But, in practice, it is easier to obtain information about the choice a consumer made than it is to know the details of all the options they considered. It also can be difficult to distinguish a "good" decision from a "bad" one, especially if that evaluation depends on consumer-specific preferences or circumstances. A product may be a good fit for one consumer but a bad fit for another. For example, a payment option mortgage may make sense for someone with irregular income and the discipline to make additional principal payments when possible; but it may be hazardous for households that continually focus on the minimum payment.

Furthermore, information may be available on outcomes, but good decisions do not necessarily imply a good outcome or vice versa. Products that were the right choice at the time may turn out to be suboptimal three to five years later, or when a household's circumstances change.

It would be helpful to know more about how consumers structure their decisions and how they go about assessing the range of products in the market. Additionally, researchers want

Box 2. When Disclosures Aren't the Right Tool

Standardized disclosures can be helpful for simple, straightforward information, such as interest rates and fees. But when products and product features become complex, other tools are needed to provide the type and level of consumer protection deemed desirable. Regulators need to consider when to disclose important information directly to consumers; when to encourage consumers to seek other education, advice, or counsel; and when to step in and provide substantive regulations that provide consumer protection.

Given the inherent limitations of disclosure, such as space and design constraints, there is a role for supplementary strategies for providing information to consumers.

- **Promoting direct consumer interaction with regulator resources.** Information and education can include print materials and web resources to complement disclosure, and can involve strategies such as public awareness campaigns and initiatives to build capacity among educators.[1] For example, required credit card disclosures refer consumers to the Board's website (www.federalreserve.gov/creditcard) to learn more about the features of credit cards that they may want to consider using. Once consumers determine what else may be important to them, they can search a database of credit card plans (www.federalreserve.gov/creditcardagreements or www.federalreserve.gov/creditcard/survey.htm) to find a card that has the features they seek.

  Furthermore, print disclosures are inherently static, while other consumer information has the potential for being dynamic. Online resources can be much more interactive and allow consumers to consider alternatives. Calculators, such as the Board's Credit Card Repayment Calculator (www.federalreserve.gov/creditcardcalculator), can help consumers get estimates of their costs and payments, and "apps" can allow consumers to do real-time comparisons at the point of sale, whether this is in the lender's office or at the kitchen table.

- **Encouraging consumers to use other education resources.** Consumer information and education can supplement and go beyond what is possible in disclosures. Materials can be layered so that consumers can get the equivalent of a "quick start" (for example, the Board issues a series of 5 Tips on products and has a *What You Need to Know* series for new rules). These brief information vehicles feed into more comprehensive resources, such as websites, that dig deeper into the details of the product features, provide examples and illustrations, and offer interactive tools.

  Findings from testing provide some insights into consumer responses to these types of materials. In the course of developing revised mortgage disclosures, testing participants were shown several educational disclosures for mortgages. One of these was a "Mortgage Shopping Checklist," which listed six action steps consumers should take before applying for a mortgage.[2] About half the participants who reviewed this disclosure felt it would be useful to them. Generally, participants who had more experience with mortgages were more likely to say they would not use the information; however, some of these participants indicated that they thought the disclosure would be useful to first-time borrowers.

- **Issuing substantive regulations to protect consumers.** In addition to improving the design of disclosures and educational materials, findings from consumer testing can also inform the decision to implement substantive regulations to protect consumers. Rules may be put into place to complement or facilitate disclosure-based protections, as in the case of the opt-in provisions for certain types of overdraft coverage discussed elsewhere in this article.

  In other cases, testing may reveal the need to develop new regulations of products or practices rather than disclosure-based protections. For example, in March 2008, the Board tested information about how credit cardholders' payments would be allocated among different balances (purchases, cash advances, and balance transfers, which usually carry different interest rates). More than half of participants already understood that banks usually applied payments to lower-rate balances before higher-rate balances; several of these commented that they thought this practice was unfair. Among those who did not have this understanding, none understood payment allocation any better after reading the explanation provided in the testing.[3] The final rule proposed by the Board in December 2008 required banks to allocate payments exceeding the minimum payment to the balance with the highest rate first or pro rata among all of the balances.

continued on next page

Box 2.—*continued*

Subsequently, the Credit CARD Act required that excess payments must always be allocated first to the balance with the highest rate. In addition, the Credit CARD Act provided that, when a balance on an account is subject to a deferred interest or similar program, excess payments must be allocated first to that balance during the last two billing cycles of the deferred interest period so that the consumer can pay the balance in full and avoid deferred interest charges. The Board's final rule issued in January 2010 mirrors the statutory requirements. However, in order to provide consumers who use deferred interest programs with additional means of avoiding deferred interest charges, the final rule also permits issuers to allocate excess payments in the manner requested by the consumer at any point during a deferred interest period. This exception permits consumers to pay off a deferred interest balance in installments over the course of the deferred interest period.[4]

[1] Sandra F. Braunstein (2009), "Financial Literacy," statement before the Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia, Committee on Homeland Security and Governmental Affairs, U.S. Senate, April 20, www.federalreserve.gov/newsevents/testimony/braunstein20090429a.htm.

[2] These recommended steps included obtaining a free credit report, deciding how much savings to put towards a home, comparing quotes from at least two lenders or brokers, reviewing two web publications, and seeking out help from a HUD-approved counselor if needed.

[3] Macro International (2008), *Design and Testing of Effective Truth in Lending Disclosures: Findings from Qualitative Consumer Research* (December), report submitted to the Board of Governors of the Federal Reserve System, www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a7.pdf.

[4] Board of Governors of the Federal Reserve System (2010), "Federal Reserve Approves Final Rules to Protect Credit Card Users from a Number of Costly Practices," press release, January 12, www.federalreserve.gov/newsevents/press/bcreg/20100112a.htm.

to understand the connections between consumers' information gathering, disclosures, decisionmaking, and outcomes.

While some information on shopping and choice has been gathered during the Board's disclosure testing, better use must be made of what is already known about shopping and choice from existing research. There is also a need to continue exploring how surveys, interviews, or perhaps more innovative data collection methods could improve understanding of information format preferences, financial product search, choice, and outcomes.

Measuring the Impact of Disclosure on Consumer Decisions

A second challenge is measuring the impact of disclosures on decisions. The context provided by a consumer's prior knowledge—or perceived knowledge—along with the explanation provided in a document and the organization of the information can greatly influence the effectiveness of disclosure. In addition, the context in which information is delivered also has a major effect on the way a consumer responds.

For example, some participants in testing of disclosures for private student loans indicated that time pressure was a factor in deciding to take the first loan offered because getting the best deal was a lower priority than getting the tuition paid on time.[42] In addition, consumers may listen to a sales agent that they trust and not read the disclosures. Or, the consumer may be under pressure to complete a transaction and choose to ignore information just to finish the task (consider how many people scroll through online disclosures and click on "I agree"—without completely reading those disclosures—in order to download content or

[42] Rockbridge Associates, Inc. (2009), *Consumer Research and Testing for Private Education Loans: Report of Findings* (March), submitted to the Board of Governors of the Federal Reserve System, www.federalreserve.gov/newsevents/press/bcreg/bcreg20090311a8.pdf; and Rockbridge Associates, Inc. (2009), *Consumer Research and Testing for Private Education Loans: Final Report of Findings* (July), report submitted to the Board of Governors of the Federal Reserve System, www.federalreserve.gov/newsevents/press/bcreg/bcreg20090730a2.pdf.

connect to a website). Consumers may understand the disclosure, but they may not know of other options or may lack the understanding of how the information applies to their own situation—in other words, they may not be making a fully informed choice. These contextual factors can easily alter or perhaps override the effects of improved disclosures.

While ex ante measurement of the effects of disclosure changes on financial behavior would be ideal for policy development, ex post evaluation is valuable as well. Efforts are under way to examine the effects of implementing the Credit CARD Act, including possible effects of the payment scenarios on repayment behavior.[43] However, given that changes under the act went into effect relatively recently, and that those changes were implemented in the midst of a major economic crisis, establishing a body of research evidence on the impacts of the changes will take time.

The Marketplace Effects of Disclosure

Another challenge is that disclosures may impact not only the behavior of consumers but also the actions of suppliers. These effects can sometimes be unpredictable or counterintuitive. For example, experimental evidence indicates that providing a conflict of interest disclosure may increase the bias in the recommendations of advisors, possibly because the advisor has less guilt about acting out of self-interest when the client has been forewarned.[44]

Disclosure policies also can affect suppliers' incentives in pricing. For example, rules for calculating the APR have been fairly explicit about what fees must be included in the calculation and what fees are "outside" the APR. Under this "some fees in, some fees out" approach for calculating the APR on a closed-end mortgage, lenders have an incentive to shift some costs into fees that are excluded from the APR, resulting in a lower APR. In its July 2009 proposed rules, the Federal Reserve proffered a more inclusive APR definition for mortgages, noting that lenders would have less incentive to include "junk fees" in credit agreements if the APR calculation included most or all fees.[45]

Optimizing versus Constrained Maximization

It is rare that disclosures start out as a *tabula rasa*. In most situations, those involved in designing disclosures are guided and, at times, constrained by language in the laws passed by Congress, the need to consider both consumer benefit and creditor burden under revised rules, or by other institutional limits. In these situations, disclosures may not help consumers optimize as much as they might only increase utility at the margin.

For example, some have argued that other metrics of overall loan cost would be better tools than the APR for consumers shopping for mortgages. However, the APR is the disclosure required by law. Likewise, simple products may only need simple disclosures, but the complexity in the marketplace requires that disclosures cover a range of options and alternatives. While "one size" may not fit all, it may be the only size available under the conditions.

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[43] Presentations from the CFPB's Conference "The CARD Act One Year Later," held on February 22, 2011, are available at www.consumerfinance.gov/credit-cards/credit-card-act/card-act-conference-key-findings/.

[44] Daylian M. Cain, George Loewenstein, and Don A. Moore (2005), "The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest," *Journal of Legal Studies,* vol. 34 (January), www.cbdr.cmu.edu/mpapers/CainLoewensteinMoore2005.pdf.

[45] Board of Governors of the Federal Reserve System (2009), *Federal Register*, vol. 74 (August 26), pp. 43232–425, http://edocket.access.gpo.gov/2009/pdf/E9-18119.pdf.

It is also the case that there can be a disconnect between when consumers need information for making decisions and when the disclosure is provided. For example, consumers may be better served by receiving information on mortgage rates and terms when they first begin to think about mortgage choices—that is, through real estate agents and at open houses, before the emotional attachment to a house and the time pressure to apply for a loan come into play. Instead, they receive this information only when they contact a lender, and given that consumers may choose to only contact one lender, there is not much of a decision to be made.

To date, almost all of the consumer-tested disclosures have been developed in a printed paper format. Given innovations in technology, it is certainly possible for consumers to have more access to interactive information and decision tools. Real-time quotes or applications that allow consumers to compare across a range of lenders or service providers raise the issues of how to design disclosures for these settings and the level of effort required by both lenders and consumers to deal with this real-time information.

Duration of Disclosure Testing

Yet another challenge in designing disclosures is that doing it well takes time. Indeed, comprehensive testing, including qualitative document development and quantitative validation testing, can take several years, depending on the complexity of the product and the disclosure documents needed to meet regulatory requirements.[46] Interagency coordination and statutory changes during development can lengthen the process. It is critical, however, to allow time for the intensive analysis at each iteration and stage of the process in order to develop a disclosure that can perform better than what has come before it.

For example, the interagency privacy notice project began with a public workshop in December 2001, shortly after the law mandating the notices went into effect. In December 2003, the eight agencies involved issued an Advance Notice of Proposed Rulemaking, seeking public comment on whether and how the agencies should develop an alternative privacy notice. In the summer of 2004, six of the agencies entered into a Memorandum of Understanding and initiated a consumer research project, issuing a report on March 2006, together with a prototype financial privacy notice.

The agencies then initiated a quantitative validation study, but in October 2006, Congress explicitly directed the agencies to develop and propose “a model form” for voluntary use by financial companies; the study was temporarily suspended. In March 2007, the agencies issued a proposed a rule using the prototype notice as the model form. The quantitative validation study resumed in March and April 2008. The analysis and final report on this was submitted in December 2008. The agencies considered further revisions to the form based on that report, and these changes were validated through additional qualitative testing.[47] In December 2009, the agencies published a final model form rule, and in April 2010, they provided an online form builder for financial institutions.

Work on revisions to credit card disclosures began in 2004, with an Advance Notice of Proposed Rulemaking issued in December 2004. The contract for consumer testing

[46] In addition, the rulemaking process includes a comment period for proposed rules. For example, the comment period for the proposed credit card rules issued in May 2007 was 120 days.

[47] See Macro International Inc. (2008), *Mall Intercept Study of Consumer Understanding of Financial Privacy Notices: Methodological Report* (September 18), submitted to the FTC, www.ftc.gov/privacy/privacyinitiatives/Macro-Report-on-Privacy-Notice-Study.pdf; and Kleimann Communication Group, Inc. (2009) *Financial Privacy Notice: A Report on Validation Testing Results* (February 12), submitted to the FTC, www.ftc.gov/privacy/privacyinitiatives/validation.pdf.

research was issued in April 2006, with the first report and proposed rule issued in May 2007.[48] Additional qualitative and quantitative testing was conducted in 2007 and 2008, with final reports and a final rule issued in December 2008.[49] In May 2009, Congress passed the Credit CARD Act, which included some additional disclosures and covered some additional products (for example, gift cards).

Conclusion

Findings from both quantitative and qualitative consumer testing conducted to inform the development of disclosures show the potential for improvements in consumer comprehension and usability of disclosures. These findings also reveal some of the limitations of disclosures, including the difficulty of making complex concepts or products understandable to consumers.

In addition to the limitations revealed by testing in a controlled environment, the impact of disclosures on consumer decisionmaking in actual financial transactions is likely to be affected by other factors, such as the context in which the disclosure is delivered and the behavior of suppliers. It is in confronting these limitations of disclosure and other real-world complications where it is particularly useful to expand the range of policy tools under discussion to include not only disclosure, but also education and substantive regulation.

The growing complexity of financial products; the number of choices, providers, products, and features; and the complexity of the regulation of these products suggest that more research is needed to inform and evaluate policies. But it also raises important questions about what research and what policies are not just informative, but truly strategic for focusing consumers and policymakers on the dimensions of choice that can meaningfully improve consumer welfare and the function of markets.

[48] Macro International Inc. (2007), *Design and Testing of Effective Truth in Lending Disclosures* (March 16), submitted to the Board of Governors of the Federal Reserve System, www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf.

[49] Macro International Inc. (2008), *Design and Testing of Effective Truth in Lending Disclosures: Findings from Experimental Study* (December 15), submitted to the Board of Governors of the Federal Reserve System, www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a8.pdf; and Macro International Inc. (2008), *Design and Testing of Effective Truth in Lending Disclosures: Findings from Qualitative Consumer Research* (December 15), submitted to the Board of Governors of the Federal Reserve System, www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a7.pdf.

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The Mortgage Market in 2010: Highlights from the Data Reported under the Home Mortgage Disclosure Act

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The Home Mortgage Disclosure Act of 1975 (HMDA) is a consumer protection statute requiring most mortgage lending institutions with offices in metropolitan areas to publicly disclose detailed information about their home-lending activity each year. The Congress intended that HMDA achieve its legislative objectives primarily through the force of public disclosure.[1] These objectives include helping members of the public determine whether financial institutions are serving the housing needs of their local communities and treating borrowers and loan applicants fairly, providing information that could facilitate the efforts of public entities to distribute funds to local communities for the purpose of attracting private investment, and helping households decide where they may want to deposit their savings. The data have also proven to be valuable in a variety of public policy and research endeavors to explore mortgage market activity; in this connection, the HMDA data have been especially valuable when combined with other types of information, such as the socioeconomic and demographic status of different populations and geographies.

The 2010 HMDA data consist of information reported by more than 7,900 home lenders, including all of the nation's largest mortgage originators. Together, the home-purchase, refinance, and home-improvement loans reported represent the majority of home lending nationwide and thus are broadly representative of all such lending in the United States.[2] The HMDA data include the disposition of each application for mortgage credit; the type, purpose, and characteristics of each home mortgage that lenders originate or purchase during the calendar year; the census-tract designations of the properties related to those loans; loan pricing information; personal demographic and other information about loan applicants, including their race or ethnicity and income; and information about loan sales.[3]

Until recently, the Federal Reserve Board implemented the provisions of HMDA through its Regulation C.[4] On July 21, 2011, rulemaking responsibility for HMDA was transferred

Note: This article was prepared in September 2011, before revisions were made to scheduled loan-size limits applicable to loans purchased by the Federal Housing Administration, Fannie Mae, and Freddie Mac. Subsequently, only the changes applicable to Fannie Mae and Freddie Mac were implemented.

1 A brief history of HMDA is available at Federal Financial Institutions Examination Council, "History of HMDA," webpage, www.ffiec.gov/hmda/history2.htm.

2 It is estimated that the HMDA data cover about 90 to 95 percent of Federal Housing Administration lending and between 75 and 85 percent of other first-lien home loans. See U.S. Department of Housing and Urban Development, Office of Policy Development and Research (2011), "A Look at the FHA's Evolving Market Shares by Race and Ethnicity," *U.S. Housing Market Conditions* (May), pp. 6–12, www.huduser.org/portal/periodicals/ushmc/spring11/USHMC_1q11.pdf.

3 A list of the items reported under HMDA for 2010 is provided in appendix A.

4 Information about Regulation C (12 C.F.R. pt. 203) is available at www.federalreserve.gov.

from the Board to the newly established Consumer Financial Protection Bureau (CFPB) (discussed later in the section "Future Changes in HMDA").[5] The Federal Financial Institutions Examination Council (FFIEC) has played, and will continue to play, a role in collecting the HMDA data from reporting institutions and facilitating public access to the information.[6] In September each year, the FFIEC has released summary tables pertaining to lending activity from the previous calendar year for each reporting lender and aggregations of home-lending activity for each metropolitan statistical area (MSA) and for the nation as a whole.[7] The FFIEC also has made available to the public a data file containing virtually all of the reported information for each lending institution.[8]

This article offers a summary of the 2010 HMDA data and provides basic tables created from these data and the HMDA data from earlier years.[9] We then narrow the focus and present more-detailed findings from our initial review of the data. Our review highlights several prominent findings:

- Mortgage originations decreased between 2009 and 2010 in the HMDA data from just under 9 million loans to fewer than 8 million loans. Most significant was the decline in the number of refinance loans despite historically low baseline mortgage interest rates throughout the year. Home-purchase loans also dropped, but less so than the decline in refinance lending.
- While loans originated under the Federal Housing Administration (FHA) mortgage insurance program and the Department of Veterans Affairs (VA) loan guarantee program continue to account for a historically large proportion of loans, such lending fell more than did other types of lending.
- We draw on data from a national credit bureau to highlight the importance of house price declines and changes in underwriting relative to earlier in the decade for refinance activity during 2010. We estimate that, in the absence of home equity problems and underwriting changes, roughly 2.3 million first-lien owner-occupant refinance loans would have been made during 2010 on top of the 4.5 million such loans that were actually originated.
- A sharp drop in home-purchase lending activity occurred in the middle of 2010, right alongside the June closing deadline (although the deadline was retroactively extended to September) of the federal first-time homebuyer tax credit program. The ending of this

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5 For information about the Consumer Financial Protection Bureau, see www.consumerfinance.gov.

6 The FFIEC (www.ffiec.gov) was established by federal law in 1979 as an interagency body to prescribe uniform examination procedures, and to promote uniform supervision, among the federal agencies responsible for the examination and supervision of financial institutions. The member agencies are the Board of Governors of the Federal Reserve System, the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and representatives from state bank supervisory agencies. Under agreements with these agencies and the Department of Housing and Urban Development, the Federal Reserve Board collects and processes the HMDA data.

7 For the 2010 data, the FFIEC prepared and made available to the public 45,961 MSA-specific HMDA reports on behalf of reporting institutions. The FFIEC also makes available to the public similar reports about private mortgage insurance (PMI) activity; for the 2010 data, it prepared and made publicly available 2,478 MSA-specific PMI reports on behalf of the PMI companies. All of the HMDA and PMI reports are available on the FFIEC's reports website at www.ffiec.gov/reports.htm.

The designation of MSAs is not static. From time to time, the Office of Management and Budget updates the list and geographic scope of metropolitan and micropolitan statistical areas. See Office of Management and Budget, "Statistical Programs and Standards," webpage, www.whitehouse.gov/omb/inforeg_statpolicy.

8 The only reported items not included in the data made available to the public are the loan application number, the date of the application, and the date on which action was taken on the application.

9 Some lenders file amended HMDA reports, which are not reflected in the initial public data release. A "final" HMDA data set reflecting these changes is created two years following the initial data release. The data used to prepare this article are drawn from the initial public release for 2009 and 2010 and from the "final" HMDA data for years prior to that. Consequently, numbers in this article for the years 2008 and earlier may differ somewhat from numbers calculated from the initial public release files.

program during 2010 may help explain the decline in the incidence of home-purchase lending to lower-income borrowers between the first and second halves of the year.

- Home-purchase lending in highly distressed census tracts identified by the Neighborhood Stabilization Program (NSP) was 75 percent lower in 2010 than it had been in these same tracts in 2005. This decline was notably larger than that experienced in other tracts and appears to primarily reflect a much sharper decrease in lending to higher-income borrowers in the highly distressed neighborhoods.
- The share of loans that originators hold in their portfolios rather than sell into the secondary market, especially among owner-occupant refinance loans, has risen since the beginning of 2009 but is still well below levels around the mid-2000s.
- National single-family home loan limits on both FHA loans and Freddie Mac and Fannie Mae purchases are scheduled to fall on October 1, 2011. Analysis of the 2010 HMDA data suggests that the number of loans affected by these limit changes is likely to be small. For example, about 1.3 percent of both the 2010 home-purchase and refinance loans fell into a size range affected by the proposed limit changes for Freddie Mac and Fannie Mae. Although the affected number of loans is small relative to the total number of loans, the analysis also shows that the number is large relative to the current jumbo loan market. How easily the private market would be able to absorb this potentially large increase in the market for jumbo loans is unclear.
- All loans reported in the 2010 HMDA data are covered under new rules governing whether a loan is classified as higher priced. The data show that the incidence of higher-priced lending across all products in 2010 was about 3.2 percent. As in the past, black and Hispanic-white borrowers were more likely in 2010, and Asian borrowers less likely, to obtain loans with prices above the HMDA price-reporting thresholds than were non-Hispanic white borrowers. These differences are significantly reduced, but not completely eliminated, after controlling for lender and borrower characteristics.
- Overall, loan denial rates remained about the same as in 2009. Analyses of the HMDA data in previous years have consistently found that denial rates vary across applicants grouped by race or ethnicity, which is also the case in 2010. However, the HMDA data do not include sufficient information to determine the extent to which these differences reflect illegal discrimination.

A Profile of the 2010 Mortgage Market

HMDA covers all of the nation's leading home lenders as well as a large number of others. Banking institutions—commercial banks, savings institutions (savings and loans and savings banks), and credit unions—account for most of the reporting entities, although many mortgage companies are covered as well. For 2010, 7,923 institutions reported on their home-lending activity under HMDA: 3,818 commercial banks; 856 savings institutions; 2,041 credit unions; and 1,208 mortgage companies, 839 of which were not affiliated with a banking institution (**table 1**).

The number of reporting institutions has fluctuated over the years. Some of the fluctuation is due to changes in reporting requirements, including increases in the minimum asset level used to determine coverage.[10] Mergers, acquisitions, and failures also account for some of

[10] For the 2011 reporting year (covering lending in 2010), the minimum asset size for purposes of coverage was $39 million. The minimum asset size changes from year to year with changes in the Consumer Price Index for Urban Wage Earners and Clerical Workers. The threshold for the 2010 data was unchanged from the level applicable to the prior year. See the FFIEC's guide to HMDA reporting at www.ffiec.gov/hmda/guide.htm.

Table 1. Distribution of reporters covered by the Home Mortgage Disclosure Act, by type of institution, 2000–10

Number

Year	Depository institution				Mortgage company			All institutions
	Commercial bank	Savings institution	Credit union	All	Independent	Affiliated[1]	All	
2000	3,609	1,112	1,691	6,412	981	332	1,313	7,725
2001	3,578	1,108	1,714	6,400	962	290	1,252	7,652
2002	3,628	1,070	1,799	6,497	986	310	1,296	7,793
2003	3,642	1,033	1,903	6,578	1,171	382	1,553	8,131
2004	3,945	1,017	2,030	6,992	1,317	544	1,861	8,853
2005	3,904	974	2,047	6,925	1,341	582	1,923	8,848
2006	3,900	946	2,037	6,883	1,334	685	2,019	8,902
2007	3,918	929	2,019	6,866	1,132	638	1,770	8,636
2008	3,942	913	2,026	6,881	957	550	1,507	8,388
2009	3,925	879	2,017	6,821	914	389	1,303	8,124
2010	3,818	856	2,041	6,715	839	369	1,208	7,923

Note: Here and in all subsequent tables, components may not sum to totals because of rounding.

[1] Subsidiary of a depository institution or an affiliate of a bank holding company.

Source: Here and in subsequent tables and figures except as noted, Federal Financial Institutions Examination Council, data reported under the Home Mortgage Disclosure Act (www.ffiec.gov/hmda).

the year-over-year changes. Finally, periodic changes in the number and geographic footprints of metropolitan areas influence reporting over time, as HMDA's coverage is limited to institutions that have at least one office in an MSA.

For 2010, the number of reporting institutions fell 2 percent from 2009, continuing a downward trend since 2006, when HMDA coverage included nearly 8,900 lenders. Among the types of reporters, the number of mortgage companies fell the most from 2009, decreasing 7 percent; since 2006, the number of mortgage companies has declined about 40 percent.

Reporting institutions vary greatly by both asset size and volume of reported mortgage lending activity. Most reporters are small, and many extend relatively few loans. For 2010, 53 percent of the banking institutions covered by HMDA had assets under $250 million, and 74 percent of them reported information on fewer than 100 loans; only 0.6 percent of these smaller banking institutions reported on more than 1,000 loans (**table 2**). Among all depository institutions, about 54 percent reported on fewer than 100 loans. Across different types of lenders, mortgage companies tend to originate larger numbers of loans on a per-reporter basis than the other institutions (38 percent of the mortgage companies reported more than 1,000 loans, a share more than five times that of depository institutions).

In any given year, institution failures and closings can affect the volume of reported loans and applications because some of the lenders that fail or were closed extended loans but did not report. Seventy-nine institutions that reported HMDA data for 2009 ceased operations and did not report lending activity for 2010.[11] Although it is not possible to know

[11] Each year, the Federal Reserve Board tracks each financial institution that is expected to report (including all lenders that reported data for the previous calendar year) and then contacts, if possible, those institutions that did not submit a report. In some cases, nonreporting is due to a cessation of business; in most others, it is the result of a merger, acquisition, or consolidation. When a merger, acquisition, or consolidation occurs, all lending by the institutions covered by HMDA in that year is supposed to be reported by the surviving entity; only when an institution goes out of business or the surviving entity is not a HMDA-covered reporter is the volume of reported loans likely affected.

Table 2. Number and distribution of home lenders, by type of lender and by number of loans, 2010

Type of lender, and subcategory (asset size in millions of dollars)	Less than 50		50–99		100–249		250–499		500–999		1,000 or more		All	
	Number	Percent of subcategory[1]	Number	Percent of subcategory[1]	Number	Percent of subcategory[1]	Number	Percent of subcategory[1]	Number	Percent of subcategory[1]	Number	Percent of subcategory[1]	Number	Percent of subcategory[1]
Depository institution														
Commercial bank														
Less than 250	1,126	53.5	426	20.2	392	18.6	116	5.5	29	1.4	15	.7	2,104	100
250–499	224	28.5	123	15.7	220	28.0	138	17.6	61	7.8	19	2.4	785	100
500–999	86	18.4	53	11.3	88	18.8	99	21.2	100	21.4	41	8.8	467	100
1,000 or more	52	11.7	24	5.4	56	12.6	42	9.5	81	18.3	188	42.4	443	100
All	1,488	39.2	626	16.5	756	19.9	395	10.4	271	7.1	263	6.9	3,799	100
Savings institution														
Less than 250	140	36.6	93	24.3	91	23.8	41	10.7	11	2.9	7	1.8	383	100
250–499	16	8.6	19	10.2	68	36.6	57	30.6	16	8.6	10	5.4	186	100
500–999	12	8.4	11	7.7	31	21.7	41	28.7	30	21.0	18	12.6	143	100
1,000 or more	5	3.5	7	5.0	13	9.2	22	15.6	31	22.0	63	44.7	141	100
All	173	20.3	130	15.2	203	23.8	161	18.9	88	10.3	98	11.5	853	100
Credit union														
Less than 250	766	55.8	300	21.9	256	18.7	41	3.0	8	.6	1	.1	1,372	100
250–499	51	16.7	34	11.1	104	34.0	80	26.1	30	9.8	7	2.3	306	100
500–999	14	7.1	10	5.1	43	21.8	55	27.9	49	24.9	26	13.2	197	100
1,000 or more		.0	1	.6	13	8.3	25	16.0	41	26.3	76	48.7	156	100
All	831	40.9	345	17.0	416	20.5	201	9.9	128	6.3	110	5.4	2,031	100
All depository institutions														
Less than 250	2,032	52.7	819	21.2	739	19.2	198	5.1	48	1.2	23	.6	3,859	100
250–499	291	22.8	176	13.8	392	30.7	275	21.5	107	8.4	36	2.8	1,277	100
500–999	112	13.9	74	9.2	162	20.1	195	24.2	179	22.2	85	10.5	807	100
1,000 or more	57	7.7	32	4.3	82	11.1	89	12.0	153	20.7	327	44.2	740	100
All	2,492	37.3	1,101	16.5	1,375	20.6	757	11.3	487	7.3	471	7.0	6,683	100
Mortgage company[2]														
All	185	16.1	110	9.5	139	12.1	119	10.3	159	13.8	440	38.2	1,152	100
All institutions	**2,677**	**34.2**	**1,211**	**15.5**	**1,514**	**19.3**	**876**	**11.2**	**646**	**8.2**	**911**	**11.6**	**7,835**	**100**

1 Distribution sums horizontally. For example, the second column, first row shows that 53.5 percent of commercial banks with assets of less than $250 million originated less than 50 loans in 2010.

2 Independent mortgage company, subsidiary of a depository institution, or an affiliate of a bank holding company.

how many applications or loans these 79 institutions originated in 2010 before discontinuing operations, one can gauge their potential importance by measuring their lending activity in 2009. In the aggregate, these nonreporting companies accounted for only 0.2 percent of the 2009 loan or application records submitted under HMDA. Therefore, it seems highly unlikely that the 2010 data are affected in any meaningful way by the underreporting that may have occurred because these lenders did not report activity for the part of 2010 in which they may have made some loans.

Reporting institutions submitted information on 12.95 million applications for home loans of all types in 2010 (excluding requests for preapproval), down about 14 percent from 2009 and far below the 27.5 million applications processed in 2006, just before the housing market decline (data derived from **table 3.A**). The majority of loan applications are approved by lenders, and most of these approvals result in extensions of credit. In some cases, an application is approved, but the applicant decides not to take out the loan; for example, in 2010, about 5 percent of all applications were approved but not accepted by the applicant (data not shown in tables). Overall, about 61 percent of the applications submitted in 2010 resulted in an extension of credit (data derived from tables 3.A and **3.B**), a share little changed from 2009.

Table 3. Home loan activity of lending institutions covered under the Home Mortgage Disclosure Act, 2000–10

A. Applications, requests for preapproval, and purchased loans

Number

Year	Applications received for home loans, by type of property				Requests for preapproval[1]	Purchased loans	Total
	1–4 family			Multifamily			
	Home purchase	Refinance	Home improvement				
2000	8,278,219	6,543,665	1,991,686	37,765	n.a.	2,398,292	19,249,627
2001	7,692,870	14,284,988	1,849,489	48,416	n.a.	3,767,331	27,643,094
2002	7,406,374	17,491,627	1,529,347	53,231	n.a.	4,829,706	31,310,285
2003	8,179,633	24,602,536	1,508,387	58,940	n.a.	7,229,635	41,579,131
2004	9,792,324	16,072,102	2,202,744	61,895	332,054	5,146,617	33,607,736
2005	11,672,852	15,898,346	2,539,158	57,668	396,686	5,874,447	36,439,157
2006	10,928,866	14,045,961	2,480,827	52,220	411,134	6,236,352	34,155,360
2007	7,609,143	11,566,182	2,218,224	54,230	432,883	4,821,430	26,702,092
2008	5,017,998	7,729,143	1,404,008	42,792	275,808	2,921,821	17,391,570
2009	4,201,057	9,935,678	826,916	26,257	209,055	4,294,528	19,493,491
2010	3,838,896	8,421,592	668,903	25,484	164,672	3,229,010	16,348,557

Note: Here and in subsequent tables, except as noted, data include first and junior liens, site-built and manufactured homes, and owner- and non-owner-occupant loans.

[1] Consists of requests for preapproval that were denied by the lender or were accepted by the lender but not acted upon by the borrower. In this article, applications are defined as being for a loan on a specific property; they are thus distinct from requests for preapproval, which are not related to a specific property. Information on preapproval requests was not required to be reported before 2004.

n.a. Not available.

The HMDA data also include information on loans purchased by reporting institutions during the reporting year, although the purchased loans may have been originated at any point in time. For 2010, lenders reported information on nearly 3.2 million loans that they had purchased from other institutions, a decline of nearly 25 percent from 2009. Finally, lenders reported on roughly 165,000 requests for preapproval of home-purchase loans that

Table 3. Home loan activity of lending institutions covered under the Home Mortgage Disclosure Act, 2000–10

B. Loans

Number

Year	Loans, by type of property				Total
	1–4 family			Multifamily	
	Home purchase	Refinance	Home improvement		
2000	4,787,356	2,435,420	892,587	27,305	8,142,668
2001	4,938,809	7,889,186	828,820	35,557	13,692,372
2002	5,124,767	10,309,971	712,123	41,480	16,188,341
2003	5,596,292	15,124,761	678,507	48,437	21,447,997
2004	6,429,988	7,583,928	966,484	48,150	15,028,550
2005	7,382,012	7,101,649	1,093,191	45,091	15,621,943
2006	6,740,322	6,091,242	1,139,731	39,967	14,011,262
2007	4,663,267	4,817,875	957,912	41,053	10,480,107
2008	3,119,692	3,457,774	568,287	31,509	7,177,262
2009	2,784,956	5,758,875	387,970	19,135	8,950,936
2010	2,541,791	4,961,814	340,604	19,128	7,863,337

did not result in a loan origination (table 3.A); preapprovals that resulted in loans are included in the count of loan extensions cited earlier.

Lending for Home Purchase or Refinancing in 2010

Although relatively stable in the past two years, the volume of home-purchase lending has fallen sharply since 2006 (**figure 1**).[12] In June 2006, the peak month for home-purchase lending that year, nearly 712,000 home-purchase loans were extended, compared with only 326,000 such loans in June 2010, the most active month that year. On a yearly basis, the number of home-purchase loans reported by lenders covered by HMDA in 2010 was down nearly 9 percent from 2009 and was 62 percent lower than in 2006 (data derived from table 3.B).

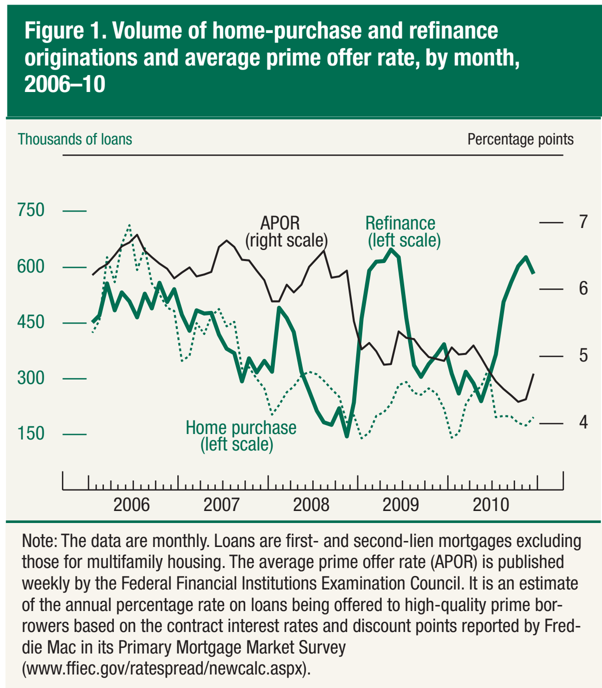

Figure 1. Volume of home-purchase and refinance originations and average prime offer rate, by month, 2006–10

Note: The data are monthly. Loans are first- and second-lien mortgages excluding those for multifamily housing. The average prime offer rate (APOR) is published weekly by the Federal Financial Institutions Examination Council. It is an estimate of the annual percentage rate on loans being offered to high-quality prime borrowers based on the contract interest rates and discount points reported by Freddie Mac in its Primary Mortgage Market Survey (www.ffiec.gov/ratespread/newcalc.aspx).

Because of the extraordinary difficulties in the housing and mortgage markets, the federal government has taken several actions to support their recovery. One of the actions, the first-time homebuyer tax credit program, reduced the tax bill or increased the amount of refund for eligible homebuyers.[13] The program was originally scheduled to end (or "sunset") on November 30, 2009, but was extended a few weeks to provide benefits to those eligible homebuyers who entered into binding contracts to purchase their homes by April 30, 2010, and closed the sales by June 30, 2010 (after the fact, the closing deadline was extended to September 30, 2010, but that extension affected only a small number of sales).

The first-time homebuyer tax credit program likely stimulated homebuying in 2009 as individuals sought to purchase their homes before the initial scheduled sunset date.[14] The extension of the law until the end of June 2010 may help explain, in part, the increase in loan volume in the spring of 2010 and then the sharp falloff in the monthly flow of new

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[12] Lenders report the date on which action on an application is taken. For originations, the "action taken" date is the closing date or date of origination for the loan. This date is the one we use to compile data at the monthly level. Generally, the interest rate on a loan is set at an earlier point known as the lock date. The interest rate series in the figure is constructed from the results of a survey of "offer rates" made by lenders to prime borrowers. The loan pricing is likely to reflect the interest rate available at the time of the lock date. Thus, the timing of the loan volume and interest rate series may be slightly misaligned in the figure.

[13] The program was not limited to first-time homebuyers. Eligibility for the tax credit also was extended to homebuyers who were long-time residents of their previous homes. The program included income and home-value limits. For more information, see Internal Revenue Service (2009), "First-Time Homebuyer Credit Extended to April 30, 2010; Some Current Homeowners Now Also Qualify," press release, November 24, www.irs.gov/newsroom/article/0,,id=215791,00.html; and Internal Revenue Service, "First-Time Homebuyer Credit," webpage, www.irs.gov/newsroom/article/0,,id=204671,00.html.

[14] Our analysis in an earlier article suggested that about one-half of the home-purchase loans in 2009 qualified under the first-time homebuyer tax credit program. See Robert B. Avery, Neil Bhutta, Kenneth P. Brevoort, and Glenn B. Canner (2010), "The 2009 HMDA Data: The Mortgage Market in a Time of Low Interest Rates and Economic Distress," *Federal Reserve Bulletin*, vol. 96, pp. A39–A77.

home-purchase originations after that despite a decline in mortgage interest rates over the remainder of the year.[15]

To a greater degree than for home-purchase lending, the volume of refinance lending is aligned with changes in interest rates, expanding as mortgage rates fall and retrenching when rates rise. The interest rate environment in both 2009 and 2010 was generally quite favorable for well-qualified borrowers who sought to refinance, particularly in the second half of 2010, when the rate on 30-year fixed-rate mortgages fell to record lows. Nonetheless, compared with 2009, the number of reported refinancings was down about 14 percent (table 3.B). (Factors affecting the level of refinance activity in 2010 are explored in the later section "Factors Influencing Refinancing Activity in 2010.")

Non-Owner-Occupant Lending

Individuals buying homes either for investment purposes or as second or vacation homes are an important segment of the housing market in general, and in some areas of the country, they are particularly important. In the current period of high foreclosures and elevated levels of short sales, investor activity helps reduce the overhang of unsold and foreclosed properties. HMDA data help document the role of non-owner-occupant lending over time because the borrower's intended occupancy status is one of the reported items.[16]

As the boom in housing emerged in the first half of the past decade, the HMDA data showed a sharp increase in non-owner-occupant lending used to purchase one- to four-family homes (**table 4**). The volume of non-owner-occupant lending then fell sharply beginning in 2007 and remained at comparably low levels through 2010. In 2010, 76 percent fewer non-owner-occupant loans were extended than in 2005, the peak year for non-owner-occupant lending. The number of non-owner-occupant loans in 2010 was little changed from that in 2009.

As shown in table 4, the post-2007 decline in non-owner-occupant lending has been more severe than that in owner-occupant lending. Between 2000 and 2005, the share of non-owner-occupant lending used to purchase one- to four-family homes rose, increasing over this period from about 9 percent to 16 percent (data derived from table 4).[17] Since 2005, the share has fallen, dropping to about 11 percent in both 2009 and 2010. Although diminished since the middle of this decade, in both the volume of lending and as a share of lending, non-owner-occupant lending continues to be an important aspect of the mortgage market.

As noted, the relative importance of non-owner-occupant lending varies from place to place. In some places, such as resort towns, non-owner-occupant lending reflects the activity of both investors and purchasers of second homes. In other areas, most of the non-owner-occupant homebuying is by investors seeking to buy units for year-round rental. The HMDA data provide an opportunity to explore the geographic variation in non-owner-oc-

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[15] The volume of home-purchase originations fell nearly 40 percent from June 2010 to July 2010 and then remained at reduced levels for the rest of the year.

[16] An investment property is a non-owner-occupied dwelling that is intended to be rented or resold for a profit. Some non-owner-occupied units—vacation homes and second homes—are for the primary use of the owners and thus would not be considered investment properties. The HMDA data do not, however, distinguish between these two types of non-owner-occupied dwellings.

[17] Research using credit record data suggests that in states that experienced the largest run-up in home prices, investors accounted for about one-half of the home-purchase loans. See Andrew Haughwout, Donghoon Lee, Joseph Tracy, and Wilbert van der Klaauw (2011), "Real Estate Investors, the Leverage Cycle and the Housing Market Crisis," paper presented at the Housing Economics and Research Conference, UCLA Ziman Center for Real Estate, Los Angeles, April, www.anderson.ucla.edu/x30674.xml.

Table 4. Home loan applications and home loans for one- to four-family properties, by occupancy status of home and type of loan, 2000–10
Number

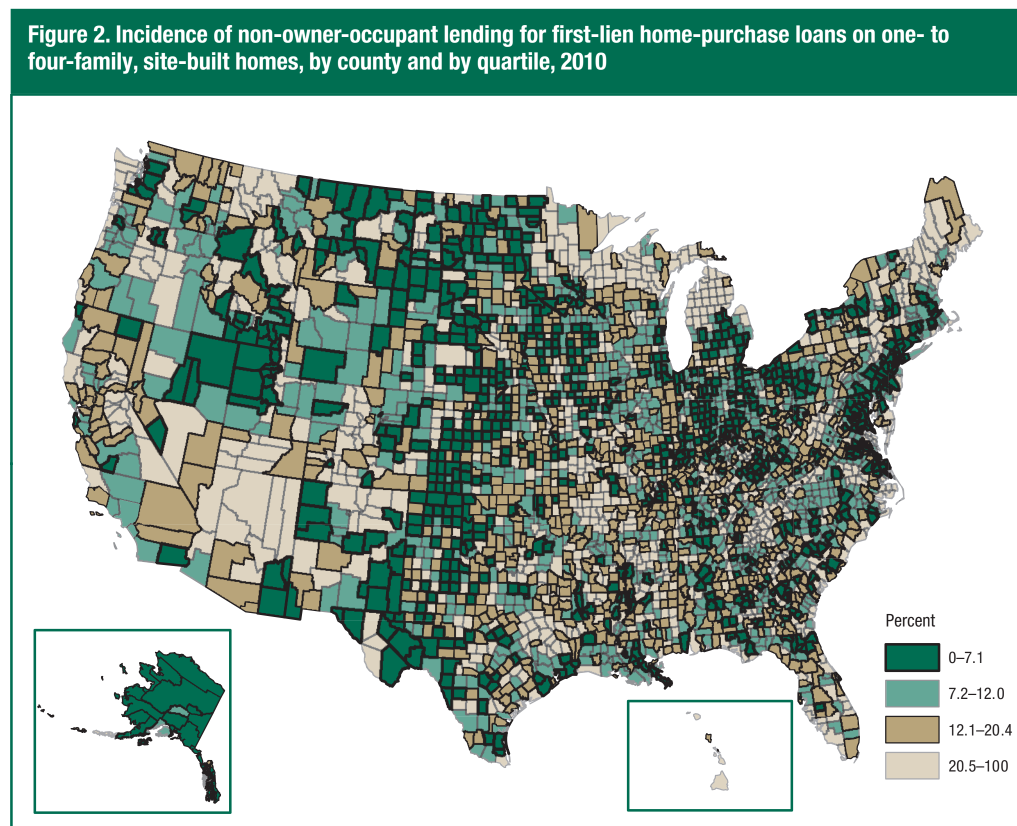
Year	Applications				Loans			
	Owner occupied		Non-owner occupied		Owner occupied		Non-owner occupied	
	Conventional	Nonconventional[1]	Conventional	Nonconventional[1]	Conventional	Nonconventional[1]	Conventional	Nonconventional[1]
A. Home purchase								
2000	6,350,643	1,311,101	604,919	12,524	3,411,887	963,345	404,133	8,378
2001	5,776,767	1,268,885	627,598	19,688	3,480,441	1,003,795	440,498	14,128
2002	5,511,048	1,133,770	747,758	13,923	3,967,834	870,599	547,963	8,474
2003	6,212,915	1,014,865	943,248	8,623	4,162,412	761,716	667,613	4,560
2004	7,651,113	799,131	1,335,241	6,839	4,946,423	574,841	906,014	2,710
2005	9,208,214	610,650	1,850,174	3,814	5,742,377	438,419	1,199,509	1,707
2006	8,695,877	576,043	1,653,154	3,792	5,281,485	416,744	1,040,668	1,425
2007	5,960,571	599,637	1,044,112	4,823	3,582,949	423,506	655,916	896
2008	2,940,059	1,424,483	647,340	6,116	1,727,692	972,605	415,930	3,465
2009	1,883,278	1,884,136	427,338	6,305	1,171,033	1,320,412	289,796	3,715
2010	1,728,715	1,689,471	415,315	5,395	1,088,855	1,166,477	284,625	1,834
B. Refinance								
2000	6,051,484	110,380	379,299	2,502	2,170,162	64,882	198,695	1,293
2001	12,737,863	705,784	823,748	17,592	6,836,106	524,228	516,616	12,181
2002	15,623,327	742,208	1,111,588	14,504	9,058,654	535,370	706,570	9,377
2003	21,779,329	1,236,467	1,563,430	23,310	13,205,472	895,735	1,007,674	15,871
2004	14,476,350	497,700	1,084,536	13,516	6,649,588	304,591	621,667	8,082
2005	14,494,441	262,438	1,135,929	5,538	6,336,004	158,474	603,914	3,257
2006	12,722,112	208,405	1,112,891	2,553	5,382,950	122,134	585,142	1,016
2007	10,173,282	375,860	1,012,827	4,213	4,123,507	196,897	496,577	894
2008	5,829,633	1,240,472	650,042	8,996	2,593,793	522,243	337,914	3,824
2009	7,251,066	2,051,766	617,707	15,139	4,404,215	998,585	348,599	7,476
2010	6,318,522	1,447,521	640,046	15,503	3,943,819	653,671	356,238	8,086
C. Home improvement								
2000	1,833,277	91,575	65,286	1,548	843,884	10,896	37,047	760
2001	1,771,472	16,276	60,598	1,143	788,560	6,722	32,990	548
2002	1,459,049	11,582	58,080	636	676,515	4,878	30,533	197
2003	1,430,380	13,876	63,806	325	642,065	5,226	31,113	103
2004	2,081,528	11,887	109,105	224	904,492	5,557	56,341	94
2005	2,401,030	10,053	127,857	218	1,026,340	4,483	62,298	70
2006	2,335,338	12,645	132,694	150	1,067,730	6,115	65,842	44
2007	2,072,688	16,717	128,700	119	887,123	9,409	61,321	59
2008	1,294,162	26,544	83,036	266	516,612	12,347	39,170	158
2009	740,061	28,437	58,171	247	348,409	11,212	28,183	166
2010	582,775	34,437	51,300	391	302,612	11,804	26,131	57

[1] Loans insured by the Federal Housing Administration or backed by guarantees from the U.S. Department of Veterans Affairs, the Farm Service Agency, or the Rural Housing Service.

cupant lending across geographies, although it is not possible to distinguish between investors and second-home buyers.

For the analysis here, we calculated the non-owner-occupant share of home-purchase lending in each county nationwide in 2010 (**figure 2**). Many of the counties with elevated non-owner-occupant lending rates are resort locations such as portions of northern New Eng-

Figure 2. Incidence of non-owner-occupant lending for first-lien home-purchase loans on one- to four-family, site-built homes, by county and by quartile, 2010



land, Michigan, Colorado, and some coastal areas.[18] Other areas may have elevated non-owner-occupant activity due to investors purchasing homes in markets that have experienced significant declines in home values, such as the "sand states" of Arizona, California, Florida, and Nevada. The sharply reduced values of properties involved in short sales or foreclosures have afforded investors and others opportunities to purchase non-owner-occupied homes in these areas.

Nevertheless, the decline in the volume of non-owner-occupant lending that has been observed nationally has affected almost all geographic areas. In all but a handful of MSAs, the percentage decline in non-owner-occupant lending between 2005 and 2010 exceeded the decline in owner-occupant lending (**figure 3**). Non-owner-occupant lending has fallen the most in the MSAs that experienced the largest declines in owner-occupant lending.

Further analysis suggests that at least some of the decline in non-owner-occupant lending stems from the locations where such loans were concentrated rather than an overall change in the national market for such loans. We selected an analysis group of census tracts in the top 5 percent of the incidence of total one- to four-family non-owner-occupant lending in MSAs in the sand states (where non-owner-occupant lending has been cited as a particular problem) in 2005. We compared the decline in lending in these tracts between 2005 and 2010 with the lending changes in all other tracts in the sand state MSAs.

[18] Many of these resort areas are in rural counties, which creates a potential bias for HMDA-based calculations. Lenders without offices in metropolitan areas do not have to report HMDA data. If borrowers for non-owner-occupant loans are less likely than those for owner-occupant loans to use local lenders, this circumstance would bias the HMDA incidence of non-owner-occupant lending upward in rural areas.

Overall, lending in the analysis group declined 74 percent between 2005 and 2010, although non-owner-occupant lending fell more in these tracts (78 percent) than owner-occupant lending (71 percent). In contrast, overall lending fell significantly less in tracts where non-owner-occupant lending had not been concentrated (59 percent), with non-owner-occupant lending again experiencing a relatively larger decline (70 percent) than owner-occupant lending (58 percent). It cannot be determined from these results whether characteristics of the tract neighborhoods or the high presence of non-owner-occupant lending led to the excessive decline.

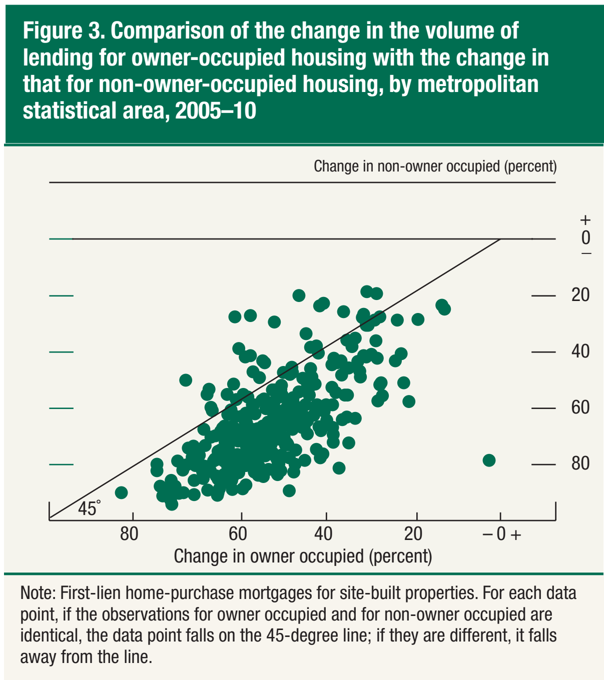


Figure 3. Comparison of the change in the volume of lending for owner-occupied housing with the change in that for non-owner-occupied housing, by metropolitan statistical area, 2005–10

Note: First-lien home-purchase mortgages for site-built properties. For each data point, if the observations for owner occupied and for non-owner occupied are identical, the data point falls on the 45-degree line; if they are different, it falls away from the line.

Types of Loans

As noted, the total number of loans to purchase homes has fallen sharply since the height of the housing boom in 2005 and 2006, when lenders extended about 7 million loans in each of those years (table 3.B). Although the total number of home-purchase loans has fallen substantially since then, virtually all of the decline has involved conventional lending; the volume of nonconventional home-purchase loans (sometimes referred to as "government backed" loans)—including loans backed by insurance from the FHA or by guarantees from the VA, the Farm Service Agency (FSA), or the Rural Housing Service (RHS)—has increased markedly since the mid-2000s. From 2006 to 2009, the total number of reported conventional home-purchase loans fell 77 percent, while the number of nonconventional home-purchase loans more than tripled (table 4). Although the number of nonconventional home-purchase loans fell some from 2009 to 2010, such loans still accounted for 46 percent of the home-purchase loan market in 2010, down marginally from a 48 percent share in 2009 but still much greater than the 8 percent share in 2006.

Nonconventional loans are a major component of the overall home-purchase loan market, but they play a much smaller role in certain segments of the market. For example, nonconventional loans accounted for only about 1 percent of the loans extended to non-owner occupants for the purchase of a home in 2010. Also, nonconventional loans made up a relatively small share (about 25 percent) of the loans used to purchase manufactured homes (**table 5**).

As in the home-purchase loan market, nonconventional lending has also garnered a larger share of the refinance market in the past few years, although the number of conventional loans used for refinancing still exceeds that of nonconventional loans by a wide margin (table 4). In 2006, conventional loans used for refinancing outnumbered nonconventional loans 48 to 1; in 2010, the proportion was about 6 to 1.

The increase in nonconventional home-purchase and refinance lending reflects several factors, such as increased loan-size limits allowed under the FHA and VA lending programs and reduced access (including more-stringent underwriting and higher prices) to con-

Table 5. Loans on manufactured homes, by occupancy status of home and type of loan, 2004–10
Number

Year	Owner occupied		Non-owner occupied	
	Conventional	Nonconventional[1]	Conventional	Nonconventional[1]
A. Home purchase				
2004	107,686	23,974	16,243	125
2005	101,539	27,229	17,927	56
2006	102,458	30,530	19,105	257
2007	95,584	28,554	13,963	92
2008	68,821	27,615	11,392	93
2009	43,253	20,558	7,895	29
2010	44,810	17,086	7,631	28
B. Refinance				
2004	79,838	6,922	6,507	57
2005	73,520	7,727	6,331	26
2006	64,969	11,750	6,240	68
2007	59,591	16,174	6,332	74
2008	44,342	21,926	6,817	177
2009	36,765	21,765	5,922	59
2010	26,304	9,748	5,013	69
C. Home improvement				
2004	17,119	128	1,269	5
2005	20,239	219	1,372	3
2006	20,886	490	1,425	2
2007	19,428	889	1,494	2
2008	12,621	681	1,324	36
2009	9,710	439	1,110	1
2010	7,963	427	991	2

1 See table 4, note 1.

ventional loans, particularly those that allow the borrower to finance more than 80 percent of the property value. (These factors and their role in 2010 lending are discussed in more detail in a later section, "The Continuing Role of Government in the Mortgage Market.")

The Private Mortgage Insurance Market

Historically, mortgage lenders have required a borrower to make a down payment before they would extend a loan to buy a home or refinance an existing mortgage. In the conventional loan market, lenders typically have required that a borrower make a down payment of at least 20 percent of a home's value unless the borrower received some type of third-party backing, such as mortgage insurance.

Private mortgage insurance (PMI) emerged in the 1950s alongside the longstanding FHA and VA loan programs to help bridge the gap between lenders reluctant to extend mortgages with high loan-to-value (LTV) ratios and consumers interested in borrowing more than 80 percent of the underlying home's value. For a borrower seeking a conventional loan with a low down payment, the lender can require that the borrower purchase mortgage insurance from PMI companies to protect the lender against default-related losses up to a contractually established percentage of the principal amount.

Over the years, PMI-backed loans became a significant part of the mortgage market. As a form of protection for lenders against losses from defaulting borrowers, PMI competes with FHA insurance and VA loan guarantees. Thus, the relative attractiveness of PMI at any point in time is closely related to FHA and VA underwriting and pricing decisions and the sizes of the loans these government agencies may back. PMI also competes against the willingness of lenders to bear the risk of loss through self-insurance by extending a first-lien mortgage with little or no down payment in conjunction with a junior-lien mortgage (often referred to as a "piggyback" loan). Historically, the annual volume of PMI issuance has varied in response to these competitive pressures and to the overall level of mortgage activity in any given year.

In 1993, the Mortgage Insurance Companies of America asked the FFIEC to process data from the largest PMI companies on applications for mortgage insurance and to produce disclosure statements for the public based on the data and timed to be released with the HMDA data.[19] The PMI data largely mirror the types of information submitted by lenders covered by HMDA. However, because the PMI companies do not receive all of the information about a prospective loan from the lenders seeking insurance coverage, some items reported under HMDA are not included in the PMI data. In particular, loan pricing information and requests for preapproval are unavailable in the PMI data.

The seven companies that reported data for 2010 dominate the PMI industry.[20] Thus, these data cover the vast majority of PMI written in the United States, allowing for meaningful analysis of these data alongside the HMDA data.[21] For 2010, the seven PMI companies reported on nearly 370,000 applications for insurance leading to the issuance of 260,000 insurance policies, down from about 636,000 applications and 367,000 policies in 2009 (**table 6**). Both the 2009 and 2010 volumes were substantially smaller than the totals reached in 2002 and 2003, when PMI issuance was about 2 million policies a year. Overall, 61 percent of the PMI policies issued in 2010 covered home-purchase loans, and the remainder covered refinance mortgages (home-improvement loans are classified as refinance loans by the PMI reporters). Virtually all of the applications for PMI policies issued involved site-built properties; less than 0.04 percent of the policies involved manufactured homes. About 10 percent of PMI insurance applications were denied in 2010, down from about 12 percent in 2009 but still substantially higher than in 2006 and 2007, when only about 2 percent of the requests for insurance were turned down (data not shown in tables).[22]

The large reduction in PMI activity reflects several factors, including reduced demand stemming from a sharp fall in homebuying activity and higher prices relative to alternatives, as well as tighter underwriting adopted by the PMI companies in response to elevated claims and losses experienced during the recent recession and the ongoing recovery.[23] The roles of these various factors can be seen from the memo items in the last seven columns of

[19] Founded in 1973, the Mortgage Insurance Companies of America is the trade association for the PMI industry.

[20] One firm that reported data in previous years, Triad Guaranty Insurance Corporation, stopped issuing new policies in July 2008 but continues to manage existing policies.

[21] Some care must be exercised in comparing the PMI and HMDA data. First, because of reporting rules, the HMDA data do not cover all lending for properties in rural areas. However, the PMI reporting firms provide information on all privately insured loans regardless of property location. Second, the "action date" for PMI issuance is the date that the PMI insurance was extended, which is often different from the date the loan was closed, which determines the HMDA action date. For loans taken out near the beginning or end of a calendar year, this factor could shift the PMI reporting into a reporting year different from that of the loan. Third, the size of the loan and borrower characteristics can also differ between the two data sources. Finally, the PMI data do not capture "pool insurance"—that is, insurance written for pools of loans rather than individual mortgage loans. The omission of this type of insurance tends to understate the breadth of PMI coverage.

[22] For the other applications that did not result in a policy being written, the application was withdrawn, the application file closed because it was not completed, or the request was approved but no policy was issued.

[23] For a more detailed analysis, see Avery and others, "The 2009 HMDA Data."

Table 6. Private mortgage insurance applications and issuance for one- to four-family properties, by occupancy status of home and type of property, 2000–10
Number

Year	Applications				Issuance			
	Owner occupied		Non-owner occupied		Owner occupied		Non-owner occupied	
	Site-built	Manufactured housing[1]	Site-built	Manufactured housing[1]	Site-built	Manufactured housing[1]	Site-built	Manufactured housing[1]
A. Home purchase								
2000	1,204,520	n.a.	95,549	n.a.	955,988	n.a.	75,473	n.a.
2001	1,266,440	n.a.	122,639	n.a.	1,002,385	n.a.	90,929	n.a.
2002	1,324,958	n.a.	153,277	n.a.	1,022,754	n.a.	115,573	n.a.
2003	1,315,221	n.a.	175,958	n.a.	1,021,476	n.a.	134,677	n.a.
2004	1,078,275	10,111	192,086	1,287	807,480	7,508	143,917	984
2005	886,749	10,470	174,174	1,480	676,758	7,512	130,945	1,171
2006	838,304	9,526	134,545	1,273	659,755	6,655	98,744	993
2007	1,260,666	7,928	148,057	1,113	1,015,240	5,531	109,772	774
2008	928,978	4,082	127,773	759	591,108	2,012	66,842	367
2009	341,311	535	14,372	92	206,878	125	5,208	29
2010	214,054	172	7,644	11	154,716	55	4,750	
B. Refinance[4]								
2000	259,245	n.a.	14,771	n.a.	185,721	n.a.	10,859	n.a.
2001	856,112	n.a.	29,870	n.a.	663,465	n.a.	17,453	n.a.
2002	1,056,788	n.a.	40,771	n.a.	775,020	n.a.	23,035	n.a.
2003	1,372,551	n.a.	46,139	n.a.	1,014,558	n.a.	27,116	n.a.
2004	597,353	6,037	31,352	233	389,563	3,956	17,243	138
2005	438,019	3,702	23,217	136	309,821	2,384	13,239	88
2006	346,978	2,554	24,201	121	234,587	1,567	14,187	78
2007	507,137	2,108	36,508	104	362,961	1,313	22,533	58
2008	454,405	1,442	33,822	123	257,189	695	11,519	34
2009	275,541	429	3,611	15	153,633	126	1,121	4
2010	145,953	135	1,437	2	99,598	56	587	0

1 Before 2004, property type was not collected; totals for site-built and manufactured housing are shown in the "Site-built" column.

table 6, which focus on owner-occupant site-built lending. Taken in isolation, PMI rose as a share of conventional lending from 2006 to 2007 and then fell back sharply in 2009 and further still in 2010. Some of this change reflects variation in the share of borrowers with high-LTV loans. However, as can be seen from the table, much of the change, particularly since 2008, reflects substitution among high-LTV credit enhancement alternatives, including nonconventional FHA and VA loans and junior-lien piggyback loans. Indeed, since 2008, the share of total home-purchase loans covered by one of these enhancements has remained quite stable (last column of table 6). Thus, the record low number of PMI policies issued in 2010 likely paints a very misleading picture regarding high-LTV lending. The steadily rising share of the loan market covered by some sort of credit enhancement evident in the last column of table 6 suggests that high-LTV loans, perhaps driven by a rising portion of the market that is composed of first-time homebuyers, may be at record high rather than record low levels.

Junior-Lien Lending

Junior-lien loans can be taken out either in conjunction with the primary mortgage (a piggyback loan) or independently of the first-lien loan. As noted in the previous section,

Table 6. Private mortgage insurance applications and issuance for one- to four-family properties, by occupancy status of home and type of property, 2000–10—*continued*
Number

Year	Memo						
	Conventional loans[2]	Ratio of loans with PMI to conventional loans	Nonconventional loans[3]	Ratio of loans with PMI plus nonconventional loans to total loans	Junior liens	Ratio of loans with PMI plus junior liens to conventional loans	Ratio of loans with PMI plus nonconventional loans and junior liens to total loans
A. Home purchase							
2000	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2001	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2002	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2003	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2004	4,209,787	19.4	573,606	29.1	736,636	36.7	44.3
2005	4,520,378	15.2	437,552	22.7	1,221,999	42.0	47.1
2006	4,013,196	16.7	416,143	24.5	1,268,289	48.0	52.9
2007	3,031,606	33.8	422,450	41.9	551,343	51.7	57.6
2008	1,636,194	36.4	971,528	60.1	91,498	41.7	63.4
2009	1,128,950	18.4	1,318,940	62.4	42,083	22.1	64.1
2010	1,048,544	14.8	1,165,087	59.6	40,311	18.6	61.4
B. Refinance[4]							
2000	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2001	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2002	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2003	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2004	6,543,036	6.0	306,995	10.3	859,752	19.1	22.7
2005	6,017,589	5.2	160,395	7.7	1,196,737	25.0	27.0
2006	4,707,669	5.0	125,718	7.5	1,588,754	38.7	40.3
2007	3,764,022	9.7	204,054	14.3	1,095,750	38.8	41.9
2008	2,554,287	10.1	532,340	25.6	400,414	25.7	38.6
2009	4,455,692	3.5	1,006,236	21.2	198,475	7.9	24.9
2010	3,990,017	2.5	661,650	16.4	162,755	6.6	19.9

[2] First-lien mortgages for owner-occupied, one- to four-family, site-built properties; excludes business loans. Business-related loans are those for which the lender reported that the race, ethnicity, and sex of the applicant or co-applicant are "not applicable."

[3] First-lien mortgages for owner-occupied, one- to four-family, site-built properties; excludes business loans. Business-related loans are those for which the lender reported that the race, ethnicity, and sex of the applicant or co-applicant are "not applicable." Loans insured by the Federal Housing Administration or backed by guarantees from the U.S. Department of Veterans Affairs, the Farm Service Agency, or the Rural Housing Service.

[4] Includes home-improvement loans. Private mortgage insurance companies do not distinguish between refinance loans and home-improvement loans in reporting. Loan totals are the summation of refinance and home-improvement loans.

n.a. Not available.

PMI Private mortgage insurance.

piggyback loans can be used by borrowers to avoid having to pay for private or government mortgage insurance. Similarly, piggyback loans can also be used to reduce the size of the first-lien loan to be within the size limits required by Freddie Mac or Fannie Mae without requiring a larger down payment by the borrower. Junior-lien loans that are taken out independently can be used for any number of purposes, including to finance home-improvement projects or, in the case of open-ended home equity lines of credit (HELOCs), to provide a readily available and relatively cheap source of credit. Under the regulations that

Table 7. Home loans for one- to four-family properties, by occupancy status of home, type of loan, and lien status, 2004–10
Number

Year	Owner occupied						Non-owner occupied					
	Conventional			Nonconventional[1]			Conventional			Nonconventional[1]		
	First lien	Junior lien	Unsecured[2]	First lien	Junior lien	Unsecured[2]	First lien	Junior lien	Unsecured[2]	First lien	Junior lien	Unsecured[2]
A. Home purchase												
2004	4,209,787	736,636	...	573,606	1,235	...	853,490	52,524	...	2,703	7	...
2005	4,520,378	1,221,999	...	437,552	867	...	1,049,555	149,954	...	1,685	22	...
2006	4,013,196	1,268,289	...	416,143	601	...	878,325	162,343	...	1,407	18	...
2007	3,031,606	551,343	...	422,450	1,056	...	605,714	50,202	...	888	8	...
2008	1,636,194	91,498	...	971,528	1,077	...	410,377	5,553	...	3,461	4	...
2009	1,128,950	42,083	...	1,318,940	1,472	...	287,760	2,036	...	3,706	9	...
2010	1,048,544	40,311	...	1,165,087	1,390	...	282,941	1,684	...	1,822	12	...
B. Refinance												
2004	6,185,418	464,170	...	304,298	293	...	608,956	12,711	...	8,069	13	...
2005	5,607,642	728,362	...	158,198	276	...	578,491	25,423	...	3,236	21	...
2006	4,347,348	1,035,602	...	121,761	373	...	546,430	38,712	...	989	27	...
2007	3,462,944	660,563	...	196,544	353	...	473,336	23,241	...	879	15	...
2008	2,374,781	219,012	...	521,863	380	...	328,844	9,070	...	3,814	10	...
2009	4,290,072	114,143	...	998,089	496	...	341,852	6,747	...	7,460	16	...
2010	3,855,876	87,943	...	653,434	237	...	350,517	5,721	...	8,078	8	...
C. Home improvement												
2004	357,618	395,582	151,292	2,697	2,243	617	40,028	8,153	8,160	30	54	10
2005	409,947	468,375	148,018	2,197	1,873	413	42,544	10,756	8,998	17	49	4
2006	360,321	553,152	154,257	3,957	1,735	423	43,913	13,739	8,190	18	20	6
2007	301,078	435,187	150,858	7,510	1,579	320	41,670	11,508	8,143	35	18	6
2008	179,506	181,402	155,704	10,477	1,610	260	26,482	5,473	7,215	135	13	10
2009	165,620	84,332	98,457	8,147	2,416	649	19,598	3,174	5,411	101	29	36
2010	134,141	74,812	93,659	8,216	2,660	928	17,730	2,482	5,919	35	17	5

[1] See table 4, note 1.
[2] Unsecured loans are collected only for home-improvement loans under the Home Mortgage Disclosure Act.
... Not applicable.

govern HMDA reporting, most of these stand-alone junior-lien loans are not reported.[24] Most piggyback loans, however, must be reported. Thus, the volume of junior-lien lending reported under HMDA may be more indicative of the volume of piggyback lending than of junior-lien lending as a whole.

Before the financial crisis and the collapse in home values, when the use of piggyback loans was more common and the size limits on Fannie Mae and Freddie Mac purchases were lower, many more junior-lien loans were reported in the HMDA data. For example, in 2006, which represented the high-water mark for junior-lien lending, over 1.3 million conventional junior liens used for the purchase of owner-occupied properties were reported under HMDA, and another 1 million conventional junior-lien loans were taken out to refi-

[24] Unless a junior lien is used for home purchase or explicitly for home improvements, it is not reported under HMDA unless it is used to refinance an existing lien. Further, about one-half of all junior liens are HELOCs, which do not have to be reported in the HMDA data regardless of the purpose of the loan.

nance loans backed by owner-occupied properties (**table 7**). Virtually all such lending was conventional; fewer than 1,000 loans involved government-backed programs. As the elevated credit risk associated with high-LTV-ratio lending became apparent during the Great Recession and its aftermath, underwriting tightened and junior-lien loans became difficult to obtain or were no longer made available. The number of junior-lien loans for the purchase of owner-occupied homes reported under HMDA fell by more than one-half in 2007, dropped sharply again in each of the ensuing years, and decreased somewhat to about 40,000 such loans in 2010. The number of junior-lien loans used for refinancing also fell substantially starting in 2007 and continued to fall, reaching almost 88,000 in 2010. Substantial declines were also observed in the number of junior-lien loans backed by non-owner-occupied properties, whether the loans were for home purchase or refinancing.

The category in which the number of junior-lien loans reported in the HMDA data has declined the least has been junior-lien loans for home-improvement purposes. In 2010, almost 80,000 junior-lien loans were used for home improvement. While this number was down 11 percent from 2009 and 86 percent from 2005, the decline was less steep than that observed for other types of junior-lien lending. As a result, junior-lien loans used for home improvement accounted for 37 percent of junior-lien loans reported under HMDA.

Loan Sales

Among the information included in the annual HMDA data is the type of purchaser for loans that are originated and sold during the year. For purposes of reporting, lenders are provided with nine types of purchasers that may be used to classify loan sale activity. Broadly, these purchaser types can be broken into those that are government related—Ginnie Mae, Fannie Mae, Freddie Mac, and Farmer Mac—and those that are not.[25] Ginnie Mae and Farmer Mac focus on loans backed directly by government guarantees or insurance, primarily FHA-insured or VA-guaranteed loans. The government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac are focused on conventional loans that meet the underwriting standards established by those entities.

Overall, 80 percent of the first-lien home-purchase and refinance loans for one- to four-family properties originated in 2010 were reported as sold during the year (data not shown in tables). The share of originations that are sold varies some from year to year and by type and purpose of the loan (**table 8**).[26] For example, about 70 percent of the conventional loans extended in 2010 for the purchase of owner-occupied one- to four-family dwellings were sold that year. In contrast, about 93 percent of the nonconventional loans used to purchase owner-occupied homes were reported as sold in 2010. The share of conventional loans made to non-owner occupants that are reported as sold is notably smaller than that of such loans made to owner occupants, as is the share of loans extended for the purchase of manufactured homes.

Although one of the few sources of information on loan sales, the HMDA data tend to understate the importance of the secondary market. HMDA reporters are instructed to record loans sold in a calendar year different from the year originated as being held in port-

[25] Ginnie Mae does not buy or sell loans; rather, it guarantees investors on the timely payment of interest and principal for mortgage-backed securities backed by FHA or VA loans. (See the Ginnie Mae website at www.ginniemae.gov.) Farmer Mac purchases certain types of agriculture-related loans. (See a description of Farmer Mac programs at www.farmermac.com/Lenders/Programs.) Fannie Mae and Freddie Mac are government-sponsored enterprises, which, while federally chartered, are privately owned. However, in 2008, these two entities were placed under government conservatorship. (See the Fannie Mae and Freddie Mac websites at www.fanniemae.com/kb/index?page=home and www.freddiemac.com.)

[26] Some loans recorded as sold in the HMDA data are sold to affiliated institutions and thus are not true secondary-market sales. In 2010, 6.3 percent of the loans recorded as sold in the HMDA data were sales to affiliates.

Table 8. Distribution of home loan sales for one- to four-family properties, by occupancy status of home and type of loan, 2000–10
Percent

Year	Owner occupied				Non-owner occupied			
	Conventional		Nonconventional[1]		Conventional		Nonconventional[1]	
	Share sold	Memo: Share sold to GSEs[2]	Share sold	Memo: Share sold to GSEs[2]	Share sold	Memo: Share sold to GSEs[2]	Share sold	Memo: Share sold to GSEs[2]
A. Home purchase								
2000	64.8	31.3	89.1	46.0	53.7	29.3	81.4	22.9
2001	66.8	34.6	86.1	46.2	57.9	34.0	92.2	23.0
2002	71.0	36.7	88.7	43.7	62.5	36.4	87.9	29.7
2003	72.3	33.1	91.2	40.7	63.1	31.8	80.8	21.6
2004	74.2	25.5	92.2	40.5	63.5	23.6	63.7	11.5
2005	75.9	18.7	89.9	32.6	69.7	18.0	49.7	16.3
2006	74.8	19.0	88.6	31.7	69.3	19.0	61.3	15.0
2007	70.1	29.1	87.6	32.5	61.4	26.9	74.9	27.6
2008	71.6	40.1	90.0	36.5	60.3	36.3	95.1	21.6
2009	70.4	39.7	91.7	34.5	57.4	34.1	88.7	35.6
2010	69.8	37.1	92.7	30.0	60.3	34.9	91.7	24.0
B. Refinance								
2000	47.4	18.0	84.5	50.0	47.3	21.7	86.3	42.8
2001	61.3	37.2	85.0	51.5	61.2	38.4	92.1	33.2
2002	66.8	40.4	85.7	45.0	65.9	43.2	81.3	45.4
2003	74.2	44.8	93.8	48.0	69.8	40.4	87.4	50.7
2004	69.0	27.6	93.2	44.2	62.2	22.6	88.0	35.9
2005	69.9	19.7	89.3	33.5	64.7	16.6	85.7	40.1
2006	65.7	15.2	86.8	31.8	64.9	15.7	79.0	29.6
2007	61.7	21.9	85.1	34.5	61.1	23.9	86.9	23.9
2008	65.3	38.0	88.8	35.4	56.8	33.0	95.7	20.4
2009	79.8	51.7	90.4	36.4	61.8	39.6	93.8	35.9
2010	76.8	46.2	90.2	38.1	65.4	40.4	90.5	43.9
C. Home improvement								
2000	6.3	1.1	15.6	4.7	4.4	.4	52.9	.5
2001	6.4	1.5	22.3	7.6	3.9	.8	73.7	1.1
2002	5.9	1.4	28.4	7.1	4.0	.9	55.3	3.6
2003	10.5	.8	43.8	6.7	6.5	.7	35.0	3.9
2004	23.6	6.0	48.7	23.5	23.1	7.5	20.2	7.4
2005	27.2	7.0	46.2	25.3	30.2	8.8	27.1	8.6
2006	22.0	5.3	60.4	31.8	29.4	8.9	29.5	15.9
2007	19.1	6.4	70.6	30.8	26.4	12.1	39.0	11.9
2008	14.7	8.7	80.0	49.2	20.0	14.5	74.7	6.3
2009	25.0	17.4	63.8	37.3	18.2	13.3	55.4	9.6
2010	21.3	13.2	60.6	34.7	18.4	12.6	47.4	28.1

1 See table 4, note 1.

2 Loans sold to government-sponsored enterprises (GSEs) include those with a purchaser type of Fannie Mae, Freddie Mac, Ginnie Mae, or Farmer Mac.

folio, leading the reported loan sales to understate the proportion of each year's originations that are eventually sold. (We deal with this issue in more detail in the later section "The Continuing Role of Government in the Mortgage Market.")

Table 9. Cumulative distribution of home loans, by borrower income and by purpose and type of loan, 2010
Percent

Upper bound of borrower income (thousands of dollars)[1]	Home purchase					Refinance				
	FHA	VA	Other[2]	Total	Memo: Higher priced[3]	FHA	VA	Other[2]	Total	Memo: Higher priced[3]
24	5.1	.9	3.2	3.8	10.4	3.4	2.8	1.9	2.1	11.2
49	42.0	23.4	25.3	32.1	48.5	28.2	20.0	15.8	16.9	44.7
74	70.0	57.8	47.1	57.5	71.0	58.6	49.4	36.3	38.4	70.0
99	85.4	78.2	63.1	73.5	82.6	78.7	71.2	55.2	57.3	83.9
124	92.7	89.5	74.4	83.2	88.6	89.4	84.7	69.7	71.5	90.7
149	96.2	94.8	81.8	88.8	91.7	94.5	91.6	79.2	80.6	93.9
199	98.7	98.5	90.0	94.3	94.9	98.1	97.2	89.4	90.2	96.7
249	99.5	99.5	93.9	96.7	96.5	99.1	99.0	93.9	94.4	97.8
299	99.7	99.8	95.9	97.8	97.3	99.4	99.6	96.1	96.4	98.5
More than 299	100	100	100	100	100	100	100	100	100	100
Memo: Borrower income, by selected loan type (thousands of dollars)[1]										
Mean	65.8	77.6	110.3	89.2	79.3	78.1	85.6	118.5	114.7	72.4
Median	55	68	78	66	51	67	75	92	89	54

Note: First-lien mortgages for owner-occupied, one- to four-family, site-built properties; excludes business loans. Business-related loans are those for which the lender reported that the race, ethnicity, and sex of the applicant or co-applicant are “not applicable.” For loans with two or more applicants, lenders covered under the Home Mortgage Disclosure Act (HMDA) report data on only two. Income for two applicants is reported jointly.

1 Income amounts are reported under HMDA to the nearest $1,000.

2 Other loans include loans originated with a Farm Service Agency or Rural Housing Service guarantee and conventional loans.

3 Higher-priced loans are those with annual percentage rates 1.5 percentage points or more above the average prime offer rate for loans of a similar type published weekly by the Federal Financial Institutions Examination Council.

FHA Federal Housing Administration.

VA Department of Veterans Affairs.

Borrower Incomes and Loan Sizes

Under the provisions of HMDA, lenders report the loan amount applied for and the applicant income that the lender relied on in making the credit decision, if income was considered in the underwriting decision. The vast majority of loan applications and loans reported under HMDA include income information. For example, in 2010, income information was not reported for only about 1 percent of the borrowers purchasing a home with a nonconventional loan and for about 3 percent of those using a conventional loan (data not shown in tables). Income information is not reported more often for refinance loans, particularly those that are nonconventional (about one-third of the FHA loans and two-thirds of the VA loans), likely because of streamlined refinance programs that do not require current income to be considered in underwriting.

While the available information on amounts borrowed and income can be evaluated in many ways, here the focus is on patterns by loan product. For home-purchase or refinance lending, borrowers using FHA and VA loans have lower mean or median incomes than other loans despite the fact that the FHA (and VA) loan limits were increased substantially in 2008, allowing the program to be used much more widely than by the lower- and moderate-income households that have been the traditional focus of the program (**table 9**). For example, in 2007, the year before the increase in loan limits, about 7 percent of FHA borrowers had incomes of $100,000 or more, while in 2010, the share increased to 15 percent. Overall, in 2010, the median incomes for FHA, VA, and conventional loan borrowers were $55,000, $68,000, and $110,000, respectively (data for only 2010 shown in tables).

Table 10. Cumulative distribution of home loans, by loan amount and by purpose and type of loan, 2010
Percent

Upper bound of loan amount (thousands of dollars)[1]	Home purchase					Refinance				
	FHA	VA	Other[2]	Total	Memo: Higher priced[3]	FHA	VA	Other[2]	Total	Memo: Higher priced[3]
24	.1	.0	.5	.3	4.1	.1	.0	.5	.4	5.6
49	1.6	.4	3.1	2.3	18.1	1.1	.5	2.6	2.3	19.8
74	8.1	2.3	9.4	8.3	35.7	5.5	3.4	8.0	7.6	37.1
99	19.7	7.3	17.6	17.6	50.0	13.7	9.6	16.8	16.2	52.1
149	48.2	27.8	37.9	41.3	71.9	38.3	31.2	37.6	37.5	71.9
199	69.7	53.7	54.0	60.5	83.4	61.3	55.2	55.3	56.0	82.4
274	86.7	78.1	70.9	78.0	91.2	82.2	78.4	73.5	74.7	90.5
417	97.0	95.2	88.3	92.4	95.9	95.4	95.7	92.3	92.8	97.4
625	99.5	99.3	96.1	97.8	98.1	99.2	99.2	97.5	97.7	99.1
729	99.9	99.7	97.5	98.6	98.6	99.8	99.7	98.5	98.7	99.4
More than 799	100	100	100	100	100	100	100	100	100	100
Memo: Loan amount (thousands of dollars)										
Mean	176.7	215.3	236.6	210.2	140.4	197.6	211.0	222.6	219.4	131.8
Median[1]	153	191	184	169	100	173	187	182	181	95

Note: First-lien mortgages for owner-occupied, one- to four-family, site-built properties; excludes business loans. Business-related loans are those for which the lender reported that the race, ethnicity, and sex of the applicant or co-applicant are "not applicable."

1 Loan amounts are reported under the Home Mortgage Disclosure Act to the nearest $1,000.

2 See table 9, note 2.

3 See table 9, note 3.

FHA Federal Housing Administration.

VA Department of Veterans Affairs.

Loan amounts also differ across loan types, with FHA or VA loans, on average, being smaller than "other" loans (**table 10**). However, an upward shift in the distribution of loan amounts for both FHA and VA home-purchase loans occurred in the past couple of years, continuing into 2010 (data for only 2010 shown in tables). The shift likely reflects the same forces that are changing the distribution of borrower incomes.

Application Disposition, Loan Pricing, and Status under the Home Ownership and Equity Protection Act

For purposes of analysis, loan applications, loans, and requests for preapproval reported under HMDA can be grouped in many ways. Every loan application and request for preapproval reported in 2010 can be categorized into 25 distinct product categories characterized by type of loan and property, purpose of the loan, and lien and owner-occupancy status (tables 11 and 12). Each product category contains information on the number of total and preapproval applications, application denials, originated loans, loans with prices above the reporting thresholds established by HMDA reporting rules for identifying higher-priced loans, loans covered by the Home Ownership and Equity Protection Act of 1994 (HOEPA), and the mean and median annual percentage rate (APR) spreads for loans reported as higher priced.

Disposition of Applications

As noted, the 2010 HMDA data include information on nearly 13 million loan applications, about 85 percent of which were acted upon by the lender (data derived from **table 11**). Patterns of denial rates are largely consistent with what has been observed in ear-

Table 11. Disposition of applications for home loans, and origination and pricing of loans, by type of home and type of loan, 2010

Type of home and loan	Applications			
	Number submitted	Acted upon by lender		
		Number	Number denied	Percent denied
1–4 family nonbusiness related[3]				
Owner occupied				
Site built				
Home purchase				
Conventional				
First lien	1,468,647	1,280,452	193,739	15.1
Junior lien	57,538	51,101	8,539	16.7
Government backed				
First lien	1,645,713	1,442,912	230,196	16.0
Junior lien	1,794	1,532	143	9.3
Refinance				
Conventional				
First lien	6,102,081	5,213,320	1,104,659	21.2
Junior lien	152,757	139,288	46,906	33.7
Government backed				
First lien	1,421,776	1,074,474	357,759	33.3
Junior lien	443	330	83	25.2
Home improvement				
Conventional				
First lien	217,286	194,078	53,581	27.6
Junior lien	161,820	146,322	65,692	44.9
Government backed				
First lien	19,308	13,603	4,889	35.9
Junior lien	10,845	8,551	5,437	63.6
Unsecured (conventional or government backed)	187,731	182,267	85,213	46.8
Manufactured				
Conventional, first lien				
Home purchase	200,165	191,498	105,052	54.9
Refinance	54,005	48,665	19,158	39.4
Other	86,655	77,187	32,703	42.4
Non-owner occupied[4]				
Conventional, first lien				
Home purchase	384,535	338,090	58,566	17.3
Refinance	606,900	506,110	150,278	29.7
Other	78,723	69,113	27,184	39.3

lier years.[27] Denial rates on applications for home-purchase loans are notably lower than those observed on applications for refinance or home-improvement loans. Denial rates on applications backed by manufactured housing are much higher than those on applications

[27] The information provided in the tables is identical to that provided in analyses of earlier years of HMDA data. Comparisons of the numbers in tables 11 and 12 with those in the tables from earlier years, including denial rates, can be made by consulting the following articles: Avery and others, "The 2009 HMDA Data"; and Robert B. Avery, Neil Bhutta, Kenneth P. Brevoort, Glenn B. Canner, and Christa N. Gibbs (2010), "The 2008 HMDA Data: The Mortgage Market during a Turbulent Year," *Federal Reserve Bulletin,* vol. 96, pp. A169–A211. Also see Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner (2008), "The 2007 HMDA Data," *Federal Reserve Bulletin*, vol. 94, pp. A107–A146; Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner (2007), "The 2006 HMDA Data," *Federal Reserve Bulletin*, vol. 93, pp. A73–A109; Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner (2006), "Higher-Priced Home Lending and the 2005 HMDA Data," *Federal Reserve Bulletin*, vol. 92, pp. A123–A166; and Robert B. Avery, Glenn B. Canner, and Robert E. Cook (2005),"New Information Reported under HMDA and Its Application in Fair Lending Enforcement," *Federal Reserve Bulletin*, vol. 91, pp. 344–94.

Table 11. Disposition of applications for home loans, and origination and pricing of loans, by type of home and type of loan, 2010—*continued*

Type of home and loan	Loans originated											
	Number	Loans with APOR spread above the threshold[1]										
		Number	Percent	Distribution, by percentage points of APOR spread						APOR spread (percentage points)		Number of HOEPA-covered loans[2]
				1.5–1.99	2–2.49	2.5–2.99	3–3.99	4–4.99	5 or more	Mean	Median	
1–4 family nonbusiness related[3]												
Owner occupied												
Site built												
Home purchase												
Conventional												
First lien	1,002,871	32,983	3.3	39.7	21.7	15.7	15.1	5.1	2.8	2.5	2.2	...
Junior lien	39,910	5,880	14.7	...	...	...	40.5	48.7	10.8	4.3	4.2	...
Government backed												
First lien	1,147,045	14,964	1.3	80.0	13.9	3.1	1.6	.5	.9	1.8	1.7	...
Junior lien	1,347	9	.7	...	...	...	33.3	55.6	11.1	4.4	4.4	...
Refinance												
Conventional												
First lien	3,825,680	49,359	1.3	42.0	17.6	12.8	13.9	5.8	8.0	2.7	2.2	917
Junior lien	85,338	10,171	11.9	...	...	...	31.6	37.5	30.9	4.8	4.4	280
Government backed												
First lien	643,178	31,696	4.9	39.3	35.4	17.5	6.5	1.0	.3	2.2	2.1	277
Junior lien	226	3	1.3	...	...	...	33.3	33.3	33.3	4.9	4.0	0
Home improvement												
Conventional												
First lien	130,514	13,160	10.1	29.3	18.2	14.2	17.0	7.7	13.7	3.2	2.6	533
Junior lien	73,908	8,222	11.1	...	...	...	31.2	36.3	32.6	4.8	4.4	238
Government backed												
First lien	7,830	1,254	16.0	23.3	32.1	23.6	12.7	5.7	2.7	2.6	2.4	15
Junior lien	2,644	2,185	82.6	...	...	...	2.0	18.2	79.9	6.5	6.7	0
Unsecured (conventional or government backed)	90,452	...	...	...	...	...	...	...	...	...	...	...
Manufactured												
Conventional, first lien												
Home purchase	44,436	35,574	80.1	4.7	5.6	7.1	19.4	17.8	45.4	5.2	4.7	...
Refinance	25,369	9,063	35.7	13.6	10.8	13.1	24.6	16.6	21.3	3.9	3.5	711
Other	36,449	6,827	18.7	25.3	16.8	11.8	18.0	11.4	16.7	3.4	2.8	330
Non-owner occupied[4]												
Conventional, first lien												
Home purchase	256,857	12,627	4.9	39.3	18.4	14.1	15.8	5.9	6.6	2.7	2.3	...
Refinance	327,819	9,656	2.9	48.1	17.8	11.5	12.9	5.1	4.7	2.5	2.0	54
Other	38,962	2,692	6.9	17.9	14.1	10.1	22.8	17.5	17.6	3.6	3.5	35

1 Average prime offer rate (APOR) spread is the difference between the annual percentage rate on the loan and the APOR for loans of a similar type published weekly by the Federal Financial Institutions Examination Council. The threshold for first-lien loans is a spread of 1.5 percentage points; for junior-lien loans, it is a spread of 3.5 percentage points.

2 Loans covered by the Home Ownership and Equity Protection Act of 1994 (HOEPA), which does not apply to home-purchase loans.

3 Business-related applications and loans are those for which the lender reported that the race, ethnicity, and sex of the applicant or co-applicant are "not applicable"; all other applications and loans are nonbusiness related.

4 Includes applications and loans for which occupancy status was missing.

Table 11. Disposition of applications for home loans, and origination and pricing of loans, by type of home and type of loan, 2010—*continued*

Type of home and loan	Applications			
	Number submitted	Acted upon by lender		
		Number	Number denied	Percent denied
Business related[3]				
Conventional, first lien				
Home purchase	29,771	28,920	973	3.4
Refinance	30,632	29,617	1,612	5.4
Other	10,266	9,684	960	9.9
Multifamily[5]				
Conventional, first lien				
Home purchase	8,315	7,689	1,004	13.1
Refinance	12,769	11,883	1,815	15.3
Other	4,400	4,034	648	16.1
Total	**12,954,875**	**11,070,720**	**2,556,789**	**23.1**

5 Includes business-related and nonbusiness-related applications and loans for owner-occupied and non-owner-occupied properties.

... Not applicable.

backed by site-built homes. For example, the denial rate for first-lien conventional home-purchase loan applications for owner-occupied site-built properties was 15.1 percent in 2010, compared with a denial rate of 55 percent for such applications for owner-occupied manufactured homes.

In addition to the application data provided under HMDA, nearly 443,000 requests for preapproval were reported as acted on by the lender in 2010 (**table 12**). About 26 percent of these requests for preapproval were denied by the lender. Not surprisingly, the number of requests for preapproval is down substantially from the levels recorded at the height of the

Table 11. Disposition of applications for home loans, and origination and pricing of loans, by type of home and type of loan, 2010—*continued*

Type of home and loan	Loans originated											
	Number	Loans with APOR spread above the threshold[1]										
		Number	Percent	Distribution, by percentage points of APOR spread						APOR spread (percentage points)		Number of HOEPA-covered loans[2]
				1.5–1.99	2–2.49	2.5–2.99	3–3.99	4–4.99	5 or more	Mean	Median	
Business related[3]												
Conventional, first lien												
Home purchase	27,321	953	3.5	22.7	29.7	22.3	21.5	2.8	1.1	2.6	2.4	...
Refinance	27,525	727	2.6	23.4	27.8	23.7	19.1	4.0	2.1	2.6	2.5	...
Other	8,528	151	1.8	16.6	17.9	14.6	28.5	12.6	9.9	3.2	3.0	...
Multifamily[5]												
Conventional, first lien												
Home purchase	6,249	209	3.3	32.5	24.9	25.4	14.8	.5	1.9	2.4	2.3	...
Refinance	9,620	285	3.0	31.6	24.6	22.5	16.8	2.8	1.8	2.5	2.4	1
Other	3,259	50	1.5	46.0	20.0	12.0	8.0	12.0	2.0	2.5	2.1	0
Total	**7,863,337**	**248,700**	**3.2**	**31.3**	**16.5**	**11.2**	**15.8**	**10.6**	**14.6**	**3.2**	**2.6**	**3,391**

Table 12. Home-purchase lending that began with a request for preapproval: Disposition and pricing, by type of home, 2010

Type of home	Requests for preapproval			Applications preceded by requests for preapproval[1]			Loan originations whose applications were preceded by requests for preapproval										
					Acted upon by lender			Loans with APOR spread above the threshold[2]									
										Distribution, by percentage points of APOR spread						APOR spread (percentage points)	
	Number acted upon by lender	Number denied	Percent denied	Number submitted	Number	Number denied	Number	Number	Percent	1.5–1.99	2–2.49	2.5–2.99	3–3.99	4–4.99	5 or more	Mean spread	Median spread
1–4 family nonbusiness related[3]																	
Owner occupied																	
Site built																	
Conventional																	
First lien	214,845	50,155	23	130,475	21,520	16,756	85,438	1,676	2.0	47.6	23.5	11.3	11.3	4.6	1.8	2.3	2.0
Junior lien	5,327	942	18	3,787	271	170	3,196	1,075	33.6	...	...	...	28.4	63.7	7.9	4.3	4.2
Government backed																	
First lien	175,857	53,837	31	109,419	13,499	12,287	79,928	1,055	1.3	87.5	10.2	1.5	.1	.2	.5	1.8	1.7
Junior lien	218	22	10	193	22	10	159		.0	...	...	...	...	...	...	...	...
Manufactured																	
Conventional, first lien	13,777	1,288	9	12,241	1,483	4,436	4,283	2,364	55.2	16.3	5.1	6.0	9.1	10.1	53.4	5.6	5.3
Other	2,147	781	36	1,324	286	255	724	15	2.1	73.3	13.3	13.3	...	...	...	1.9	1.7
Non-owner occupied[4]																	
Conventional, first lien	28,822	5,378	19	19,395	2,983	2,290	13,045	427	3.3	41.0	16.6	14.1	14.3	9.6	4.5	2.7	2.3
Other	1,195	450	38	724	258	295	154	10	6.5	20.0	...	...	40.0	10.0	30.0	4.3	3.7
Business related[3]																	
Conventional, first lien	398	19	5	372	41	17	309	15	4.9	13.3	26.7	46.7	6.7	6.7	.0	2.7	2.8
Other	106	5	5	98	12	19	65	1	1.5	...	...	...	100.0	...	...	3.9	3.9
Multifamily[5]																	
Conventional, first lien	96	4	4	88	9	10	67	3	4.5	...	33.3	66.7	...	...	...	2.4	2.6
Other	15			15	5	2	8	1	12.5	100.0	...	...	...	...	...	1.6	1.6
Total	**442,803**	**112,881**	**25**	**278,131**	**40,389**	**36,547**	**187,376**	**6,642**	**3.5**	**34.6**	**10.6**	**6.3**	**11.7**	**15.8**	**21.2**	**3.8**	**2.9**

1 These applications are included in the total reported in table 11.
2 See table 11, note 1.
3 See table 11, note 3.
4 See table 11, note 4.
5 See table 11, note 5.
... Not applicable.

housing boom. In 2006, covered institutions reported that they received nearly 1.2 million requests for preapproval upon which they took action (data not shown in tables).

Rule Changes Related to Higher-Priced Lending

The rules governing whether a loan is classified as higher priced under HMDA were changed in 2008, with implementation affecting loan classifications for applications after October 1, 2009. All loans reported in the 2010 HMDA data, regardless of the date of

application, are covered under the new rules. The purpose of the rule change was to address concerns that had arisen about the distortive effects of changes in the interest rate environment on the reporting of higher-priced lending under the original methodology.[28] Under the original methodology, changes in underlying market rates of interest, particularly a steepening or flattening of the yield curve, could result in two loans of equivalent credit and prepayment risk being classified differently under HMDA as higher priced or not at different points in time, an outcome that was unintended.[29]

To address the distortions arising from the method used to classify loans as higher priced or not, the price-reporting rules under HMDA were modified. Lenders are now required to compare the APR on the loan with the "average prime offer rate" (APOR) for loans of a similar type (for example, a 30-year fixed-rate mortgage). The APOR, which is published weekly by the FFIEC, is an estimate of the APR on loans being offered to high-quality prime borrowers based on the contract interest rates and discount points reported by Freddie Mac in its Primary Mortgage Market Survey (PMMS).[30] If the difference is more than 1.5 percentage points for a first-lien loan or more than 3.5 percentage points for a junior-lien loan, then the loan is classified as higher priced and the rate spread is reported. Since APORs move with changes in market rates and are product specific, it is anticipated that the distortions that existed under the old methodology will be overcome.

The Incidence of Higher-Priced Lending

The data show that the incidence of higher-priced lending across all products in 2010 was about 3.2 percent (table 11).[31] The incidence varies across loan types, products, and purposes. First, in almost all cases, nonconventional loans have a lower incidence of higher-priced lending than do comparable conventional loan products, although the differences in incidence are much smaller than in the period when many conventional loans were subprime or near prime. In 2010, among first-lien home-purchase loans for site-built homes, 3.3 percent of conventional loans had APRs above the price-reporting threshold, versus 1.3 percent of nonconventional loans. Second, with few exceptions, first-lien loans have a lower incidence of higher-priced lending than do junior-lien loans for the same purposes. For example, in 2010, the incidence of higher-priced lending for conventional first-lien refinance loans was 1.3 percent, whereas for comparable junior-lien loans it was 11.9 percent. This relationship is found despite the fact that the threshold for reporting a

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[28] The rules for reporting loan pricing information under HMDA were originally adopted in 2002, covering lending beginning in 2004. These older rules required lenders to compare the APR on the loan with the yield on a Treasury security with a comparable term to maturity to determine whether the loan should be considered higher priced: If the difference exceeded 3 percentage points for a first-lien loan or 5 percentage points for a junior-lien loan, the loan was classified as higher priced and the rate spread (the amount of the difference) was reported.

[29] For a more detailed discussion of the problems with the old price-reporting rules that led to the change, see Avery and others, "The 2009 HMDA Data."

[30] The weekly PMMS reports the average contract rates and points for all loans and the margin for adjustable-rate loans for loans offered to prime borrowers (those who pose the lowest credit risk). The survey currently reports information for two fixed-rate mortgage products (30-year and 15-year terms) and two adjustable-rate mortgage products (1-year adjustable rate and a 5-year adjustable rate). See Freddie Mac, "Weekly Primary Mortgage Market Survey (PMMS)," webpage, www.freddiemac.com/pmms; and Federal Financial Institutions Examination Council, "New FFIEC Rate Spread Calculator," webpage, www.ffiec.gov/ratespread/newcalc.aspx.

[31] In previous articles exploring the distortions created by the old loan pricing classification methodology (see Avery and others, "The 2009 HMDA Data"), we used an adjustment technique that tried to address those distortions. The adjustment technique was similar to the new reporting rules, though it was also clearly inferior to them and could not have been implemented without access to date information, which is not part of the public use file. Without this adjustment, comparison of higher-priced data for loans covered by the old reporting rules with such data for loans covered by the new ones is not appropriate. Even with the adjustment, it is not possible to adjust the data for loans reported under the old rules to make them fully comparable to data reported under the new rules. For this reason, we restrict our discussion here to the 2010 data.

junior-lien loan as higher priced is 2 percentage points higher than it is for so reporting a first-lien loan. Third, manufactured-home loans exhibit the greatest incidence of higher-priced lending across all loan categories, a result consistent with the elevated credit risk associated with such lending. For 2010, 80 percent of the conventional first-lien loans used to purchase manufactured homes were higher priced.

Rate Spreads for Higher-Priced Loans

Although there is considerable variation across loan products in the incidence of higher-priced lending, the variation across products in mean and median APOR spreads as reported in the HMDA data is much smaller. For example, for 2010, the mean APOR spread reported for higher-priced conventional first-lien loans for the purchase of an owner-occupied site-built home was about 2.5 percentage points, compared with about 1.8 percentage points for higher-priced first-lien nonconventional loans used for the same purpose (table 11).

It is worth noting that the vast majority of nonconventional loans reported as higher priced in 2010 exceeded the HMDA price-reporting thresholds by only a small amount: Specifically, 80 percent of the higher-priced nonconventional first-lien home-purchase loans had reported spreads within 50 basis points of the threshold. By comparison, only about 40 percent of the comparable conventional loans reported as higher priced had prices this close to the margin of reporting. In contrast, the share of higher-priced nonconventional refinancing loans with APORs close to the margin of reporting (39 percent) is a little less than the share of higher-priced conventional refinancing loans with such APORs (about 42 percent).

As expected, consistent with the higher reporting threshold of junior-lien lending, higher-priced junior-lien loan products have higher mean and median APOR spreads than do higher-priced first-lien loans. Higher-priced loans for manufactured homes differ from other loan products in that they generally have the highest mean spreads. In 2010, the typical higher-priced conventional first-lien loan to purchase a manufactured home had a reported spread of about 5.2 percentage points, compared with an average spread of roughly 2.5 percentage points for comparable higher-priced loans for site-built properties.

HOEPA Loans

The HMDA data indicate which loans are covered by the protections afforded by HOEPA. Under HOEPA, certain types of mortgage loans that have interest rates or fees above specified levels require additional disclosures to consumers and are subject to various restrictions on loan terms.[32] For 2010, 655 lenders reported extending nearly 3,400 loans covered by HOEPA (table 11; data regarding lenders not shown in tables). In comparison, 1,153 lenders reported on about 6,500 loans covered by HOEPA in 2009. In the aggregate, HOEPA-related lending made up less than 0.1 percent of all of the originations of home-secured refinancings and home-improvement loans reported for 2010 (data derived from tables).[33]

[32] Unlike the threshold rules used to report higher-priced loans, the threshold rules used to identify HOEPA loans did not change between 2009 and 2010, and thus the 2010 number of HOEPA loans is comparable to that of earlier years. The requirement to report HOEPA loans in the HMDA data relates to whether the loan is subject to the original protections of HOEPA, as determined by the coverage test in the Federal Reserve Board's Regulation Z, 12 C.F.R. pt. 226.32(a). The required reporting is not triggered by the more recently adopted protections for "higher-priced mortgage loans" under Regulation Z, notwithstanding that those protections were adopted under authority given to the Board by HOEPA. See 73 Fed. Reg. 44522 (July 30, 2008).

[33] HOEPA does not apply to home-purchase loans.

Factors Influencing Refinancing Activity in 2010

As discussed earlier, the APOR for a 30-year fixed-rate mortgage fell sharply at the end of 2008 and into 2009, and then it fell to well under 5 percent in 2010 (figure 1). Moreover, these rate declines appear to have sparked elevated refinance activity in early 2009 and late 2010. Still, overall refinance activity in both 2009 and 2010 appears low compared with what might have been expected given the sharp decline in interest rates. For example, interest rates last fell sharply in the early 2000s, and refinance volume peaked in 2003 at over 15 million loans, more than the combined refinance volume in 2009 and 2010 (table 3.B).

One explanation for subdued refinance activity is that lenders may be less willing or less able to take risk than earlier in the decade. The Federal Reserve's quarterly Senior Loan Officer Opinion Survey on Bank Lending Practices indicates that lenders have tightened credit standards during the past few years.[34] Lenders could also be adjusting prices in light of perceptions that borrowers with the same nominal characteristics (credit score, for example) pose more risk now than they did several years ago because of the substantially weaker and more uncertain conditions in employment and housing markets. Lenders may also be pricing risk more stringently because they are passing on certain fees from the GSEs. In 2008, both Fannie Mae and Freddie Mac started charging additional fees ("loan-level pricing adjustments") on loans to borrowers in credit score and LTV ranges in which they had not charged such fees before. In addition to these factors, the increased fees and tighter underwriting by PMI companies noted earlier and the increased presence of junior-lien loans—which must be closed, refinanced, or resubordinated—relative to the past may also be impeding refinance activity.

Subdued refinance activity may also stem from the fact that the financial standing of many borrowers has been undermined by sharp house price declines and the associated loss of home equity, especially for those residing in Arizona, California, Florida, Michigan, and Nevada, where home prices fell more than 20 percent from the end of 2006 to the end of 2009, according to the Federal Housing Finance Agency (FHFA) home price index.[35] A borrower with little or no home equity may need to pay down his or her loan balance substantially before being able to qualify for a refinance, which could be difficult.

That said, a few programs have been introduced in recent years to help facilitate refinancing for those with little or no equity. Perhaps most notable is the Home Affordable Refinance Program. To be eligible, borrowers must be current on their payments, and their loans must have been originated before June 2009, be backed by the GSEs, and have balances that do not exceed 125 percent of the respective home values. Thus far, the program has had less of an effect than initially expected, perhaps because of some issues raised previously, such as getting junior-lien holders to agree to resubordinate their loans under the new refinance loan.[36]

To help describe refinance activity in more detail than is possible with the HMDA data, we draw on a relatively new data source—the FRBNY Consumer Credit Panel/Equifax. The panel is a nationally representative longitudinal database of individuals with detailed infor-

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[34] See Board of Governors of the Federal Reserve System, "Senior Loan Officer Opinion Survey on Bank Lending Practices," webpage, www.federalreserve.gov/boarddocs/SnLoanSurvey.

[35] See Federal Housing Finance Agency, "House Price Index," webpage, www.fhfa.gov/Default.aspx?Page=14. Elevated levels of unemployment and underemployment across much of the country have also likely damped refinancings, since reduced incomes and unstable employment make qualifying for loans more difficult.

[36] For a more detailed discussion of why the Home Affordable Refinance Program may not have had more robust results thus far, see Elizabeth A. Duke (2011), "Rebalancing the Housing Market," speech delivered at the Federal Reserve Board Policy Forum "The Housing Market Going Forward: Lessons Learned from the Recent Crisis," Washington, September 1, www.federalreserve.gov/newsevents/speech/duke20110901a.htm.

mation, at a quarterly frequency beginning in 1999, on consumer and mortgage debt and loan performance drawn from the credit records collected and maintained by Equifax, one of the three national credit bureaus.[37] The data include three key pieces of information with respect to this analysis: (1) details on each mortgage outstanding for a given consumer, including the year of origination and current balance; (2) each consumer's credit score as of the end of 2009; and (3) each consumer's geographic location at the level of the census block (a subunit of a census tract).[38]

Refinance mortgage loans are not explicitly identified in the credit bureau data, but because we can follow a given mortgage borrower over time, we can infer whether that borrower refinanced his or her mortgage during any particular period. Estimates of "refinance rates" (the shares of borrowers that refinanced their mortgages) during 2010 are provided by credit score, geography, and year of loan origination for those with mortgages outstanding as of the end of 2009 (**table 13**, top panel). To simplify the analysis, we focus on consumers who had exactly one closed-end mortgage with an outstanding balance of at least $50,000 as of the end of 2009 and stayed in the same census block over the course of 2010 (a proxy for not having changed residence; we simply want to omit from the analysis those who moved).[39] We then look at their mortgage accounts at the end of 2010 and classify consumers as having refinanced during 2010 if they (1) opened at least one closed-end mortgage in 2010 and (2) no longer had a positive-balance mortgage with an origination date matching that of the mortgage that was outstanding at the end of 2009.

Estimated refinance rates in 2010 were highest among consumers with pristine credit scores (820 or higher) whose loans were originated between 2006 and 2008—years with relatively high interest rates.[40] Within these origination years, lower credit scores were associated with much lower refinance rates within both groups of states. For example, in "other" states—those states that did not experience the largest declines in home values—refinance rates for consumers with credit scores of 680 to 719 were less than half of those for consumers with the highest credit scores.

Estimated refinance rates are also generally lower for borrowers in the five states that experienced house price declines of 20 percent or more ("sharpest declines") within each score group, especially for loans originated between 2005 and 2007—the time that house prices peaked. Those who purchased homes without significant down payments or reduced their equity substantially through refinancing during this period would have been most affected

[37] The data are drawn using a methodology to ensure that the same individuals can be tracked over time, and that the data are representative of all individuals with a credit record as of the end of each quarter. For more information on these data, see Donghoon Lee and Wilbert van der Klaauw (2010), "An Introduction to the FRBNY Consumer Credit Panel," Federal Reserve Bank of New York Staff Reports 479 (New York: Federal Reserve Bank of New York, November). It is important to note that all individuals in the database are anonymous: Names, street addresses, and Social Security numbers have been suppressed. Individuals are distinguished and can be linked over time through a unique, anonymous consumer identification number assigned by Equifax.

[38] This score is generated from the Equifax Risk Score 3.0 model. The Equifax Risk Score 3.0 is a credit score produced from a general-purpose risk model that predicts the likelihood an individual will become 90 days or more delinquent on any account within 24 months after the score is calculated. The Equifax Risk Score 3.0 ranges from 280 to 850, with a higher score corresponding to lower relative risk (for more information, see www.equifax.com). An individual's credit score at the end of 2009 represents a reasonable metric of the score that would have been available to a lender that received an application for a refinancing during 2010.

[39] Those consumers with relatively small balances are less likely to find it in their financial interest to refinance. Indeed, table 10 indicates that more than 97 percent of refinance loans in 2010 were for amounts in excess of $50,000.

[40] Unfortunately, the credit bureau data lack information on the interest rate of the loan or the structure of the loan (for example, whether it is an adjustable- or fixed-rate mortgage). Thus, we cannot determine more precisely whether a given borrower has a strong financial incentive to refinance. For example, borrowers with adjustable-rate mortgages may be less inclined to refinance because they already enjoy the benefits of falling rates.

Table 13. Estimated refinance rates for borrowers with outstanding loans in states grouped by degree of decline in house prices, by year of loan origination and credit score category, 2010 and 2003
Percent

Year of loan origination	Estimated refinance rates during 2010										
	Credit score category[1]									Memo	
	Less than 680		680–719		720–819		820 or more		All	APOR difference[3]	Proportion of borrowers
	Steepest declines[2]	Other[2]	Steepest declines[2]	Other[2]	Steepest declines[2]	Other[2]	Steepest declines[2]	Other[2]			
Before 2003	.7	1.9	4.5	7.1	9.1	12.8	10.8	13.5	8.5	n.a.	10.3
2003	1.3	2.1	6.8	8.4	11.4	14.1	14.2	15.3	11.6	1.1	13.5
2004	.8	1.8	5.0	8.2	11.2	14.7	15.8	18.1	10.5	1.2	8.4
2005	.6	1.8	4.5	9.3	10.0	16.6	15.8	22.8	10.3	1.2	10.7
2006	.5	2.4	3.9	10.8	9.4	19.4	17.0	23.1	9.2	1.7	10.9
2007	1.3	3.8	4.4	12.1	11.5	19.7	17.0	24.0	10.9	1.6	12.6
2008	5.6	6.1	12.3	14.7	20.1	22.7	27.2	28.9	16.8	1.3	13.0
2009	5.0	4.5	7.8	6.2	10.8	8.6	15.1	10.5	8.4	.4	20.6
Memo											
All origination years	1.7	3.2	6.4	9.7	11.8	14.8	15.6	17.4	10.7	...	100.0
Proportion of borrowers	7.0	22.0	2.0	7.6	11.1	37.7	3.7	8.8	100.0	...	...
Estimated refinance rates during 2003											
Before 1996	21.6	18.3	30.2	28.9	33.6	34.9	31.1	29.1	29.3	n.a.	11.6
1996	24.0	18.6	30.4	36.7	43.2	40.4	30.8	37.9	32.1	2.1	2.7
1997	25.0	18.5	36.0	38.4	47.6	46.8	42.5	41.0	35.6	1.9	3.4
1998	24.1	20.8	41.3	39.3	49.8	45.5	51.3	44.2	39.4	1.2	12.0
1999	25.7	19.9	41.4	39.2	48.1	44.7	48.2	39.3	36.3	1.7	10.3
2000	27.6	21.6	48.1	43.9	48.1	47.1	36.8	45.3	34.2	2.3	5.9
2001	35.6	28.2	46.0	39.1	52.5	46.6	57.9	47.8	41.4	1.2	25.3
2002	29.1	24.3	34.9	29.7	38.2	32.8	47.1	33.6	31.4	.7	28.8
Memo											
All origination years	28.7	23.1	39.3	35.4	44.3	40.7	44.7	38.6	35.5	...	100.0
Proportion of borrowers	8.1	23.7	3.3	9.5	12.9	38.8	1.3	2.5	100.0	...	...

[1] Credit scores for borrowers are measured as of the beginning of the year.

[2] "Steepest declines" consists of the five states with the steepest declines in house prices from 2006 to 2009: Arizona, California, Florida, Michigan, and Nevada; "other" consists of all remaining states.

[3] The average prime offer rate (APOR), which is published weekly by the Federal Financial Institutions Examination Council, is an estimate of the annual percentage rate on 30-year fixed-rate loans being offered to high-quality prime borrowers based on the contract interest rates and discount points reported by Freddie Mac in its Primary Mortgage Market Survey. The APOR difference is the difference in average annual APOR between the year of loan origination and the year of refinance. For 2010, the average annual APOR is 4.75 percent; for 2003, it is 5.885 percent.

Source: Federal Reserve Bank of New York Consumer Credit Panel/Equifax.

n.a. Not available.

... Not applicable.

by declining house prices. Also, the difference in refinance rates tends to rise as credit scores fall, suggesting that low equity seems to compound the problem of lower scores in efforts to refinance. For example, among those with loans originated in 2006, the estimated refinance rate for consumers with pristine credit scores is nearly 25 percent in the other states, compared with roughly 17 percent in the states with the sharpest declines, while for the group with the second-highest score (720–819), this difference becomes more pronounced—about 19 percent versus 9 percent.

In contrast, analogous estimates for 2003 in the bottom panel of table 13 indicate that refinance rates that year did not vary systematically across state groups and did not fall with credit scores until scores dropped below 680. In other words, the current pattern of refinance activity across state and credit score groups does not appear to be explained by his-

torical precedent. The findings overall provide evidence consistent with the view that losses of home equity, weak economic conditions, and tighter underwriting (whether due to decreased appetite for risk or an increased assessment of risk) damped refinance activity in 2010.[41]

We can use the estimates in table 13 to make an inference about the share of mortgagors at the end of the 2009 who would have refinanced during 2010 if home equity was not an impediment and underwriting was similar to what it was in 2003 (that is, similar across credit score groups except for the group with scores below 680). Specifically, if we assume that refinance rates for each state-score-year group were identical to the refinance rates for those with pristine scores in other states and that, as in 2003, refinance rates for those with scores below 680 are about 60 percent of what they were for pristine score types, then the overall refinance rate in 2010 would have been just over 16 percent instead of just under 11 percent.[42]

This "counterfactual" refinance rate might be conservative since it abstracts away from the problems posed by the increased incidence of junior liens, noted earlier. However, we also estimated refinance rates for those with a positive-balance HELOC and found nearly identical refinance rates as those shown in table 13.[43] The counterfactual rate might also be conservative because declining house prices affected borrowers in the other states at least to some extent, but, notably, we found refinance rates for those in the subset of states where prices have not declined since 2006 to be very similar to those for the other states as a whole (data not shown in tables). Overall, this exercise suggests that refinance rates could have been just over 5 percentage points, or just over 50 percent, higher in the absence of home equity problems and underwriting changes. Applying that number to the HMDA data implies that roughly an additional 2.3 million first-lien owner-occupant refinance loans would have been made during 2010 on top of the roughly 4.5 million such loans that were in fact originated (data derived from table 7).

The Continuing Role of Government in the Mortgage Market

The HMDA data for 2008 and 2009 showed that the share of new mortgage loans either explicitly or implicitly guaranteed by the federal government rose dramatically from 2006. This increased government role continued in 2010, with the share of loans that were originated through the FHA, VA, and, to a much lesser extent, FSA or RHS programs, or that were owned outright or in mortgage pools guaranteed by Fannie Mae or Freddie Mac, remaining about the same as it was in 2009. This section discusses the underlying causes of this trend. To facilitate our analysis, we employ a revised data set designed to correct for one of the limitations in the HMDA reporting system.

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[41] One could imagine comparing denial rates on refinance applications in the HMDA data across geographies and over time to gauge the difficulty of refinancing currently. However, as discussed later, changes over time in the composition of applicants as credit conditions change would likely confound such an analysis.

[42] For example, instead of a refinance rate of 22.7 percent for 2008 borrowers in other states with a score between 720 and 819, such borrowers would have had a refinance rate of 28.9 percent. Similarly, instead of a refinance rate of 10 percent for 2005 borrowers in the steepest-decline states, they would have had a refinance rate of 22.5 percent. After adjusting the refinance rates for each cell in this manner, the counterfactual rate is then calculated as a weighted average of each cell, where the weights are given by the share of borrowers in each cell.

[43] Analysis of the data suggests that of those with at least one closed-end mortgage with a balance above $50,000 at the end of 2009, about two-thirds had just that one mortgage, about 13 percent had two first-lien mortgages, and about 20 percent had a junior lien—either a closed-end mortgage or a HELOC with a positive balance. Of those with a junior lien, about two-thirds had a HELOC as opposed to a closed-end junior lien. Because of the data structure, it is difficult to estimate refinance rates for those who have a closed-end junior-lien loan. Also note that the bureau data do not identify junior-lien loans explicitly; instead, we assume that those with a HELOC and those with a second closed-end mortgage that is no more than 25 percent of the size of the other closed-end mortgage have a junior lien.

Under HMDA reporting rules, all loans originated under the FHA, VA, FSA, or RHS programs must be identified as such.[44] However, loans placed in pools that are guaranteed by or sold to the GSEs Fannie Mae and Freddie Mac are identified only if they are sold directly to the GSEs or directly placed in a pool during the same year of the loan origination. The HMDA data therefore tend to undercount loans ultimately sold to the GSEs for two reasons. First, sales can take place in a year subsequent to origination, especially among loans originated during the fourth quarter. Second, lenders may not sell loans directly to the GSEs but instead may sell them to other financial institutions that form mortgage pools for which investors subsequently obtain GSE credit guarantees.

For the analysis in this section, we adjust the HMDA data to attempt to correct for the undercount of GSE loans. First, in addition to reporting their mortgage originations, financial institutions are also required to report their loan purchases and the types of purchasers if the loans are resold. Using information on loan size, location, date of origination, and date of purchase, we were able to match more than 50 percent of the loans that were originated from 2006 to 2010 and then sold to other financial institutions to the records for the same loans in the loan purchase files. From those matched loans, we were then able to obtain the ultimate loan dispositions from the filings of loan purchases. Of the portion we were unable to match, most were originated (and purchased) by one large organization, which supplied us with the aggregate disposition of the purchased loans. For those sold loans that we were still unable to match, we assumed that the distribution of the ultimate disposition matched that of similar loans that we could match.

Second, to address the undercount of GSE loans originated in October through December of each year, we used an imputation formula based on the allocation of loans originated in the preceding September and the following January to assign the ultimate disposition of conventional loans.[45] The imputation was conducted separately for the largest mortgage originators and took account of the characteristics of the loan, including size and location.

Figure 4 illustrates the changing structure of the mortgage market between 2006 and 2010 using our adjusted data for the four major loan types reported under HMDA. It groups first-lien site-built mortgages into four distinct categories: (1) loans insured by the FHA, backed by the VA, or issued or guaranteed by the FSA or RHS (“nonconventional”); (2) conventional loans sold to Fannie Mae or Freddie Mac or placed in pools guaranteed by them (“GSE”); (3) conventional loans sold to an affiliate or held in the portfolio of the originating lender (“portfolio”); and (4) all other conventional loans, including those sold into the private securitization market or to unaffiliated institutions (“other”). Panels 4.A, 4.B, and 4.C show patterns for owner-occupant home-purchase, refinance, and home-improvement loans; panel 4.D shows patterns for all non-owner-occupant loans regardless of purpose.[46]

Our adjusted data show a greater role for the GSEs than that implied by the raw HMDA data. The raw HMDA data reported by lenders show that 39.6 percent of owner-occupant

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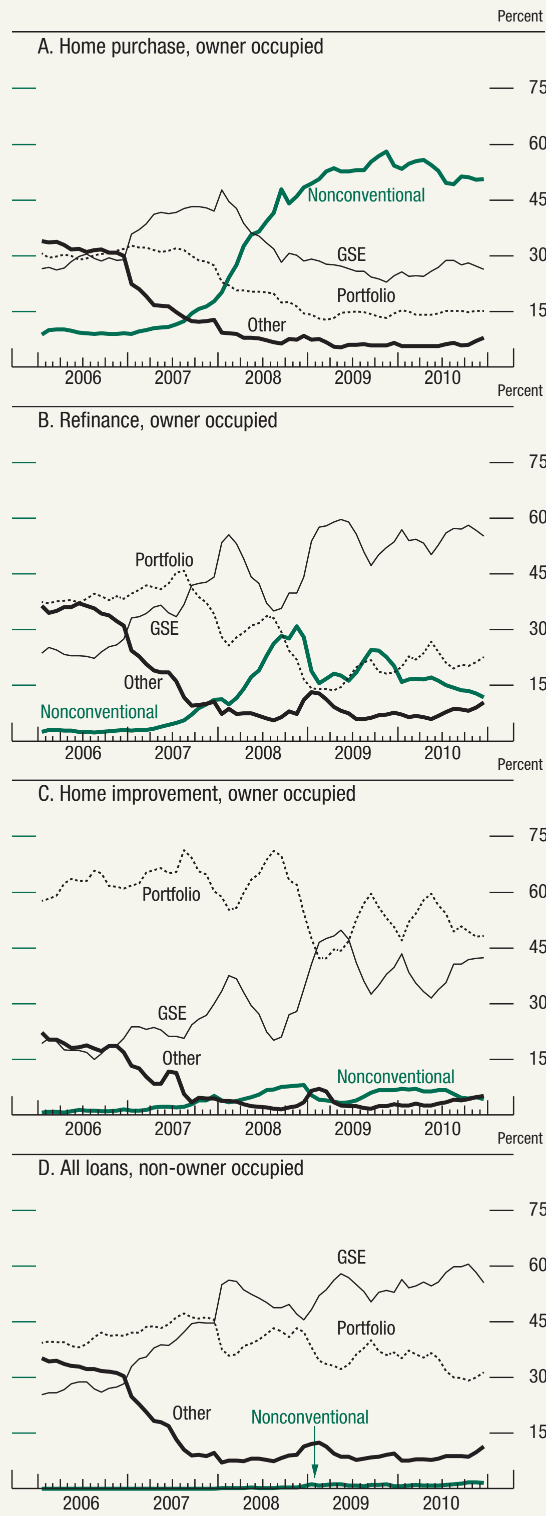
[44] For the 2010 reporting year, 77.5 percent of the nonconventional first-lien owner-occupant home-purchase loans were FHA loans, 15.2 percent were VA guaranteed, and 7.3 percent were covered under the FSA or RHS programs. For nonconventional refinance loans, 79.2 percent were FHA, 20.3 percent VA, and 0.4 percent FSA or RHS.

[45] For 2010, only the September data were used.

[46] The home-improvement and non-owner-occupant loan categories are more heterogeneous than the other two. The home-improvement category may include some “cash-out” refinance loans, which would be treated as refinancings except that some of the funds are used for home improvements, as well as smaller new loans on homes that previously had no mortgage. The non-owner-occupant category presented here is heterogeneous by construction since it includes all types of loans. As a consequence of this heterogeneity, the disposition of liens in these two categories is likely more sensitive to market changes than that of liens in the refinance and home-purchase categories.

Figure 4. Share of lending, by purpose of loan and occupancy status of home and by type of loan, 2006–10



Note: The data are monthly. Loans are first liens on one- to four-family, site-built properties and exclude business loans. Business-related loans are those for which the lender reported that the race, ethnicity, and sex of the applicant or co-applicant are "not applicable." For definitions of loan types, see text.

refinance loans originated in 2010 were reported as sold directly to the GSEs or placed in a mortgage pool guaranteed by them (data derived from tables 7 and 8); our revised data imply that the "correct" figure is likely to be much higher (over 55 percent).

The data in figure 4 show that the subprime-based private securitization market declined at the end of 2006 and throughout 2007, while the GSEs gained market share. Portfolio and nonconventional market shares remained relatively constant until the end of 2007. The years 2008 through 2010 show a different dynamic, with nonconventional home-purchase market share rising dramatically and then remaining constant before dropping somewhat in 2010. The GSEs play a much more prominent role in the refinance market; their share rose dramatically at the beginning of 2008, fell through August, and then rose again into 2009 and 2010. Portfolio and other lending dropped precipitously from 2007 to 2009 before increasing somewhat in 2010, particularly in the refinance market.

These changing patterns reflect the actions of a number of players. Nonconventional lending has traditionally focused on the high-LTV market, offering investors mortgage insurance protection against borrower default. PMI companies also offer similar insurance for high-LTV conventional loans, with PMI (or some other credit enhancement) required by statute for loans with LTVs above 80 percent that are sold to the GSEs. Lenders can also choose to forgo PMI and (1) hold the loan directly or (2) issue a junior-lien piggyback loan for the portion of the loan above 80 percent and still sell the 80 percent loan to the GSEs. The choice among PMI,

public mortgage insurance, or a piggyback loan is likely to be made by borrowers (and lenders) based on the relative pricing and underwriting standards of the PMI and the non-conventional loan products. Prices and underwriting established by purchasers in the secondary market also matter. Both GSEs charge fees for loans they purchase or guarantee, with the fees varying by LTV and credit quality and subject to change over time. The GSE, FHA, and VA programs are also subject to statutory limits on loan size, which can and have been changed. Finally, the willingness of financial institutions to hold mortgages in portfolio is likely to be sensitive to their cost of funds, their capital position, and other factors.

Many of these items have changed over the past five years and likely influenced lending outcomes, as described in previous articles. Relative to previous years, there was relatively little change in 2010. The most notable event, discussed earlier, was the expiration of the first-time homebuyer tax credit program. The program—which, in an earlier article, we estimated that one-half of the home-purchase loans in 2009 qualified for—expired in April 2010 for loans closing through June 2010. By targeting first-time homebuyers, the program likely stimulated demand for high-LTV home-purchase mortgages. An FHA loan may have had particular appeal for such borrowers because the FHA allowed the tax credit to be used in advance as part of the down payment. This factor may potentially explain the decline in nonconventional market share in the latter part of 2010. However, another factor may also have been in play. In April 2010, the FHA raised its upfront underwriting fee 0.5 percentage point.[47] The share of nonconventional loans in the home-purchase market peaked in April—well before the end of the first-time homebuyer tax credit program—and fell about 4 percentage points, remaining at that level through the end of the year. Notably, the share of nonconventional loans in the refinance market, which was unaffected by the tax credit program, peaked in May and declined about 4 percentage points thereafter.

In the sections that follow, we discuss the differential implications that these changes may have had for particular groups and the potential effects that proposed changes in the GSE and FHA limits may have on the marketplace.

Demographic Patterns

As discussed earlier, 2008 and 2009 were characterized by the increased roles of the GSEs and of the FHA, VA, FSA, and RHS programs. Such government-related lending continued at roughly the same levels in 2010. This section examines how government-related lending played out differently across borrower groups. We differentiate among borrowers by race and ethnicity, relative income (for both the neighborhood and the borrower), location (state), type of lender, and indicators of low-quality lending.

Changes in the share and number of home-purchase and refinance loans from 2006 to 2010 for different groups are shown (**tables 14.A** and **14.B**). These data indicate different patterns for home-purchase lending compared with refinance lending. For example, the shares of home-purchase loans to black and Hispanic-white borrowers decreased from 2006 to 2009, but the decrease in these groups' shares of the refinance market was more severe and continued in 2010. Also, the share of refinance loans to borrowers with low or moderate incomes (LMIs) fell significantly from 2006 to 2010, while the share of home-purchase loans to such borrowers increased significantly. Most of this growth took place in 2008 and 2009 but was sustained in 2010, when the first-time homebuyer tax credit program was still in place. Notably, the share of home-purchase lending to LMI borrowers fell significantly

[47] Fees were raised for mortgages with case numbers assigned (generally at the point of FHA application) after April 5, 2010. Most of the mortgages closing in April probably had case numbers assigned before the price rise.

Table 14. Distribution across various defining loan characteristics, by type of loan, 2006–10

A. Home purchase

Percent except as noted

Characteristic	Nonconventional[1]	GSE[2]	Other[3]	Portfolio[4]	Overall incidence	Memo: Total loans
	2006					
Minority status of borrower[5]						
Black or African American	12.7	5.0	11.6	7.5	8.6	378,832
Hispanic white	9.7	7.4	16.8	12.0	12.0	530,196
Asian	1.0	4.7	4.7	4.8	4.4	193,106
Non-Hispanic white	67.4	72.4	53.7	63.2	63.2	2,788,537
Other minority or missing[6]	9.3	10.6	13.3	12.5	11.9	524,820
LMI census tract or borrower[7]						
Census tract	16.6	12.1	18.7	15.7	15.7	694,040
Borrower	39.7	24.9	20.0	23.4	24.3	1,071,650
Other[8]	52.6	65.6	61.6	60.6	61.6	2,718,443
Missing[9]	1.0	2.8	6.4	7.0	5.0	221,735
Loan characteristic or occupancy status						
High payment-to-income ratio[10]	10.1	11.4	23.5	17.0	16.9	744,714
Non-owner occupant[11]	.1	16.4	15.7	19.3	15.8	828,530
Property location[12]						
Sand states	7.6	15.4	31.6	23.9	22.4	989,164
Rust states	14.6	17.3	11.6	13.9	14.2	626,722
Other	77.8	67.3	56.8	62.2	63.4	2,799,605
Type of lender						
Depository	34.6	45.4	24.6	59.8	42.1	1,857,480
Affiliate of depository	24.8	38.8	23.5	12.2	24.5	1,083,165
Independent mortgage company	40.6	15.8	52.0	28.0	33.4	1,474,846
Memo						
Share of loans[13]	9.4	28.4	31.9	30.2	100.0	. . .
Number of loans	415,642	1,255,763	1,410,690	1,333,396	4,415,491	4,415,491

Note: See general note to table 10.

1 See table 4, note 1.

2 See table 8, note 2.

3 Other loans are conventional loans sold to non-government-related or non-affiliate institutions.

4 Portfolio loans are conventional loans held by the lender or sold to an affiliate institution.

5 Categories for race and ethnicity reflect revised standards established in 1997 by the Office of Management and Budget. Applicants are placed under only one category for race and ethnicity, generally according to the race and ethnicity of the person listed first on the application. However, under race, the application is designated as joint if one applicant reported the single designation of white and the other reported one or more minority races. If the application is not joint but more than one race is reported, the following designations are made: If at least two minority races are reported, the application is designated as two or more minority races; if the first person listed on an application reports two races, and one is white, the application is categorized under the minority race. For loans with two or more applicants, lenders covered under the Home Mortgage Disclosure Act report data on only two.

6 Other minority consists of American Indian or Alaskan Native, and Native Hawaiian or other Pacific Islander. “Missing” indicates that information for the characteristic was missing on the application.

7 Low- or moderate-income (LMI) borrowers have lower income, or the property is in a lower-income census tract. Borrower income is the total income relied upon by the lender in the loan underwriting. Income is expressed relative to the median family income of the metropolitan statistical area (MSA) or statewide non-MSA in which the property being purchased is located. “Lower” is less than 80 percent of the median. The income category of a census tract is the median family income of the tract relative to that of the MSA or statewide non-MSA in which the tract is located. “Lower” is less than 80 percent of the median.

8 Other consists of all non-lower- and non-missing-income borrowers who are not in a lower-income census tract.

9 Income was not relied upon in the underwriting of the loan.

10 High payment-to-income ratio is 30 percent or more.

11 Loan share is calculated as the percentage of non-owner-occupant loans to total first-lien mortgages for one- to four-family, site-built properties; excludes business loans.

12 “Sand states” consist of Arizona, California, Florida, and Nevada; “rust states” consist of Illinois, Indiana, Michigan, Ohio, and Wisconsin; “other” consists of all other states.

13 Loan share is calculated for all first-lien mortgages for owner-occupied, one- to four-family, site-built properties; excludes business loans in the appropriate year.

... Not applicable.

Table 14. Distribution across various defining loan characteristics, by type of loan, 2006–10—*continued*

A. Home purchase—*continued*

Percent except as noted

Characteristic	Nonconventional[1]	GSE[2]	Other[3]	Portfolio[4]	Overall incidence	Memo: Total loans
	2007					
Minority status of borrower[5]						
Black or African American	13.5	6.1	7.3	7.2	7.5	260,102
Hispanic white	10.0	8.2	9.4	10.8	9.4	324,813
Asian	.9	4.6	4.7	5.3	4.4	151,796
Non-Hispanic white	65.7	69.9	66.6	64.6	67.2	2,319,963
Other minority or missing[6]	9.9	11.1	12.0	12.0	11.4	393,252
LMI census tract or borrower[7]						
Census tract	16.5	13.3	13.7	15.4	14.4	496,923
Borrower	34.0	25.4	22.9	23.8	25.6	881,813
Other[8]	56.8	64.9	64.6	62.7	63.2	2,179,254
Missing[9]	1.4	2.2	4.5	4.5	3.2	110,259
Loan characteristic or occupancy status						
High payment-to-income ratio[10]	9.6	14.4	18.1	16.4	15.0	519,152
Non-owner occupant[11]	.1	14.2	13.5	18.2	13.9	557,248
Property location[12]						
Sand states	10.0	16.1	22.2	22.1	18.1	626,126
Rust states	13.4	15.8	11.3	13.6	14.1	486,601
Other	76.6	68.2	66.5	64.3	67.7	2,337,199
Type of lender						
Depository	42.0	54.9	30.4	73.7	55.3	1,906,245
Affiliate of depository	20.5	30.0	21.4	10.8	21.5	742,984
Independent mortgage company	37.5	15.1	48.2	15.4	23.2	800,697
Memo						
Share of loans[13]	12.2	41.0	15.9	30.9	100.0	. . .
Number of loans	421,731	1,415,691	546,954	1,065,550	3,449,926	3,449,926

in the second half of 2010, after the homebuyer program expired (data not shown in tables).

We also show trends in two metrics of loan quality that can be derived from the HMDA data—the percentage of loans with estimated front-end debt-payment-to-income (PTI) ratios exceeding 30 percent (a warning level in underwriting) and the percentage of loans for non-owner-occupied properties.[48] Both measures fell significantly over the sample period, although most of this decline had taken place before 2009. In 2010, patterns for these measures diverge as the incidence of high-PTI lending declines and that of non-owner-occupant lending increases for both home-purchase and refinance lending.

Some of the changes from 2006 to 2010 may reflect factors specific to certain geographic areas rather than factors specific to certain demographic groups. For instance, a decline in lending in California relative to the rest of the nation would tend to generate a relative decline in lending to Hispanic white borrowers because of the prevalence of this group in California. Indeed, the share of loans extended to residents of the sand states—Arizona, California, Florida, and Nevada—declined, particularly for refinance lending from 2006 to 2009, rebounding some in 2010. Nevertheless, even after controlling for differential trends

[48] The monthly mortgage payment used for the PTI ratio is estimated assuming all mortgages are fully amortizing 30-year fixed mortgages. If the loan pricing spread is reported in the HMDA data, the loan contract rate is assumed to be the same as the APR. Otherwise, it is assumed to be equal to the APOR plus 20 basis points prevailing at the loan's estimated lock date.

Table 14. Distribution across various defining loan characteristics, by type of loan, 2006–10—*continued*

A. Home purchase—*continued*

Percent except as noted

Characteristic	Nonconventional[1]	GSE[2]	Other[3]	Portfolio[4]	Overall incidence	Memo: Total loans
	2008					
Minority status of borrower[5]						
Black or African American	10.6	3.4	3.6	4.4	6.3	165,326
Hispanic white	11.4	6.7	5.0	7.1	8.4	221,125
Asian	1.7	7.6	5.4	5.0	4.7	124,028
Non-Hispanic white	65.7	70.2	76.3	71.7	69.3	1,817,967
Other minority or missing[6]	10.6	12.1	9.6	11.7	11.3	295,369
LMI census tract or borrower[7]						
Census tract	15.8	11.3	10.6	12.4	13.2	345,114
Borrower	34.8	23.9	27.9	26.1	28.7	752,263
Other[8]	56.2	68.1	65.1	62.3	62.3	1,634,396
Missing[9]	1.8	1.3	1.5	5.1	2.2	58,967
Loan characteristic or occupancy status						
High payment-to-income ratio[10]	10.0	12.5	14.0	11.3	11.5	300,482
Non-owner occupant[11]	.1	17.3	13.7	20.8	12.1	362,514
Property location[12]						
Sand states	20.3	20.5	17.6	14.7	19.1	500,134
Rust states	13.2	13.7	12.4	14.7	13.6	357,154
Other	66.5	65.8	70.0	70.6	67.3	1,766,527
Type of lender						
Depository	49.0	69.4	38.4	76.6	60.8	1,594,761
Affiliate of depository	12.2	16.0	9.9	7.1	12.4	324,708
Independent mortgage company	38.8	14.6	51.6	16.3	26.8	704,346
Memo						
Share of loans[13]	37.2	35.5	7.8	19.5	100.0	. . .
Number of loans	976,496	930,285	204,881	512,152	2,623,815	2,623,815

in lending across markets—that is, removing overall market trends from the analysis—the racial and income trends described earlier mostly remain (data not shown in tables).

Borrowers of different demographic groups showed large differences in their propensity to use different types of loans, with significant changes from year to year. All groups showed substantial increases in their use of nonconventional loans from 2006 through 2009 (data derived from tables 14.A and 14.B).[49] Black and Hispanic-white borrowers, however, relied particularly heavily on these government programs, a trend that continued in 2010. In 2010, more than 80 percent of home-purchase loans and more than 40 percent of refinance loans to black borrowers were nonconventional. For Hispanic white borrowers in 2010, nearly three-fourths of their home-purchase loans and 25 percent of their refinance loans were nonconventional. In 2006, over 40 percent of home-purchase and refinance loans to both black and Hispanic-white borrowers were sold into the private securities market or sold to a nongovernment purchaser. By 2007, these shares had dropped significantly, and the GSE and portfolio shares of loans among these groups had grown. In 2008 and 2009, the share of home-purchase loans to black and Hispanic-white borrowers that were sold to the GSEs fell, while the share of refinance loans to both groups that were sold to the GSEs rose from 2007 through 2009 and remained flat in 2010.

[49] The incidence of a type of loan for a group can be calculated from the data in tables 14.A and 14.B by multiplying the number of loans of a given type (shown as memo items in the last rows of the tables) by the share attributable to a group and then dividing the result by the product of the total number of loans and the overall incidence for the group. For example, the incidence of nonconventional refinance lending for blacks in 2010 was (1,164,102 x 0.093) / (2,211,409 x 0.06) = 81.6 percent.

Table 14. Distribution across various defining loan characteristics, by type of loan, 2006–10—*continued*

A. Home purchase—*continued*

Percent except as noted

Characteristic	Nonconventional[1]	GSE[2]	Other[3]	Portfolio[4]	Overall incidence	Memo: Total loans
	2009					
Minority status of borrower[5]						
Black or African American	8.5	1.7	2.1	3.8	5.7	139,223
Hispanic white	11.6	4.3	4.8	5.8	8.5	207,398
Asian	2.5	9.8	7.6	6.0	5.2	127,383
Non-Hispanic white	66.7	72.7	75.4	73.7	69.8	1,705,278
Other minority or missing[6]	10.6	11.4	10.0	10.7	10.8	264,419
LMI census tract or borrower[7]						
Census tract	14.8	8.9	9.9	11.8	12.6	307,507
Borrower	44.1	27.1	29.8	30.6	36.9	902,855
Other[8]	48.6	66.3	63.9	59.0	55.6	1,357,856
Missing[9]	1.9	1.8	1.6	4.9	2.3	56,110
Loan characteristic or occupancy status						
High payment-to-income ratio[10]	7.2	7.2	8.5	6.1	7.1	173,996
Non-owner occupant[11]	.1	17.0	15.7	21.4	9.4	252,616
Property location[12]						
Sand states	22.5	21.3	24.2	13.4	21.0	512,741
Rust states	12.5	14.8	9.7	15.1	13.3	324,397
Other	65.1	63.9	66.1	71.5	65.7	1,606,563
Type of lender						
Depository	47.7	67.9	36.2	80.2	56.8	1,388,372
Affiliate of depository	11.5	12.8	7.0	7.1	11.0	267,763
Independent mortgage company	40.7	19.3	56.8	12.8	32.2	787,566
Memo						
Share of loans[13]	53.9	25.9	6.2	14.1	100.0	...
Number of loans	1,316,296	632,774	150,303	344,328	2,443,701	2,443,701

Patterns of loan-type incidence for LMI borrowers and borrowers living in LMI census tracts are similar to those for black and Hispanic-white borrowers but are more muted. Loans to these borrowers were less likely to be sold on the nongovernment secondary market in 2006, and the shift toward nonconventional loans in 2008 and 2009 was not as large. The share of borrowers with income missing from their loan applications fell from 2006 through 2009 (more than one-half of these loans were sold into the private secondary market in 2006). The incidence of missing income for refinance loans actually rose in 2008 and 2009, likely the result of "streamlined" refinance programs.

In 2006 and 2007, nonconventional loans as well as GSE loans were significantly less likely than portfolio or private secondary-market loans to be classified as low quality by our measures—high PTI or non-owner occupant. However, by 2008, this lower incidence for high-PTI loans had largely disappeared.

Loans originated in the sand states in 2006 and 2007 were much more likely to be sold into the private secondary market than loans originated in other states. By 2008, differences in the disposition patterns between the sand states and the rest of the country had largely disappeared in the home-purchase market, perhaps in part because of changes in the FHA and GSE loan limits. However, in the refinance market, loans originated in the sand states in 2008 and 2009 were more likely to be purchased by the GSEs and less likely to be part of the nonconventional loan programs than loans in other states.

Table 14. Distribution across various defining loan characteristics, by type of loan, 2006–10—*continued*
A. Home purchase—*continued*
Percent except as noted

Characteristic	Nonconventional[1]	GSE[2]	Other[3]	Portfolio[4]	Overall incidence	Memo: Total loans
	2010					
Minority status of borrower[5]						
Black or African American	9.3	1.7	2.1	3.9	6.0	133,479
Hispanic white	12.3	4.1	4.3	5.8	8.7	192,629
Asian	2.7	10.0	7.6	5.8	5.4	119,582
Non-Hispanic white	65.3	72.7	77.0	74.3	69.3	1,532,692
Other minority or missing[6]	10.3	11.5	9.0	10.2	10.5	233,027
LMI census tract or borrower[7]						
Census tract	14.7	8.5	8.7	11.0	12.1	267,862
Borrower	44.4	25.0	26.5	29.5	36.0	795,853
Other[8]	49.2	69.0	68.2	61.4	57.4	1,269,444
Missing[9]	1.2	1.2	.8	4.0	1.6	35,451
Loan characteristic or occupancy status						
High payment-to-income ratio[10]	6.3	4.5	4.6	4.1	5.4	118,567
Non-owner occupant[11]	.0	19.5	16.7	20.8	10.3	254,770
Property location[12]						
Sand states	23.0	22.5	21.2	13.1	21.3	471,150
Rust states	12.1	15.0	10.8	15.5	13.3	293,754
Other	64.9	62.5	68.0	71.3	65.4	1,446,505
Type of lender						
Depository	44.9	64.3	33.6	76.2	54.0	1,194,152
Affiliate of depository	12.1	13.3	6.3	7.8	11.4	251,801
Independent mortgage company	43.0	22.4	60.1	16.0	34.6	765,456
Memo						
Share of loans[13]	52.6	26.5	6.1	14.8	100.0	...
Number of loans	1,164,102	585,550	135,216	326,540	2,211,409	2,211,409

Loan-Size Limits

Before 2008, the National Housing Act, as amended in 1998 Mortgagee Letter 1998-28, required that FHA mortgage limits for one- to four-family homes be set at 95 percent of the median house price prevailing in an area (either county or MSA), subject to an overall national minimum and maximum.[50] Loans purchased by the GSEs were also subject to a limit, based on national median house prices, which was fixed at $417,000 for single-family homes in the continental United States from 2006 to 2008. The Congress authorized an increase in these limits as part of the Economic Stimulus Act, passed in February 2008; it did so again as part of the Housing and Economic Recovery Act (HERA), enacted in July 2008; and it did so once more as part of the American Recovery and Reinvestment Act, passed in February 2009.[51]

[50] For counties in an MSA, the limit for the county with the highest median house price is used for all counties in the MSA. In 2006 and 2007, the national maximum for FHA single-family home loans was $271,050 in most areas of the country. VA loans do not have a size limit, but they do have a guarantee limit, which is tied to GSE loan limits. FSA loans are also subject to different, and generally higher, limits. Only LMI borrowers in rural areas are eligible for RHS loans, but the loans do not have an explicit maximum size limit.

[51] New standards released on March 6, 2008, raised the limit for GSE one- to four-family home loans to 125 percent of the area median house price, subject to an overall limit of $729,750 for single-family homes in the continental United States (the limit could also not be lower than $417,000). FHA limits were also raised to 125 percent of the median house price prevailing in an area, subject to the same $729,750 national maximum for single-family homes applicable to the GSEs.

Table 14. Distribution across various defining loan characteristics, by type of loan, 2006–10
B. Refinance
Percent except as noted

Characteristic	Nonconventional[1]	GSE[2]	Other[3]	Portfolio[4]	Overall incidence	Memo: Total loans
	2006					
Minority status of borrower[5]						
Black or African American	15.4	6.4	11.2	9.4	9.5	421,906
Hispanic white	7.9	8.1	12.7	10.1	10.5	465,534
Asian	.6	2.8	3.0	3.0	2.9	129,561
Non-Hispanic white	65.0	68.8	54.4	63.5	61.7	2,745,229
Other minority or missing[6]	11.2	13.9	18.7	13.9	15.5	690,582
LMI census tract or borrower[7]						
Census tract	19.9	14.3	20.3	17.9	17.9	796,633
Borrower	29.1	26.0	23.1	25.8	25.0	1,114,002
Other[8]	41.5	61.6	59.9	59.7	59.8	2,660,680
Missing[9]	22.4	4.7	5.3	4.6	5.4	238,240
Loan characteristic or occupancy status						
High payment-to-income ratio[10]	8.9	16.7	34.9	21.6	24.7	1,099,408
Non-owner occupant[11]	.5	10.1	10.5	10.9	10.3	512,617
Property location[12]						
Sand states	10.6	28.3	38.5	29.9	32.0	1,424,317
Rust states	22.1	16.6	11.8	14.6	14.3	638,511
Other	67.4	55.0	49.6	55.5	53.7	2,389,984
Type of lender						
Depository	30.1	44.4	20.4	60.1	41.6	1,852,818
Affiliate of depository	21.3	42.4	24.6	17.6	26.2	1,165,423
Independent mortgage company	48.6	13.2	55.0	22.3	32.2	1,434,571
Memo						
Share of loans[13]	2.7	24.3	34.9	38.1	100.0	...
Number of loans	121,388	1,081,771	1,552,086	1,697,567	4,452,812	4,452,812

Note: See notes to table 14.A.

The new FHA and GSE limits have remained in place, with only modest variation, since early 2008. However, barring congressional action, national single-family home loan limits on both FHA and GSE lending are scheduled to fall from $729,750 to $625,500 on October 1, 2011. Both FHA and GSE loan limits in areas not subject to the national cap are scheduled to fall from the current 125 percent to 115 percent of the area's median house price, with GSE single-family loans still subject to a base limit of $417,000.

Analysis presented in a previous article concluded that the increased loan limits accounted for less than 10 percent of the growth in nonconventional lending in 2008 and an even smaller portion of the growth in GSE loan purchases.[52] Here we examine what the effects of the limit changes scheduled for October 1, 2011, are likely to be, based on lending patterns observed in 2010.

Analysis released by the Department of Housing and Urban Development (HUD) suggests that 669 counties and county equivalents, predominantly located in high-cost areas on both coasts, will face changed FHA loan limits for one- to four-family homes as of October 1,

[52] See Avery and others, "The 2008 HMDA Data."

Table 14. Distribution across various defining loan characteristics, by type of loan, 2006–10—*continued*

B. Refinance—*continued*

Percent except as noted

Characteristic	Nonconventional[1]	GSE[2]	Other[3]	Portfolio[4]	Overall incidence	Memo: Total loans
	2007					
Minority status of borrower[5]						
Black or African American	15.8	6.5	8.3	8.9	8.3	302,575
Hispanic white	7.2	8.3	9.7	9.7	9.1	331,243
Asian	.6	2.9	3.2	3.4	3.0	110,107
Non-Hispanic white	63.8	67.9	60.8	63.5	64.7	2,363,168
Other minority or missing[6]	12.7	14.4	18.0	14.4	14.9	545,126
LMI census tract or borrower[7]						
Census tract	19.4	14.4	16.3	17.0	16.0	585,951
Borrower	27.0	24.3	20.8	23.8	23.7	864,197
Other[8]	48.0	64.0	64.9	61.9	62.4	2,278,791
Missing[9]	16.6	3.7	4.7	4.5	4.9	179,165
Loan characteristic or occupancy status						
High payment-to-income ratio[10]	9.7	16.9	27.2	20.7	19.8	724,001
Non-owner occupant[11]	.3	10.9	10.8	11.8	10.8	439,923
Property location[12]						
Sand states	10.0	25.0	32.6	28.5	26.9	982,417
Rust states	22.1	16.5	11.4	14.6	15.2	555,083
Other	68.0	58.5	55.9	56.9	57.9	2,114,719
Type of lender						
Depository	38.6	52.1	23.3	70.2	54.0	1,971,896
Affiliate of depository	15.9	32.9	28.4	18.0	25.2	918,701
Independent mortgage company	45.4	15.0	48.3	11.7	20.9	761,622
Memo						
Share of loans[13]	5.4	37.1	16.7	40.9	100.0	...
Number of loans	196,178	1,354,690	608,485	1,492,866	3,652,219	3,652,219

2011.[53] Similar analysis by the FHFA suggests that 250 counties and county equivalents will face changes in GSE limits.[54] These numbers are not fully set, and some disagreement remains as to what the final changes will be.[55] Nevertheless, we use the projected limit changes forecast by HUD and FHFA to identify lending in 2010 in potentially affected areas.[56]

All of the counties facing changes in GSE limits are in high-cost areas where 2010 GSE and FHA limits are the same. For about one-half of these counties, the FHA and GSE limits are projected to be reduced by the same amount, and future borrowers seeking loans in size ranges affected by the limits would not be able to use either the FHA or GSE programs. In the remaining counties facing GSE limit changes, the FHA limits are projected to fall below the $417,000 GSE base limit for single-family homes. In these counties, borrow-

53 U.S. Department of Housing and Urban Development (2011), "Potential Changes to FHA Single-Family Loan Limits beginning October 1, 2011 from Implementation of the Housing and Economic Recovery Act of 2008," market analysis brief, May 26, portal.hud.gov/hudportal/documents/huddoc?id=FHA_Loan_Limits_HERA.pdf.

54 Federal Housing Finance Agency (2011), "Possible Declines in Conforming Loan Limits," Mortgage Market Note 11-01, revised May 26, www.fhfa.gov/rss.aspx?page=77&id=0.

55 See Robert Dietz and Natalia Siniavskaia (2011), *GSE and FHA Loan Limit Changes for 2011: Scope of Impact,* Special Studies (Washington: National Association of Home Builders, June 1), www.nahb.org/reference_list.aspx?sectionID=734.

56 A similar analysis was done using the 2009 HMDA data. See Josiah Madar and Mark A. Willis (forthcoming), "Why We Need to Pay Attention to the Upcoming FHA and GSE Loan Limit Reductions," working paper (New York: Furman Center for Real Estate and Urban Policy).

Table 14. Distribution across various defining loan characteristics, by type of loan, 2006–10—*continued*
B. Refinance—*continued*
Percent except as noted

Characteristic	Nonconventional[1]	GSE[2]	Other[3]	Portfolio[4]	Overall incidence	Memo: Total loans
	2008					
Minority status of borrower[5]						
Black or African American	12.9	3.8	3.2	5.7	5.9	173,990
Hispanic white	6.6	5.7	4.1	5.6	5.7	166,460
Asian	.8	4.0	3.5	2.9	3.1	90,200
Non-Hispanic white	66.2	73.0	78.0	74.6	72.6	2,125,675
Other minority or missing[6]	13.6	13.4	11.2	11.2	12.7	371,098
LMI census tract or borrower[7]						
Census tract	16.4	10.4	9.1	12.5	11.9	349,779
Borrower	24.6	22.5	22.0	26.2	23.9	698,388
Other[8]	48.2	68.2	71.1	64.3	63.7	1,865,918
Missing[9]	20.5	3.5	1.7	2.9	6.3	183,152
Loan characteristic or occupancy status						
High payment-to-income ratio[10]	10.8	12.5	14.1	11.9	12.2	355,909
Non-owner occupant[11]	.3	9.7	8.8	12.4	8.9	285,676
Property location[12]						
Sand states	9.3	20.2	18.5	15.4	16.8	491,249
Rust states	18.9	17.4	16.4	17.4	17.6	515,072
Other	71.8	62.4	65.1	67.2	65.6	1,921,102
Type of lender						
Depository	42.4	70.9	39.5	79.4	65.7	1,923,557
Affiliate of depository	12.3	16.9	12.7	12.1	14.4	422,510
Independent mortgage company	45.2	12.2	47.9	8.5	19.9	581,356
Memo						
Share of loans[13]	18.0	46.6	7.6	27.7	100.0	. . .
Number of loans	526,300	1,365,322	223,593	812,208	2,927,423	2,927,423

ers with loan requests between $417,000 and the current limits will no longer have access to either the FHA or GSE programs. Borrowers who will no longer be eligible for FHA loans with requests below $417,000 in these counties and borrowers in counties facing only declines in their FHA limits will still meet GSE loan-size standards. Consequently, in our analysis, we divide 2010 loans into eight groups based on proposed GSE and FHA limit changes: *loans in counties with projected GSE limit changes with loan sizes* (1) below both the 2010 GSE/FHA and proposed 2011 FHA limits, (2) above the 2011 FHA limit but below the proposed 2011 GSE limit, (3) below the 2010 GSE/FHA limit but above the proposed 2011 GSE limit, or (4) above both the 2010 and proposed 2011 GSE/FHA limits (jumbo loans); *loans in counties with projected FHA* but not *GSE limit changes with loan sizes* (5) below both the 2010 and proposed FHA 2011 limits, (6) below the 2010 FHA limit but above the proposed 2011 FHA limit, or (7) above both the 2010 and proposed 2011 FHA limits; and *loans* (8) in counties with no changes in either the GSE or FHA loan limits.

Totals for first-lien owner-occupant one- to four-family home-purchase and refinance 2010 lending based on these groupings are presented (**tables 15.A** and **15.B**). Lending totals are shown for the market as a whole and for various demographic and other loan characteristics. For comparison purposes, we also give overall figures for jumbo loans—those with loan sizes above the GSE (and FHA) loan limits for their areas in 2010.

Overall, only 1.3 percent of the 2010 home-purchase loans (and 1.3 percent of refinance loans) fell into a size range that is currently eligible for both the FHA and GSE programs

Table 14. Distribution across various defining loan characteristics, by type of loan, 2006–10—*continued*

B. Refinance—*continued*

Percent except as noted

Characteristic	Nonconventional[1]	GSE[2]	Other[3]	Portfolio[4]	Overall incidence	Memo: Total loans
	2009					
Minority status of borrower[5]						
Black or African American	9.9	1.8	1.5	2.9	3.5	184,715
Hispanic white	6.7	2.8	2.7	3.7	3.7	194,931
Asian	1.2	5.1	4.5	3.4	4.1	214,526
Non-Hispanic white	69.0	77.9	81.4	77.3	76.4	4,036,066
Other minority or missing[6]	13.2	12.4	10.0	12.6	12.3	651,511
LMI census tract or borrower[7]						
Census tract	12.9	6.1	5.8	8.6	7.8	410,913
Borrower	17.8	19.6	19.2	23.7	19.9	1,049,444
Other[8]	30.6	72.6	75.5	68.7	64.3	3,396,044
Missing[9]	48.8	4.2	1.8	2.9	12.2	642,540
Loan characteristic or occupancy status						
High payment-to-income ratio[10]	6.5	5.9	7.0	5.2	6.0	318,238
Non-owner occupant[11]	.5	5.6	5.3	10.1	5.4	304,291
Property location[12]						
Sand states	12.0	17.4	17.8	13.2	15.7	831,014
Rust states	16.3	19.2	15.1	18.1	18.1	956,928
Other	71.7	63.4	67.1	68.7	66.1	3,493,807
Type of lender						
Depository	45.0	74.5	48.2	84.6	68.3	3,606,134
Affiliate of depository	9.4	11.6	5.7	6.3	9.8	516,553
Independent mortgage company	45.6	13.9	46.1	9.1	21.9	1,159,062
Memo						
Share of loans[13]	18.9	55.7	8.9	16.5	100.0	...
Number of loans	996,883	2,943,187	469,542	872,137	5,281,749	5,281,749

but will not be eligible for either program under the proposed limits (column 3). An additional 2.1 percent of 2010 home-purchase loans (and 2.4 percent of refinance loans) would potentially have been affected by the FHA changes in markets where GSE limits are unchanged (column 6) or FHA limits fall more than GSE limits (column 2).

However, within these ranges, the proposed changes likely would have had a significant effect—53.4 percent of the home-purchase loans and 59.6 percent of the refinance loans originated in 2010 in size ranges that would have exceeded the proposed 2011 GSE size limits were sold to the GSEs. For FHA loans, the effect is somewhat smaller but still significant—43.7 percent of the home-purchase loans with sizes eligible under 2010 limits but ineligible under 2011 limits in counties with no GSE changes were FHA or VA loans. For refinance loans, only 15.2 percent of loans meeting these criteria were FHA or VA loans.

Borrowers affected by FHA limit changes but with loan sizes under the GSE limits would appear to be likely to have the GSEs as a viable option if the changes are implemented (although lending standards for FHA loans differ from those for loans eligible for purchase by the GSEs in ways other than just loan size). In 2010, 35.0 percent of home-purchase borrowers and 58.8 percent of refinance borrowers falling into a size range affected by the proposed FHA changes in areas where GSE limits are unchanged had their loans sold to the GSEs.

It is more difficult to know what options will be available for borrowers no longer eligible under either the GSE or FHA programs. On the one hand, the overall share of national

Table 14. Distribution across various defining loan characteristics, by type of loan, 2006–10—*continued*
B. Refinance—*continued*
Percent except as noted

Characteristic	Nonconventional[1]	GSE[2]	Other[3]	Portfolio[4]	Overall incidence	Memo: Total loans
	2010					
Minority status of borrower[5]						
Black or African American	8.3	1.8	1.3	2.5	2.9	129,539
Hispanic white	6.5	3.0	2.5	3.5	3.5	159,529
Asian	1.7	6.3	6.3	4.1	5.1	231,709
Non-Hispanic white	72.0	76.2	80.1	77.1	76.1	3,427,377
Other minority or missing[6]	11.6	12.7	9.8	12.8	12.3	555,817
LMI census tract or borrower[7]						
Census tract	11.5	6.1	5.5	7.7	7.2	323,864
Borrower	18.5	19.1	16.9	20.5	19.1	861,326
Other[8]	38.9	76.0	78.6	64.1	68.3	3,074,326
Missing[9]	39.3	1.1	.9	11.5	8.9	400,435
Loan characteristic or occupancy status						
High payment-to-income ratio[10]	3.9	3.9	3.5	4.2	3.9	175,837
Non-owner occupant[11]	1.1	7.3	6.5	9.3	6.8	329,180
Property location[12]						
Sand states	14.7	19.3	19.3	16.3	18.0	809,714
Rust states	14.1	19.5	14.0	20.2	18.4	830,582
Other	71.2	61.2	66.6	63.5	63.6	2,863,675
Type of lender						
Depository	45.9	71.5	39.0	86.1	68.3	3,077,907
Affiliate of depository	8.3	12.0	5.0	5.6	9.5	428,287
Independent mortgage company	45.8	16.5	56.1	8.3	22.2	997,777
Memo						
Share of loans[13]	14.5	55.7	8.1	21.7	100.0	. . .
Number of loans	652,922	2,510,493	365,277	975,279	4,503,971	4,503,971

lending for loans that would be affected by changes in the GSE limit was considerably higher in 2010 than in 2008 and 2009 (bottom of tables 15.A and 15.B). However, it is about the same as the share in 2006 and 2007, before the limits were raised. These figures suggest that factors other than GSE (and FHA) loan limits affected the relative amount of lending taking place within these bands.

On the other hand, if the loans affected by the GSE (and FHA) changes had been forced into the jumbo market in 2010, this move would have resulted in a 50 percent increase in the size of the national home-purchase jumbo market and a 63 percent increase in that of the national refinance jumbo market.[57] Holding such loans on the portfolios of originating institutions would have meant an increase of over 20 percent in portfolioed loans for institutions serving the 250 counties where limits were changed. These numbers are substantial

[57] The effects of the limit changes (and the disappearance of the private secondary securities market) are evident in the substantial decline of the jumbo share of the mortgage market from 2007 to 2008. On the surface, it would appear that none of the jumbo market loans would have been eligible for the FHA/VA programs or for purchase by the GSEs. Yet in 2010, almost one-fourth of the home-purchase loans, and 16 percent of the refinance loans, exceeding the maximum GSE/FHA loan limits were reported in the HMDA data as nonconventional or sold to the GSEs. One explanation for this result is that the loans may be for two- to four-family homes, which have higher limits. Some are VA loans, which are not strictly subject to the limits but only to a limitation on the insurance guarantee (about 35 percent of jumbo nonconventional loans were VA loans, a percentage significantly higher than the overall share of VA nonconventional loans). Some may simply be reporting errors or have loan sizes very near the limits such that rounding errors may have led to their misclassification. This issue may be of particular concern for FHA loans—almost one-half of all 2010 FHA loans reported as exceeding the FHA loan limit had loan sizes within $10,000 of the limit.

Table 15. Distribution across various defining loan characteristics, by type of loan and by loan size in relation to government-sponsored enterprise or Federal Housing Administration loan limits, 2010

A. Home purchase

Percent

Characteristic	Counties with GSE/FHA limit change				Only FHA limit change			Unaffected market[1]	Memo	
	Less than all limits[1]	Only FHA limit status changed[1]	FHA and GSE limit status changed[1]	Greater than all limits[1]	Less than both FHA limits[1]	FHA limit status changed[1]	Greater than all FHA limits[1]		2010 overall incidence	2010 jumbo loans
Minority status of borrower[2]										
Black or African American	6.3	2.4	1.6	1.4	6.6	2.9	2.4	6.1	6.0	3.4
Hispanic white	13.2	7.3	3.1	3.1	8.4	3.5	2.2	6.6	8.7	4.2
Asian	11.4	8.2	16.3	9.3	3.2	5.1	4.8	2.1	5.4	5.5
Non-Hispanic white	55.5	68.2	59.7	64.6	72.3	76.2	77.5	77.1	69.3	71.4
Other minority or missing[3]	13.6	13.9	19.3	21.6	9.5	12.3	13.0	8.1	10.5	15.6
LMI census tract or borrower[4]										
Census tract	18.2	2.9	3.9	2.8	13.0	3.2	2.9	8.5	12.1	1.9
Borrower	34.3	.2	.1	.1	46.2	1.2	.3	35.8	36.0	1.9
Other[5]	56.6	96.1	95.0	95.3	48.6	94.6	95.7	58.0	57.4	68.7
Missing[6]	.9	.8	1.1	1.7	.9	1.1	1.2	2.8	1.6	27.5
Loan characteristic, type of loan, or occupancy status										
High payment-to-income ratio[7]	10.3	6.1	9.9	7.9	3.9	4.9	3.4	2.6	5.4	5.9
Nonconventional[8]	50.2	31.9	21.0	14.0	60.2	43.7	15.1	53.9	52.6	18.7
GSE[9]	31.8	42.9	53.4	1.8	23.1	35.0	41.8	23.1	26.5	5.8
Other[10]	7.0	13.0	8.9	3.1	5.6	8.5	9.9	5.4	6.1	3.4
Portfolio[11]	11.0	12.2	16.7	81.2	11.0	12.9	33.1	17.7	14.8	72.2
Non-owner occupant[12]	10.5	14.2	5.2	13.3	10.9	7.9	10.2	9.9	10.3	12.9
Property location[13]										
Sand states	40.9	39.4	53.7	40.0	23.7	28.0	15.7	2.4	21.3	20.0
Rust states	.0	.0	.0	.0	23.5	17.7	22.9	15.5	13.3	8.4
Other	59.0	60.6	46.3	60.0	52.8	54.3	61.4	82.1	65.4	71.6
Type of lender										
Depository	48.6	50.9	58.5	76.4	49.3	51.0	61.6	60.8	54.0	66.4
Affiliate of depository	9.6	8.3	11.2	13.0	11.4	11.5	14.4	12.5	11.4	9.4
Independent mortgage company	41.8	40.8	30.3	10.6	39.3	37.5	23.9	26.7	34.6	24.2
Memo[14]										
2010 share of loans	27.8	.7	1.3	1.0	29.1	1.4	2.5	36.2	100.0	2.6
2009 share of loans	27.4	.7	.8	.8	29.8	1.3	2.1	37.1	100.0	3.1
2008 share of loans	25.3	1.0	.9	1.2	28.5	1.7	3.0	38.5	100.0	3.7
2007 share of loans	23.3	1.1	1.0	2.3	28.6	1.9	3.5	38.3	100.0	8.9
2006 share of loans	24.7	1.2	1.2	2.3	36.4	1.5	2.4	30.2	100.0	10.1

Note: See general note to table 10.

1 "Less than all limits" indicates loans made with loan size less than the old and newly proposed loan-size limit for both government-sponsored enterprise (GSE) and Federal Housing Administration (FHA) loans. "Only FHA limit status changed" indicates loans made with loan size between the old and newly proposed FHA loan limits but unaffected by the GSE limit changes. "FHA and GSE limit status changed" indicates loans made with loan size between both the old and newly proposed GSE and FHA loan limits. "Greater than all limits" indicates loans made with a loan size greater than both the old and newly proposed loan-size limits for GSE and FHA loans. "Less than both FHA limits" indicates loans made with loan size less than the old and newly proposed loan-size limit for FHA loans. "FHA limit status changed" indicates loans made with loan size between the old and newly proposed FHA loan limits. "Greater than all FHA limits" indicates loans made with a loan size greater than both the old and newly proposed loan-size limits for FHA loans. "Unaffected market" indicates loans made in counties that had no change in the GSE or FHA limits.

2 See table 14.A, note 5.

3 See table 14.A, note 6.

4 See table 14.A, note 7.

5 See table 14.A, note 8.

6 See table 14.A, note 9.

7 See table 14.A, note 10.

8 See table 4, note 1.

9 See table 8, note 2.

10 See table 14.A, note 3.

11 See table 14.A, note 4.

12 See table 14.A, note 11.

13 See table 14.A, note 12.

14 See table 14.A, note 13.

Table 15. Distribution across various defining loan characteristics, by type of loan and by loan size in relation to government-sponsored enterprise or Federal Housing Administration loan limits, 2010

B. Refinance

Percent

Characteristic	Counties with GSE/FHA limit change				Only FHA limit change			Unaffected market[1]	Memo	
	Less than all limits[1]	Only FHA limit status changed[1]	FHA and GSE limit status changed[1]	Greater than all limits[1]	Less than both FHA limits[1]	FHA limit status changed[1]	Greater than all FHA limits[1]		2010 overall incidence	2010 jumbo loans
Minority status of borrower[2]										
Black or African American	3.0	1.3	.8	.9	2.8	1.5	1.4	3.3	2.9	1.3
Hispanic white	5.1	4.0	2.0	1.8	3.0	1.9	1.4	2.8	3.5	1.9
Asian	10.3	6.0	15.4	7.1	2.9	5.1	4.0	1.6	5.1	4.9
Non-Hispanic white	65.1	72.9	62.6	69.3	80.4	79.2	81.6	83.4	76.1	77.1
Other minority or missing[3]	16.5	15.7	19.2	20.9	10.9	12.2	11.7	8.9	12.3	14.9
LMI census tract or borrower[4]										
Census tract	9.2	2.4	2.3	1.9	7.6	3.0	2.3	5.9	7.2	1.7
Borrower	18.7	1.3	.2	.2	23.3	2.2	.9	20.1	19.1	1.5
Other[5]	68.1	89.2	93.5	94.5	63.3	86.3	92.5	67.4	68.3	74.9
Missing[6]	8.4	7.4	4.2	3.5	9.9	8.9	4.4	9.2	8.9	22.0
Loan characteristic, type of loan, or occupancy status										
High payment-to-income ratio[7]	6.2	6.7	8.2	8.6	2.7	5.5	4.9	2.2	3.9	6.9
Nonconventional[8]	11.3	11.1	10.0	6.4	16.2	15.2	5.2	17.4	14.5	8.8
GSE[9]	59.9	61.0	59.6	1.9	56.2	58.8	54.0	52.4	55.7	8.7
Other[10]	9.2	11.6	12.3	2.4	6.9	9.0	10.1	7.7	8.1	4.0
Portfolio[11]	19.5	16.2	18.2	89.2	20.7	17.0	30.7	22.4	21.7	78.6
Non-owner occupant[12]	7.2	9.3	3.8	9.7	6.2	4.9	7.0	7.1	6.8	9.6
Property location[13]										
Sand states	37.8	31.6	63.0	42.6	11.5	19.3	11.6	1.6	18.0	20.9
Rust states	.0	.0	.0	.0	33.9	30.0	29.5	23.2	18.4	13.4
Other	62.2	68.3	37.0	57.4	54.6	50.8	58.9	75.1	63.6	65.8
Type of lender										
Depository	64.9	62.7	56.8	78.0	68.9	61.6	65.7	72.1	68.3	76.4
Affiliate of depository	8.3	8.2	10.8	14.6	9.8	10.1	12.8	9.9	9.5	11.5
Independent mortgage company	26.7	29.1	32.5	7.4	21.3	28.2	21.5	18.0	22.2	12.1
Memo[14]										
2010 share of loans	31.9	.7	1.3	.9	28.3	1.7	2.9	32.3	100.0	2.1
2009 share of loans	30.7	.7	.6	.5	28.3	1.8	3.1	34.2	100.0	2.0
2008 share of loans	27.8	.8	.6	1.0	28.7	1.8	3.2	36.1	100.0	2.8
2007 share of loans	31.7	1.2	1.2	2.3	28.5	1.7	3.2	30.1	100.0	9.3
2006 share of loans	28.5	1.3	2.0	3.3	28.8	1.7	2.9	31.5	100.0	10.5

Note: See notes to table 15.A.

and suggest that at least some of these loans would not have been originated or would have been originated only at higher prices.

Examination of the demographic data shows that borrowers with loan sizes eligible under 2010 limits but ineligible under 2011 limits for both GSE and FHA limit changes were disproportionately Asian, lived outside LMI census tracts, had non-LMI incomes, and used independent mortgage banks, relative to the average borrower. More than one-half of such borrowers lived in the sand states, and none lived in the "rust states" of Illinois, Indiana, Michigan, Ohio, and Wisconsin (because none of the affected counties lie in the rust states). Such borrowers were also more likely than average to have a PTI ratio exceeding 30 percent.

Borrowers facing only FHA limit changes similarly were less likely than average to live in LMI census tracts or have LMI incomes, but unlike those affected by the GSE limits, such borrowers show geographic and racial distributions similar to the national averages.

Credit Circumstances in Neighborhood Stabilization Program Neighborhoods

Concerns about neighborhoods experiencing high levels of housing market distress have been a particular focus of public policy in recent years. This focus has been motivated by the belief that elevated levels of foreclosure and property abandonment can adversely affect not only those directly involved in the foreclosures, but also others in the surrounding neighborhood.[58] Such negative externalities or spillover effects may arise as foreclosed and often vacant properties attract vandalism and crime, and these units may be poorly maintained, casting a pall over the neighboring properties and adversely affecting their market values.[59] In the extreme, these spillover effects can help create a self-reinforcing downward spiral that can devastate the quality of life in an area.

To address the foreclosure problem, as part of the 2008 HERA, the Congress established and funded the Neighborhood Stabilization Program.[60] The NSP provides emergency assistance to state and local governments seeking to support neighborhoods experiencing high levels of property abandonment and foreclosure. To help ensure that funds are appropriately targeted, the monies are directed to households or individuals with incomes less than 120 percent of the broader area median income.

To bolster congressional efforts, in December 2010, the federal bank and savings institution regulatory agencies revised the regulations that implement the Community Reinvestment Act (CRA) to support the stabilization of communities hard hit by elevated foreclosures.[61] In particular, the revised regulations encourage covered institutions to support the NSP. Under the CRA rules, lenders are encouraged to make loans and investments and provide services to support NSP activities to individuals and neighborhoods beyond the traditional focus of the CRA (specifically, individuals and neighborhoods classified as lower income). Allowing banking institutions to receive CRA consideration for activities in NSP-targeted

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[58] See Paul A. Joice (2011), "Neighborhood Stabilization Program," U.S. Department of Housing and Urban Development, *Cityscape: A Journal of Policy Development and Research,* vol. 13 (1), pp. 135–41.

[59] See, for example, Kai-yan Lee (2008), "Research Review: Spillover Effects of Foreclosures on Communities," Federal Reserve Bank of Boston, *New England Community Developments,* issue 2, pp. 10–12, www.bostonfed.org/commdev/necd/index.htm#2008. Estimates of spillover effects on surrounding properties are also in Center for Responsible Lending (2009), "Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 Billion in 2009 Alone; 69.5 Million Homes Lose $7,200 on Average," May, www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-accelerating-foreclosures-to-cost-neighbors-436-billion-in-2009-alone-73-4-million-homes-lose-5-900-on-average.html.

[60] The NSP is administered by HUD. Funds are distributed to acquire, repair, and resell foreclosed and abandoned properties. Since the creation of the program, additional funding has been provided in two subsequent laws: the American Recovery and Reinvestment Act of 2009 and the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010. Although each of the three laws has the same broad objective, the provisions of the laws differ in how the funds may be allocated. For more information about the NSP, see U.S. Department of Housing and Urban Development, "Neighborhood Stabilization Program Resource Exchange," webpage, http://hudnsphelp.info/index.cfm.

[61] For more information, see Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision (2010), "Agencies Expand Scope of Community Reinvestment Act Regulations to Encourage Support for HUD Neighborhood Stabilization Program Activities," joint press release, December 15, www.federalreserve.gov/newsevents/press/bcreg/20101215a.htm. For details on the proposed revision to the CRA, see Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision (2010), "Agencies Propose to Expand Scope of Community Reinvestment Act Regulations to Encourage Depository Institution Support for HUD Neighborhood Stabilization Program Activities," joint press release, June 17, www.federalreserve.gov/newsevents/press/bcreg/20100617c.htm.

neighborhoods provides additional incentives for these institutions to leverage government funds targeted to these areas and populations.

Under the NSP program, funds may be used in different ways, including for the purchase or rehabilitation of abandoned or foreclosed properties, the demolition of blighted structures, and the redevelopment of demolished or vacant properties. NSP funds can also be used to help homebuyers purchase properties. The NSP is a nationwide program, but participation requirements may differ across states and cities.

In deciding which neighborhoods to target, HUD relies on a statistical model that estimates which neighborhoods are likely to be experiencing high rates of foreclosure and mortgage delinquencies. Based on the outputs of this model, each census tract is given an NSP score ranging from 1 to 20. Scores are scaled so that each score point is given to 5 percent of the census tracts. Census tracts with NSP scores in the top quintile ("high-NSP tracts"), those with scores of 17 to 20, are eligible for aid. "Lower-NSP tracts," those with scores below 17, are not generally eligible for aid unless they are in states that have very few tracts with NSP scores above 17, in which case the state is permitted to use a lower-threshold NSP score for identifying areas eligible for NSP funds.

An evaluation of the effectiveness of the NSP program is beyond the scope of this article. Some of the interventions, like the changes to the CRA, are too new to evaluate, and others require more data than HMDA provides. However, the HMDA data can be used to assess mortgage activity across all areas scored for the NSP program. Because the NSP program has been in existence for a few years, it is possible that recent loan flows may have been affected by the program to some degree. Nevertheless, this analysis can highlight some of the potential challenges involved in aiding these communities.

Substantial differences between high-NSP tracts and lower-NSP tracts existed long before the recent difficulties in mortgage and housing markets emerged. In the 2000 census, high-NSP tracts were characterized by higher minority concentrations and lower relative-income levels than lower-NSP tracts (**table 16**). Similarly, lending activity in these tracts before the subprime crisis was notably different. Using 2005 as a reference point, lending in the high-NSP tracts was characterized by elevated rates of loan denial; larger incidences of higher-priced loans, piggyback loans, and non-owner-occupant lending; and smaller shares of lending by lenders subject to the CRA. New home buyers in areas with high-NSP tracts also tended to have lower credit scores than buyers in other areas.

Since 2005, lending activity in high-NSP tracts has fallen faster than in lower-NSP tracts. In 2005, more home-purchase loans were extended in high-NSP tracts than in tracts in any of the other NSP score quintiles. Since 2005, declines in home-purchase lending volumes have been particularly steep in high-NSP neighborhoods. In 2010, home-purchase lending in high-NSP tracts was down 75 percent from 2005 levels. This decline was much more rapid than that experienced in the other NSP quintiles. As a result, in 2010, fewer loans were originated in the high-NSP tracts than in any of the other NSP quintiles, a reversal of the pattern observed in 2005.

One potential reason for the steeper decline in home-purchase lending in the high-NSP neighborhoods is offered by the role of the sand states. House price declines have been particularly steep in these states, and previous HMDA analyses have shown that mortgage lending has fallen more steeply in these states since the height of the housing boom. Because the high-NSP tracts are more likely to be located in the sand states than lower-NSP tracts—in 2005, the sand states accounted for 71 percent of loans to high-NSP neighborhoods, a share double that of any of the other NSP quintiles—we would expect the more-rapid lending declines experienced by the sand states to result in a faster decline in

Table 16. Borrower, loan, and census-tract characteristics related to lending in areas grouped by Neighborhood Stabilization Program score, 2005 and 2010

Percent

Characteristic	NSP score[1]					
	1–4	5–8	9–12	13–16	17–20	All
2005						
Borrower						
Income ratio (percent of area median)[2]						
Lower	14.8	21.7	25.4	27.1	19.5	21.4
Middle	20.9	24.8	25.4	23.9	21.8	23.2
High	60.2	49.3	44.8	44.2	52.3	50.4
Minority[3]	18.8	17.1	21.3	29.8	45.5	27.1
Memo: Mean credit score[4]	**728.0**	**708.0**	**697.0**	**688.0**	**675.0**	**701.0**
Loan or application characteristic or occupancy status						
Higher priced[5]	8.9	15.6	20.9	26.9	36.0	22.0
Non-owner occupant[6]	13.7	14.2	15.9	18.3	24.5	17.6
Nonconventional[7]	5.7	8.6	8.9	8.0	4.6	7.0
Denial rate	10.4	12.9	15.2	17.8	21.4	15.9
Piggyback[8]	12.4	15.3	16.9	19.5	25.1	18.1
Census tract of property[9]						
Minorities as a percent of population[10]	24.0	18.1	23.8	36.3	55.9	31.6
Income ratio (percent of area median)[11]	127.6	111.4	101.2	93.3	83.2	103.3
CRA assessment area[12]	34.7	29.3	27.1	25.6	21.7	27.5
Sand states[13]	7.6	8.7	14.1	29.4	70.7	27.7
Memo: Total loans	**1,167,022**	**1,157,129**	**1,093,234**	**1,025,695**	**1,358,619**	**5,801,699**

Note: First-lien home-purchase mortgages for one- to four-family, site-built properties.

1 The Neighborhood Stabilization Program (NSP) score is based on the NSP3 score created by the Department of Housing and Urban Development. The NSP score classifies census tracts into 5 percent "buckets" on a range of 1 to 20, with 1 being the best tracts and 20 being the worst in terms of a variety of factors, such as foreclosure rates. NSP scores determine eligibility for NSP funding; census tracts with the highest scores are considered the tracts with the greatest need for support. See text for further details.

2 Borrower income is the total income relied upon by the lender in the loan underwriting. Income is expressed relative to the median family income of the metropolitan statistical area (MSA) or statewide non-MSA in which the property being purchased is located. "Lower" is less than 80 percent of the median; "middle" is 80 percent to 119 percent; and "high" is 120 percent or more.

3 See table 14.A, note 5. Minority borrowers are borrowers other than non-Hispanic whites.

4 Credit scores are for those individuals who moved into the census tract in 2005 or 2010, as appropriate, and took out a first mortgage during that year. Note that because of differences between reporting requirements under the Home Mortgage Disclosure Act (HMDA) and the information provided to the consumer credit reporting agencies, the credit scores presented may differ some from those of the borrowers included in the HMDA data. Credit score data from the Federal Reserve Bank of New York Consumer Credit Panel/Equifax.

5 See table 9, note 3.

6 Includes loans for which occupancy status was missing.

7 See table 4, note 1.

8 In piggyback lending, borrowers simultaneously receive a first-lien loan and a junior-lien (piggyback) loan to purchase a home from the same lender.

9 Census-tract data for minority and income characteristics are derived from tract-weighted means based on population. Minority and income data are based on the 2000 census and are calculated for tracts that originated at least one loan in the appropriate year.

10 See table 14.A, note 5. Those other than non-Hispanic whites are considered minorities. This characteristic reflects the average minority population of the census tracts in the NSP score group.

11 The income category of a census tract is the median family income of the tract relative to that of the MSA or statewide non-MSA in which the tract is located as derived from the 2000 census. "Lower" is less than 80 percent of the median; "middle" is 80 percent to 119 percent; and "high" is 120 percent or more.

12 The loan was made in a neighborhood that is in a Community Reinvestment Act (CRA) assessment area of the lender.

13 Sand states consist of Arizona, California, Florida, and Nevada.

Source: Department of Housing and Urban Development; Federal Financial Institutions Examination Council, data reported under the Home Mortgage Disclosure Act.

Table 16. Borrower, loan, and census-tract characteristics related to lending in areas grouped by Neighborhood Stabilization Program score, 2005 and 2010—*continued*
Percent

Characteristic	NSP score[1]					
	1–4	5–8	9–12	13–16	17–20	All
2010						
Borrower						
Income ratio (percent of area median)[2]						
Lower	19.7	29.3	35.7	41.6	46.0	32.8
Middle	22.9	25.6	25.4	24.0	23.4	24.3
High	55.3	43.1	36.8	32.3	29.0	41.0
Minority[3]	17.9	15.5	18.8	26.8	42.4	22.9
Memo: Mean credit score[4]	**754.0**	**738.0**	**729.0**	**720.0**	**710.0**	**734.0**
Loan or application characteristic or occupancy status						
Higher priced[5]	1.5	2.1	2.8	3.1	3.0	2.4
Non-owner occupant[6]	9.6	10.3	11.4	12.4	14.5	11.4
Nonconventional[7]	32.4	44.7	50.7	55.6	63.0	47.4
Denial rate	11.0	12.9	15.0	17.4	20.9	15.0
Piggyback[8]	.6	.4	.3	.3	.2	.4
Census tract of property[9]						
Minorities as a percent of population[10]	23.8	17.9	23.7	35.9	55.0	31.1
Income ratio (percent of area median)[11]	128.0	111.6	101.4	93.7	84.2	103.8
CRA assessment area[12]	39.1	31.0	29.3	30.0	33.6	33.0
Sand states[13]	7.6	8.3	13.4	29.7	71.6	22.7
Memo: Total loans	**615,001**	**550,180**	**466,428**	**392,822**	**384,384**	**2,408,815**

lending to high-NSP tracts. However, the HMDA data reveal that lending volumes in high-NSP tracts located outside of the sand states actually fell slightly more (73 percent) than in the sand states (71 percent). This result suggests that the declines in lending volumes that are observed for the high-NSP tracts do not simply reflect geographic differences.[62]

A second possible reason for the steeper declines in home-purchase lending in the high-NSP neighborhoods is the role of the non-owner-occupant lending in these neighborhoods. Again, using 2005 as the base year, the share of home-purchase lending backed by non-owner-occupied properties in high-NSP tracts (25 percent) was 6 percentage points higher than in any of the lower-NSP quintiles. Since non-owner-occupant lending has fallen more rapidly than lending for owner-occupied properties across the board (as noted earlier), this finding can help explain some of the more-rapid decline in the lending activity in high-NSP neighborhoods. Non-owner-occupant lending fell 83 percent in the high-NSP tracts between 2005 and 2010—a decline that was higher than that observed for overall home-purchase lending in the high-NSP tracts or in the lower-NSP quintiles over the same period. Nevertheless, when the analysis is limited to owner-occupant lending, home-purchase lending has still fallen substantially in high-NSP tracts (68 percent) and at a rate that is well above the declines in lower-NSP tracts.

This outcome suggests that the steeper decline in lending in high-NSP neighborhoods appears to be broadly based, in that it has not been limited to non-owner-occupant lending or lending in specific states or MSAs. Instead, the steeper decline appears to reflect a changing pattern of home-purchase activity by higher-income borrowers. Loans to lower-

[62] This finding differs with the conclusions of an analysis of lending in high-foreclosure neighborhoods conducted in a previous article (see Avery and others, "The 2009 HMDA Data"). That analysis suggested that the more-rapid declines in lending activity in high-foreclosure neighborhoods, compared with other neighborhoods, largely reflected geographic differences.

income borrowers declined less steeply between 2005 and 2010 in high-NSP tracts (31 percent) than in lower-NSP tracts (36 percent). This pattern is reversed for lending to higher-income borrowers. In high-NSP tracts, loans to higher-income borrowers were 84 percent lower than they had been in 2005. While lower-NSP tracts also experienced sharp contractions, the declines have been less severe. The percentage decline in the high-NSP tracts was 13 percentage points above the fourth NSP quintile and 35 percentage points higher than the declines in the first quintile. The patterns for loans to middle-income borrowers have also contracted more sharply in high-NSP tracts, though the sizes of the differences have not been as large.

This changing income pattern of homebuyers suggests a challenge that efforts like the NSP confront in attempting to stabilize neighborhoods. Not only has home-purchase lending declined more rapidly in the highly distressed neighborhoods identified, but also the composition of the borrowers taking out loans has shifted notably toward those with lower incomes. While the share of loans going to higher-income borrowers in the lower-NSP quintiles declined from 50 percent in 2005 to 43 percent in 2010, in high-NSP tracts the decline was much steeper, falling from 52 percent in 2005 to 29 percent in 2010. This outcome suggests that much of the decline in lending in the highly distressed tracts reflects reduced inflows from higher-income borrowers. The lower income levels of new borrowers in the high-NSP tracts may inhibit the stabilization of these communities.

Differences in Lending Outcomes by Race, Ethnicity, and Sex of the Borrower

One reason the Congress amended HMDA in 1989 was to enhance its value for fair lending enforcement by adding to the items reported the disposition of applications for loans and the race, ethnicity, and sex of applicants. A similar motivation underlay the decision to add pricing data for higher-priced loans in 2004. Over the years, analyses of HMDA data have consistently found substantial differences in the incidence of higher-priced lending and in application denial rates across racial and ethnic lines, differences that cannot be fully explained by factors included in the HMDA data.[63] Analyses also have found that differences across groups in mean APR spreads paid by those with higher-priced loans were generally small.[64] Here we examine the 2010 HMDA data to determine the extent to which these differences persist.

The analysis here presents aggregated lending outcomes across all reporting institutions. Patterns for any given financial institution may differ from those shown, and for any given financial institution, relationships may vary by loan product, geographic market, and loan purpose. Further, although the HMDA data include some detailed information about each mortgage transaction, many key factors that are considered by lenders in credit underwriting and pricing are not included. Accordingly, it is not possible to determine from HMDA data alone whether racial and ethnic pricing disparities reflect illegal discrimination. However, analysis using the HMDA data can account for some factors that are likely related to the lending process. Given that lenders offer a wide variety of loan products for which basic

[63] See Avery, Brevoort, and Canner, "The 2006 HMDA Data"; Avery, Brevoort, and Canner, "Higher-Priced Home Lending and the 2005 HMDA Data"; and Avery, Canner, and Cook, "New Information Reported under HMDA."

[64] See, for example, Andrew Haughwout, Christopher Mayer, and Joseph Tracy (2009), *Subprime Mortgage Pricing: The Impact of Race, Ethnicity, and Gender on the Cost of Borrowing*, Staff Report 368 (New York: Federal Reserve Bank of New York, April); and Marsha J. Courchane (2007), "The Pricing of Home Mortgage Loans to Minority Borrowers: How Much of the APR Differential Can We Explain?" *Journal of Real Estate Research*, vol. 29 (4), pp. 399–439.

terms and underwriting criteria can differ substantially, the analysis here can only be viewed as suggestive.

Comparisons of average outcomes (both loan pricing and denials) for each racial, ethnic, or sex group are made both before and after accounting for differences in the borrower-related factors contained in the HMDA data (income; loan amount; location of the property, or MSA; and presence of a co-applicant) and for differences in borrower-related factors plus the specific lending institution used by the borrower.[65] Comparisons for lending outcomes across groups are of three types: gross (or "unmodified"), modified to account for borrower-related factors (or "borrower modified"), and modified to account for borrower-related factors plus lender (or "lender modified").[66] The analysis here distinguishes between conventional and nonconventional lending, reflecting the different underwriting standards and fees associated with these two broad loan product categories.[67]

Incidence of Higher-Priced Lending by Race, Ethnicity, and Sex

As noted earlier, 2010 is the first HMDA reporting year for which all of the loans subject to higher-priced loan reporting used the new Freddie Mac PMMS threshold (the PMMS threshold was also used for the last three months of 2009). Before October 1, 2009, a Treasury-based threshold was used. The change in threshold makes it problematic to compare the reported incidence of higher-priced lending in 2010 with the incidence reported for previous years. Nevertheless, in previous articles, we have employed a methodology that adjusted the Treasury-based spread to a spread over the 30-year fixed-rate mortgage APOR reported in the PMMS. For almost all of the period from 2006 to 2009, this methodology gave a good approximation of the incidence of loans with APOR spreads more than 1.75 percentage points above the PMMS (25 basis points higher than the cutoff for higher-priced reporting in 2010). Calculations using the "adjusted spread" showed that the estimated incidence of loans more than 1.75 percentage points above the PMMS is significantly reduced from 2006 to 2008 for all racial and ethnic groups, and that differences across groups are considerably smaller since 2008 than in the years prior.[68] Data reported for the last three months of 2009 using the new threshold showed only modest differences across groups.

The overall reported incidence of higher-priced lending is slightly higher in 2010 than for the last three months of 2009. Group patterns are similar. The 2010 HMDA data indicate that black and Hispanic-white borrowers are more likely, and Asian borrowers less likely, to obtain conventional loans with prices above the HMDA price-reporting thresholds than are non-Hispanic white borrowers (**table 17.A**). These relationships hold both for home-purchase and refinance lending and for nonconventional loans (**table 17.B**). For example, for conventional home-purchase lending in 2010, the incidence of higher-priced lending was 6.0 percent for black borrowers, 7.1 percent for Hispanic white borrowers, and 1.0 percent for Asians, compared with 3.3 percent for non-Hispanic white borrowers.

The gross differences in the incidence of higher-priced lending between non-Hispanic whites and blacks or Hispanic whites in 2010 are significantly reduced, but not completely

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65 Excluded from the analysis are applicants residing outside the 50 states and the District of Columbia as well as applications deemed to be business related. Applicant gender is controlled for in the racial and ethnic analyses, and race and ethnicity are controlled for in the analyses of gender differences.

66 For purposes of presentation, the borrower- and lender-modified outcomes shown in the tables are normalized so that, *for the base comparison group* (non-Hispanic whites in the case of comparison by race and ethnicity and males in the case of comparison by sex), the mean at each modification level is the same as the gross mean.

67 Although results here are reported for nonconventional lending as a whole, the analysis controls for the specific type of government-backed loan program (FHA, VA, or FSA/RHS) used by the borrower or loan applicant.

68 See Avery and others, "The 2008 HMDA Data."

Table 17. Incidence of higher-priced lending, unmodified and modified for borrower- and lender-related factors, by type and purpose of the loan and by race, ethnicity, and sex of borrower, 2010

A. Conventional loan

Percent except as noted

Race, ethnicity, and sex	Home purchase				Refinance			
	Number of loans	Unmodified incidence	Modified incidence, by modification factor		Number of loans	Unmodified incidence	Modified incidence, by modification factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race other than white only[1]								
American Indian or Alaska Native	3,066	6.62	5.43	3.82	8,915	2.93	1.84	1.65
Asian	87,321	1.02	2.87	3.39	219,886	0.22	0.97	1.31
Black or African American	21,982	6.00	5.44	3.98	74,144	3.96	2.88	1.92
Native Hawaiian or other Pacific Islander	2,357	2.04	3.37	3.57	7,428	0.85	1.61	1.35
Two or more minority races	364	1.92	2.98	3.07	1,378	0.73	1.44	1.25
Joint	14,776	2.37	3.41	3.43	56,000	0.80	1.51	1.53
Missing	88,728	1.04	1.77	3.38	403,288	0.59	0.83	1.34
White, by ethnicity[1]								
Hispanic white	41,665	7.08	5.00	3.81	110,378	2.30	1.73	1.61
Non-Hispanic white	731,874	3.34	3.34	3.34	2,919,913	1.33	1.33	1.33
Sex								
One male	271,589	3.35	3.35	3.35	731,931	1.46	1.46	1.46
One female	196,692	2.94	2.79	3.12	576,115	1.73	1.37	1.40
Two males[2]	10,960	7.23	7.23	7.23	26,429	1.59	1.59	1.59
Two females[2]	8,256	4.17	5.32	6.67	25,460	1.70	1.40	1.47

Note: First-lien mortgages for owner-occupied, one- to four-family, site-built properties; excludes business loans. Business-related loans are those for which the lender reported that the race, ethnicity, and sex of the applicant or co-applicant are “not applicable.” For definition of higher-priced lending and explanation of modification factors, see text and table 9, note 3. Loans taken out jointly by a male and female are not tabulated here because they would not be directly comparable with loans taken out by one borrower or by two borrowers of the same sex.

1 See table 14.A, note 5.

2 Data reflect updates to the Home Mortgage Disclosure Act (HMDA) files received by the Federal Financial Institutions Examination Council since the public release of the files in September 2011. The updated data are primarily corrections of gender identification of applicants previously submitted by one large lender. All other data in the tables and figures presented in this article are unchanged and reflect the HMDA files as originally released to the public in September 2011.

n.a. Not available.

eliminated, after controlling for lender and borrower characteristics. For example, the gross 2010 difference in the incidence of higher-priced conventional lending for home-purchase loans between Hispanic whites and non-Hispanic whites of 3.7 percent falls to only about 0.5 percentage point when the other factors available within the HMDA data are accounted for. For both conventional and nonconventional lending, the black-versus-non-Hispanic-white disparity is reduced to about 0.6 percentage point for both home-purchase and refinance loans. These disparities are significantly lower than the higher-priced incidence disparities observed from 2004 to 2007 using both the old Treasury-based threshold and our PMMS-based adjusted spread.

With regard to the sex of applicants, we report differences between one male and one female and between two males and two females. Here, no notable differences are evident for either conventional or nonconventional lending.

Rate Spreads by Race, Ethnicity, and Sex

The 2010 data indicate that among borrowers with higher-priced loans, the gross APOR spreads are similar across groups for both home-purchase and refinance lending. This

Table 17. Incidence of higher-priced lending, unmodified and modified for borrower- and lender-related factors, by type and purpose of the loan and by race, ethnicity, and sex of borrower, 2010

B. Nonconventional loan

Percent except as noted

Race, ethnicity, and sex	Home purchase				Refinance			
	Number of loans	Unmodified incidence	Modified incidence, by modification factor		Number of loans	Unmodified incidence	Modified incidence, by modification factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race other than white only[1]								
American Indian or Alaska Native	7,047	1.35	1.34	1.08	2,636	4.74	3.58	2.09
Asian	31,550	0.76	0.81	0.88	10,898	3.14	3.26	3.13
Black or African American	106,782	2.39	1.91	1.56	53,487	9.88	5.48	4.20
Native Hawaiian or other Pacific Islander	5,133	1.05	1.25	1.15	2,400	4.25	3.51	3.40
Two or more minority races	750	0.67	1.73	1.62	349	1.72	2.79	2.93
Joint	16,561	0.62	1.18	0.91	11,048	1.96	3.35	3.49
Missing	88,344	1.37	1.06	1.03	57,523	2.50	2.63	2.27
White, by ethnicity[1]								
Hispanic white	134,178	2.18	1.24	1.21	36,241	5.77	3.16	2.90
Non-Hispanic white	742,748	1.01	1.01	1.01	458,231	4.62	4.62	4.62
Sex								
One male	393,079	1.42	1.42	1.42	177,634	4.12	4.12	4.12
One female	275,264	1.81	1.32	1.34	118,046	9.28	5.50	5.05
Two males[2]	17,524	1.39	1.39	1.39	5,706	1.63	1.63	1.63
Two females[2]	13,442	1.55	1.39	1.59	4,983	3.65	3.48	2.55

Note: See notes to table 17.A.

result holds for both conventional (**table 18.A**) and nonconventional lending (**table 18.B**). For example, for conventional home-purchase loans, the gross mean APOR spread was 2.74 percentage points for black borrowers and 2.66 percentage points for Hispanic white borrowers, while it was 2.48 percentage points for non-Hispanic white borrowers and 2.45 percentage points for Asian borrowers. Accounting for borrower-related factors or the specific lender used by the borrowers reduces these differences.

Denial Rates by Race, Ethnicity, and Sex

Analyses of the HMDA data in previous years have consistently found that denial rates vary across applicants grouped by race or ethnicity. This is also the case in 2010. In 2010, as in past years, blacks and Hispanic whites had notably higher gross denial rates than non-Hispanic whites, while the differences between Asians and non-Hispanic whites generally were fairly small by comparison (**tables 19.A** and **19.B**). For example, in 2010, the denial rates for conventional home-purchase loans were 30.9 percent for blacks, 22.9 percent for Hispanic whites, 14.4 percent for Asians, and 12.3 percent for non-Hispanic whites. The pattern was about the same for nonconventional home-purchase lending, although the gap in gross denial rates between blacks or Hispanic whites and non-Hispanic whites was smaller than for conventional home-purchase loans; the gap between Asians and non-Hispanic whites was higher.

For both conventional and nonconventional lending, controlling for borrower-related factors in the HMDA data generally reduces the differences among racial and ethnic groups. Accounting for the specific lender used by the applicant reduces differences further,

Table 18. Mean average prime offer rate spreads, unmodified and modified for borrower- and lender-related factors, for higher-priced loans on one- to four-family homes, by type and purpose of the loan and by race, ethnicity, and sex of borrower, 2010

A. Conventional loan

Percent except as noted

Race, ethnicity, and sex	Home purchase				Refinance			
	Number of higher-priced loans[1]	Unmodified mean spread	Modified mean spread, by modification factor		Number of higher-priced loans[1]	Unmodified mean spread	Modified mean spread, by modification factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race other than white only[2]								
American Indian or Alaska Native	203	2.81	2.67	2.64	261	2.99	3.18	2.71
Asian	888	2.45	2.53	2.43	474	2.34	2.67	2.55
Black or African American	1,318	2.74	2.91	2.64	2,934	3.31	3.25	2.70
Native Hawaiian or other Pacific Islander	48	2.54	2.57	2.56	63	2.68	3.03	2.63
Two or more minority races	7	2.52	2.66	2.36	10	2.75	2.38	2.67
Joint	350	2.70	2.76	2.49	448	2.68	2.60	2.65
Missing	919	2.28	2.27	2.54	2,394	2.68	3.26	2.59
White, by ethnicity[2]								
Hispanic white	2,949	2.66	2.52	2.53	2,537	3.00	2.74	2.66
Non-Hispanic white	24,458	2.48	2.48	2.48	38,698	2.63	2.63	2.63
Sex								
One male	9,095	2.54	2.54	2.54	10,677	2.72	2.72	2.72
One female	5,773	2.48	2.48	2.51	9,946	2.80	2.73	2.72
Two males[3]	792	2.56	2.56	2.56	419	2.75	2.75	2.75
Two females[3]	344	2.55	2.48	2.98	434	2.91	2.52	2.95

Note: For definition of higher-priced lending and explanation of modification factors, see text. Loans taken out jointly by a male and female are not tabulated here because they would not be directly comparable with loans taken out by one borrower or by two borrowers of the same sex. For definition of average prime offer rate spread, see table 11, note 1.

1 See table 9, note 3.

2 See table 14.A, note 5.

3 Data reflect updates to the Home Mortgage Disclosure Act (HMDA) files received by the Federal Financial Institutions Examination Council since the public release of the files in September 2011. The updated data are primarily corrections of gender identification of applicants previously submitted by one large lender. All other data in the tables and figures presented in this article are unchanged and reflect the HMDA files as originally released to the public in September 2011.

n.a. Not available.

although unexplained differences remain between non-Hispanic whites and other racial and ethnic groups.

Conventional lending denial rate disparities between groups, both gross and controlling for other factors, have narrowed somewhat in the past several years. For example, the conventional home-purchase denial rate disparity between blacks and non-Hispanic whites, controlling for all factors, narrowed from 10.8 percentage points in 2008 to 9.2 percentage points in 2010. This narrowing appears to stem more from changes in the composition of the applicant pool over time than from changes in the way lenders act on specific applications. For example, the gross overall denial rate for conventional home-purchase loans used in the analysis of this section fell about 0.3 percentage point from 2009 to 2010 (data not shown in tables). Yet if the analysis is restricted to a comparison of applicants of the same race, gender, income, location, and loan request, applying to the same lender, the denial rate rose about 0.2 percentage point. A similar analysis using 2008 and 2009 data shows that a gross decline in the denial rate of about 2.9 percentage points between the two years drops to almost zero when controlling for borrower characteristics and lender. An analysis of refinance loans shows similar patterns, although the differences between gross denial rate

Table 18. Mean average prime offer rate spreads, unmodified and modified for borrower- and lender-related factors, for higher-priced loans on one- to four-family homes, by type and purpose of the loan and by race, ethnicity, and sex of borrower, 2010

B. Nonconventional loan

Percent except as noted

Race, ethnicity, and sex	Home purchase: Number of higher-priced loans[1]	Home purchase: Unmodified mean spread	Home purchase: Modified mean spread, by modification factor: Borrower-related	Home purchase: Modified mean spread, by modification factor: Borrower-related plus lender	Refinance: Number of higher-priced loans[1]	Refinance: Unmodified mean spread	Refinance: Modified mean spread, by modification factor: Borrower-related	Refinance: Modified mean spread, by modification factor: Borrower-related plus lender
Race other than white only[2]								
American Indian or Alaska Native	95	1.84	1.81	1.78	125	2.20	2.12	2.12
Asian	239	1.83	1.81	1.83	342	2.10	2.12	2.15
Black or African American	2,556	1.83	1.85	1.89	5,286	2.39	2.31	2.26
Native Hawaiian or other Pacific Islander	54	1.99	1.78	1.89	102	2.09	2.07	2.09
Two or more minority races	5	1.62	1.79	1.95	6	2.10	2.01	2.09
Joint	103	1.93	1.96	1.66	217	2.08	2.15	2.20
Missing	1,213	1.83	1.84	1.80	1,437	2.03	2.22	2.07
White, by ethnicity[2]								
Hispanic white	2,929	1.77	1.79	1.84	2,091	2.26	2.17	2.16
Non-Hispanic white	7,510	1.86	1.86	1.86	21,178	2.17	2.17	2.17
Sex								
One male	5,600	1.82	1.82	1.82	7,322	2.21	2.21	2.21
One female	4,984	1.83	1.82	1.81	10,955	2.29	2.22	2.22
Two males[3]	243	1.77	1.77	1.77	93	2.03	2.03	2.03
Two females[3]	208	1.77	1.73	1.74	182	2.03	2.24	2.03

Note: See notes to table 18.A.

changes and changes controlling for borrower characteristics and lender are more muted. Patterns for nonconventional lending are similar but also more muted.

Some Limitations of the Data in Assessing Fair Lending Compliance

Both previous research and experience gained in the fair lending enforcement process show that unexplained differences in the incidence of higher-priced lending and in denial rates among racial or ethnic groups stem, at least in part, from credit-related factors not available in the HMDA data, such as measures of credit history (including credit scores) and LTV and differences in choice of loan products. Differential costs of loan origination and the competitive environment also may bear on the differences in pricing, as may differences across populations in credit-shopping activities.

Despite these limitations, the HMDA data play an important role in fair lending enforcement. The data are regularly used by bank examiners to facilitate the fair lending examination and enforcement processes. When examiners for the federal banking agencies evaluate an institution's fair lending risk, they analyze HMDA price data and loan application outcomes in conjunction with other information and risk factors that can be drawn directly from loan files or electronic records maintained by lenders, as directed by the Interagency

Table 19. Denial rates on applications, unmodified and modified for borrower- and lender-related factors, by type and purpose of the loan and by race, ethnicity, and sex of applicant, 2010

A. Conventional loan application

Percent except as noted

Race, ethnicity, and sex	Home purchase				Refinance			
	Number of applications acted upon by lender	Unmodified denial rate	Modified denial rate, by modification factor: Borrower-related	Modified denial rate, by modification factor: Borrower-related plus lender	Number of applications acted upon by lender	Unmodified denial rate	Modified denial rate, by modification factor: Borrower-related	Modified denial rate, by modification factor: Borrower-related plus lender
Race other than white only[1]								
American Indian or Alaska Native	4,874	30.9	25.1	17.4	15,873	38.0	36.0	27.7
Asian	112,928	14.4	15.0	14.3	291,887	18.5	21.7	21.8
Black or African American	34,916	30.9	24.8	21.5	141,550	41.3	35.6	31.1
Native Hawaiian or other Pacific Islander	3,279	20.8	17.3	15.5	11,972	31.7	31.4	25.8
Two or more minority races	541	26.6	23.4	14.1	2,271	32.1	35.1	29.0
Joint	18,241	12.5	15.1	13.1	72,901	17.5	22.3	20.6
Missing	121,297	18.8	18.6	15.5	619,516	28.3	27.5	23.3
White, by ethnicity[1]								
Hispanic white	59,719	22.9	17.3	16.5	178,990	31.9	27.0	25.0
Non-Hispanic white	894,301	12.3	12.3	12.3	3,844,364	19.0	19.0	19.0
Sex								
One male	352,879	16.5	16.5	16.5	1,073,760	25.6	25.6	25.6
One female	251,817	15.9	14.7	15.2	827,460	24.8	23.5	23.8
Two males[2]	14,497	18.1	18.1	18.1	68,883	58.4	58.4	58.4
Two females[2]	10,901	18.3	16.6	15.9	40,212	32.0	32.8	36.1

Note: First-lien mortgages for owner-occupied, one- to four-family, site-built properties; excludes business loans. Business-related loans are those for which the lender reported that the race, ethnicity, and sex of the applicant or co-applicant are “not applicable.” For explanation of modification factors, see text. Applications made jointly by a male and female are not tabulated here because they would not be directly comparable with applications made by one applicant or by two applicants of the same sex.

1 See table 14.A, note 5.

2 Data reflect updates to the Home Mortgage Disclosure Act (HMDA) files received by the Federal Financial Institutions Examination Council since the public release of the files in September 2011. The updated data are primarily corrections of gender identification of applicants previously submitted by one large lender. All other data in the tables and figures presented in this article are unchanged and reflect the HMDA files as originally released to the public in September 2011.

n.a. Not available.

Fair Lending Examination Procedures.[69] The availability of broader information allows the examiners to draw firm conclusions about institution compliance with the fair lending laws.

It is important to keep in mind that the HMDA data, as currently constituted, can be used only to detect differences in pricing across groups for loans with APRs above the reporting threshold; pricing differences may exist among loans below the threshold. This gap in the loan pricing information will be addressed in coming years as the CFPB implements the expanded data reporting requirements set forth in the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd–Frank Act), including the provision requiring the reporting of rate spread information for all loans (see the next section).

69 The Interagency Fair Lending Examination Procedures are available at www.ffiec.gov/PDF/fairlend.pdf.

Table 19. Denial rates on applications, unmodified and modified for borrower- and lender-related factors, by type and purpose of the loan and by race, ethnicity, and sex of applicant, 2010

B. Nonconventional loan application

Percent except as noted

Race, ethnicity, and sex	Home purchase				Refinance			
	Number of applications acted upon by lender	Unmodified denial rate	Modified denial rate, by modification factor		Number of applications acted upon by lender	Unmodified denial rate	Modified denial rate, by modification factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race other than white only[1]								
American Indian or Alaska Native	9,187	18.1	18.2	16.6	4,900	39.1	41.6	35.7
Asian	41,472	18.4	17.4	16.2	18,754	34.1	35.6	33.0
Black or African American	145,752	22.0	20.1	19.3	105,774	42.2	41.6	37.8
Native Hawaiian or other Pacific Islander	6,697	18.2	16.8	15.4	3,939	32.0	39.1	35.7
Two or more minority races	1,002	20.4	16.4	13.9	796	48.0	50.7	42.8
Joint	19,901	12.6	14.1	13.3	16,577	26.5	31.8	31.3
Missing	118,582	20.4	20.9	18.3	130,599	48.3	43.9	33.6
White, by ethnicity[1]								
Hispanic white	179,737	19.9	16.4	16.3	62,190	33.2	35.2	34.7
Non-Hispanic white	892,067	12.7	12.7	12.7	715,795	29.5	29.5	29.5
Sex								
One male	496,319	16.4	16.4	16.4	306,236	35.0	35.0	35.0
One female	346,589	16.3	15.2	15.5	203,795	35.4	33.1	33.5
Two males[2]	23,455	20.5	20.5	20.5	9,291	31.2	31.2	31.2
Two females[2]	1,777	19.2	17.4	16.3	8,465	33.9	30.9	29.7

Note: See notes to table 19.A.

Future Changes in HMDA

The Dodd–Frank Act includes many provisions that change the landscape of the financial services industry generally and that of the mortgage market in particular. Two provisions in the Dodd–Frank Act bear directly on the HMDA data. First, title X of the Dodd–Frank Act shifts the responsibility for writing rules to implement a host of consumer protection statutes, including HMDA, to the new CFPB. With respect to HMDA, the CFPB has authority to prescribe rules regarding (1) the nature and scope of the data to be collected and reported, (2) the method of submitting data, (3) the format and content of disclosures, and (4) required modifications to the HMDA data prior to public disclosure by the FFIEC and the reporting entities to help protect the privacy of individuals.

Second, the Dodd–Frank Act amended HMDA, requiring covered institutions to collect and report several new data items. The new data items range widely and include information about loan terms, the property and originator involved in the transaction, and the borrower, as well as a unique loan identification number.

The New Data Items

The following enumerates the new data items that must be reported and those that were mentioned in the Dodd–Frank Act but for which discretion was left to the CFPB to decide whether to include them in the required reporting. The new items fall into several categories; the items that may be included at the discretion of the CFPB are noted.

- *Loan terms*
  - — Total points and fees

- APOR rate spread for all loans, measured against a benchmark rate to be determined by the CFPB (now required only for higher-priced loans)
- Duration (and existence) of prepayment penalty
- Indicator of whether mortgage has an adjustable rate
- Length of introductory interest rate period for adjustable-rate mortgages
- Presence of negative amortization feature
- Term to maturity

- *Property information*
  - Property value
  - Parcel identification number, at the option of the CFPB

- *Originator information*
  - Origination channel (such as retail loan officer or broker)
  - Originator identification number (as set forth in the Secure and Fair Enforcement for Mortgage Licensing Act, or SAFE Act), at the option of the CFPB[70]

- *Borrower information*
  - Credit score, in a form determined by the CFPB
  - Age

- *Universal loan identification number*, at the option of the CFPB

Four of these items are currently being collected by institutions covered by HMDA but are not reported or disclosed to the public. These items are required inputs into the "rate spread calculator" made available to covered entities by the FFIEC to determine whether the APOR spread on a loan is large enough to require reporting of the interest rate spread.[71] The four items are (1) the term to maturity, (2) the APOR spread, (3) an indicator of whether the loan has a fixed or adjustable interest rate, and (4) the length of the introductory rate period for adjustable-rate loans.

The Dodd–Frank Act also stipulated changes in the way in which the new data items (except for borrower age) would be released to the public as compared with the current data release. The act states that the new items will be reported in grouped form as counts of loans and loan dollars, with the CFPB determining the appropriate groupings.

Timing

At the time of this writing, there is some uncertainty about the schedule for forthcoming changes to HMDA rules. Under the Dodd–Frank Act, reporting entities are given a period of time to make changes to their data collection and reporting systems before compliance must begin with a revised rule. Following the issuance of final rules, a minimum of nine additional months must pass before data collection begins. On the January 1 following that nine-month period, institutions would be required to begin collecting the new data elements, with reporting of the modified data by March 1 of the next calendar year. For example, if new final rules are adopted in February 2013, collection of the expanded data would begin January 1, 2014, with reporting beginning in 2015.

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[70] The SAFE Act created the Nationwide Mortgage Licensing System and Registry, which will, among other things, assign unique identifying numbers to all residential mortgage originators employed by banking institutions, Farm Credit System institutions, and others, including mortgage companies and brokers. See Federal Financial Institutions Examination Council, "Secure and Fair Enforcement for Mortgage Licensing Act (S.A.F.E. Act) FAQs," webpage, www.ffiec.gov/safeact.htm.

[71] See Federal Financial Institutions Examination Council, "New FFIEC Rate Spread Calculator," webpage, www.ffiec.gov/ratespread/NewBulkRateSpread.aspx.

APPENDIX A: REQUIREMENTS OF REGULATION C

The Federal Reserve Board's Regulation C requires lenders to report the following information on home-purchase and home-improvement loans and on refinancings:

For each application or loan

- application date and the date an action was taken on the application
- action taken on the application
  — approved and originated
  — approved but not accepted by the applicant
  — denied (with the reasons for denial—voluntary for some lenders)
  — withdrawn by the applicant
  — file closed for incompleteness
- preapproval program status (for home-purchase loans only)
  — preapproval request denied by financial institution
  — preapproval request approved but not accepted by individual
- loan amount
- loan type
  — conventional
  — insured by the Federal Housing Administration
  — guaranteed by the Department of Veterans Affairs
  — backed by the Farm Service Agency or Rural Housing Service
- lien status
  — first lien
  — junior lien
  — unsecured
- loan purpose
  — home purchase
  — refinance
  — home improvement
- type of purchaser (if the lender subsequently sold the loan during the year)
  — Fannie Mae
  — Ginnie Mae
  — Freddie Mac
  — Farmer Mac
  — Private securitization
  — Commercial bank, savings bank, or savings association
  — Life insurance company, credit union, mortgage bank, or finance company
  — Affiliate institution
  — Other type of purchaser

For each applicant or co-applicant

- race
- ethnicity
- sex
- income relied on in credit decision

For each property

- location, by state, county, metropolitan statistical area, and census tract
- type of structure
  - — one- to four-family dwelling
  - — manufactured home
  - — multifamily property (dwelling with five or more units)
- occupancy status (owner occupied, non-owner occupied, or not applicable)

For loans subject to price reporting

- spread above comparable Treasury security for applications taken prior to October 1, 2010
- spread above average prime offer rate for applications taken on or after October 1, 2010

For loans subject to the Home Ownership and Equity Protection Act

- indicator of whether loan is subject to the Home Ownership and Equity Protection Act

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Legal Developments: Fourth Quarter, 2010

Orders Issued Under Bank Holding Company Act

Order Issued Under Section 3 of the Bank Holding Company Act

SKBHC Holdings LLC
Corona del Mar, California

Order Approving the Formation of a Bank Holding Company

SKBHC Holdings LLC ("SKBHC") has requested the Board's approval under section 3 of the Bank Holding Company Act ("BHC Act")[1] to become a bank holding company and to acquire all the voting shares of Starbuck Bancshares, Inc. ("Bancshares") and indirectly acquire Bancshares' wholly owned subsidiary bank, The First National Bank of Starbuck ("Bank"), both of Starbuck, Minnesota.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (75 *Federal Register* 16,808 (April 2, 2010)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

SKBHC is a newly organized corporation formed by an individual who will become the chief executive officer and chairman of the board of SKBHC. SKBHC will be capitalized by a group of investors to enable it to acquire Bancshares and Bank and to make future acquisitions of other institutions either through Federal Deposit Insurance Corporation resolutions or on an open-bank basis. SKBHC plans to acquire institutions primarily in the Pacific Northwest, West Coast, and the Southwest regions of the United States.[2]

Bank, with total assets of approximately $17 million, is the 439th largest insured depository institution in Minnesota, controlling deposits of approximately $15.5 million, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the state.[3]

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or that would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from

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[1] 12 U.S.C. 1842.

[2] Any future expansion proposal would be subject to review and approval by the Board or other relevant federal banking agency on its own merits under the standards of the BHC Act or Bank Merger Act.

[3] Asset and deposit data are as of June 30, 2010. Ranking data are also as of June 30, 2010, and reflect merger activity through that date. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

approving a proposal that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[4]

SKBHC does not currently control a depository institution. Based on all the facts of record, the Board has concluded that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of banking resources in any relevant banking market and that competitive considerations are consistent with approval.

Financial, Managerial, and Supervisory Considerations and Future Prospects

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors.[5] The Board has considered those factors in light of all the facts of record, including supervisory and examination information received from the relevant federal supervisor of Bank and publicly reported and other available financial information, including information provided by SKBHC. In addition, the Board has consulted with the primary federal supervisor of Bank.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary banks and significant nonbanking operations. The Board also evaluates the financial condition of the combined organization, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important.

The Board has considered carefully the financial factors of this proposal. Bancshares and Bank currently are well capitalized and would remain so on consummation of the proposal. SKBHC also would be well capitalized and in compliance with relevant capital standards on consummation. The transaction is structured as a cash purchase funded from the proceeds of an issuance of new holding company stock in SKBHC, in exchange for a drawdown of capital from its investors.[6] Based on its review of those factors, the Board finds that SKBHC has sufficient financial resources to effect the proposal and to comply with the Board's Small Bank Holding Company Policy Statement.[7]

The Board also has considered the managerial resources of the applicant, including the proposed management of the organization. The Board has reviewed the examination records of Bank, including assessments of its current management, risk-management systems, and operations. In addition, the Board has considered the supervisory experience of the other relevant banking agencies with Bank, including its record of compliance with applicable banking laws and anti-money-laundering laws, and the proposed management officials and principal shareholders of SKBHC. The Board also has considered SKBHC's plan for the proposed acquisition, including the proposed management of SKBHC and

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[4] 12 U.S.C. § 1842(c)(1).

[5] 12 U.S.C. § 1842(c)(2) and (3).

[6] The remaining capital commitments of SKBHC's investors are available for an 18-month period to fund ongoing operations and expenses, satisfy any applicable regulatory requirements, and fund potential additional acquisitions.

[7] SKBHC will be a small bank holding company after acquiring Bancshares and will be subject to the Small Bank Holding Company Policy Statement, as long as it has less than $500 million in total consolidated assets.

proposed changes in management at Bancshares and Bank after the acquisition. In addition, the Board has considered carefully the future prospects of SKBHC, Bancshares, and Bank in light of the financial and managerial resources and proposed business plan.

Based on all the facts of record, the Board concludes that considerations relating to the financial and managerial resources and future prospects involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

Convenience and Needs Considerations

In acting on proposals under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[8] The Board has carefully considered all the facts of record, including evaluations of the CRA performance record of Bank, information provided by SKBHC, and public comment received on the proposal. The Board has also considered confidential supervisory information provided by the Office of the Comptroller of the Currency ("OCC"), Bank's primary federal regulator. Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the OCC, as of January 3, 2005. The OCC has scheduled a CRA performance examination of Bank for July 2010.

Several commenters expressed concerns that information in the application about SKBHC's plans to provide products and services to its communities was insufficient. As noted above, Bank received a "satisfactory" rating at its most recent CRA performance. Examiners found that the majority of Bank's loans were made within the assessment area and that Bank's record of lending to borrowers of different incomes and businesses of different sizes exceeded the standard for achieving a "satisfactory" rating.

SKBHC represents that the proposal would provide convenience to, and meet the needs of, Bank's customers by continuing products and services currently offered by Bank at the same levels as Bank now provides. SKBHC also represents that its management would not diminish Bank's commitment to meeting the credit needs of the community in which it operates, including the needs of low- and moderate-income geographies and individuals. In addition, SKBHC plans to form a CRA Committee responsible for ensuring Bank's continued commitment to its CRA performance.

Based on a review of the entire record, the Board has concluded that convenience and needs considerations and the CRA performance record of Bank are consistent with approval of the proposal.

Conclusion

Based on the foregoing, and in light of all facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered the application record in light of the factors that it is required to consider under the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by SKBHC with all the conditions imposed in this order and the commitments made to the Board in connection with the application. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

[8] 12 U.S.C. § 2901 et seq.

The proposed transaction may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of San Francisco, acting pursuant to delegated authority.

By order of the Board of Governors, effective October 26, 2010.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Warsh, Duke, Tarullo, and Raskin.

Robert deV. Frierson
Deputy Secretary of the Board

Order Issued Under Sections 3 and 4 of the Bank Holding Company Act

Caja de Ahorros de Valencia, Castellón y Alicante, Bancaja
Valencia, Spain

Banco Financiero y de Ahorros, S.A.
Madrid, Spain

Order Approving the Acquisition of a Bank Holding Company

Caja de Ahorros de Valencia, Castellón y Alicante, Bancaja ("Bancaja"), Valencia, Spain, a foreign banking organization subject to the Bank Holding Company Act ("BHC Act"),[1] and Banco Financiero y de Ahorros, S.A. ("New Bank"), Madrid, Spain, a newly formed foreign bank (collectively, "Applicants"), have requested the Board's approval under section 3 of the BHC Act[2] to acquire control of Caja de Ahorros y Monte de Piedad de Madrid ("Caja Madrid"), and thereby indirectly acquire Caja Madrid's subsidiaries, Caja Madrid Cibeles S.A. ("Cibeles"), both of Madrid; CM Florida Holdings, Inc. ("CM Florida"), Coral Gables, Florida; and City National Bancshares, Inc. ("CNB") and City National Bank of Florida ("Bank"), both of Miami, Florida. Caja Madrid, Cibeles, CM Florida, and CNB are financial holding companies.

Notice of the proposal, affording interested persons an opportunity to comment, has been published (75 *Federal Register* 69,666 (2010)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

Bancaja, with total consolidated assets equivalent to $153 billion, is the sixth largest depository organization in Spain and operates a branch in Miami. New Bank, on a pro forma basis, will have total assets of approximately $470 billion and will be the third largest banking institution by total assets in Spain.

New Bank was formed as a commercial bank under the laws of Spain in connection with the proposed integration of seven savings banks, or *cajas de ahorros*,[3] into a single financial group through a *Sistema Institucional de Protección* ("SIP"). A SIP integrates a group of *cajas de ahorros* into a united economic group headed by a commercial bank while allowing each *caja de ahorros* to maintain the regional approach of its business. The Spanish gov-

[1] Bancaja operates a branch in the United States and, therefore, is subject to the BHC Act (12 U.S.C. § 3106(a)).

[2] 12 U.S.C. § 1842.

[3] *Cajas de ahorros* have no shareholders but are controlled by governing bodies that represent various groups, such as depositors, employees, the local government, and local companies.

ernment and the Bank of Spain have promoted such integration transactions in an effort to consolidate the number of *cajas de ahorros* operating in Spain. New Bank will serve as the central point of governance and the head of the integrated group and, thus, will exercise control over the management and policies of Caja Madrid and each of the other six *cajas de ahorros* in the group.

Caja Madrid will hold approximately 52 percent of the total issued shares of New Bank and will be its largest shareholder. Bancaja will hold approximately 38 percent of the total issued shares of New Bank. Each of the remaining five *cajas de ahorros* will own less than 3 percent of New Bank.[4]The five *cajas de ahorros* are (1) Caja Insular de Ahorros de Canarias, Las Palmas, (2) Caja de Ahorros y Monte de Piedad de Ávila, Ávila, (3) Caixa d'Estalvis Laietana, Mataró, (4) Caja de Ahorros de Segovia, Segovia, and (5) Caja de Ahorros de la Rioja, Logroño, all of Spain.

By entering into the integration transaction, New Bank will be eligible to receive funds from the *Fondo de Reestructuración Ordenada Bancaria* ("FROB"), which was created by the Spanish government to support and facilitate integration transactions among Spanish financial institutions. In exchange for the funds, FROB will purchase perpetual convertible preference shares of New Bank that are convertible to voting shares if not redeemed in five years. The five-year period may be extended for two additional years with the approval of the Bank of Spain.

FROB proposes to invest up to €4.465 billion in New Bank. FROB's investment in New Bank would represent approximately 30 percent of the total equity and if converted to voting shares, would currently represent 30 percent of New Bank's voting shares.

Competitive Considerations

The BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking markets. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by its probable effect in meeting the convenience and needs of the community to be served.[4]

Bancaja operates an uninsured branch in Miami. Applicants do not currently control a U.S. insured depository institution. Based on all the facts of record, the Board has concluded that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of banking resources in any relevant banking market and that competitive considerations are consistent with approval.

Financial, Managerial, and Supervisory Considerations and Future Prospects

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors.[5] The Board has considered these factors in light of all the facts of record, including supervisory and examination information received from the Office of the Comptroller of the Currency ("OCC"), the primary federal supervisor of Bank, and publicly reported and other available information, including information

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4 12 U.S.C. § 1842(c)(1).

5 12 U.S.C. § 1842(c)(2) and (3).

provided by Applicants. The Board also has consulted with the Bank of Spain, the agency with primary responsibility for the supervision and regulation of Spanish banks, including Bancaja and New Bank.

In evaluating the financial factors in proposals involving bank holding companies, the Board reviews the financial condition of the applicants and the target depository institution. The Board also evaluates the financial condition of the pro forma organization, including its capital position, asset quality, earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the financial factors of the proposal. The capital levels of Bancaja and New Bank exceed the minimum levels that would be required under the Basel Capital Accord and are considered to be equivalent to the capital levels that would be required of a U.S. banking organization. In this regard, FROB proposes to invest up to €4.465 billion in New Bank, which would substantially enhance the capital and financial strength of New Bank and its affiliated savings banks.[6] In addition, Bank is well capitalized and would remain so on consummation. Based on its review of the record, the Board finds that Applicants have sufficient financial resources to effect the proposal.

The Board also has considered the managerial resources of the organizations involved. The Board has reviewed the examination records of Bancaja, CM Florida, and Bank, including assessments of their management, risk-management systems, and operations. The Board has also consulted with the Bank of Spain. In addition, the Board has considered its supervisory experiences, and those of other relevant banking supervisory agencies, with the organizations and their records of compliance with applicable banking law and with anti-money-laundering laws. The Board also has considered Applicants' plans for implementing the proposal, including the proposed management of the organization after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors.[7]

Section 3 of the BHC Act also provides that the Board may not approve an application involving a foreign bank unless the bank is subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in the bank's home country.[8] As noted, the Bank of Spain is the primary supervisor of Spanish banks, including Applicants. The Board previously has determined that Bancaja is subject to comprehensive supervision

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[6] The Board received a comment concerning, among other matters discussed later, the losses that Caja Madrid has suffered in certain foreign investments. Because of FROB's investment of up to €4.465 billion, the Board believes New Bank and Caja Madrid have sufficient financial resources to effect the proposal.

[7] Section 3 of the BHC Act also requires the Board to determine that an applicant has provided adequate assurances that it will make available to the Board such information on its operations and activities and those of its affiliates that the Board deems appropriate to determine and enforce compliance with the BHC Act (12 U.S.C. § 1843(c)(3)(A)). The Board has reviewed the restrictions on disclosure in the relevant jurisdictions in which Applicants operate and has communicated with relevant government authorities concerning access to information. In addition, Bancaja and New Bank must, to the extent not prohibited by applicable law, make available to the Board such information on the operations of its affiliates that the Board deems necessary to determine and enforce compliance with the BHC Act, the International Banking Act, and other applicable federal laws. In light of the commitments and conditions in this case, the Board has concluded that Applicants have provided adequate assurances of access to any appropriate information the Board may request.

[8] 12 U.S.C. § 1843(c)(3)(B). As provided in Regulation Y, the Board determines whether a foreign bank is subject to consolidated home-country supervision under the standards set forth in Regulation K. *See* 12 CFR 225.13(a)(4). Regulation K provides that a foreign bank will be considered subject to comprehensive supervision or regulation on a consolidated basis if the Board determines that the bank is supervised or regulated in such a manner that its home-country supervisor receives sufficient information on the worldwide operations of the bank, including its relationship with any affiliates, to assess the bank's overall financial condition and its compliance with laws and regulation. *See* 12 CFR 211.24(c)(1).

on a consolidated basis by its home-country supervisor.[9] The Board also has determined that other banks in Spain were subject to home-country supervision on a consolidated basis.[10] New Bank is supervised by the Bank of Spain on substantially the same terms and conditions as Bancaja and those other banks. Based on all the facts of record, the Board has determined that Bancaja continues to be, and New Bank will be, subject to comprehensive supervision on a consolidated basis by their home-country supervisor.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board is required to consider the effects of the proposal on the convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[11] The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods.[12]

The Board has considered carefully all the facts of record, including evaluations of the CRA performance record of Bank, other information provided by Applicants, confidential supervisory information, and a public comment received on the proposal. The commenter alleged that Bank has engaged in disparate treatment of minority individuals in home mortgage lending.

CRA Performance Evaluations

As provided in the CRA, the Board has reviewed the convenience and needs factor in light of the evaluations by the appropriate federal supervisor of the CRA performance record of the relevant insured depository institution. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[13]

Bank received an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of May 18, 2009.[14] Applicants have represented that they do not intend to change Bank's CRA program on consummation.

A. HMDA and Fair Lending Record

The Board has carefully considered Bank's fair lending record and Home Mortgage Disclosure Act ("HMDA") data in light of the public comment contending that Bank denied a disproportionate percentage of loan applications from African Americans in the Miami

9 *See Caja de Ahorros de Valencia, Castellón y Alicante, Bancaja*, 84 *Federal Reserve Bulletin* 231 (1998).

10 *See, e.g., Caja de Ahorros y Monte de Piedad de Madrid*, 95 *Federal Reserve Bulletin* B23 (2009); *Caja de Ahorros del Mediterráneo*, 92 *Federal Reserve Bulletin* C133 (2006); *Caja de Ahorros de Galicia, Caixa Galicia*, 92 *Federal Reserve Bulletin* C132 (2006); *Banco Popular Español S.A.*, 92 *Federal Reserve Bulletin* C130 (2006).

11 12 U.S.C. § 1842(c)(2).

12 12 U.S.C. § 2901 et seq.

13 *See Interagency Questions and Answers Regarding Community Reinvestment*, 75 *Federal Register* 11,642 and 11,665 (2010).

14 With the exception of community development loans, the evaluation period for the Lending Test was January 1, 2006, through December 31, 2008. For community development loans, the Investment Test, and the Service Test, the evaluation period was April 6, 2006, the date of the last CRA evaluation, through May 18, 2009.

Metropolitan Statistical Area ("MSA"). The Board has focused its analysis on the 2009 HMDA data reported by Bank.[15]

Although the HMDA data may reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not Bank is excluding or imposing higher costs on any group on a prohibited basis. The Board recognizes that HMDA data alone provide only limited information about the covered loans.[16] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of Bank's compliance with fair lending laws.

The record of this application, including confidential supervisory information, indicates that Bank has taken steps to ensure compliance with fair lending and other consumer protection laws. The Board also has considered the HMDA data in light of other information, including the overall performance record of Bank under the CRA. Bank's established efforts and its record of performance demonstrate that Bank is active in helping to meet the credit needs of its entire community.

B. Conclusion on Convenience and Needs and CRA Performance

The Board has considered carefully all the facts of record, including reports of examination of the CRA record of the institution involved, information provided by Applicants, the comment received on the proposal, and confidential supervisory information. Based on a review of the entire record, the Board has concluded that convenience and needs considerations and the CRA performance record of Bank are consistent with approval of the proposal.

Conclusion

Based on the foregoing and all facts of record, the Board has determined that the transaction should be, and hereby is, approved.[17] In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes.[18] The Board's approval is specifically conditioned

[15] The Board reviewed HMDA data from the Miami and Ft. Lauderdale MSAs, as well as from Bank's entire CRA assessment area.

[16] The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

[17] This approval includes any approvals required under section 3 of the BHC Act as a result of the indirect acquisition of shares of Bank by FROB.

[18] The commenter requested that the Board hold a public meeting or hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a written recommendation of denial of the application. The

on compliance by Applicants with the conditions in this order and all the commitments made to the Board in connection with the proposal.[19] For purposes of this action, these commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Atlanta, acting pursuant to delegated authority.

By order of the Board of Governors, effective December 16, 2010.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Warsh, Duke, Tarullo, and Raskin.

Robert deV. Frierson
Deputy Secretary of the Board

Orders Issued Under Bank Merger Act

Centennial Bank
Conway, Arkansas

Order Approving the Merger of Banks and the Establishment of Branches

Centennial Bank ("Centennial"),[1] a state member bank, has requested the Board's approval under section 18(c) of the Federal Deposit Insurance Act[2] ("Bank Merger Act") to acquire the assets and assume the liabilities of Gulf State Community Bank ("Gulf State"), Carrabelle, Florida. Centennial also proposes to establish and operate branches at the locations of the acquired branches of Gulf State.

The Federal Deposit Insurance Corporation ("FDIC") has been appointed receiver of Gulf State and has scheduled the sale of certain assets and the transfer of certain liabilities of Gulf State for November 19, 2010. The FDIC has recommended immediate action by the Board to prevent the probable failure of Gulf State. On the basis of the information before the Board, the Board finds that it must act immediately pursuant to the Bank Merger Act[3]

Board has not received such a recommendation from the appropriate supervisory authorities. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if necessary or appropriate to clarify the factual issues related to the application and to provide an opportunity for testimony (12 CFR 223.16(e), 262.25(d)). The Board has considered carefully the commenter's request in light of all the facts of record. In the Board's view, the commenter had ample opportunity to submit its views and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The commenter's request fails to demonstrate why written comments do not present its views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the request for a public meeting or hearing on the proposal is denied.

[19] The Board has provided certain temporary exemptions to Bancaja and New Bank under section 4(c)(9) of the BHC Act (12 U.S.C. §1843(c)(9)), which authorizes the Board to grant exemptions to foreign companies from the nonbanking restrictions of the BHC Act when the exemptions would not be substantially at variance with the purposes of the act and would be in the public interest. *See* Board letter to Alcides I. Avila, Esq., dated December 16, 2010

[1] Centennial is a subsidiary of Home Bancshares, Inc., also of Conway.

[2] 12 U.S.C. § 1828(c).

[3] 12 U.S.C. § 1828(c)(3).

to safeguard the depositors of Gulf State. Accordingly, public notice of the application and an opportunity for comment are not required by the Bank Merger Act.

Centennial, the only bank subsidiary of Home Bancshares, Inc., has total assets of approximately $3.8 billion and operates in Arkansas and Florida, controlling total deposits of approximately $3.0 billion.[4] Gulf State, with total assets of approximately $117 million, operates only in Florida, controlling deposits of approximately $116 million. On consummation of the proposal, Centennial would become the 34th largest insured depository institution in Florida, controlling deposits of approximately $1.5 billion, which represent less than 1 percent of total deposits in Florida.

Interstate Analysis

Section 102 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal Act") authorizes a bank to merge with another bank under certain conditions unless, before June 1, 1997, the home state of one of the banks involved in the transaction adopted a law expressly prohibiting merger transactions involving out-of-state banks.[5] For purposes of the Riegle-Neal Act, the home state of Centennial is Arkansas, and the home state of Gulf State is Florida.[6] The Riegle-Neal Act provides an exception to certain requirements of section 102 of the act for merger transactions involving banks in default or in danger of default.[7] The proposal complies with all other requirements of the Riegle-Neal Act. Accordingly, approval of the proposed transaction is consistent with the Riegle-Neal Act.

Competitive Considerations

The Board has considered carefully the competitive effects of the proposal in light of the facts of record. The Bank Merger Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The Bank Merger Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community served.[8]

Centennial and Gulf State compete directly in two Florida banking markets: the Tallahassee banking market and the Franklin County banking market.[9] The Board has reviewed carefully the competitive effects of the proposal in both banking markets in light of all the facts of record. In particular, the Board has considered the financial condition of Gulf State and the fact that the Florida Office of Financial Regulation ("FOFR") has placed the bank in FDIC receivership. In addition, the FDIC, as receiver for Gulf State, has selected

[4] These data reflect Centennial's recent acquisitions of Bayside Savings Bank, Coastal Community Bank, and Wakulla Bank, all of Florida. For purposes of this order, insured depository institutions include commercial banks, savings banks, and savings associations.

[5] *See* 12 U.S.C. § 1831u.

[6] 12 U.S.C. § 1831u(a)(4) and (g)(4).

[7] 12 U.S.C. § 1831u(e). The excepted requirements include provisions relating to the application and approval process.

[8] 12 U.S.C. § 1828(c)(5).

[9] The Tallahassee banking market is defined as Gadsden, Jefferson, Leon, and Wakulla counties, Florida. The Franklin County banking market is defined as Franklin County, Florida.

Centennial's bid for Gulf State in accordance with the least-cost resolution requirements in the Federal Deposit Insurance Act.[10]

Under the proposal, Centennial would purchase the assets and assume the liabilities of Gulf State and thereby merge Gulf State's businesses into a viable, going concern with demonstrated capital strength and management capability. Centennial's proposal would continue the availability of credit opportunities and banking services to the customers and communities that Gulf State served and would avoid serious economic disruption to Gulf State depositors. The FDIC actively solicited bids for Gulf State and selected Centennial's proposal under the procedures specified by Congress in the Federal Deposit Insurance Act for resolving failed banks.[11] The FDIC considered this proposal and determined that Centennial's bid represented the lowest cost to the Deposit Insurance Fund. On this basis, the Centennial proposal is the only means before the Board of achieving the public benefits discussed above.

Under these circumstances, and after careful consideration of all the facts of record, the Board concludes that the anticompetitive effects of this proposal in the relevant markets are clearly outweighed in the public interest by the probable effect of the Centennial proposal in meeting the convenience and needs of the communities to be served in Florida.

Financial and Managerial Resources and Future Prospects

The Bank Merger Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential supervisory and examination information from the FOFR and federal banking supervisors of the institutions involved, and publicly reported and other financial information, including information provided by Centennial.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary depository institutions and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial resources, the Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the financial resources of the organizations involved in the proposal. Centennial is well capitalized and would remain so on consummation of the proposal. In addition, the parent holding company of Centennial, Home Bancshares, Inc., recently raised in a public offering approximately $150 million in additional capital, of which a sufficient portion will be downstreamed to Centennial to support the proposed and future transactions. Based on its review of the record in this case, the Board finds that Centennial has sufficient financial resources to effect the proposal. As noted, the proposed transaction is structured as a purchase of assets and assumption of liabilities from the FDIC as receiver.

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[10] The least-cost procedures require the FDIC to choose the resolution method in which the total amount of the FDIC's expenditures and obligations incurred (including any immediate or long-term obligation and any direct or contingent liability) is the least costly to the deposit insurance fund of all possible methods. *See* 12 U.S.C. §§ 1821, 1822, and 1823(c)–(k). Centennial was the only bidder for Gulf State.

[11] *See* 12 U.S.C. §§ 1821, 1822, and 1823(c)– (k).

The Board also has considered the managerial resources of Centennial. The Board has reviewed the examination records of Centennial, including assessments of its management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of other relevant banking supervisory agencies, including the FDIC, with both organizations and their records of compliance with applicable banking and anti-money-laundering laws. The Board also has considered Centennial's plans for implementing the proposal, including its plans for managing the integration of the acquired assets and operations into the bank.

Based on all the facts of record, the Board concludes that considerations relating to the financial and managerial resources and future prospects of Centennial are consistent with approval under the Bank Merger Act, as are the other statutory factors.

Convenience and Needs Considerations

In acting on a proposal under the Bank Merger Act, the Board is required to consider the effects of the proposal on the convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[12] Centennial received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Reserve Bank of St. Louis, as of May 4, 2009. Gulf State received a "satisfactory" rating at its most recent CRA performance evaluation by the FDIC, as of February 1, 2006. After consummation of the proposal, Centennial plans to implement its CRA policies at the Gulf State branches and consumer lending operations acquired in the proposal.

As noted, the Board believes that the proposal will result in substantial benefits to the convenience and needs of the communities to be served by maintaining the availability of credit and deposit services to Gulf State customers. Centennial has represented that consummation of the proposal would allow it to provide a broader range of financial products and services to the customers of Gulf State. Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs of the communities to be served and the CRA performance records of the relevant depository institutions are consistent with approval.

Conclusion

Based on the foregoing and all facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the Bank Merger Act. The Board's approval is specifically conditioned on compliance by Centennial with the commitments made to the Board in connection with the application and the conditions imposed in this order. These commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The transaction may be consummated immediately but in no event later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of St. Louis, acting pursuant to delegated authority.

[12] 12 U.S.C. §§ 2901–2908.

By order of the Board of Governors, effective November 19, 2010.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Warsh, Duke, Tarullo, and Raskin.

Robert deV. Frierson
Deputy Secretary of the Board

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Legal Developments: First Quarter, 2011

Orders Issued Under Bank Holding Company Act

Orders Issued Under Section 3 of the Bank Holding Company Act

First Niagara Financial Group, Inc.
Buffalo, New York

Order Approving the Acquisition of a Bank Holding Company

First Niagara Financial Group, Inc. (''FNF Group'') and FNFG Merger Sub, Inc. (''FNFG''), a wholly owned subsidiary of FNF Group, both of Buffalo, New York, have requested the Board's approval under section 3 of the Bank Holding Company Act (''BHC Act'')[1] to acquire NewAlliance Bancshares, Inc. (''NewAlliance'') and its subsidiary bank, NewAlliance Bank, both of New Haven, Connecticut.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (75 *Federal Register* 68608 (2010)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.

FNF Group, with total consolidated assets of approximately $21.1 billion, controls FN Bank, which operates in Pennsylvania and New York. FN Bank is the 10th largest insured depository institution in Pennsylvania, controlling deposits of approximately $6.9 billion, which represent 2.4 percent of the total amount of deposits of insured depository institutions in that state.[3]

NewAlliance, with total consolidated assets of $9 billion, controls NewAlliance Bank, which operates in Connecticut and Massachusetts. NewAlliance Bank is the 6th largest insured depository institution in Connecticut and 67th largest insured depository institution in Massachusetts, controlling deposits of $4.9 billion and $380 million, respectively.

Interstate Analysis

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the bank holding company's home state if certain conditions are met. For purposes of the BHC Act, the home

1 12 U.S.C. § 1842.

2 Specifically, FNF Group has requested approval for FNFG to merge with NewAlliance, with NewAlliance as the surviving entity. After the merger, FNF Group would merge NewAlliance Bank with and into First Niagara Bank, National Association (''FN Bank''), a wholly owned subsidiary of FNF Group. FN Bank has filed an application with the Office of the Comptroller of the Currency pursuant to the Bank Merger Act (12 U.S.C. § 1828(c)) to merge with NewAlliance Bank.

3 Deposit data are as of June 30, 2010. In this context, insured depository institutions include commercial banks, savings associations, and savings banks. For the reasons discussed later in this order, Pennsylvania is the home state of FNF Group under the BHC Act.

state of FNF Group is Pennsylvania,[4] and NewAlliance is located in Connecticut and Massachusetts.[5] Based on a review of all the facts of record, including relevant state statutes, the Board finds that the conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[6]

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly. The BHC Act also prohibits the Board from approving a proposed bank acquisition that would substantially lessen competition in any relevant banking market unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[7]

FNF Group and NewAlliance compete directly in the Metropolitan New York banking market ("Metro New York banking market").[8] The Board has reviewed carefully the competitive effects of the proposal in this banking market in light of all the facts of record, including the number of competitors that would remain and the relative shares of total deposits in insured depository institutions in the Metro New York banking market ("market deposits") that they would control,[9] the concentration level of market deposits and the increase in that level, as measured by the Herfindahl–Hirschman Index ("HHI") and the Department of Justice Bank Merger Competitive Review guidelines ("DOJ Bank Merger Guidelines"),[10] and other characteristics of the market.

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4 A bank holding company's home state is the state in which the total deposits of all banking subsidiaries of such company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later (12 U.S.C. § 1841(o)(4)(C)).

5 For purposes of section 3(d) of the BHC Act, the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch (12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and 1842(d)(2)(B)).

6 12 U.S.C. §§ 1842(d)(1)(A)–(B) and 1842(d)(2)–(3). FNF Group is adequately capitalized and adequately managed, as defined by applicable law. NewAlliance Bank has been in existence and operated for the minimum period of time required by applicable state laws and for more than five years. *See* 12 U.S.C. § 1842(d)(1)(B)(i)–(ii). On consummation of the proposal, FNF Group would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States (12 U.S.C. § 1842(d)(2)(A)). FNF Group also would control less than 30 percent of, and less than the applicable state deposit cap for, the total amount of deposits in insured depository institutions in the relevant states (12 U.S.C. § 1842(d)(2)(B)–(D)). All other requirements of section 3(d) of the BHC Act would be met on consummation of the proposal.

7 12 U.S.C. § 1842(c)(1).

8 Formally designated the Metropolitan New York-New Jersey-Connecticut-Pennsylvania banking market, the market is defined as Bronx, Dutchess, Kings, Nassau, New York, Orange, Putnam, Queens, Richmond, Rockland, Suffolk, Sullivan, Ulster, and Westchester counties, New York; Bergen, Essex, Hudson, Hunterdon, Middlesex, Mercer, Monmouth, Morris, Ocean, Passaic, Somerset, Sussex, Union, and Warren counties, New Jersey; Monroe and Pike counties, Pennsylvania; and Fairfield County, Bridgewater, Canaan, Cornwall, Kent, New Milford, North Canaan, Roxbury, Salisbury, Sharon, Warren, and Washington townships, including the cities of Cornwall Bridge, Falls Village, Lakeville, Marble Dale, New Preston, Salisbury, and Washington Depot in Litchfield County, and Ansonia, Beacon Falls, Derby, Milford, Oxford, and Seymour townships in New Haven County, all in Connecticut.

9 Deposit and market share data are based on data reported by insured depository institutions in the summary of deposits data as of June 30, 2010, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift institution deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991).

10 Under the DOJ Bank Merger Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally would not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. Although the DOJ and the Federal Trade Commission recently issued revised Horizontal

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Bank Merger Guidelines in the Metro New York banking market. On consummation, the banking market would remain unconcentrated, as measured by the HHI, and numerous competitors would remain in the banking market.[11]

The DOJ has advised the Board that consummation of the proposal is not likely to have a significantly adverse competitive effect in the Metro New York banking market. The Board also has received no objection to the proposal from any federal banking agency.

Based on all the facts of record, the Board has concluded that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

Financial, Managerial, and Other Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and banks involved in the proposal and certain other supervisory factors.[12] The Board has carefully considered these factors in light of all the facts of record, including supervisory and examination information received from the relevant federal and state supervisors of the organizations involved in the proposal and other available financial information, including information provided by FNF Group.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary depository institutions and the organizations' significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the proposal under the financial factors. FNF Group, NewAlliance, and their subsidiary depository institutions are well capitalized and would remain so on consummation of the proposal. The proposed transaction is structured as a partial share exchange and a partial cash purchase of shares. FNF Group will use existing resources to fund the cash purchase of shares.[13] Based on its review of the record, the Board also finds that FNF Group has sufficient financial resources to effect the proposal.

The Board also has considered the managerial resources of the organizations involved and of the proposed combined organization. The Board has reviewed the examination records of FNF Group, NewAlliance, and their subsidiary depository institutions, including assess-

Merger Guidelines, the DOJ has confirmed that its Bank Merger Guidelines, which were issued in 1995, were not modified. Press Release, Department of Justice (August 19, 2010), available at www.justice.gov/opa/pr/2010/August/10-at-938.html.

[11] FNF Group operates the 207th largest depository organization in the market, controlling deposits of approximately $91 million, which represent less than 1 percent of market deposits. NewAlliance controls $339 million in deposits, which represents less than 1 percent of market deposits. After consummation, FNF Group would become the 109th largest depository organization in the market, controlling deposits of approximately $430 million, which represent less than 1 percent of market deposits. The HHI would remain unchanged for the Metro New York banking market.

[12] 12 U.S.C. § 1842(c)(2) and (3).

[13] FNF Group has issued almost $1 billion in common equity since late 2008.

ments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant bank supervisory agencies with the organizations and their records of compliance with applicable banking law, including anti-money-laundering laws. FNF Group and its subsidiary depository institution are considered to be well managed. The Board also has considered FNF Group's plans for implementing the proposal, including the proposed management after consummation of the proposal.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.[14]

Convenience and Needs and CRA Performance Considerations

In acting on a proposal under section 3 of the BHC Act, the Board must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant depository institutions under the Community Reinvestment Act ("CRA").[15]

The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.

The Board has considered carefully all the facts of record, including reports of examination of the CRA performance records of the subsidiary banks of FNF Group and NewAlliance, data reported by FNF Group and NewAlliance under the Home Mortgage Disclosure Act ("HMDA"),[16] other information provided by FNF Group, confidential supervisory information, and public comments received on the proposal. The Board received several comments expressing concern that the acquisition would reduce the availability of credit to LMI individuals, small businesses, and home buyers in New Haven. Commenters also expressed concerns about FN Bank's overall CRA record and its lending record to minorities.

A. CRA Performance Evaluation

As provided in the CRA, the Board evaluates the record of performance of an institution in light of examinations by the appropriate federal supervisors of the CRA performance records of the relevant institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it repre-

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[14] A commenter expressed concern about the level of compensation and severance paid to NewAlliance management and its board of directors. Compensation paid in the past to officials of an institution being acquired is not a factor related to the financial resources of the applicant, which is the focus of the standards of review under the BHC Act. The Board has reviewed the financial resources of the applicant in light of the financial condition of NewAlliance. The Board also reviewed the severance proposal in the context of the financial condition of NewAlliance and the Board's guidance on incentive compensation. As noted above, FNF Group has sufficient resources to complete the transaction as proposed and will remain well capitalized after consummation of the proposal. Moreover, the interests of NewAlliance management and its board have been disclosed to the shareholders of both NewAlliance and FNF Group.

[15] 12 U.S.C. § 2903; 12 U.S.C. § 1842(c)(2).

[16] 12 U.S.C. § 2801 et seq.

sents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[17]

FN Bank received a "satisfactory" rating under the CRA at its most recent performance evaluation by the Office of Thrift Supervision ("OTS"),[18] as of March 12, 2007 ("2007 Evaluation").[19] The Federal Deposit Insurance Corporation rated NewAlliance Bank "outstanding" after its most recent CRA evaluation, as of December 8, 2008. FNF Group has represented that, after the acquisition of NewAlliance Bank, the combined organization will offer an expanded range of additional middle-market lending products and enhanced cash-management services, including in the communities served by NewAlliance Bank.[20]

CRA Performance of FN Bank. In the 2007 Evaluation, examiners considered FN Bank's overall lending performance to be acceptable. Examiners reported that the bank's distribution of HMDA-reportable mortgage loans among areas of different income levels was reasonable, and they commended FN Bank for using flexible and innovative mortgage loan programs to help make credit available to LMI individuals and businesses within its assessment areas. In addition, examiners reported that the bank's practice of extending loans to businesses with gross annual revenues $1 million or less, as well as making loans in small dollar amounts, was excellent throughout its assessment areas. Examiners also noted in the 2007 Evaluation that FN Bank's level of community development lending was very good.

During the evaluation period, FN Bank made more than 5,000 small business loans[21] totaling $830.4 million and was one of the largest Small Business Administration lenders in western New York. FN Bank's community development lending during the evaluation period totaled approximately $151 million. Since the 2007 Evaluation, FN Bank has maintained a reasonable level of home mortgage, small business, and community development lending. In 2009, the bank originated more than 4,200 HMDA-reportable home mortgage loans totaling approximately $618.4 million and more than 3,100 small business loans totaling $449.3 million throughout its assessment areas. FNF Group has stated that FN Bank extended more than $506 million in community development loans, originated $89 million in multifamily loans, and extended more than $1 billion in small business loans since 2007. To complement its community development and multifamily lending activities, FN Bank is an active participant with the Federal Home Loan Bank of New York in providing grant funding to nonprofit housing agencies that develop affordable housing. FN Bank also has

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[17] *See Interagency Questions and Answers Regarding Community Reinvestment*, 75 *Federal Register* 11642 at 11665 (2010).

[18] FN Bank was a federal savings bank that converted to a national bank on April 9, 2010.

[19] The evaluation period in the 2007 Evaluation was 2004–2006. One commenter asserted that FNF Group's previous acquisitions had resulted in a decline in the CRA performance of the acquired depository institutions, specifically citing a decline in the Albany-Schenectady-Troy, New York Metropolitan Statistical Area. FNF Group entered the Albany-Schenectady-Troy market with two acquisitions in 2004 and 2005. The Board notes that the evaluation period covered FNF Group's initial entry into the Albany-Schenectady-Troy market and that FN Bank would not have had sufficient time to implement its programs in the area before the examination. The 2007 Evaluation notes that the acquisitions greatly expanded FN Bank's operations, resulting in significant changes to the bank's business profile.

[20] One commenter requested that FN Bank set forth a definitive plan to ensure that it would continue to serve the credit needs of the communities served by NewAlliance. FNF Group has stated that it does not plan any reduction in products or services available to NewAlliance's communities. FN Bank also has set forth an enhanced CRA plan for the combined organization. The Board consistently has stated that neither the CRA nor the federal banking agencies' CRA regulations require depository institutions to make pledges or enter into commitments or agreements with any organization and that the enforceability of any such third-party pledges, initiatives, and agreements are matters outside the CRA. *See Bank of America Corporation*, 90 *Federal Reserve Bulletin* 217, 232–33 (2004). Instead, the Board focuses on the existing CRA performance record of an applicant and the programs that an applicant has in place to serve the credit needs of its assessment areas at the time the Board reviews a proposal under the convenience and needs factor.

[21] In this context, "small business loans" are loans with original amounts of $1 million or less that are secured by nonfarm, nonresidential properties or are commercial and industrial loans to borrowers in the United States.

provided funding for 29 affordable housing projects throughout its assessment areas, totaling $6.6 million, to build more than 600 units of affordable housing. FN Bank is a qualified participant for programs conducted by the Pennsylvania Housing Finance Agency and has tripled its volume in federal and state mortgage programs (such as Federal Housing Administration, Veterans Affairs, and New York and Pennsylvania Housing Finance Agency programs) by increasing its percentage of loans originated under such programs from 6.4 percent of total loans in 2007 to more than 19 percent in 2009.

In the 2007 Evaluation, examiners reported that FN Bank consistently demonstrated strong performance under the investment test, noting that its performance was outstanding in the majority of its assessment areas.[22] FN Bank represents that it began participating in low-income-housing tax programs in 2010 and has committed $25 million toward such programs. The bank invested in a nonprofit organization that promotes housing growth in economically challenged areas as well as apartments that qualify for low-income-housing tax credits.

Examiners commended FN Bank's service performance throughout its assessment areas in the 2007 Evaluation. Examiners reported that the bank's retail delivery systems were generally good and that its distribution of branches among geographies of different income levels was adequate.[23] Examiners also commended FN Bank for its community development services, which typically responded to the needs of the communities served by the bank throughout its assessment areas.

CRA Performance of NewAlliance Bank. As noted, NewAlliance Bank received an overall "outstanding" rating in its 2008 Evaluation ("NewAlliance 2008 Evaluation").[24] Under the lending test, NewAlliance Bank received a "high satisfactory" rating, and the examiners reported that the bank's distribution of loans among borrowers of different income levels showed excellent responsiveness to the credit needs of LMI borrowers and small businesses. They reported that the bank's overall lending levels reflected good responsiveness to its assessment areas' credit needs.

Examiners reported that NewAlliance Bank was a leader in making community development loans. During the evaluation period, the bank originated 70 community development loans totaling $102.2 million. Examiners noted that the quality and quantity of such lending reflected a high degree of responsiveness to the economic development, affordable housing, and community service needs of the assessment areas.

NewAlliance Bank received an "outstanding" rating under the investment test in the NewAlliance 2008 Evaluation. Examiners commended NewAlliance Bank's leadership role in providing a significant level of qualified community development investments and grants throughout its assessment areas. Examiners also commended the bank's extensive use of innovative investments to support community development initiatives.

In the NewAlliance 2008 Evaluation, the bank received an "outstanding" rating under the service test. Examiners found that NewAlliance Bank's services were accessible to all portions of the assessment areas and that the bank provided good access to banking services for LMI communities. Examiners also reported that the bank's employees, officers, and

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[22] One commenter expressed concern about FN Bank's amount of charitable donations. FN Bank represented that it has a record of providing significant corporate philanthropic donations in all the communities it serves. The Board notes that neither the CRA nor the agencies' implementing rules require institutions to engage in charitable giving.

[23] Since the evaluation period, FN Bank added five branches to LMI census tracts.

[24] The evaluation period in the NewAlliance 2008 Evaluation was 2005–2008.

directors have been active in providing community development services to community organizations and individuals and in providing financial education to area residents and businesses.

B. HMDA and Fair Lending Record

The Board also has considered the lending data reported under HMDA[25] for 2007, 2008, and 2009 by, and the fair lending records of, FN Bank and NewAlliance Bank in light of a public comment on the proposal. One commenter alleged, based on 2008 and 2009 HMDA data, that FN Bank's lending to African American borrowers lagged behind the lending records of other lenders in several of the assessment areas served by the bank. The commenter also criticized the lending by NewAlliance Bank to African Americans and Hispanics in certain assessment areas.

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not FN Bank and NewAlliance Bank are excluding or imposing higher costs on any group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[26] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

Accordingly, the Board has taken into account other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by FNF Group, NewAlliance, and their subsidiaries. In addition, the Board has considered information provided by FNF Group about its compliance-risk-management systems.

The Board previously has reviewed FNF Group's record and concluded that it has taken steps to ensure compliance with fair lending and other consumer protection laws and regulations.[27] The Board found that FNF Group had policies and procedures to help ensure compliance with all fair lending and consumer protection laws applicable to its lending activities, and those policies and procedures will apply to the combined institution on consummation of the proposal. FNF Group's compliance program includes annual training of lending personnel, regular fair lending analyses, and oversight and monitoring of consumer lending functions. FNF Group represented to the Board that it performs quarterly loan file assessments to monitor compliance with lending laws and regulations. In addition, mortgage loan applications slated for denial undergo a second review to ensure complete and careful treatment of loan applicants and to prevent discriminatory lending practices. FN Bank also implemented a formal complaint-resolution process managed by the bank's vice president for customer relations.

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[25] The Board has reviewed the HMDA and CRA data reported by FN Bank and NewAlliance Bank. Each bank's lending in its combined assessment areas, its headquarters' assessment area (the Buffalo, New York Metropolitan Statistical Area for FN Bank and the New Haven, Connecticut Metropolitan Statistical Area for NewAlliance Bank), as well as assessment areas of interest to the commenters, were reviewed.

[26] The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

[27] *First Niagara Financial Group, Inc.*, 96 *Federal Reserve Bulletin* B7 (2010).

Based on a review of the entire record and for the reasons discussed above, including the consultations with the appropriate supervisors, the Board has concluded that considerations relating to convenience and needs and the CRA performance records of FN Bank and NewAlliance Bank are consistent with approval of the proposal.[28]

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application under section 3 of the BHC Act should be, and hereby is, approved.[29] In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by FNF Group with all the conditions imposed in this order and all the commitments made to the Board in connection with the application and on the receipt of all other required regulatory approvals for the proposal. These conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of New York, acting pursuant to delegated authority.

By order of the Board of Governors, effective March 31, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, and Raskin. Absent and not voting: Governor Warsh.

Robert deV. Frierson
Deputy Secretary of the Board

The Goldman Sachs Group, Inc.
New York, New York

Order Approving Retention of Shares of a Bank

The Goldman Sachs Group, Inc. ("Goldman"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's

[28] Some commenters expressed concern that the proposed acquisition would result in a loss of jobs. The effect of a proposed transaction on employment in a community is not among the factors that the Board is authorized to consider under the BHC Act, and the federal banking agencies, courts, and the Congress consistently have interpreted the convenience and needs factor to relate to the effect of a proposal on the availability and quality of banking services in a community. *See, e.g., Wells Fargo & Company*, 82 *Federal Reserve Bulletin* 445, 457 (1996).

[29] Some commenters also requested that the Board hold a public meeting or hearing on the proposal. Section 3(b) of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authorities for the bank to be acquired make a timely written recommendation of denial of the application (12 CFR 225.16(e)). The Board has not received such a recommendation from the appropriate supervisory authorities. Under its regulations, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if a meeting or hearing is necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony (12 CFR 262.3(e) and 262.25(d)). The Board has considered carefully the commenters' requests in light of all the facts of record. In the Board's view, the commenters have had ample opportunity to submit views and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The requests fail to identify disputed issues of fact that are material to the Board's decision that would be clarified by a public meeting or hearing. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the requests for a public meeting or hearing on the proposal are denied.

approval under section 3 of the BHC Act[1] to retain 9.8 percent of the outstanding common stock of Avenue Financial Holdings, Inc. ("Avenue") and thereby indirectly retain voting shares of Avenue Bank, both of Nashville, Tennessee.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (74 *Federal Register* 48,970 (2009)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.[3]

Goldman, with total consolidated assets of approximately $911 billion, engages in investment and commercial banking, securities underwriting and dealing, asset management, trading, and other activities both in the United States and overseas. Goldman controls Goldman Sachs Bank USA ("GS Bank"), New York, New York, a state member bank that operates branches in New York and Salt Lake City, Utah. GS Bank has total assets of approximately $89 billion and controls deposits of approximately $32 billion.[4] Avenue Bank, with total assets of approximately $589 million, controls deposits of $480 million and operates only in Tennessee.[5]

Noncontrolling Investment

Goldman has stated that it does not propose to control or exercise a controlling influence over Avenue and that its investment in Avenue is passive.[6] In this light, Goldman has agreed to abide by certain commitments substantially similar to those on which the Board has previously relied in determining that an investing bank holding company would not be able to exercise a controlling influence over another bank holding company or bank for purposes of the BHC Act ("Passivity Commitments").[7] For example, Goldman has committed not to exercise or attempt to exercise a controlling influence over the management or policies of Avenue or any of its subsidiaries; not to seek or accept more than one representative on the board of directors of Avenue or any of its subsidiaries; and not to have any officer, employee, or agent interlocks with Avenue or any of its subsidiaries. The Passivity

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[1] 12 U.S.C. § 1842.

[2] Avenue Bank's predecessor was Planters Bank of Tennessee, Maury City, Tennessee. Avenue was formed in 2006, acquired the bank in 2007, changed its name to Avenue Bank, and moved its headquarters to Nashville. Goldman holds the shares of Avenue through an indirect subsidiary, Goldman Sachs Investment Partners Master Fund, L.P., a Cayman Islands limited partnership. The fund acquired the shares in Avenue's private equity offering as a passive investment.

[3] A commenter noted that the Board waived public notice of Goldman's application to become a bank holding company in September 2008. The Board's order approving the application explains the basis for this waiver. *The Goldman Sachs Group, Inc.*, 94 *Federal Reserve Bulletin* C101 (2008) ("*Goldman Order*").

[4] Asset and deposit data are as of December 31, 2010.

[5] In acting on Goldman's application to become a bank holding company, the Board determined that emergency conditions existed that justified the Board's expeditious action. *Goldman Order*, C101. In light of those emergency conditions and Goldman's status as a minority investor in Avenue, Goldman was permitted to file a retroactive application to retain the Avenue shares.

[6] Although the acquisition of less than a controlling interest in a bank or bank holding company is not a normal acquisition for a bank holding company, the requirement in section 3(a)(3) of the BHC Act that the Board's approval be obtained before a bank holding company acquires more than 5 percent of the voting shares of a bank suggests that Congress contemplated the acquisition by bank holding companies of between 5 percent and 25 percent of the voting shares of banks. *See* 12 U.S.C. §1842(a)(3). On this basis, the Board previously has approved the acquisition by a bank holding company of less than a controlling interest in a bank or bank holding company. *See, e.g., Penn Bancshares, Inc.*, 92 *Federal Reserve Bulletin* C37 (2006) (acquisition of up to 24.89 percent of the voting shares of a bank holding company); *S&T Bancorp Inc.*, 91 *Federal Reserve Bulletin* 74 (2005) (acquisition of up to 24.9 percent of the voting shares of a bank holding company); *Brookline Bancorp, MHC*, 86 *Federal Reserve Bulletin* 52 (2000) (acquisition of up to 9.9 percent of the voting shares of a bank holding company).

[7] These commitments are set forth in the appendix.

Commitments also include certain restrictions on the business relationships of Goldman with Avenue.

Based on these considerations and all the other facts of record, the Board has concluded that Goldman would not acquire control of, or have the ability to exercise a controlling influence over, Avenue through the proposed retention of Avenue voting shares. The Board notes that the BHC Act requires Goldman to file an application and receive the Board's approval before the company could directly or indirectly acquire additional shares of Avenue or attempt to exercise a controlling influence over Avenue.[8]

Competitive Considerations

The Board has considered carefully the competitive effects of the proposal in light of all the facts of the record. Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the Board finds that the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[9]

Goldman and Avenue do not compete directly in any relevant banking market. Based on all the facts of record, the Board has concluded that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any relevant banking market and that competitive factors are consistent with approval of the proposal.

Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has carefully considered these factors in light of all the facts of record, including confidential supervisory and examination information received from the relevant federal and state supervisors of the organizations involved, publicly reported and other financial information, information provided by Goldman, and public comments received on the proposal.

In evaluating the financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary depository institutions and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the applicant, including its capital position, asset quality, earnings prospects, and the impact of the proposed funding of the transaction.

The Board has carefully considered the financial factors of the proposal. Goldman, GS Bank, Avenue, and Avenue Bank are well capitalized. Goldman acquired its ownership

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[8] 12 U.S.C. § 1842. *See, e.g., Emigrant Bancorp, Inc.*, 82 *Federal Reserve Bulletin* 555 (1996).

[9] 12 U.S.C. § 1842(c)(1).

interest in Avenue before becoming a bank holding company and used existing cash resources to effect the acquisition.

The Board also has considered the managerial resources of the organizations involved. The Board has reviewed the examination records of Goldman, Avenue, and their subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking law and with anti-money-laundering laws.

On April 16, 2010, the Securities and Exchange Commission ("SEC") brought a civil action against Goldman and one of its vice presidents for allegedly defrauding investors by misstating and omitting key facts about a collateralized debt obligation ("CDO") transaction it marketed in 2007, before becoming a bank holding company in September 2008. The CDO transaction involved subprime mortgages, and the marketing occurred as the U.S. housing market was beginning to decline. On July 14, 2010, Goldman settled the action with the SEC. As part of the settlement, Goldman acknowledged that its CDO marketing materials contained incomplete information. Goldman agreed to a settlement penalty of $550 million and to certain undertakings with respect to its business practices for the offering of residential mortgage-backed securities that were designed to ensure that written marketing materials for such offerings are not misleading and do not contain any material misstatement.[10]

The Board has reviewed the SEC action and settlement and actions taken by Goldman to improve its risk-management processes. In May 2010, Goldman announced the creation of a "Business Standards Committee" to conduct an overall review of the firm's business standards. In January 2011, the committee concluded an eight-month review of Goldman's business standards and issued a report of its findings and recommended reforms, including reforms designed to improve the transparency of communication and disclosure with regard to Goldman's risk-management structure, culture, and processes. As part of its ongoing supervision of Goldman's implementation of risk-management and regulatory compliance systems since becoming a bank holding company, the Board will continue to assess Goldman's implementation and maintenance of the committee's recommendations and its business standards and risk-management practices.[11] In addition, the Board will continue to review Goldman's risk-management controls and processes for monitoring investments in other banking organizations and for complying with all regulatory requirements associated with such investments.

Based on all the facts of record, the Board has concluded that the financial and managerial resources and future prospects of Goldman, Avenue, and their subsidiaries are consistent with approval of this application, as are the other supervisory factors the Board must consider under section 3 of the BHC Act.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the

[10] *Sec. and Exch. Comm'n v. Goldman, Sachs & Co.*, 10-CV-3229 (BSJ) (S.D.N.Y. 2010). The total penalty included $250 million in restitution to investors and $300 million in penalties to the SEC.

[11] In connection with the continuous supervision of Goldman's regulatory compliance systems, Board staff is also monitoring all new developments in certain ongoing investigations by several state authorities regarding Goldman's participation in municipal bond markets.

Community Reinvestment Act (“CRA”).[12] The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution’s record of meeting the credit needs of its entire community, including low- and moderate-income (“LMI”) neighborhoods, in evaluating banking proposals.[13]

The Board has considered carefully all the facts of record, including the reports of examination of the CRA performance records of Goldman’s subsidiary insured depository institution and Avenue Bank, data reported by Goldman and Avenue Bank under the Home Mortgage Disclosure Act (“HMDA”),[14] as well as other information provided by Goldman, confidential supervisory information, and public comment received on the proposal. A commenter expressed concern about Goldman’s involvement in subprime lending, including the activities of Litton Loan Servicing L.P. (“Litton”), a loan servicing subsidiary of GS Bank. The commenter also alleged, based on HMDA data, that Avenue Bank had engaged in disparate treatment of minority individuals in home mortgage lending.

A. CRA Performance Evaluation

As provided in the CRA, the Board has considered the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance record of Goldman’s insured depository institution. An institution’s most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution’s overall record of performance under the CRA by its appropriate federal supervisor.[15]

GS Bank was formed in November 2008 through the merger of Goldman’s existing Utah industrial bank into its New York limited-purpose trust company, with the surviving organization doing business as Goldman Sachs Bank USA. GS Bank has not been evaluated under the CRA by the Federal Reserve Bank of New York; however, its industrial bank predecessor with the same name received a CRA composite rating of “satisfactory” at its most recent CRA performance evaluation by the Federal Deposit Insurance Corporation (“FDIC”), as of June 16, 2008. Avenue Bank received an “outstanding” rating at its most recent CRA performance evaluation by the FDIC, as of June 29, 2010.

B. HMDA and Compliance with Fair Lending and Other Consumer Protection Laws

The Board has carefully considered the fair lending records and HMDA data of Goldman and Avenue in light of public comments received on the proposal. The commenter alleged, based on 2008 HMDA data, that Avenue Bank in the Nashville Metropolitan Statistical Area (“MSA”) made a disproportionately small number of prime-rate loans to African American borrowers seeking home mortgage refinancing loans. The Board’s analysis of the lending-related allegations included a review of 2008 and 2009 HMDA data reported by Avenue Bank, which originates prime residential mortgage loans, and of the bank’s 2008 and 2009 HMDA lending data in its combined CRA assessment areas.[16]

[12] 12 U.S.C. §§ 2901–2908; 12 U.S.C. § 1842(c)(2).

[13] 12 U.S.C. § 2903.

[14] 12 U.S.C. §§ 2801–2810.

[15] *See Interagency Questions and Answers Regarding Community Reinvestment,* 75 *Federal Register* 11642 at 11665 (2010).

[16] The bank’s 2008 combined CRA assessment areas consisted of portions of the Davidson and Williamson counties in the Nashville MSA, Chester County in the Jackson, Tennessee MSA, and Crockett County, a non-MSA Tennessee county.

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, denials, or pricing among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not Avenue Bank is excluding or imposing higher costs on any racial or ethnic group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[17] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Moreover, the Board believes that all bank holding companies and their affiliates should conduct mortgage lending operations that are free of abusive lending practices and in compliance with all consumer protection laws.

Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance by Avenue's subsidiary insured depository institution with fair lending laws. The Board also has consulted with the FDIC, Avenue Bank's primary federal supervisor. In addition, the Board has considered information provided by Avenue about its compliance risk-management systems.

The record of this application, including confidential supervisory information, indicates that Avenue Bank has taken steps to ensure compliance with fair lending and other consumer protection laws and regulations. Avenue Bank's loan policies include a comprehensive fair lending policy that prohibits Avenue Bank and its employees from engaging in discriminatory lending practices. The bank's lending employees are required to participate in training that includes compliance with fair lending laws and other applicable laws and regulations for accepting, underwriting, and processing consumer credit applications. Avenue Bank's credit committee reviews monthly a summary of every consumer loan application for adherence to fair lending requirements. Additionally, Avenue Bank hires an independent party to perform fair lending compliance reviews.

The commenter also expressed concern about the subprime lending practices of Goldman and Litton.[18] Litton services subprime loans originated by third parties but does not originate or purchase any residential mortgage loans. It also has no role in the lending practices of the residential mortgage originators.[19] Goldman has represented that Litton conducts quality control testing to ensure compliance with its internal policies and procedures, as

[17] The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

[18] The commenter also expressed concern about Goldman's involvement in residential mortgage securitization. Goldman has represented that it does not currently make warehouse loans to originators of nontraditional mortgages, originate nontraditional mortgages, or purchase them from originators for purposes of securitization. Goldman also represented that it does not refer customers to any subprime mortgage lender.

[19] The commenter expressed concern about subprime loans originated by Fremont Investment and Loan ("Fremont") that the commenter has alleged were acquired by Litton. Fremont was a subprime lender whose parent, Fremont General, filed for bankruptcy in 2008. Litton acquired the servicing rights for loans originated by Fremont but did not acquire ownership of the loans and was not involved in originating them.

well as the applicable consumer protection laws and regulations, and reports the results to Goldman monthly. In addition, Goldman's internal audit function monitors compliance by Litton and other subsidiaries with applicable consumer protection laws.

The Federal Reserve is conducting an in-depth review of practices at Litton and other large mortgage servicers, including a review of internal controls and processes related to all aspects of servicer operations. The Federal Reserve has supervisory authority over bank holding companies and their nonbank subsidiaries and may take supervisory or other actions in connection with those reviews, as the Board determines to be appropriate. In addition, as part of its supervisory process, the Board will continue to monitor the operations of Litton as well as other Goldman subsidiaries to ensure that their processes and procedures comply with applicable consumer protection laws and regulations.

C. Conclusion on Convenience and Needs and CRA Performance

The Board has carefully considered all the facts of record, including evaluations of the CRA performance records of GS Bank and Avenue Bank, information provided by Goldman and Avenue Bank, comments received on the proposal, and confidential supervisory information. Based on a review of the entire record, including the noncontrolling nature of the investment, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant insured depository institutions are consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by Goldman with the conditions imposed in this order and the commitments made to the Board in connection with the application.[20] For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

By order of the Board of Governors, effective March 11, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, and Raskin. Absent and not voting: Governor Warsh.

Robert deV. Frierson
Deputy Secretary of the Board

[20] The commenter requested that the Board hold a public meeting or hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a written recommendation of denial of the application. The Board has not received such a recommendation from those authorities. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if necessary or appropriate to clarify material factual issues related to the application and to provide an opportunity for testimony (12 CFR 225.16(e), 262.25(d)). The Board has considered carefully the commenter's request in light of all the facts of record. As noted, the commenter had ample opportunity to submit its views and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The commenter's request fails to demonstrate why written comments do not present its views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the request for a public meeting or hearing on the proposal is denied.

Appendix

Passivity Commitments

The Goldman Sachs Group, Inc. (“Goldman Sachs”), New York, New York, and its subsidiaries and affiliates (collectively, the “Goldman Sachs Group”), will not, without the prior approval of the Board or its staff, directly or indirectly:

1. Exercise or attempt to exercise a controlling influence over the management or policies of Avenue Financial Holdings Inc. (“Avenue Financial”), Nashville, Tennessee, or any of its subsidiaries;
2. Have or seek to have more than one representative of the Goldman Sachs Group serve on the board of directors of Avenue Financial or any of its subsidiaries;
3. Permit any representative of the Goldman Sachs Group who serves on the board of directors of Avenue Financial or any of its subsidiaries to serve (i) as the chairman of the board of directors of Avenue Financial or any of its subsidiaries, (ii) as the chairman of any committee of the board of directors of Avenue Financial or any of its subsidiaries, (iii) as a member of any committee of the board of directors of Avenue Financial or any of its subsidiaries if the Goldman Sachs Group representative occupies more than 25 percent of the seats on the committee, or (iv) as a member of any committee of the board of directors of Avenue Financial or any of its subsidiaries with the authority to act on behalf of the full board of directors between formal meetings;
4. Have or seek to have any employee or representative of the Goldman Sachs Group serve as an officer, agent, or employee of Avenue Financial or any of its subsidiaries;
5. Take any action that would cause Avenue Financial or any of its subsidiaries to become a subsidiary of Goldman Sachs;
6. Own, control, or hold with power to vote securities that (when aggregated with securities that the officers and directors of the Goldman Sachs Group own, control, or hold with power to vote) represent 25 percent or more of any class of voting securities of Avenue Financial or any of its subsidiaries;
7. Own or control equity interests that would result in the combined voting and nonvoting equity interests of the Goldman Sachs Group and its officers and directors to equal or exceed 25 percent of the total equity capital of Avenue Financial or any of its subsidiaries, except that, if the Goldman Sachs Group and its officers and directors own, hold, or have the power to vote less than 15 percent of the outstanding shares of any class of voting securities of Avenue Financial, the Goldman Sachs Group and its officers and directors may own or control equity interests greater than 25 percent, but in no case more than 33.3 percent, of the total equity capital of Avenue Financial or any of its subsidiaries;
8. Propose a director or slate of directors in opposition to a nominee or slate of nominees proposed by the management or board of directors of Avenue Financial or any of its subsidiaries;
9. Enter into any agreement with Avenue Financial or any of its subsidiaries that substantially limits the discretion of Avenue Financial’s management over major policies and decisions, including, but not limited to, policies or decisions about employing and compensating executive officers; engaging in new business lines; raising additional debt or equity capital; merging or consolidating with another firm; or acquiring, selling, leasing, transferring, or disposing of material assets, subsidiaries, or other entities;
10. Solicit or participate in soliciting proxies with respect to any matter presented to the shareholders of Avenue Financial or any of its subsidiaries;
11. Dispose or threaten to dispose (explicitly or implicitly) of equity interests of Avenue Financial or any of its subsidiaries in any manner as a condition or inducement of specific action or non-action by Avenue Financial or any of its subsidiaries; or
12. Enter into any other banking or nonbanking transactions with Avenue Financial or any of its subsidiaries, except that the Goldman Sachs Group may establish and main-

tain deposit accounts with Avenue Financial, provided that the aggregate balance of all such deposit accounts does not exceed $500,000 and that the accounts are maintained on substantially the same terms as those prevailing for comparable accounts of persons unaffiliated with Avenue Financial.

The terms used in these commitments have the same meanings as set forth in the Bank Holding Company Act of 1956 (''BHC Act''), as amended, and the Board's Regulation Y.

Goldman Sachs understands that these commitments constitute conditions imposed in writing in connection with the Board's findings and decisions in Goldman Sachs's application to retain 9.8 percent of the outstanding common stock of Avenue Financial, pursuant to section 3(a)(3) of the BHC Act, and, as such, may be enforced in proceedings under applicable law. Goldman Sachs further understands that it generally must file an application and receive prior approval of the Board, pursuant to section 3(a)(3) of the BHC Act, for any subsequent acquisition of control of voting shares of Avenue Financial that would result in Goldman Sachs, directly or indirectly, owning or controlling additional voting shares in excess of 9.8 percent of the outstanding common shares of Avenue Financial.

Orders Issued Under Sections 3 and 4 of the Bank Holding Company Act

Chuo Mitsui Trust Holdings, Inc.
Tokyo, Japan

Order Approving the Acquisition of a Bank Holding Company and Notice to Engage in Nonbanking Activities

Chuo Mitsui Trust Holdings, Inc. (''CMTH''), a corporation organized under the laws of Japan, has requested the Board's approval under section 3 of the Bank Holding Company Act (''BHC Act'')[1] to become a bank holding company by acquiring The Sumitomo Trust & Banking Co., Ltd. (''STB''), Osaka, Japan, a bank organized under the laws of Japan and a bank holding company under the BHC Act, thereby indirectly acquiring Sumitomo Trust and Banking Co. (U.S.A.) (''STBUSA''), Hoboken, New Jersey, a wholly owned subsidiary of STB. In addition, CMTH has requested the Board's approval under sections 4(c)(8) and 4(j) of the BHC Act and section 225.28 of the Board's Regulation Y[2] to retain a CMTH subsidiary and to acquire nonbanking companies of STB and thereby engage in certain permissible nonbanking activities.[3]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (75 *Federal Register* 80501 (2010)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in sections 3 and 4 of the BHC Act.

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1 12 U.S.C. § 1842.

2 12 U.S.C. §§ 1843(c)(8) and 1843(j); 12 CFR 225.28.

3 These nonbanking activities are providing financial and investment advisory activities, in accordance with section 225.28(b)(6) of the Board's Regulation Y (12 CFR 225.28(b)(6)). Specifically, CMTH has requested approval (i) to retain indirect control of all the voting and equity interests of Chuo Mitsui Investments, Inc. (''CMI''), New York, New York, and (ii) to acquire indirect control of (a) approximately 99 percent of the voting and equity interests of Nikko AM Americas Holding Co., Inc. (''NAHC''), New York, New York, a wholly owned subsidiary of Nikko Asset Management Co., Ltd., Tokyo, of which STB directly owns approximately 99 percent of the voting and equity interests, and (b) approximately 99 percent of the voting and equity interests of Nikko Asset Management Americas, Inc., New York, New York, a wholly owned subsidiary of NAHC (together with NAHC, the ''Nikko U.S. Entities''). STB has previously received approval to control the Nikko U.S. Entities and thereby engage in investment advisory activities in the United States. Letter dated September 29, 2009, from Natasha Kosoff, Staff Director, Federal Reserve Bank of New York, to William J. Sweet, Esq.

The transaction will be effected through an exchange of shares (“Share Exchange”) after which CMTH will become the sole shareholder of STB and the indirect shareholder of all the outstanding shares of common stock of STBUSA. Upon consummation of the Share Exchange, CMTH will change its name to Sumitomo Mitsui Trust Holdings, Inc.[4]

CMTH, with total consolidated assets of $161.1 billion, is the sixth largest banking group in Japan.[5] Through its subsidiaries, CMTH primarily engages in trust and banking businesses and other financial services in Japan and conducts certain asset management operations in the United States, the United Kingdom, and Hong Kong SAR. The Chuo Mitsui Trust and Banking Company, Limited, Tokyo (“CMTB”), a wholly owned subsidiary of CMTH, accounts for a substantial majority of CMTH’s assets. CMTB maintains a representative office in New York, New York,[6] but has no other U.S. banking operations.

STB, with total consolidated assets of $245.6 billion, is a registered bank holding company that primarily engages in trust and banking businesses and other financial services in Japan and conducts commercial banking, asset management or custodial operations in the United States, the United Kingdom, the People’s Republic of China, Hong Kong SAR, Singapore, and Luxembourg. STBUSA, with total assets of $1.3 billion, is a state-chartered bank in New Jersey that is insured by the Federal Deposit Insurance Corporation. STBUSA offers custodial and securities lending services primarily for Japanese institutional investors and their overseas branches and affiliates.

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking markets. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[7]

In addition to operating STBUSA, STB engages in banking operations in the United States through a branch in New York, New York. CMTH does not currently control a U.S. insured depository institution. Based on all the facts of record, the Board concludes that consummation of the proposal would not have any significantly adverse effects on competition and that the competitive factors are consistent with approval.

Financial, Managerial, and Other Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and banks involved in the proposal and certain other supervisory factors.[8] The Board also reviews the financial and managerial resources of the organizations involved in a proposal under section 4 of the BHC Act.[9] The

[4] As a result of the Share Exchange, three Japanese trust banks, STB, CMTB, and Chuo Mitsui Asset Trust and Banking Company, Limited, will be wholly owned subsidiaries of CMTH. CMTH and STB intend that these three banks will be merged on April 1, 2012, with STB as the surviving entity. The combined subsidiary will be renamed Sumitomo Mitsui Trust Bank, Limited.

[5] Data are as of December 31, 2010, unless otherwise noted.

[6] *See The Chuo Mitsui Trust & Banking Co., Ltd.*, 86 *Federal Reserve Bulletin* 702 (2000).

[7] 12 U.S.C. § 1842(c)(1).

[8] 12 U.S.C. § 1842(c)(2) and (3).

[9] 12 CFR 225.26(b).

Board has carefully considered these factors in light of all the facts of record, including supervisory and examination information received from the relevant federal and state supervisors of the organizations involved, and publicly reported and other available information, including information provided by CMTH. The Board also has consulted with the Japanese Financial Services Agency ("FSA"), the agency with primary responsibility for the supervision and regulation of Japanese banking organizations, including CMTH and STB.[10]

In evaluating financial factors in proposals involving bank holding companies, the Board reviews the financial condition of the applicants and the target depository institutions. In assessing financial resources, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the pro forma organization, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has carefully considered the proposal under the financial factors. The capital levels of CMTH exceed the minimum levels that would be required under the Basel Capital Accord and are considered to be equivalent to the capital levels that would be required of a U.S. banking organization. In addition, STBUSA is well capitalized and would remain so on consummation. Based on its review of the record, the Board also finds that CMTH has sufficient financial resources to effect the proposal. As noted, the proposed transaction is structured as a share exchange.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board has reviewed the examination records of STBUSA, including assessments of its management, risk-management systems, and operations. As noted, the Board has also consulted with the FSA. In addition, the Board has considered its supervisory experiences and those of the other relevant bank supervisory agencies with the organizations and their records of compliance with applicable banking law, including anti-money-laundering laws.

Based on all the facts of record, the Board has concluded that considerations relating to the managerial resources and future prospects of the organizations involved are consistent with approval.

Section 3 of the BHC Act also provides that the Board may not approve an application involving a foreign bank unless the bank is subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in the bank's home country.[11] The Board has determined that other banks in Japan were subject to home-country supervision on a consolidated basis.[12] STB is supervised by the FSA on substantially the same terms and conditions as those other Japanese banks. Based on all the facts of record, the

[10] The FSA approved CMTH's application to acquire STB on March 1, 2011.

[11] 12 U.S.C. § 1842(c)(3)(B). As provided in Regulation Y, the Board determines whether a foreign bank is subject to consolidated home-country supervision under the standards set forth in Regulation K. *See* 12 CFR 225.13(a)(4). Regulation K provides that a foreign bank will be considered subject to comprehensive supervision or regulation on a consolidated basis if the Board determines that the bank is supervised or regulated in such a manner that its home-country supervisor receives sufficient information on the worldwide operations of the bank, including its relationship with any affiliates, to assess the bank's overall financial condition and its compliance with laws and regulation. *See* 12 CFR 211.24(c)(1).

[12] *See, e.g., Mizuho Financial Group, Inc.*, 89 *Federal Reserve Bulletin* 181 (2003); *Mitsubishi Tokyo Financial Group, Inc.*, 87 *Federal Reserve Bulletin* 349 (2001); *Sumitomo Bank Ltd.*, 83 *Federal Reserve Bulletin* 54 (1997); and *Sumitomo Bank Ltd.*, 82 *Federal Reserve Bulletin* 369 (1996).

Board has determined that STB is subject to comprehensive supervision on a consolidated basis by its home-country supervisor.[13]

In evaluating this proposal, the Board also considered whether CMTH is subject to comprehensive supervision or regulation on a consolidated basis by appropriate authorities in its home country. The system of comprehensive supervision or regulation may vary, depending on the nature of the acquiring company and the proposed investment.[14] As noted, the FSA is the supervisor of Japanese banking organizations, including holding companies such as CMTH.[15] As such, the FSA may conduct inspections of CMTH and its subsidiaries and require CMTH to submit reports about its operations on a consolidated basis. The FSA also may review transactions between CMTH and its subsidiaries and has authority to require CMTH to take measures necessary to ensure the safety and soundness of the CMTH organization. Based on all the facts of record, the Board has determined that CMTH is subject to comprehensive supervision on a consolidated basis by its appropriate home-country authorities for purposes of this application.[16]

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.[17]

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board is required to consider the effects of the proposal on the convenience and needs of the communities to be served,[18] including, where applicable, the records of performance of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[19] STBUSA is a special-pur-

[13] The Board also has previously found that CMTH's subsidiary Japanese bank is subject to comprehensive supervision on a consolidated basis by its home-country supervisor. *See The Chuo Mitsui Trust & Banking Co., Ltd.*, 86 *Federal Reserve Bulletin* 702 (2000).

[14] *China Investment Corporation*, 96 *Federal Reserve Bulletin* B31 (2010).

[15] *See, e.g., Mitsubishi UFJ Financial Group, Inc.*, 95 *Federal Reserve Bulletin* B34 (2009); *Mitsubishi Tokyo Financial Group, Inc.*, 87 *Federal Reserve Bulletin* 349 (2001).

[16] Section 3 of the BHC Act also requires the Board to determine that an applicant has provided adequate assurances that it will make available to the Board such information on its operations and activities and those of its affiliates that the Board deems appropriate to determine and enforce compliance with the BHC Act (12 U.S.C. § 1842(c)(3)(A)). The Board has reviewed the restrictions on disclosure in the relevant jurisdictions in which CMTH operates and has communicated with relevant government authorities concerning access to information. In addition, CMTH has committed that, to the extent not prohibited by applicable law, it will make available to the Board such information on the operations of its affiliates that the Board deems necessary to determine and enforce compliance with the BHC Act and other applicable federal law. CMTH also has committed to cooperate with the Board to obtain any waivers or exemptions that may be necessary to enable its affiliates to make any such information available to the Board. In light of these commitments, the Board has concluded that CMTH has provided adequate assurances of access to any appropriate information the Board may request.

[17] A commenter asserted that both CMTH and STB have been involved in the subprime and predatory lending industries in the United States and that the proposal could increase such activities in the combined organization. Neither CMTH nor STB engages in any retail lending activities in the United States (including subprime lending). Although both Japanese banking organizations incurred losses before 2009 on subprime-related investments, current financial reports show that both CMTH and STB significantly reduced their holdings in these investments.

The commenter also made several allegations that are outside the limited statutory factors that the Board is authorized to consider when reviewing an application under the BHC Act. *See, e.g., The Royal Bank of Scotland Group plc*, 90 *Federal Reserve Bulletin* 87, 88 n.16 (2004); *The Royal Bank of Scotland Group plc*, 89 *Federal Reserve Bulletin* 386, 389 n.26 (2003); *Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

[18] 12 U.S.C. § 1842(c)(2).

[19] 12 U.S.C. § 2901 et seq.

pose bank exempt from performance evaluations under the CRA.[20] Upon consummation of the proposal, STBUSA would continue to operate as a special-purpose bank and provide global custody and securities lending services as part of a larger organization. Based on a review of the entire record, the Board has concluded that convenience and needs considerations are consistent with approval of the proposal.

Nonbanking Activities

CMTH also has filed a notice under sections 4(c)(8) and 4(j) of the BHC Act to retain its ownership interest in CMI, to indirectly acquire the Nikko U.S. Entities, and to engage in nonbanking activities that are permissible for bank holding companies.[21] The Board has previously determined by regulation that the financial and investment advisory activities for which CMTH has requested approval are closely related to banking for purposes of section 4(c)(8) of the BHC Act.[22] As part of its evaluation of the public interest factors under section 4(j) of the BHC Act, the Board also must determine that the operations of CMI and the Nikko U.S. Entities "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."[23]

The Board has considered the competitive effects of CMTH's proposed retention of CMI and acquisition of STB's nonbanking subsidiaries and activities in light of all the facts of record. CMI and STB both engage in financial and investment advisory services in the United States. The geographic market for financial and investment advisory services in the United States is regional or national in scope, with numerous competitors. CMI and the Nikko U.S. Entities compete directly only to a limited extent. Moreover, it is expected that CMI will be liquidated in the third quarter of 2011. As a result, the Board finds that consummation of the proposal would have a minimal effect on competition for these services.

In addition, the Board has reviewed the public benefits of the proposed acquisition. Consummation of the proposal would strengthen the organization and would result in benefits to current and future customers of the U.S. nonbanking operations. For the reasons discussed above, and based on the entire record, the Board has determined that the conduct of the proposed nonbanking activities within the framework of Regulation Y and Board precedent is not likely to result in significantly adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices.

Based on all the facts of record, the Board has concluded that consummation of the proposal can reasonably be expected to produce public benefits that would outweigh any likely adverse effects. Accordingly, the Board has determined that the balance of the public benefits under the standard of section 4(j)(2) of the BHC Act is consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application and notice should be, and hereby are, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to con-

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[20] 12 CFR 345.11(c)(3).

[21] 12 U.S.C. §§ 1843(c)(8) and 1843(j).

[22] 12 CFR 225.28(b)(6).

[23] 12 U.S.C. § 1843(j)(2)(A).

sider under the BHC Act. The Board's approval is specifically conditioned on compliance by CMTH with all the commitments made to the Board in connection with the application and notice and on the receipt of all other required regulatory approvals for the proposal. The Board's approval of the proposed nonbanking activities is subject to all the conditions set forth in Regulation Y, including those in sections 225.7 and 225.25(c),[24] and to the Board's authority to require such modification or termination of the activities of a bank holding company or any of its subsidiaries as the Board finds necessary to ensure compliance with, and to prevent evasion of, the provisions of the BHC Act and the Board's regulations and orders issued thereunder. These conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of New York, acting pursuant to delegated authority.

By order of the Board of Governors, effective March 15, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, and Raskin. Absent and not voting: Governor Warsh.

Robert deV. Frierson
Deputy Secretary of the Board

[24] 12 CFR 225.7 and 225.25(c).

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Legal Developments: Second Quarter, 2011

Orders Issued Under Bank Holding Company Act

Orders Issued Under Section 3 of the Bank Holding Company Act

Hancock Holding Company
Gulfport, Mississippi

Order Approving the Acquisition of a Bank Holding Company

Hancock Holding Company ("Hancock"), Gulfport, Mississippi, has requested the Board's approval under section 3 of the Bank Holding Company Act ("BHC Act")[1] to acquire Whitney Holding Corporation ("Whitney") and indirectly acquire Whitney's wholly owned subsidiary bank, Whitney National Bank, both of New Orleans, Louisiana.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (76 *Federal Register* 7211 (February 9, 2011)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in the BHC Act.

Hancock, with total consolidated assets of approximately $8.2 billion, is the 110th largest depository organization in United States, controlling approximately $7.0 billion in deposits. Hancock controls three subsidiary banks, HBLA, HBAL, and Hancock Bank, which operate in four states.[3] Hancock is the third largest depository organization in Mississippi, controlling deposits of approximately $4.6 billion, and the sixth largest depository organization in Louisiana, controlling deposits of approximately $2.2 billion.

Whitney, with total consolidated assets of approximately $11.8 billion, is the 82nd largest depository organization in the United States. Whitney National Bank, Whitney's only subsidiary depository institution,[4] operates in Alabama, Florida, Louisiana, Mississippi, and Texas. Whitney is the 4th largest depository organization in Louisiana, controlling deposits of approximately $8.6 billion, and the 53rd largest depository institution in Mississippi, controlling deposits of approximately $155 million.

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[1] 12 U.S.C. § 1842.

[2] Hancock is a financial holding company within the meaning of the BHC Act. On April 29, 2011, the Federal Deposit Insurance Corporation ("FDIC") approved applications filed by Hancock under the Bank Merger Act (12 U.S.C. § 1828(c)) to merge Whitney National Bank and Hancock's subsidiary bank, Hancock Bank of Alabama ("HBAL"), Mobile, Alabama, into another subsidiary bank of Hancock, Hancock Bank of Louisiana ("HBLA"), Baton Rouge, Louisiana. That same day, the FDIC also approved an application filed by Hancock under the Bank Merger Act to sell and transfer to Hancock Bank, Gulfport, the Florida and Alabama branches of HBLA acquired in the merger of Whitney National Bank, HBAL, and HBLA.

[3] HBLA operates in Louisiana; HBAL operates in Alabama; and Hancock Bank operates in Florida and Mississippi.

[4] For purposes of this order, insured depository institutions include commercial banks, savings banks, and savings associations.

On consummation of the proposal, Hancock would become the 55th largest depository organization in the United States, with total consolidated assets of approximately $20 billion. Hancock would control deposits of approximately $16.2 billion, which represent less than 1 percent of the total amounts of deposits of insured depository institutions in the United States. In Mississippi, Hancock would remain the third largest depository organization, controlling deposits of approximately $4.7 billion, which represent approximately 10 percent of deposits of insured depository institutions in the state. In Louisiana, Hancock would become the largest depository organization, controlling deposits of approximately $10.8 billion, which represent approximately 25 percent of deposits of insured depository institutions in the state. In Alabama, Hancock would become the 16th largest depository organization, controlling deposits of approximately $673 million, which represent less than 1 percent of deposits of insured depository institutions in the state. In Florida, Hancock would become the 26th largest depository organization, controlling deposits of approximately $2.6 billion, which represent less than 1 percent of deposits of insured depository institutions in the state. In Texas, Hancock would become the 64th largest depository organization, controlling deposits of $740 million, which represent less than 1 percent of deposits of insured depository institutions in the state.

Interstate Analysis

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the bank holding company's home state if certain conditions are met. For purposes of the BHC Act, the home state of Hancock is Mississippi,[5] and Whitney is located in Alabama, Florida, Louisiana, Mississippi, and Texas.[6]

Based on a review of all the facts of record, including relevant state statutes, the Board finds that the conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[7] In light of all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

Competitive Considerations

The BHC Act prohibits the Board from approving a proposal that would result in a monopoly or that would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[8]

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[5] A bank holding company's home state is the state in which the total deposits of all banking subsidiaries of such company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later (12 U.S.C. § 1841(o)(4)(C)).

[6] For purposes of section 3(d) of the BHC Act, the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch (12 U.S.C. §§ 1841(o)(4)–(7), 1842(d)(1)(A), and 1842(d)(2)(B)).

[7] 12 U.S.C. §§ 1842(d)(1)(A)–(B) and 1842(d)(2)–(3). Hancock is adequately capitalized and adequately managed, as defined by applicable law. Whitney National Bank has been in existence and operated for the minimum period of time required by applicable state laws and for more than five years. *See* 12 U.S.C. § 1842(d)(1)(B)(i)–(ii). On consummation of the proposal, Hancock would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States (12 U.S.C. § 1842(d)(2)(A)). In addition, Hancock would control less than 30 percent, or the applicable percentage established under state law, of the total amount of deposits of insured depository institutions in the relevant states. *See* 12 U.S.C. § 1842(d)(2)(B)–(C). All other requirements of section 3(d) of the BHC Act would be met on consummation of the proposal.

[8] 12 U.S.C. § 1842(c)(1).

The subsidiary depository institutions of Hancock and Whitney compete directly in nine banking markets, located in Alabama, Florida, Mississippi, and Louisiana. The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record and the public comments on the proposal.[9] In particular, the Board has considered the number of competitors that would remain in the banking markets, the relative shares of total deposits in depository institutions in the markets ("market deposits") controlled by Hancock's insured depository institutions and Whitney National Bank,[10] the concentration levels of market deposits and the increase in those levels as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Bank Merger Guidelines"),[11] and other characteristics of the markets. In addition, the Board has considered commitments made by Hancock to the Board to reduce the potential that the proposal would have adverse effects on competition by divesting eight Whitney branches, accounting for a total of approximately $202 million in deposits, that operate in two banking markets, one in Mississippi and one in Louisiana.

A. Banking Markets within Established Guidelines

Consummation of the proposal would be consistent with Board precedent and within the thresholds of the DOJ Bank Merger Guidelines in six of the banking markets in which Hancock's subsidiary depository institutions and Whitney National Bank directly compete.[12] On consummation of the proposal, one market would remain highly concentrated, three markets would remain moderately concentrated, and two would remain unconcentrated, as measured by the HHI. The change in HHI in the one highly concentrated market would be small and consistent with Board precedent and the thresholds in the DOJ Bank Merger Guidelines. In each of the banking markets, numerous competitors would remain.

B. Certain Banking Markets with Divestitures

After accounting for the branch divestitures,[13] consummation of the acquisition would be consistent with Board precedent and the thresholds in the DOJ Bank Merger Guidelines in

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9 One commenter expressed general concerns about the competitive effects of this proposal and the effects it might have on consumer choices for banking services.

10 Deposit and market share data are as of June 30, 2010, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. In recognition that thrift institutions have become, or have the potential to become, significant competitors of commercial banks, the Board regularly has included thrift deposits in the market concentration and market share calculations on a 50 percent weighted basis. *See*, e.g., *First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52, 55 (1991).

11 Under the DOJ Bank Merger Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally would not be challenged (in the absence of other factors indicating anti-competitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. Although the DOJ and the Federal Trade Commission recently issued revised Horizontal Merger Guidelines, the DOJ has confirmed that its merger guidelines, which were issued in 1995, were not changed. Press Release, Department of Justice (August 19, 2010), available at www.justice.gov/opa/pr/2010/August/10-at-938.html.

12 These banking markets and the effects of the proposal on their concentrations of banking resources are described in Appendix A.

13 Hancock has committed that, not later than 60 days after consummating the proposed acquisition, it will execute an agreement for the proposed divestiture in the Biloxi, Mississippi, and Washington Parish, Louisiana, banking markets, consistent with this order, with one or more purchasers determined by the Board to be competitively suitable. Hancock has acknowledged that divestiture of a branch in the Washington Parish market must be made to a competitor outside the market. Hancock also has committed to complete the divestiture within 180 days after consummation of the proposed merger. In addition, Hancock has committed that, if it is unsuccessful in completing the proposed divestiture within such time period, it will transfer the unsold branch to an independent trustee who will be instructed to sell the branch to an alternate purchaser or purchasers in accordance with the terms of this order and without regard to price. Both the trustee and any alternate purchaser must be deemed acceptable to the Board. *SeeBankAmerica Corporation*, 78 *Federal Reserve Bulletin* 338 (1992); *United New Mexico Financial Corporation*, 77 *Federal Reserve Bulletin* 484 (1991).

the Biloxi, Mississippi, and Washington Parish, Louisiana, banking markets.[14] Although both markets would remain highly concentrated, the HHI would increase no more than 112 points in the Biloxi market and no more than 181 points in the Washington Parish market. In addition, 14 other depository institutions would operate in the Biloxi market and 4 other depository institutions would operate in the Washington Parish market.

C. Tangipahoa Banking Market

In the Tangipahoa banking market ("Tangipahoa Market"),[15] Hancock operates the third largest depository institution, controlling deposits of approximately $174 million, which represent approximately 14 percent of market deposits. Whitney operates the fourth largest depository institution in the market, controlling deposits of approximately $108 million, which represent approximately 8 percent of market deposits. On consummation of the merger the proposal, Hancock would become the second largest depository institution in the market, controlling deposits of approximately $282 million, which represent approximately 22 percent of market deposits. The HHI would increase 228 points to 1842.

Several factors indicate that the increase in concentration in the Tangipahoa Market, as measured by the HHI and Hancock's market share, overstates the potential competitive effects of the proposal in the market. After consummation of the proposal, 14 other commercial bank and thrift competitors would remain in the market. The Board has also considered the competitive influence of two active community credit unions in the Tangipahoa Market. Both credit unions offer a wide range of products, operate at least one street-level branch, and have broad membership criteria that include most of the residents in Tangipahoa Market.[16] The Board has concluded that the activities of such credit unions exert competitive influence that mitigates, in part, the potential effects of the proposal.[17]

D. Views of Other Agencies and Conclusion on Competitive Considerations

The DOJ also has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that, in light of the proposed divestitures, consummation of the proposal would not likely have a significantly adverse effect on competition in any relevant banking market.[18] In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on these and other facts of record, the Board has concluded that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any relevant banking market. Accordingly, based on all the facts of record and subject to completion of the proposed divestitures, the Board has determined that competitive considerations are consistent with approval.

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[14] These banking markets and the effects of the proposal on their concentrations of banking resources are described in Appendix B.

[15] The Tangipahoa Market is defined as Tangipahoa Parish, Louisiana, excluding the city of Kentwood.

[16] The Board previously has considered the competitiveness of certain active credit unions as a mitigating factor. *See*, e.g., *The PNC Financial Services Group, Inc.*, 93 *Federal Reserve Bulletin* C65 (2007); *Regions Financial Corporation*, 93 *Federal Reserve Bulletin* C16 (2007); *Wachovia Corporation*, 92 *Federal Reserve Bulletin* C183 (2006); *F.N.B. Corporation*, 90 *Federal Reserve Bulletin* 481 (2004).

[17] These credit unions control approximately $38 million in deposits in the market that, on a 50 percent weighted basis, represent approximately 3 percent of market deposits. With these deposits weighted at 50 percent, Hancock would control approximately 21 percent of the market deposits, and the HHI would increase 215 points to 1742.

[18] Hancock has committed to the Board that it will comply with its divestiture agreement with DOJ dated April 1, 2011.

Financial, Managerial, and Future Prospects and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors.[19] The Board has considered those factors in light of all the facts of record, including confidential supervisory and examination information from the relevant federal and state supervisors of the organizations involved, publicly reported and other financial information, information provided by Hancock, and public comments received on the proposal.[20]

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary banks and significant nonbanking operations. The Board also evaluates the financial condition of the combined organization, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important.

The Board has carefully considered the financial factors of this proposal. Hancock and its subsidiary depository institutions are well capitalized and would remain so on consummation of the proposal. Whitney and Whitney National Bank currently are well capitalized. The proposed transaction is structured as a share exchange. Based on its review of the record, the Board concludes that Hancock has sufficient financial resources to effect the proposal.

The Board has also considered the managerial resources of the applicant, including the proposed management of the organization. The Board has reviewed the examination records of Hancock and its subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant bank supervisory agencies with the organizations and their records of compliance with applicable banking law, including anti-money-laundering laws. Hancock and its subsidiary depository institutions are considered to be well managed. The Board also has considered Hancock's plans of implementing the proposal, including the proposed management after consummation of the proposal. In addition, the Board has considered the future prospects of the organizations involved in the proposal in light of financial and managerial resources and the proposed business plan.

Based on all the facts of record, the Board concludes that consideration relating to the financial and managerial resources and future prospects of the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

[19] 12 U.S.C. § 1842(c)(2) and (3).

[20] One commenter expressed concern about a lawsuit filed by Whitney shareholders against Whitney, its board of directors, and Hancock that alleges, among other things, breach of fiduciary duty to shareholders by directors and conflicts of interest in selecting Hancock over another potential acquirer. The litigation is in its preliminary stages, and no wrongdoing has been adjudicated. The commenter, citing a press report, also asserted that Whitney's board of directors should have selected another company's competing bid, described only as "Company A" in Hancock's filings with the Securities and Exchange Commission.

The Board has considered these concerns in its review of Hancock's proposal and other information relating to the financial and managerial factors the Board must consider under section 3 of the BHC Act.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board is required to consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[21] The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low and moderate-income neighborhoods, in evaluating expansionary proposals.[22]

A. CRA Performance Evaluations

As provided in the CRA, the Board has considered the convenience and needs factor in light of the evaluations by the appropriate federal supervisor of the CRA performance records of Hancock's insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[23]

HBLA, HBAL, and Hancock Bank received "satisfactory" ratings at their most recent CRA performance evaluations by the FDIC, as of January 4, 2010, March 30, 2009, and June 11, 2007, respectively. Whitney National Bank received an "outstanding" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency, as of February 7, 2007. Hancock has represented that after the acquisition, the combined organization will offer the same or substantially similar products and services as are currently offered by the respective organizations.

B. HMDA and Fair Lending Record

The Board has considered carefully all the facts of record, including reports of examination of the CRA performance records of Hancock's subsidiary insured depository institutions and Whitney National Bank, data reported by Hancock and Whitney under the Home Mortgage Disclosure Act ("HMDA"),[24] other information provided by Hancock, confidential supervisory information, and public comment received on the proposal. A commenter alleged, based on 2009 HMDA data, that Hancock's subsidiary depository institutions denied the home mortgage loan applications by African American and Hispanic borrowers more frequently than those by nonminority applications in certain metropolitan statistical areas ("MSAs").[25]

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, denial, or pricing among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not Hancock is excluding any racial or ethnic group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing informa-

[21] 12 U.S.C. §§ 2901 et seq.

[22] 12 U.S.C. § 2903.

[23] *See Interagency Questions and Answers Regarding Community Reinvestment*, 75 *Federal Register* 11642 at 11665 (2010).

[24] 12 U.S.C. §§ 2801 et seq.

[25] The Board reviewed HMDA data for 2008 and 2009 for Hancock's insured depository institutions in their combined assessment areas and the individual MSAs cited in the comment.

tion, provide only limited information about the covered loans.[26] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Moreover, the Board believes that all bank holding companies and their affiliates must conduct their mortgage lending operations without any abusive lending practices and in compliance with all consumer protection laws.

Because of the limitations of HMDA data, the Board has considered these data and taken into account other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by Hancock's subsidiary insured depository institutions. The Board also has consulted with the FDIC, the primary federal supervisor of Hancock's subsidiary banks. In addition, the Board has considered information provided by Hancock about its fair lending policies, procedures, and practices.

The record of this application, including confidential supervisory information, indicates that Hancock has taken steps to ensure compliance with fair lending and other consumer protection laws and regulations. Hancock also represents that its subsidiary banks have such compliance policies and procedures in place. Specifically, Hancock's subsidiary banks maintain a fair lending compliance program that includes centralized underwriting of consumer credit and mortgage applications to ensure consistency and minimize subjectivity in reaching credit decisions. Moreover, all mortgage application denials and exceptions to Hancock's compliance policies and procedures are subject to additional review. Hancock also provides annual fair lending training for all its employees and has provided additional training for its compliance and lending staff. Hancock regularly conducts internal audits of its fair lending programs, including independent third-party analysis of HMDA and CRA lending patterns. Hancock anticipates that the fair lending program of the resulting bank will be a combination of the fair lending compliance programs of Hancock's subsidiary banks and Whitney National Bank.

The Board also has considered the HMDA data in light of other information, including the overall performance records of the subsidiary banks of Hancock and Whitney National Bank under the CRA. These established efforts and records of performance demonstrate that the institutions are active in helping to meet the credit needs of their entire communities.

C. Conclusion on Convenience and Needs and CRA Performance

The Board has considered carefully all the facts of record, including reports of examination of the CRA records of the subsidiary banks of Hancock, information provided by Hancock, public comments received on the proposal, and confidential supervisory information, including records of compliance with consumer laws and regulations.[27] Hancock represented that it would be able to offer a broader array of banking products and services to the customers served by Whitney National Bank. In addition, consummation of the pro-

[26] The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

[27] The commenter also expressed general concern that the proposal would have "anti-consumer effects."

posal would allow the combined organization to continue to provide credit and other financial services in support of the convenience and needs of the communities served by Whitney National Bank. Based on a review of the entire record, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant insured depository institutions are consistent with approval of the transaction.

Conclusion

Based on the foregoing, and in light of all the facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes.[28] The Board's approval is specifically conditioned on compliance by the applicant with the conditions in this order and all the commitments made to the Board in connection with the proposal.[29] For purposes of this transaction, these commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Atlanta, acting pursuant to delegated authority.

By order of the Board of Governors, effective May 13, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, and Raskin.

Robert deV. Frierson
Deputy Secretary of the Board

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[28] The commenter requested that the Board extend the comment period on the proposal. As previously noted, the Board has accumulated a significant record in this case, including reports of examination, confidential supervisory information, public reports and information, and considerable public comment. In the Board's view, the commenter has had ample opportunity to submit its views, as discussed above, and, in fact, has provided substantial written submissions that the Board has carefully considered in acting on the proposal. Moreover, the BHC Act and Regulation Y require the Board to act on proposals submitted under those provisions within certain time periods. Based on a review of all the facts of record, the Board has concluded that the record in this case is sufficient to warrant action at this time and that further delay in considering the proposal, extension of the comment period, or denial of the proposal on the grounds discussed above, including informational insufficiency, is not warranted.

[29] The commenter also requested that the Board hold a public meeting or hearing on the proposal on the branch closings and the loss of service that would result. Hancock has not represented that it will close any branch and has stated that any branch closings that may occur in the future would be limited to branches that are in very close proximity to each other. Moreover, federal banking law provides a specific mechanism for addressing branch closings. Federal law requires an insured depository institution to provide notice to the public and to the appropriate federal supervisory agency before closing a branch. *See* 12 U.S.C. § 1831r-1; *Joint Policy Statement Regarding Branch Closings*, 64 *Federal Register* 34844 (June 29, 1999).

Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a written recommendation of denial of the application. The Board has not received such a recommendation from a supervisory authority. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if necessary or appropriate to clarify material factual issues related to the application and to provide an opportunity for testimony (12 CFR 225.16(e), 262.3(e), and 262.25(d)). The Board has considered carefully the commenter's request in light of all the facts of record. As noted, the commenter had ample opportunity to submit views and submitted written comments that the Board has carefully considered. The commenter's request fails to demonstrate why written comments do not present its views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the request for a public meeting or hearing on the proposal is denied.

Appendix A

Hancock and Whitney Banking Markets Consistent with Board Precedent and DOJ Banking Merger Guidelines without Divestitures

Bank	Rank	Amount of Deposits (dollars)	Market Deposit Shares (percent)	Resulting HHI	Change in HHI	Remaining Number of Competitors
Mobile Area, Alabama—Mobile County and the towns of Bay Minette, Daphne, Fairhope, Loxley, Point Clear, Robertsdale, Silverhill, Spanish Fort, and Summerdale, all in Baldwin County.						
Hancock Pre-Consummation	9	165.5 mil.	2.1	1612	17	24
Whitney	7	316.5 mil.	4.0			
Hancock Post-Consummation	6	482.0 mil.	6.1			
Fort Walton Beach Area, Florida—Okaloosa and Walton counties and the western half of Holmes County, including the town of Ponce de Leon.						
Hancock Pre-Consummation	9	167.9 mil.	4.0	755	22	24
Whitney	14	118.5 mil.	2.8			
Hancock Post-Consummation	5	286.4 mil.	6.8			
Pensacola Area, Florida—Escambia and Santa Rosa counties.						
Hancock Pre-Consummation	7	275.0 mil.	5.1	1199	42	18
Whitney	8	223.1 mil.	4.1			
Hancock Post-Consummation	4	498.1 mil.	9.2			
Baton Rouge Area, Louisiana— Ascension, East Baton Rouge, Iberville, Livingston, and West Baton Rouge Parishes; the northern half of Assumption Parish, including the towns of Napoleonville, Pierre Part, and Plattenville; and the town of Union in Saint James Parish.						
Hancock Pre-Consummation	4	1.2 bil.	8.3	2100	89	41
Whitney	5	789.0 mil.	5.4			
Hancock Post-Consummation	3	2.0 bil.	13.6			
New Orleans Area, Louisiana—Jefferson, Orleans, Plaquemines, Saint Bernard, Saint Charles, Saint John the Baptist, and Saint Tammany Parishes; and Saint James Parish, excluding the town of Union.						
Hancock Pre-Consummation	12	455.7 mil.	1.7	1653	51	37
Whitney	3	4.1 bil.	15.0			
Hancock Post-Consummation	2	4.5 bil.	16.7			
Lafayette Area, Louisiana — Acadia, excluding the town of Mermentau; Lafayette, Saint Landry, and Vermilion Parish, excluding the town of Gueydan; and the portion of Saint Martin Parish north of Iberia Parish.						
Hancock Pre-Consummation	25	74.0 mil.	1.0	786	10	41
Whitney	5	392.2 mil.	5.3			
Hancock Post-Consummation	4	466.2 mil.	6.2			

Note: Data are as of June 30, 2010. All amounts of deposits are unweighted. All rankings, market deposit shares, and HHIs are based on thrift institution deposits weighted at 50 percent.

Appendix B

Hancock and Whitney Banking Markets Consistent with Board Precedent and DOJ Banking Merger Guidelines After Divestitures

Bank	Rank	Amount of Deposits (dollars)	Market Deposit Shares (percent)	Resulting HHI	Change in HHI	Remaining Number of Competitors
Biloxi, Mississippi — Harrison and Hancock counties and the city of Ocean Springs in Jackson County.						
Pre-Divestiture						
Hancock Pre-Consummation	1	1.7 bil.	46	2973	383	14
Whitney	6	155 mil.	4.1			
Hancock Post-Consummation	1	1.9 bil.	50.2			
Post-Divestiture						
Hancock Post-Consummation	1	1.7 bil.	46	2703 (if sold to in-market purchaser(s)) or 2591 (if sold to out-of-market purchaser(s))	≤ 112 (if sold to in-market purchaser(s)) or 0 (if sold to out-of-market purchaser(s))	14
Branches Divested	6	155 mil. (All Whitney Branches)	4.1			

(continued on next page)

Appendix B—*continued*

Hancock and Whitney Banking Markets Consistent with Board Precedent and DOJ Banking Merger Guidelines After Divestitures—*continued*

Bank	Rank	Amount of Deposits (dollars)	Market Deposit Shares (percent)	Resulting HHI	Change in HHI	Remaining Number of Competitors
Washington Parish, Louisiana— Washington Parish.						
Pre-Divestiture						
Hancock Pre-Consummation	1	149.1 mil.	29.2	2885	797	4
Whitney	4	69.8 mil.	13.7			
Hancock Post-Consummation	1	218.9 mil.	42.8			
Post-Divestiture						
Hancock Post-Consummation	1	172.2 mil.	33.7	2269	181	4
Branch Divested to Out-of-Market Purchaser*	5	46.7 mil. (1 branch)	9.1			

Note: Data are as of June 30, 2010. All amounts of deposits are unweighted. All rankings, market deposit shares, and HHIs are based on thrift institution deposits weighted at 50 percent.

* Hancock has committed to divest the branch to an out-of-market purchaser.

Concurring Statement by Governor Tarullo

I approve the application as presented based on information received by the Board indicating that the institution that proposes to purchase the branches to be divested in the Biloxi area is competitively suitable.

Mitsubishi UFJ Financial Group, Inc.
Tokyo, Japan

Order Approving Acquisition of Interests in a Bank Holding Company and Certain Nonbanking Subsidiaries

Mitsubishi UFJ Financial Group, Inc. ("MUFG"), a foreign banking organization that is a financial holding company for purposes of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire up to 24.9 percent of the voting shares of Morgan Stanley, New York, New York, and thereby indirectly acquire an interest in Morgan Stanley's subsidiary banks, Morgan Stanley Bank, National Association ("MS Bank"), Salt Lake City, Utah; and Morgan Stanley Private Bank, National Association ("MSPB"), Purchase, New York. In addition, MUFG has requested the Board's approval to acquire interests in the nonbanking operations of Morgan Stanley that are engaged in activities described in section 4(k) of the BHC Act.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (76 *Federal Register* 17,418 (2011)). The time for filing comments has expired and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.

MUFG, with total consolidated assets of approximately $2.5 trillion as of March 31, 2011, is the largest banking organization in Japan. MUFG owns the Bank of Tokyo-Mitsubishi UFJ, Ltd. ("BTMU") and Mitsubishi UFJ Trust and Banking Corporation ("MUTB"), both of Tokyo. BTMU operates branches, agencies, and representative offices in several

[1] 12 U.S.C. § 1842.

[2] This notice is required under section 163(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

states.[3] It also controls Bank of Tokyo-Mitsubishi UFJ Trust Company ("BTMUT"), New York, New York, and UnionBanCal Corporation and its subsidiary bank, Union Bank, N.A. ("Union Bank"), both of San Francisco. MUTB operates a branch and controls Mitsubishi UFJ Trust & Banking Corporation (U.S.A.) ("MUTB USA"), both of New York, New York. MUFG controls deposits of approximately $60 billion, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States.[4]

Morgan Stanley, with total consolidated assets of approximately $836 billion, engages in investment banking, securities underwriting and dealing, asset management, trading, and other activities in the United States and abroad.[5] Morgan Stanley controls MS Bank, which operates one branch in Utah, with total assets of approximately $68.6 billion and deposits of approximately $56.7 billion. In addition, Morgan Stanley controls MSPB, with total assets of approximately $7.4 billion and deposits of approximately $6.4 billion.[6]

In 2008, the Board approved MUFG's acquisition of up to 24.9 percent of the voting shares of Morgan Stanley.[7] MUFG consummated its initial investment in Morgan Stanley in 2008 by purchasing two different series of preferred stock, one of which is convertible into common stock. Subsequently, MUFG acquired additional common stock. MUFG is currently deemed to own 19.23 percent of Morgan Stanley's voting shares.[8] MUFG now intends to convert all of its outstanding convertible preferred stock in Morgan Stanley to common shares, after which MUFG would own approximately 22.4 percent of Morgan Stanley's voting shares. In addition, MUFG is seeking authority to acquire, from time to time, additional shares of Morgan Stanley pursuant to an investor agreement in order to maintain a specific level of ownership in Morgan Stanley.[9]

Noncontrolling Investment

MUFG has stated that it does not propose to control or exercise a controlling influence over Morgan Stanley and that its investment in Morgan Stanley will continue to be a passive investment.[10] MUFG has agreed to continue to abide by certain commitments it

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3 BTMU operates branches in California, Illinois, New York, and Washington; agencies in Georgia and Texas; and representative offices in the District of Columbia, Kentucky, Minnesota, New Jersey, and Texas.

4 Deposit data for MUFG's subsidiary banks are as of March 31, 2011.

5 Asset data for Morgan Stanley and asset and deposit data for MS Bank and MSPB are as of March 31, 2011.

6 In addition, Morgan Stanley holds a noncontrolling 9.9 percent interest in a bank holding company, Chinatrust Financial Holding Company, Ltd., Taipei, Taiwan, and a national bank, Herald National Bank, New York, New York. *SeeMorgan Stanley*, 95 *Federal Reserve Bulletin* B86 and B93 (2009).

7 *Mitsubishi UFJ Financial Group, Inc.*, 95*Federal Reserve Bulletin* B34 (2009) ("Mitsubishi UFJ").

8 The authority to make the initial and additional investments expired April 6, 2011.

9 The investor agreement between MUFG and Morgan Stanley would provide MUFG with both (i) preemptive rights to participate in certain securities offerings and (ii) the authority to acquire additional shares of Morgan Stanley in the open market up to the ownership level it would acquire on consummation of the conversion transaction. MUFG will need to preserve a certain ownership level to account for its investment in Morgan Stanley using the equity method of accounting and to comply with its commitment to the Board to maintain its investment at a certain level. MUFG made that commitment in connection with its request to have a second director representative on the board of directors of Morgan Stanley without being deemed to exercise a controlling influence over that company.

10 Although the acquisition of less than a controlling interest in a bank or bank holding company is not a normal acquisition for a bank holding company, the requirement in section 3(a)(3) of the BHC Act that the Board's approval be obtained before a bank holding company acquires more than 5 percent of the voting shares of a bank suggests that Congress contemplated the acquisition by bank holding companies of between 5 percent and 25 percent of the voting shares of banks. *See* 12 U.S.C. § 1842(a)(3). On this basis, the Board previously has approved the acquisition by a bank holding company of less than a controlling interest in a bank or bank holding company. *See*, e.g., *China Investment Corporation*, 96 *Federal Reserve Bulletin* B31 (2010) (acquisition of up to 10 percent of the voting shares of a bank holding company); *Mitsubishi UFJ*, *supra*, (acquisition of up to 24.9 percent of the voting shares of a bank holding company); *Brookline Bancorp, MHC*, 86 *Federal Reserve*

provided in 2008,[11] which are similar to those previously relied on by the Board in determining that an investing company would not be able to exercise a controlling influence over another bank holding company for purposes of the BHC Act.For example, MUFG committed not to exercise or attempt to exercise a controlling influence over the management or policies of Morgan Stanley or any of its subsidiaries. The commitments also included certain restrictions on the business relationships of MUFG with Morgan Stanley.

In connection with the Board's decision in 2008, MUFG committed to have no more than one representative serve on the board of directors of Morgan Stanley or its subsidiaries. After the proposed conversion of convertible preferred shares to common shares, MUFG would have two representatives serving on the board of directors of Morgan Stanley. The Board considered carefully the potential for the proposed change in MUFG's voting power on Morgan Stanley's board to create the ability of MUFG to exercise a controlling influence over Morgan Stanley for purposes of the BHC Act. In reaching its determination that the increased voting power would not have such an effect, the Board considered the size, composition, and expertise of the members of the Morgan Stanley board of directors and the fact that a majority of the members of the board would continue to be independent of management, MUFG, and other investors. The Board also considered that MUFG representatives would represent less than 15 percent of the total membership of the board and that neither MUFG representative would be able to second a motion offered by the other MUFG representative. In addition, an MUFG representative would be able to cast only one vote on any committee or subcommittee of the board. The Board also relied on certain commitments made by MUFG with respect to, among other things, maintaining the level of its voting investment in Morgan Stanley and using reasonable best efforts to assist Morgan Stanley should Morgan Stanley decide to seek additional funding from other sources.[12]

Based on these facts and commitments, the Board has determined that it would not at this time initiate a control proceeding in this case based on the structure of the proposed investment. The Board notes that the BHC Act would require MUFG to file an application and receive the Board's approval before MUFG may directly or indirectly acquire additional shares of Morgan Stanley above the proposed investment level or attempt to exercise a controlling influence over Morgan Stanley or any of its subsidiaries.[13]

Competitive Considerations

The Board has considered carefully the competitive effects of the proposal in light of all the facts of record. Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[14]

Bulletin 52 (2000) (acquisition of up to 9.9 percent of the voting shares of a bank holding company); *Mansura Bancshares, Inc.*, 79 *Federal Reserve Bulletin* 37 (1993) (acquisition of 9.7 percent of the voting shares of a bank holding company).

[11] MUFG provided passivity commitments in 2008 in connection with the Board's approval of its application to acquire up to 24.9 percent of the voting shares of Morgan Stanley. *See Mitsubishi UFJ, supra*.

[12] *See* Board letter to H. Rodgin Cohen, Esq., dated April 22, 2011.

[13] 12 U.S.C. § 1842. *See*, e.g., *Emigrant Bancorp, Inc.*, 82 *Federal Reserve Bulletin* 555 (1996).

[14] 12 U.S.C. § 1842(c)(1).

The Board previously has stated that one company need not acquire control of another company to lessen competition between them substantially.[15] The Board has found that noncontrolling interests in directly competing depository institutions may raise serious questions under the BHC Act and has stated that the specific facts of each case will determine whether the minority investment in a company would be anticompetitive.[16] Because the subsidiary insured depository institutions of MUFG and Morgan Stanley compete directly in the metropolitan New York-New Jersey-Pennsylvania-Connecticut ("Metro New York") banking market,[17] the Board reviewed carefully the competitive effects of the proposal in the Metro New York banking market in connection with the approval granted MUFG in 2008. In particular, the Board considered the number of competitors that would remain in the banking market, the relative shares of total deposits in depository institutions in the market ("market deposits") controlled by MUFG and Morgan Stanley, and the concentration level of market deposits and the increase in the level as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines").

In connection with the current application, the Board has again considered the facts related to the relevant banking markets and has determined that consummation of this proposal is consistent with Board precedent[18] and within the thresholds of the DOJ Guidelines in the Metro New York banking market.[19] On consummation, the Metro New York banking market would remain moderately concentrated, and numerous competitors would remain in the market.[20]

The DOJ also has reviewed the proposal and has advised the Board that it does not believe that MUFG's ownership interest in Morgan Stanley is likely to have a significant adverse effect on competition in any relevant banking or other market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board has concluded that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration

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[15] *See* e.g., *Sun Trust Banks, Inc.*, 76 *Federal Reserve Bulletin* 542 (1990).

[16] *See* e.g., *BOK Financial Corp.*, 81*Federal Reserve Bulletin* 1052, 1053-54 (1995).

[17] The Metro New York banking market includes Bronx, Dutchess, Kings, Nassau, New York, Orange, Putnam, Queens, Richmond, Rockland, Suffolk, Sullivan, Ulster, and Westchester counties in New York; Bergen, Essex, Hudson, Hunterdon, Middlesex, Monmouth, Morris, Ocean, Passaic, Somerset, Sussex, Union, and Warren counties and the northern portion of Mercer County in New Jersey; Monroe and Pike counties in Pennsylvania, and Fairfield County and portions of Litchfield and New Haven counties in Connecticut.

[18] Deposit and market share data are as of June 30, 2010, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See*, e.g., *Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386, 387 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743, 744 (1984). The Board regularly has included thrift institution deposits in the market share calculation on a 50 percent weighted basis. *See*, e.g., *First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52, 55 (1991).

[19] Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. Although the DOJ and the Federal Trade Commission recently issued revised Horizontal Merger Guidelines, the DOJ has confirmed that the DOJ Bank Merger Guidelines, which were issued in 1995, were not changed. DOJ press release (August 19, 2010), available at www.justice.gov/opa/pr/2010/August/10-at-938.html.

[20] On consummation, the HHI would remain unchanged at 1299, and 273 insured depository institution competitors would remain in the Metro New York banking market. The deposits of MUFG and Morgan Stanley, on a combined basis, would represent less than 1 percent of market deposits.

of resources in any relevant banking market and that competitive considerations are consistent with approval.[21]

Financial, Managerial, and Other Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including supervisory and examination information from various U.S. banking supervisors of the institutions involved, publicly reported and other financial information, and information provided by MUFG. In addition, the Board has consulted with the Japanese Financial Services Agency ("FSA"), the agency with primary responsibility for the supervision and regulation of Japanese banking organizations, including MUFG.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary banks and significant nonbanking operations. The Board also evaluates the financial condition of the pro forma organization, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transactions. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important.

The Board has carefully considered the financial factors of the proposal. The capital levels of MUFG exceed the minimum levels that would be required under the Basel Capital Accord and are considered to be equivalent to the capital levels that would be required of a U.S. banking organization. In addition, the subsidiary depository institutions involved in the proposal are well capitalized and would remain so on consummation. Based on its review of the record, the Board finds that MUFG has sufficient financial resources to effect the proposal.

The Board also has considered the managerial resources of the organizations involved. The Board has reviewed the examination records of MUFG and its subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking law, including anti-money-laundering laws. Based on all the facts of record, the Board has concluded that considerations relating to the managerial resources and future prospects of the organizations involved are consistent with approval.[22]

[21] Competitive considerations in nonbanking markets are set forth in the discussion on nonbanking activities.

[22] A commenter asserted that recently announced losses at a joint venture between MUFG and Morgan Stanley reflect poorly on MUFG's managerial capacity and its ability to avoid predatory lending. MUFG has reviewed management and controls at the joint venture and has strengthened its risk-management framework. In addition, MUFG has increased the amount of capital held by the joint venture. There appears to be no relationship between the losses at the joint venture, which engages in securities activities in Japan, and predatory lending, as asserted by the commenter.

The commenter also referred to news reports regarding Morgan Stanley's mortgage servicer, Saxon Mortgage Services, Inc., with respect to a class action lawsuit involving the Home Affordable Modification Program and a lawsuit under the Servicemembers Civil Relief Act. In addition, the commenter referred to a settlement by Morgan Stanley with the Office of the Attorney General of the Commonwealth of Massachusetts regarding allegedly unfair residential mortgage loans. As noted above, MUFG does not control the operations of Morgan Stanley and cannot exercise a controlling influence over its management. Moreover, as part of its ongoing supervision of Morgan Stanley, the Board monitors the status of government investigations, consults as needed with relevant regulatory authorities, and periodically reviews Morgan Stanley's liability from material litigation.

Section 3 of the BHC Act also provides that the Board may not approve an application involving a foreign bank unless the bank is subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in the bank's home country.[23] The FSA is the primary supervisor of Japanese banking organizations. The Board previously has determined that BTMU and MUTB are subject to comprehensive supervision on a consolidated basis by their home-country supervisor.[24] In that determination, the Board took into account the FSA's supervisory authority with respect to MUFG (operating at the time as Mitsubishi Tokyo Financial Group, Inc.) and its nonbanking subsidiaries.[25] Based on this finding and all the facts of record, the Board has concluded that BTMU and MUTB continue to be subject to comprehensive supervision on a consolidated basis by their home-country supervisor. As noted, the FSA is the primary supervisor of Japanese banking organizations, including holding companies such as MUFG.[26] The FSA may conduct inspections of MUFG and its subsidiaries and require MUFG to submit reports about its operations on a consolidated basis. The FSA also may review transactions between MUFG and its subsidiaries and has authority to require MUFG to take measures necessary to ensure the safety and soundness of the MUFG organization. Based on all the facts of record, the Board has determined that MUFG is subject to comprehensive supervision on a consolidated basis by its appropriate home-country authorities for purposes of this application.[27]

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved are consistent with approval, as are the other supervisory factors under the BHC Act.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant depository institutions under the Community

Finally, the commenter raised allegations that are outside the limited statutory factors that the Board is authorized to consider when reviewing an application under the BHC Act. *See*, e.g., *The Royal Bank of Scotland Group plc*, 90 *Federal Reserve Bulletin* 87, 88 n.16 (2004); *The Royal Bank of Scotland Group plc,* 89 *Federal Reserve Bulletin* 386, 389 n.26 (2003); *Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

[23] 12 U.S.C. § 1842(c)(3)(B). As provided in Regulation Y, the Board determines whether a foreign bank is subject to consolidated home-country supervision under the standards set forth in Regulation K. *See* 12 CFR 225.13(a)(4). Regulation K provides that a foreign bank will be considered subject to comprehensive supervision or regulation on a consolidated basis if the Board determines that the bank is supervised or regulated in such a manner that its home-country supervisor receives sufficient information on the worldwide operations of the bank, including its relationship with any affiliates, to assess the bank's overall financial condition and its compliance with laws and regulations. *See* 12 CFR 211.24(c)(1).

[24] *See Mitsubishi Tokyo Financial Group, Inc.*, 87 *Federal Reserve Bulletin* 349 (2001). At that time, BTMU was named The Bank of Tokyo-Mitsubishi, Ltd. and MUTB was named The Mitsubishi Trust and Banking Corporation.

[25] *Id.*

[26] *See*, e.g., *Chuo Mitsui Trust Holdings, Inc.*, (Order dated March 15, 2011).

[27] Section 3 of the BHC Act also requires the Board to determine that an applicant has provided adequate assurances that it will make available to the Board such information on its operations and activities and those of its affiliates that the Board deems appropriate to determine and enforce compliance with the BHC Act (12 U.S.C. § 1842(c)(3)(A)). The Board has reviewed the restrictions on disclosure in the relevant jurisdictions in which MUFG operates and has communicated with relevant government authorities concerning access to information. In addition, MUFG previously has committed that, to the extent not prohibited by applicable law, it will make available to the Board such information on the operations of its affiliates that the Board deems necessary to determine and enforce compliance with the BHC Act, the International Banking Act, and other applicable federal laws. MUFG also previously has committed to cooperate with the Board to obtain any waivers or exemptions that may be necessary to enable its affiliates to make such information available to the Board. In light of these commitments, the Board has concluded that MUFG has provided adequate assurances of access to any appropriate information the Board may request.

Reinvestment Act ("CRA").[28] The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, in evaluating bank expansionary proposals.[29]

The Board has carefully considered the convenience and needs factor and the CRA performance records of the relevant insured depository institutions. MUFG's subsidiary banks each received "outstanding" or "satisfactory" ratings,[30] and MS Bank received an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of January 25, 2010.[31] In addition, consummation of the proposal would strengthen the financial resources of Morgan Stanley by converting preferred stock to voting common shares and better enable its depository institution subsidiaries to provide services to and to assist in meeting the credit needs of their communities.

Based on all the facts of record, the Board has concluded that considerations relating to convenience and needs of the communities to be served and the CRA performance records of the relevant depository institutions are consistent with approval of the proposal.

Nonbanking Activities

Morgan Stanley engages in nonbanking activities that are financial in nature as described in section 4(k)(4) of the BHC Act.[32] Section 4(k)(6) of the BHC Act generally permits financial holding companies such as MUFG to acquire shares of companies that conduct activities that are financial in nature without prior Board approval.[33] Section 163(b) of the Dodd-Frank Act, however, contains an exception to this rule that requires prior Board approval of an acquisition by a bank holding company with assets of $50 billion or more of shares of any company with assets of at least $10 billion that is engaged in activities described in section 4(k) of the BHC Act. MUFG and Morgan Stanley exceed those asset thresholds and, accordingly, the proposal requires the Board's prior approval.

In reviewing a notice under section 163(b) of the Dodd-Frank Act, the Board is required to consider the standards listed in section 4(j)(2) of the BHC Act.[34] Accordingly, the Board has considered carefully whether the proposed acquisition "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."[35] In addition, the Board has considered the extent to which the proposed acquisition

[28] 12 U.S.C. § 1842(c)(2); 12 U.S.C. §§ 2901 et seq.

[29] 12 U.S.C. § 2903.

[30] The most recent CRA performance evaluations of its insured depository subsidiaries are as follows: (1) Union Bank ("outstanding") by the Office of the Comptroller of the Currency ("OCC") as of June 2009; (2) BTMUT ("outstanding") by the Federal Deposit Insurance Corporation ("FDIC") as of July 2010; and (3) MUTB USA ("satisfactory") by the FDIC as of December 2006.

[31] MS Bank became a national bank on September 23, 2008, on its conversion from a Utah-chartered industrial bank. MSPB became a national bank on July 1, 2010, on its conversion from a limited-purpose savings association that was not subject to the CRA. MSPB has not yet been evaluated under the CRA by the OCC.

[32] 12 U.S.C. § 1843(k)(4).

[33] 12 U.S.C. § 1843(k)(6).

[34] The Dodd-Frank Act § 163(b)(4).

[35] 12 U.S.C. § 1843(j)(2).

"would result in greater or more concentrated risks to global or United States financial stability or the United States economy."[36]

As part of its review of the factors enumerated in section 4(j)(2) of the BHC Act, the Board has considered carefully the financial and managerial resources of the companies involved, the effect of the proposal on competition in the relevant markets, and the public benefits of the proposal. As previously noted, the Board has concluded, based on its review of the record, that considerations relating to the financial and managerial resources of the organizations involved in the proposal are consistent with approval.

In addition, the Board carefully considered the competitive effects of MUFG's proposed acquisition of additional voting shares of Morgan Stanley. In the United States, MUFG's operations consist primarily of commercial banking through its retail banking subsidiary in California. Morgan Stanley does not engage in retail banking to any significant extent. Moreover, Morgan Stanley engages extensively in nonbank financial activities. MUFG has a limited presence in such activities in the United States. As a result, even if MUFG were to be considered to control Morgan Stanley, a combination of the two firms would be unlikely to raise competitive issues. The proposed marginal increase in the percentage of Morgan Stanley's shares that would be held by MUFG would have no significant competitive effects in any relevant market. As a result, the Board expects that consummation of the proposal would have a de minimis effect on competition for these services.

The Board also has reviewed carefully the public benefits and possible adverse effects of the proposal. The record indicates that consummation of the proposal would strengthen Morgan Stanley's capital position and allow Morgan Stanley to better serve its customers. For the reasons discussed above, and based on all the facts of record, the Board has determined that consummation of the proposal is not likely to result in significant adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices, and that consummation of the proposal can reasonably be expected to produce public benefits that would outweigh any likely adverse effects. Accordingly, the Board has determined that the balance of public benefits is consistent with approval.

As required by section 163(b) of the Dodd-Frank Act, the Board also has considered the extent to which the proposed acquisition would result in greater or more concentrated risks to global or United States financial stability or to the United States economy. In its review under this factor, the Board has considered whether the proposal would result in a material increase in risks to financial stability, due to an increase in the size of the acquirer or in the extent of the interconnectedness of the financial system, or in a reduction in the availability of substitute providers of critical financial products or services. As discussed above, MUFG has stated that it does not propose to control or exercise a controlling influence over Morgan Stanley and would need Board approval before acquiring control or exercising a controlling influence. Consummation of this proposal would not result in a significant decrease in the availability of substitute providers of critical financial services or a significant increase in the size of MUFG because MUFG will not control Morgan Stanley. For the same reason, and because the increase in MUFG's and Morgan Stanley's economic exposure to each other would be relatively small, this proposal will not result in a significant increase in the interconnectedness of the financial system. As a result, the Board has concluded that the change in the risk to global or United States financial stability or to the United States economy associated with this transaction would be inconsequential. Based

[36] The Dodd-Frank Act § 163(b)(4).

on all the facts or record, the Board concludes that the considerations under this factor are consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the proposal should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes.[37] The Board's approval is specifically conditioned on compliance by MUFG with all the commitments made to and relied on by the Board in connection with the application.[38] For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated before the fifteenth calendar day after the effective date of this order. The conversion transaction must be consummated no later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of San Francisco ("Reserve Bank"), acting pursuant to delegated authority. Subject to the conversion transaction being consummated within that three-month period, MUFG may acquire additional shares up to 24.9 percent of the voting shares of Morgan Stanley within one year after the effective date of this order, such period subject to extension for good cause by the Board or the Reserve Bank, acting pursuant to delegated authority.[39]

By order of the Board of Governors, effective June 14, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, and Raskin.

Robert deV. Frierson
Deputy Secretary of the Board

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[37] The commenter requested that the Board extend the comment period on the proposal. In the Board's view, the commenter has had ample opportunity to submit its views and, in fact, has provided written submissions that the Board has carefully considered in acting on the proposal. Moreover, the BHC Act and Regulation Y require the Board to act on proposals submitted under those provisions within certain time periods. Based on a review of all the facts of record, the Board has concluded that the record in this case is sufficient to warrant action at this time and that further delay in considering the proposal, extension of the comment period, or denial of the proposal on the grounds discussed above, is not warranted.

[38] The commenter also requested that the Board hold a public hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a written recommendation of denial of the application. The Board has not received such a recommendation from the appropriate supervisory authorities. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if necessary or appropriate to clarify the factual issues related to the application and to provide an opportunity for testimony (12 CFR 223.16(e), 262.25(d)). As noted above, MUFG will not be acquiring control of Morgan Stanley or its depository institutions, and the commenter's request fails to demonstrate why written comments do not present its views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the request for a public meeting or hearing on the proposal is denied.

[39] No further approval would be required for MUFG to acquire shares to comply with its commitment to the Board to maintain an investment in at least 20 percent of the voting common equity of Morgan Stanley and to use its reasonable best efforts to honor a Board request to provide additional capital to preserve the maximum level of ownership of total equity of Morgan Stanley that MUFG achieved before the date of the Board's request. *See* Board letter to H. Rodgin Cohen, Esq., *supra*.

United Bankshares, Inc.
Charleston, West Virginia

Order Approving the Acquisition of a Bank Holding Company

United Bankshares, Inc. ("United") and its wholly owned subsidiary, UBC Holding Company, Inc. ("UBC"), both of Charleston, have requested the Board's approval under section 3 of the Bank Holding Company Act ("BHC Act")[1] to acquire Centra Financial Holdings, Inc. ("Centra") and its subsidiary bank, Centra Bank, Inc. ("Centra Bank"), both of Morgantown, and all of West Virginia.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (76 *Federal Register* 20350 (2011)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

United, with total consolidated assets of approximately $7.2 billion, is the 92nd largest insured depository organization in the United States, controlling $5.7 billion in deposits.[3] United controls two subsidiary banks, United Bank, Inc. ("UB-WV"), Parkersburg, West Virginia, and United Bank ("UB-VA"), Fairfax, Virginia, that operate in West Virginia, Maryland, Ohio, Virginia, and the District of Columbia.[4] United is the 2nd largest depository organization in West Virginia, controlling deposits of approximately $2.9 billion, which represent 10.1 percent of the total amount of deposits of insured depository institutions in the state. United is the 19th largest depository organization in Maryland, controlling deposits of approximately $479.2 million, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the state.

Centra, with total consolidated assets of $1.3 billion, controls Centra Bank, which operates in West Virginia, Maryland, and Pennsylvania. Centra Bank is the 9th largest insured depository institution in West Virginia, the 71st largest insured depository institution in Maryland, and the 99th largest insured depository institution in Pennsylvania, controlling deposits of $718.5 million, $116.4 million, and $341.0 million, respectively.

On consummation of the proposal, United would become the 81st largest depository organization in the United States, with total consolidated assets of approximately $8.6 billion. United would control deposits of approximately $6.8 billion, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States. In West Virginia, United would remain the 2nd largest depository organization, controlling deposits of approximately $3.6 billion (approximately 12.6 percent of deposits of insured depository institutions in the state); in Maryland, it would remain the 19th largest depository organization, controlling deposits of approximately $595.6 million (less than 1 percent of deposits of insured depository institutions in the state); and in Pennsylvania, it would become the 99th largest depository organization, controlling deposits of approxi-

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1 12 U.S.C. § 1842.

2 Specifically, United has requested that Centra and its four second-tier holding companies, Centra Financial Corporation-Hagerstown, Inc.; Centra Financial Corporation-Martinsburg, Inc.; Centra Financial Corporation-Morgantown, Inc.; and Centra Financial Corporation-Uniontown, Inc., all of Morgantown, merge with and into UBC.

3 Deposit data are as of June 30, 2010, updated to reflect mergers through April 23, 2011. In this context, insured depository institutions include commercial banks, savings associations, and savings banks. National deposit data and rankings are as of December 31, 2010.

4 UB-WV operates in West Virginia and Ohio. UB-VA operates in Maryland, Virginia, and the District of Columbia.

mately $341.0 million (less than 1 percent of deposits of insured depository institutions in the state).

Interstate Analysis

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the bank holding company's home state if certain conditions are met. For purposes of the BHC Act, the home state of United is West Virginia,[5] and Centra is located in West Virginia, Maryland, and Pennsylvania.[6] Based on a review of all the facts of record, including relevant state statutes, the Board finds that the conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[7]

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly. The BHC Act also prohibits the Board from approving a proposed bank acquisition that would substantially lessen competition in any relevant banking market unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[8]

United and Centra have subsidiary depository institutions that compete directly in two West Virginia banking markets: the Martinsburg and the Morgantown banking markets. The Board has reviewed carefully the competitive effects of the proposal in these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking markets, the relative shares of total deposits in depository institutions in the markets ("market deposits") controlled by United and Centra,[9] the concentration levels of market deposits and the increase in those levels as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[10] and other characteristics of the markets.

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[5] A bank holding company's home state is the state in which the total deposits of all banking subsidiaries of such company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later (12 U.S.C. § 1841(o)(4)(C)).

[6] For purposes of section 3(d) of the BHC Act, the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch (12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and 1842(d)(2)(B)).

[7] 12 U.S.C. §§ 1842(d)(1)(A)–(B) and 1842(d)(2)–(3). United is adequately capitalized and adequately managed, as defined by applicable law. Centra Bank has been in existence and operated for the minimum period of time required by applicable state laws and for more than five years. *See* 12 U.S.C. § 1842(d)(1)(B)(i)–(ii). On consummation of the proposal, United would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States (12 U.S.C. §1842(d)(2)(A)). United also would control less than 30 percent of, and less than the applicable state deposit cap for, the total amount of deposits in insured depository institutions in the relevant states (12 U.S.C. § 1842(d)(2)(B)-(D)). All other requirements of section 3(d) of the BHC Act would be met on consummation of the proposal.

[8] 12 U.S.C. § 1842(c)(1).

[9] Deposit and market share data are as of June 30, 2010, updated to reflect mergers through April 23, 2011.

[10] Under the DOJ Guidelines, a market is considered unconcentrated if the postmerger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally would not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. Although the DOJ and the Federal Trade Commission recently issued revised Horizontal Merger Guidelines, the DOJ has confirmed that its guidelines for bank mergers or acquisitions, which were issued in 1995, were not changed. Press Release, Department of Justice (August 19, 2010), available at www.justice.gov/opa/pr/2010/August/10-at-938.html.

A. Banking Market within Established Guidelines

Consummation of the proposal would be consistent with Board precedent and within the DOJ Guidelines in the Martinsburg banking market.[11] On consummation of the proposal, the market would remain moderately concentrated, as measured by the HHI. The change in the HHI in the market would be consistent with Board precedent and the thresholds in the DOJ Guidelines, and a number of competitors would remain.[12]

B. Banking Market Warranting Special Scrutiny

The structural effects that consummation of the proposal would have on the Morgantown banking market[13] warrant a detailed review because the concentration level on consummation would exceed the threshold levels in the DOJ Guidelines. UBWV is the sixth largest insured depository institution in the Morgantown banking market, controlling deposits of approximately $184.3 million, which represent approximately 8.1 percent of the market deposits. Centra Bank is the largest depository institution in the market, controlling deposits of approximately $535.4 million, which represent approximately 23.6 percent of market deposits. On consummation, the HHI in this market would increase 383 points, from 1719 to 2102, and the pro forma market share of the combined entity would be approximately 31.7 percent.

The Board has considered carefully whether other factors either mitigate the competitive effects of the proposal or indicate that the proposal would have a significantly adverse effect on competition in the Morgantown banking market.[14] Several factors indicate that the increase in concentration in the Morgantown banking market, as measured by the HHI and market share, overstates the potential competitive effects of the proposal in the market. After consummation of the proposal, eight other commercial bank competitors would remain, some with a significant presence in the market. The second largest bank competitor in the market would control 22 percent of market deposits, and three other bank competitors in the market each would control between 9 percent and 17 percent of market deposits.

In addition, the Board has evaluated the competitive influence of two active community credit unions in the Morgantown banking market: The United Federal Credit Union ("United Credit Union"), Morgantown, and Fairmont Federal Credit Union ("Fairmont Credit Union"), Fairmont. Both credit unions offer a wide range of products, operate at least one street-level branch, and have broad membership criteria that include most of the residents in the Morgantown banking market.[15] Moreover, Fairmont Credit Union is a sig-

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[11] The Martinsburg banking market is defined as Berkeley County, West Virginia, excluding the portion of that county included in the Hagerstown Rand McNally Marketing Area ("RMA").

[12] UB-WV would be the second largest depository institution in the market, controlling deposits of $218.4 million, which would represent approximately 20.9 percent of market deposits. The HHI would increase 25 points to 1764.

[13] The Morgantown banking market is defined as the Morgantown RMA and the nonRMA portions of Monongalia and Preston counties, West Virginia.

[14] The number and strength of factors necessary to mitigate the competitive effects of a proposal depend on the size of the increase in, and resulting level of, concentration in a banking market. *SeeNationsBank Corp.*, 84 *Federal Reserve Bulletin* 129 (1998).

[15] The Board previously has considered the competitiveness of certain active credit unions as a mitigating factor. *See*, e.g., *The PNC Financial Services Group, Inc.*, 93 *Federal Reserve Bulletin* C65 (2007); *Regions Financial Corporation*, 93 *Federal Reserve Bulletin* C16 (2007); *Wachovia Corporation*, 92 *Federal Reserve Bulletin* C183 (2006); and *F.N.B. Corporation,* 90 *Federal Reserve Bulletin* 481 (2004).

nificant source of commercial loans,[16] and competition from that credit union closely approximates competition from a commercial bank. Accordingly, the Board has concluded that deposits controlled by this institution should be weighted at 100 percent in market-share calculations.[17] The Board has also concluded that the activities of such credit unions exert a competitive influence that mitigates, in part, the potential effects of the proposal.[18]

In addition, the record of recent entry into the Morgantown banking market indicates the market's attractiveness for entry. The Board notes that five depository institutions have entered the market de novo since 2000. Other factors indicate that the market remains attractive for entry. From 2003 to 2008, the Morgantown banking market's population grew twice as fast as other metropolitan areas in West Virginia, and the market's annualized rates of deposit growth and income growth exceeded the averages for other urban areas in West Virginia and the averages for all metropolitan areas in the United States.

C. View of Other Agencies and Conclusion on Competitive Considerations

The DOJ also has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agency has been afforded an opportunity to comment and has not objected to the proposal.

Based on these and other facts of record, the Board has concluded that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any relevant banking market. Accordingly, based on all the facts of record, the Board has determined that competitive considerations are consistent with approval.

Financial, Managerial, and Other Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and banks involved in the proposal and certain other supervisory factors.[19] The Board has carefully considered these factors in light of all the facts of record, including supervisory and examination information received from the relevant federal and state supervisors of the organizations involved in the proposal, and other available financial information, including information provided by United.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary depository institutions and the organizations' significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and

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[16] Fairmont Credit Union has a ratio of commercial and industrial loans to assets of approximately 6 percent, which is comparable to the ratio for some commercial banks in the market and greater than the ratio for some thrift institutions that the Board has previously found to be full competitors of commercial banks.

[17] The Board has previously indicated that it may consider the competitiveness of a thrift institution at a level greater than 50 percent of deposits when appropriate. *See*, e.g., *Banknorth Group, Inc.*, 75 *Federal Reserve Bulletin* 703 (1989). As noted, Fairmont Credit Union's commercial-loan-to-asset ratio is higher than the ratio for many thrift institutions that have been weighted at 100 percent in past Board orders. *See*, e.g., *The PNC Financial Services Group, Inc.*, *supra*.

[18] These credit unions control approximately $68.1 million in deposits in the market that, on a 50 percent weighted basis for United Credit Union and a 100 percent weighted basis for Fairmont Credit Union, represent approximately 2.6 percent of market deposits. Accounting for the revised weightings of these deposits, United would control approximately 30.9 percent of market deposits, and the HHI would increase 363 points to 1996.

[19] 12 U.S.C. § 1842(c)(2) and (3).

earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the proposal under the financial factors. United, Centra, and their subsidiary depository institutions are well capitalized and would remain so on consummation of the proposal. The proposed transaction is structured as a share exchange. Based on its review of the record, the Board also finds that United has sufficient financial resources to effect the proposal.

The Board also has considered the managerial resources of the organizations involved and of the proposed combined organization. The Board has reviewed the examination records of United, Centra, and their subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant bank supervisory agencies with the organizations and their records of compliance with applicable banking law, including anti-money-laundering laws. United and its subsidiary depository institutions are considered to be well managed. The Board also has considered United's plans for implementing the proposal, including the proposed management after consummation of the proposal. In addition, the Board has considered the future prospects of the organizations involved in the proposal in light of the financial and managerial resources and the proposed business plan.

Based on all the facts of record, the Board concludes that consideration relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

Convenience and Needs and CRA Performance Considerations

In acting on a proposal under section 3 of the BHC Act, the Board must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant depository institutions under the Community Reinvestment Act ("CRA").[20] The Board has carefully considered the convenience and needs factor and the CRA performance records of UB-WV, UB-VA, and Centra Bank in light of all the facts of record. As provided in the CRA, the Board evaluates the record of performance of an institution in light of examinations by the appropriate federal supervisors of the CRA performance records of the relevant institutions.[21] UBWV, UB-VA, and Centra Bank received "satisfactory" ratings at their most recent examinations for CRA performance by the Federal Reserve Bank of Richmond (UB-WV and UB-VA) and the Federal Deposit Insurance Corporation (Centra Bank), as of February 2, 2009, February 2, 2009, and July 16, 2008, respectively. Based on a review of the entire record, the Board has concluded that considerations relating to convenience and needs considerations and the CRA performance records of UB-WV, UB-VA, and Centra Bank are consistent with approval of the proposal.

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[20] 12 U.S.C. §§ 2901 et seq.; 12 U.S.C. § 1842(c)(2).

[21] The Interagency Questions and Answers Regarding Community Reinvestment provide that an institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, onsite evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor. 75 *FederalRegister* 11642 at 11665 (2010).

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application under section 3 of the BHC Act should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by United with all the conditions imposed in this order and all the commitments made to the Board in connection with the application and on receipt of all other required regulatory approvals for the proposal. These conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Richmond, acting pursuant to delegated authority.

By order of the Board of Governors, effective June 20, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, and Raskin.

Robert deV. Frierson
Deputy Secretary of the Board

Orders Issued Under Sections 3 and 4 of the Bank Holding Company Act

Bank of Montreal
Toronto, Canada

Order Approving the Acquisition of a Bank Holding Company and Notice to Engage in Nonbanking Activities

Bank of Montreal, Toronto, Canada, and its subsidiaries, Harris Financial Corp. ("HFC"), Harris Bankcorp, Inc. ("HBI"), and Mike Merger Sub, LLC ("Interim Sub"), all of Chicago, Illinois (collectively, "Applicants"), have requested the Board's approval under section 3 of the Bank Holding Company Act ("BHC Act")[1] to acquire Marshall & Ilsley Corporation ("M&I"), Milwaukee, and its two subsidiary banks, M&I Marshall & Ilsley Bank ("M&I Bank"), Milwaukee, and M&I Bank of Mayville, Mayville, all of Wisconsin.[2] In addition, Applicants have requested the Board's approval under sections 4(c)(8) and 4(j) of the BHC Act and section 225.24 of the Board's Regulation Y to acquire M&I's subsidiary savings bank, M&I Bank FSB ("M&I Savings Bank"), Las Vegas, Nevada, and other nonbanking subsidiaries of M&I and thereby engage in activities in accordance with section 225.28(b) of the Board's Regulation Y.[3] Harris Bank also has given notice under sec-

[1] 12 U.S.C. § 1842. Applicants also have requested the Board's approval to hold and exercise options that allow Bank of Montreal to purchase up to 19.7 percent of M&I's outstanding common stock, if certain events occur. The options would expire on consummation of M&I's merger with Interim Sub.

[2] Bank of Montreal, HFC, and HBI are financial holding companies within the meaning of the BHC Act. Interim Sub is being established to facilitate the M&I acquisition. Interim Sub has requested the Board's approval under section 3 of the BHC Act to become a bank holding company through the merger of M&I with and into Interim Sub. Interim Sub would then merge with and into HFC.

[3] 12 U.S.C. §§ 1843(c)(8) and (j); 12 CFR 225.24 and 28(b). *See* Appendix A for a list of these subsidiaries and their respective activities. Applicants also propose to acquire certain other M&I subsidiaries in accordance with

tion 25 of the Federal Reserve Act ("FRA") and section 211.3 of Regulation K in order to continue to operate M&I Bank's foreign branch in the Cayman Islands.[4]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (76 *Federal Register* 10,595 (2011)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in the BHC Act.

Bank of Montreal, with total consolidated assets equivalent to $436 billion, is the 4th largest depository organization in Canada.[5] Bank of Montreal operates branches in New York City and Chicago, an agency in Houston, and through HFC and HBI, controls Harris Bank, Harris Bank Arizona, and Harris Central National Association ("Harris Central"), Roselle, Illinois. HFC, with total consolidated assets of $74 billion, is the 29th largest depository organization in the United States, controlling $30.5 billion in deposits.[6] Harris Bank operates in Illinois, Indiana, and Wisconsin; and Harris Bank Arizona operates in Arizona, Florida, and Washington. Harris Central operates only in Illinois. HFC is the 3rd largest depository organization in Illinois, controlling deposits of approximately $26.8 billion. In Indiana, HFC is the 15th largest depository organization, controlling deposits of approximately $1.8 billion, and in Wisconsin, it is the 10th largest depository organization, controlling deposits of approximately $1.4 billion. In Arizona, HFC is the 18th largest depository organization, controlling deposits of approximately $407 million, and in Florida, it is the 214th largest depository organization, controlling deposits of approximately $114 million.

M&I has total consolidated assets of approximately $49.7 billion, and its subsidiary insured depository institutions operate in nine states.[7] M&I is the 326th largest depository organization in Illinois, controlling deposits of approximately $98 million. In Indiana, M&I is the 13th largest depository organization, controlling deposits of approximately $1.87 billion, and in Wisconsin, it is the largest depository organization, controlling deposits of approximately $24.16 billion. In Arizona, M&I is the 6th largest depository organization, controlling deposits of approximately $2.66 billion, and in Florida, it is the 33rd largest depository organization, controlling deposits of approximately $1.65 billion.

On consummation of the proposal, HFC would become the 22nd largest depository organization in the United States in terms of assets, with total consolidated assets of approximately $126.2 billion. HFC would control deposits of approximately $70 billion, which represent approximately 1 percent of the total amount of deposits of insured depository institutions in the United States. In Illinois, HFC would remain the 3rd largest depository organization, controlling deposits of approximately $26.9 billion, which represent approximately 7.5 percent of the total amount of deposits of insured depository institutions in the

section 4(k) of the BHC Act, 12 U.S.C. § 1843(k). As part of this proposal, HFC would purchase all of M&I's preferred shares and associated warrants acquired by the Department of the Treasury under Treasury's Capital Purchase Program.

4 12 U.S.C. §§ 601-604a; 12 CFR 211.3. M&I Bank and M&I Savings Bank would be contributed by HFC to HBI. M&I Savings Bank would then convert into a national bank, and M&I Bank, the former M&I Savings Bank, and The Harris Bank, National Association ("Harris Bank Arizona"), Scottsdale, Arizona, would merge into Harris National Association ("Harris Bank"), Chicago. Bank of Montreal has filed the required applications with the Office of the Comptroller of the Currency ("OCC") and the Office of Thrift Supervision ("OTS") to effect those transactions.

5 Canadian asset and ranking data are as of April 30, 2011, and are based on the exchange rate as of that date.

6 Asset data are as of March 31, 2011, and nationwide deposit ranking data are as of June 30, 2010. Statewide deposit and ranking data are as of June 30, 2010, and reflect merger activity as of March 29, 2011.

7 M&I Bank operates in Arizona, Florida, Illinois, Indiana, Kansas, Minnesota, Missouri, and Wisconsin. M&I Bank of Mayville also operates in Wisconsin. In addition, M&I Savings Bank operates in Nevada, Minnesota, and Wisconsin.

state ("state deposits"). HFC would also become the 5th largest depository organization in Indiana, controlling deposits of approximately $3.67 billion (approximately 3.7 percent of state deposits); in Wisconsin, it would become the largest depository organization, controlling deposits of approximately $25.6 billion (approximately 20.2 percent of state deposits); in Arizona, it would become the 6th largest depository organization, controlling deposits of approximately $3.1 billion (approximately 3.6 percent of state deposits); and in Florida, it would become the 31st largest depository organization, controlling deposits of approximately $1.76 billion (less than 1 percent of state deposits).

Interstate Analysis

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the bank holding company's home state if certain conditions are met. For purposes of the BHC Act, the home state of Applicants is Illinois,[8] and M&I's subsidiary banks are located in eight states.[9]

Based on a review of all the facts of record, including relevant state statutes, the Board finds that the conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[10] In light of all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

Competitive Considerations

The BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by its probable effect in meeting the convenience and needs of the community to be served.[11] The Board also must consider the competitive effects of a proposal to acquire a savings association under the public benefits factor of section 4 of the BHC Act.

Applicants and M&I have subsidiary depository institutions that compete directly in thirteen banking markets, including markets in Arizona, Florida, Indiana, and Wisconsin. The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking markets, the relative shares of total deposits in depository institutions ("market deposits") controlled by Applicants and

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8 *See* 12 U.S.C. § 1842(d). A bank holding company's home state is the state in which the total deposits of all banking subsidiaries of such company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later.

9 For purposes of section 3(d), the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch (12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and (d)(2)(B)). M&I's subsidiary banks are located in Arizona, Florida, Illinois, Indiana, Kansas, Minnesota, Missouri, and Wisconsin.

10 12 U.S.C. §§ 1842(d)(1)(A)–(B) and 1842(d)(2)–(3). Applicants are adequately capitalized and adequately managed, as defined by applicable law. M&I's two subsidiary banks have been in existence and operated for the minimum period of time required by applicable state laws and for more than five years. *See* 12 U.S.C. § 1842(d)(1)(B)(i)–(ii). On consummation of the proposal, Applicants would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States (12 U.S.C. § 1842(d)(2)(A)). Applicants would also control less than 30 percent of, and less than the applicable state deposit cap for, the total amount of deposits of insured depository institutions in the relevant states (12 U.S.C. § 1842(d)(2)(B)–(D)). All other requirements of section 3(d) of the BHC Act would be met on consummation of the proposal.

11 12 U.S.C. § 1842(c)(1).

M&I in the markets,[12] the concentration levels of market deposits and the increases in those levels as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[13] and other characteristics of the markets.

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in all thirteen banking markets.[14] On consummation, each of the banking markets would either remain unconcentrated or moderately concentrated as measured by the HHI, or the HHI would increase less than 200 points. In addition, numerous competitors would remain in all the banking markets.

The DOJ has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the transaction would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any of the banking markets where Applicants and M&I compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board also reviews financial and managerial resources of the organizations involved in a proposal under section 4 of the BHC Act.[15] The Board has carefully considered these factors in light of all the facts of record, including confidential supervisory and examination information from the U.S. banking supervisors of the institutions involved, and publicly reported and other financial information, including information provided by Applicants.[16] The Board also has con-

[12] Deposit and market share data are based on data reported by insured depository institutions in the summary of deposits data as of June 30, 2010, adjusted to reflect mergers and acquisitions as of February 11, 2011, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See*, e.g., *Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift institution deposits in the market share calculation on a 50 percent weighted basis. *See*, e.g., *First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991). The deposits of M&I Savings Bank are weighted at 100 percent because the thrift institution is owned by a commercial banking organization. *See*, e.g., *Norwest Corporation*, 78 *Federal Reserve Bulletin* 452 (1992).

[13] Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is less than 1000, moderately concentrated if the postmerger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI is more than 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. Although the DOJ and the Federal Trade Commission recently issued revised Horizontal Merger Guidelines, the DOJ has confirmed that its guidelines for bank mergers or acquisitions, which were issued in 1995, were not modified. Press Release, Department of Justice (August 19, 2010), available at www.justice.gov/opa/pr/2010/August/10-at-938.html.

[14] Definitions of the banking markets and the effects of the proposal on concentrations of banking resources in the markets are described in Appendix B.

[15] 12 CFR 225.26(b).

[16] Some commenters expressed concerns about the compensation to be paid to certain management at M&I Bank in light of M&I's participation in Treasury's Capital Purchase Program. As noted, M&I's preferred shares held

sulted with the Office of the Superintendent of Financial Institutions ("OSFI"), the agency with primary responsibility for the supervision and regulation of Canadian banks, including Bank of Montreal.

In evaluating the financial resources in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary insured depository institutions and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial resources, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has carefully considered the financial resources of the organizations involved in the proposal. The capital levels of Bank of Montreal exceed the minimum levels that would be required under the Basel Capital Accord and are therefore considered to be equivalent to the capital levels that would be required of a U.S. banking organization. In addition, the subsidiary depository institutions involved in the proposal are well capitalized and would remain so on consummation. Based on its review of the record, the Board finds that Applicants have sufficient financial resources to effect the proposal.

The Board also has considered the managerial resources of the organizations involved. The Board has reviewed the examination records of Applicants, M&I, and their subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of other relevant banking supervisory agencies, including the OCC and the OTS, with the organizations and their records of compliance with applicable banking and anti-money-laundering laws. The Board also has considered Applicants' plans for implementing the acquisition, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors.[17]

Section 3 of the BHC Act also provides that the Board may not approve an application involving a foreign bank unless the bank is subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in the bank's home country.[18]

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by Treasury under the program will be fully redeemed as part of this proposal. In addition, the Board has reviewed the financial and managerial factors in this proposal, including the compensation noted by commenters, in the context of the financial and managerial condition of the Applicants, M&I, and the resulting organization.

[17] Section 3 of the BHC Act also requires the Board to determine that an applicant has provided adequate assurances that it will make available to the Board such information on its operations and activities and those of its affiliates that the Board deems appropriate to determine and enforce compliance with the BHC Act (12 U.S.C. § 1842(c)(3)(A)). The Board has reviewed the restrictions on disclosure in the relevant jurisdictions in which Bank of Montreal operates and has communicated with relevant government authorities concerning access to information. In addition, Bank of Montreal has committed that, to the extent not prohibited by applicable law, it will make available to the Board such information on the operations of its affiliates that the Board deems necessary to determine and enforce compliance with the BHC Act, the International Banking Act, and other applicable federal laws. Bank of Montreal also has committed to cooperate with the Board to obtain any waivers or exemptions that may be necessary to enable its affiliates to make such information available to the Board. Based on all facts of record, the Board has concluded that Bank of Montreal has provided adequate assurances of access to any appropriate information the Board may request.

[18] 12 U.S.C. § 1842(c)(3)(B). As provided in Regulation Y, the Board determines whether a foreign bank is subject to consolidated home country supervision under the standards set forth in Regulation K. *See* 12 CFR

As noted, the OSFI is the primary supervisor of Canadian banks, including Bank of Montreal. The Board previously has determined that Bank of Montreal is subject tocomprehensive supervision on a consolidated basis by its home-country supervisor.[19] Based on this finding and all the facts of record, the Board has concluded that Bank of Montreal continues to be subject to comprehensive supervision on a consolidated basis by its home-country supervisor.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board is required to consider the effects of the proposal on the convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[20] The Board must also review the records of performance under the CRA of the relevant insured depository institutions when acting on a notice under section 4 of the BHC Act to acquire voting securities of an insured savings association.[21] The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[22]

The Board has considered carefully all the facts of record, including evaluations of the CRA performance records of insured depository subsidiaries of HFC and M&I, data reported by HFC and M&I under the Home Mortgage Disclosure Act ("HMDA"),[23] other information provided by Applicants, confidential supervisory information, and public comments received on the proposal. Although some commenters provided positive comments about the CRA performance of the depository institution subsidiaries of Applicants and M&I in certain markets, the same commenters also expressed opposition to the applications and notices and requested that the Board not approve the proposal unless HFC made specific CRA commitments in certain Metropolitan Statistical Areas ("MSAs"). Other commenters asserted that Applicants and M&I had not adequately served the credit and investment needs of its LMI communities. Commenters also expressed concern that the proposal might reduce the availability of credit to LMI neighborhoods and communities of color. Commenters alleged that M&I Bank and Harris Bank had not served the credit needs of minorities and had engaged in disparate treatment of minorities in their lending activities in certain markets. A commenter also expressed concerns that the branching records of M&I Bank and Harris Bank in predominantly minority census tracts were not proportionate to the percentage of the population residing in those tracts in the Milwaukee MSA.[24]

225.13(a)(4). Regulation K provides that a foreign bank will be considered subject to comprehensive supervision or regulation on a consolidated basis if the Board determines that the bank is supervised or regulated in such a manner that its home country supervisor receives sufficient information on the worldwide operations of the bank, including its relationship with any affiliates, to assess the bank's overall financial condition and its compliance with laws and regulations. *See* 12 CFR 211.24(c)(1).

[19] *SeeBank of Montreal*, 91 *Federal Reserve Bulletin* C14 (2005) and 80 *Federal Reserve Bulletin* 925 (1994).

[20] 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 1842(c)(2).

[21] *See,* e.g., *North Fork Bancorporation, Inc.*, 86 *Federal Reserve Bulletin* 767 (2000).

[22] 12 U.S.C. § 2903.

[23] 12 U.S.C. § 2801 et seq.

[24] Applicants indicate that their branch network in the Milwaukee MSA is principally the result of their entry into that market in 2008 through acquisitions. Applicants further note that the acquisition of M&I would significantly expand their branch network in predominantly minority tracts in the Milwaukee MSA.

A. CRA Performance Evaluations

As provided in the CRA, the Board has reviewed the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the relevant insured depository institutions' CRA performance records. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[25]

HFC's subsidiary banks each received a "satisfactory" rating at its most recent CRA performance evaluation by the OCC.[26] M&I Bank and M&I Savings Bank received an "outstanding" and "satisfactory" CRA performance rating, respectively, at their most recent evaluations by the relevant federal supervisors.[27] Applicants have represented that, on consummation of the proposed merger of M&I Bank, the former M&I Savings Bank, and Harris Bank Arizona into Harris Bank, Harris Bank would select elements from each bank to meet the needs of the communities that the combined organization would serve.[28]

CRA Performance of Harris Bank. In Harris Bank's CRA evaluation,[29] examiners considered the bank's overall rating to be "satisfactory," with lending performance rated "high satisfactory." Examiners reported that the bank's geographic distribution of HMDA loans and small loans to businesses were adequate and that the

bank's lending activity reflected excellent responsiveness to the credit needs of its assessment area, considering its size, resources, and the market for deposits and loans in the Chicago assessment area. Examiners also noted that during the evaluation period, Harris Bank made 112 community development loans totaling $172 million and that its community development lending addressed the need for affordable housing, economic development, and community services, and supported efforts to stabilize and revitalize the community. During the evaluation period, Harris Bank made more than 26,000 small business loans totaling more than $2.6 billion in its assessment areas and in particular, 470 small business loans totaling $84.8 million in the Milwaukee assessment area.[30] Examiners also noted that the bank's distribution of small loans to businesses of different revenue sizes was excellent.

[25] *See Interagency Questions and Answers Regarding Community Reinvestment*, 75 *Federal Register* 11,642 at 11,665 (2010).

[26] The most recent CRA performance evaluations for Harris Bank and Harris Bank Arizona were as of July 1, 2009. Harris Central is a special-purpose bank exempt from performance evaluations under the CRA (12 CFR 345.11(c)(3)).

[27] The most recent CRA performance evaluations for Harris Bank and Harris Bank Arizona were as of July 1, 2009. Harris Central is a special-purpose bank exempt from performance evaluations under the CRA (12 CFR 345.11(c)(3)).

[28] Several commenters requested that Applicants commit to undertake certain activities in the communities Applicants will serve on consummation of the proposal, including activities related to home lending and foreclosure, economic development, consumer lending and services, community development, and philanthropy. Applicants have stated that they plan to explore new methods and approaches to enhance the level of services provided to the communities they serve. The Board consistently has stated that neither the CRA nor the federal banking agencies' CRA regulations require depository institutions to make pledges or enter into commitments or agreements with any organization and that the enforceability of any such third-party pledges, initiatives, and agreements are matters outside the CRA. *See Bank of America Corporation*, 90 *Federal Reserve Bulletin* 217, 23233 (2004). Instead, the Board focuses on the existing CRA performance record of an applicant and the programs that an applicant has in place to serve the credit needs of its assessment areas at the time the Board reviews a proposal under the convenience and needs factor. In addition, the Board notes that neither the CRA nor the agencies' implementing rules require institutions to engage in charitable giving.

[29] The evaluation period was January 1, 2006, through June 30, 2009.

[30] In this context, "small business loans" are loans with original amounts of $1 million or less that are secured by nonfarm, nonresidential properties or are commercial and industrial loans to borrowers in the United States. Commenters alleged that the small business lending performance of Harris Bank in 2009 was worse when compared to all lenders with respect to loans less than $100,000 in the Milwaukee MSA. The Applicants note that

The bank received a "high satisfactory" rating in the investment test. Examiners noted that Harris Bank exhibited a good level of responsiveness to credit and community development needs and that the bank made qualified investments within its assessment areas through equity-equivalent investments, purchases of securities, cash contributions, and grants totaling almost $166 million during the evaluation period.

The bank also received a "high satisfactory" rating in the service test. Examiners noted that the bank has an adequate distribution of delivery systems that are reasonably accessible to individuals and geographies of different income levels in the Chicago assessment area. Within LMI geographies, the bank opened six offices and closed one during the evaluation period. Examiners noted that the bank's strategy during much of the evaluation period placed an emphasis on opening offices in LMI geographies, which improved access to the bank's offices in those geographies. The bank also offers various alternative systems for delivering retail banking services.

CRA Performance of Harris Bank Arizona. Harris Bank Arizona received an overall "satisfactory" rating in its 2009 evaluation.[31] Under the lending test, Harris Bank Arizona received a "high satisfactory" rating, and examiners reported that the lending levels demonstrated excellent responsiveness to the credit needs of the bank's assessment areas. Examiners also noted that the bank's geographic distribution of loans was considered adequate, with a good level of lending to borrowers of different income levels.

Harris Bank Arizona received an "outstanding" rating under the investment test and examiners reported that the bank had an excellent level of qualified investment activity and community development lending within its assessment areas.

Harris Bank Arizona received a "low satisfactory" rating under the service test and examiners reported that the bank had an adequate geographic distribution of bank offices.

CRA Performance of M&I Bank. As noted, M&I Bank received an overall "outstanding" rating in its 2009 evaluation.[32] Under the lending test, M&I Bank received a "high satisfactory" rating, and the examiners reported that the distribution of loans to small businesses was good. During the evaluation period, M&I Bank made 32,600 small business loans totaling almost $6.8 billion throughout its assessment areas, with 19,600 small business loans totaling $3.9 billion to businesses in Wisconsin.[33] Examiners reported that the bank's lending activity reflected good responsiveness to credit needs throughout the bank's assessment areas.

Examiners reported that M&I Bank was a leader in making community development loans and made extensive use of innovative and flexible lending practices. During 2007 and 2008, M&I Bank originated 551 community development loans totaling approximately $1.4 bil-

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the bank's performance in small business lending is consistent with its peers. Moreover, there is no standard for the percentage of small business loans in amounts of $100,000 or less that a reporting institution is required to make.

[31] The evaluation period was January 1, 2006, through June 30, 2009.

[32] The evaluation period was January 1, 2007, through December 31, 2008. Several commenters expressed concerns that M&I Bank might not continue to maintain its "outstanding" CRA rating after consummation of the proposal. Applicants note that M&I Bank has received a composite CRA rating of "outstanding" in its nine previous CRA evaluations. Applicants have also stated that they will review their and M&I's current products and services with a view toward selecting elements from each to meet the credit needs of the communities that the combined organization will serve.

[33] One commenter alleged that M&I Bank's small business lending in 2009 was worse when compared to all lenders with respect to loans less than $100,000 in the Milwaukee MSA. As previously noted, there is no standard for the percentage of small business loans in amounts of $100,000 or less that a reporting institution is required to make.

lion in its assessment areas. The majority of those loans were for affordable housing and economic development projects.

M&I Bank received an "outstanding" rating under the investment test. Examiners noted that the bank had an excellent level of qualified community development investments and grants and often served in a leadership position, particularly with respect to those investments not routinely provided by private investors. Examiners commended the bank for exhibiting excellent responsiveness to credit and community development needs.

M&I Bank also received an "outstanding" rating under the service test. Examiners found that M&I Bank's retail delivery systems were accessible to all portions of its assessment areas and that banking services and business hours were tailored to the convenience and needs of those areas, which included LMI census tracts and individuals. Examiners noted that banking services and business hours were tailored to meet the convenience and needs of the bank's assessment areas, including LMI areas.

CRA Performance of M&I Savings Bank. M&I Savings Bank received an overall "satisfactory" rating in its 2008 evaluation.[34] Under the lending test, M&I Savings Bank received a "low satisfactory" rating. Examiners reported that although the savings bank's overall lending activities were strong, the majority of its HMDA and small business loans were made outside its two assessment areas and that the lending levels reflected adequate responsiveness to the assessment areas' credit needs. Examiners reported that the savings bank generated a very strong volume of community development loans that provided a counterbalance for limited HMDA loan activity within its assessment areas.

M&I Savings Bank received an "outstanding" rating under the investment test. Examiners found a substantial amount of qualified investments and noted that when all those investments were considered, the total amount was 173 percent of the amount in the preceding examination and represented approximately 1.2 percent of the institution's assets.

M&I Savings Bank received a "low satisfactory" rating under the service test. Examiners noted that the savings bank had limited deposit-taking offices and derived a major portion of its funding from brokers. Community development services were considered to be adequate. Examiners also reported that the savings bank offered various banking services, including free ATM transactions, direct telephone banking, and electronic online banking.

B. HMDA and Fair Lending Records

The Board has carefully considered the HMDA data for 2008, 2009, and preliminary data for 2010 reported by HFC's and M&I's insured depository institutions, in their respective combined assessment areas and in the MSAs of concern to the commenters,[35] and the fair lending records of HFC and M&I, in light of public comments received on the proposal. Several commenters alleged, based on HMDA data reported in 2009, that HFC and M&I had not adequately served the credit needs of their LMI communities or had engaged in disparate treatment of minority individuals in home mortgage lending.

HMDA lending data for HFC's depository institutions in 2008 and 2009 in their combined assessment areas were generally consistent with the aggregate lending by all reporting lend-

[34] The evaluation period was January 1, 2005, through December 31, 2007.

[35] For HFC, the MSAs of concern to the commenters include the MSAs for Chicago, Illinois; Gary, Indiana; and Milwaukee, Wisconsin. For M&I, the commenters expressed concern about the Appleton, Eau Claire, Madison, and Milwaukee MSAs in Wisconsin; the Indianapolis MSA in Indiana; the Orlando MSA in Florida; the Phoenix MSA in Arizona; and the St. Louis MSA in Missouri.

ers in the relevant assessment areas ("aggregate lenders") with respect to the percentage of their loans to African Americans and in predominantly minority census tracts but lagged the aggregate lenders in their lending in LMI census tracts in both years. However, the banks' lending exceeded the aggregate lenders in loans to Hispanic borrowers and in loans to LMI individuals generally. The denial rates to African Americans relative to white applicants (denial disparity ratios or "DDR") in the combined assessment areas, in Illinois (HFC's home state), and in Chicago specifically were consistent with, or lower than, the aggregate lenders' DDRs in 2008 and 2009. For Hispanic borrowers, the DDR was generally consistent with the aggregate lenders in both years in those areas. The Board has also reviewed preliminary 2010 HMDA data and notes a significant decrease in the volume of applications and loans for HFC's depository institutions and the industry as a whole due to a weak housing market. This decline appears to have had a greater effect in predominantly minority and LMI geographies.

The HMDA-reportable lending data for 2008 for M&I's depository institutions in their combined assessment areas generally lagged aggregate lenders in lending to African Americans and Hispanics, in predominantly minority census tracts, and to LMI individuals. In 2009, HMDA-reportable lending data were generally consistent with the data for aggregate lenders with respect to the percentage of its loans to African Americans and Hispanics and in LMI census tracts but lagged aggregate lenders in the percentage of loans to LMI individuals and in predominantly minority census tracts. The DDR for African Americans relative to white applicants in the combined assessment areas was higher than for aggregate lenders in 2008 but was largely consistent with aggregate lenders in 2009. For Hispanic borrowers, the DDR was largely consistent with aggregate lenders in both years.

Several commenters were particularly concerned about the 2009 HMDA data for M&I's and HFC's depository institutions in the Milwaukee MSA. With respect to M&I, the lending performance slightly exceeded that of aggregate lenders with respect to the percentage of its loans to African Americans and Hispanics, in predominantly minority census tracts, and in LMI census tracts. The depository institutions were slightly higher than aggregate lenders with respect to their percentage of loans to LMI individuals. The DDR for African Americans in the MSA was lower than aggregate lenders in 2009 but was higher for Hispanics in the same year. The Board has also reviewed preliminary 2010 HMDA data in the Milwaukee MSA and notes significant improvements in lending to African Americans and Hispanics, in predominantly minority census tracts, in LMI census tracts, and to LMI individuals.

The HMDA-related lending performance of HFC's depository institutions in the Milwaukee MSA in 2009 was consistent with or exceeded that of aggregate lenders with respect to the percentage of loans to Hispanics, in predominantly minority census tracts, in LMI tracts, and to LMI individuals but lagged aggregate lenders with respect to the percentage of loans to African Americans. The DDRs for African Americans and Hispanics in the MSA were lower than the aggregate lenders in 2009.

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not HFC is excluding or imposing higher costs on any group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[36] HMDA data, therefore,

[36] The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In

have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by HFC, M&I, and their subsidiaries. The Board also has consulted with the OCC about the fair lending compliance records of Harris Bank and Harris Bank Arizona and with the OTS about the fair lending compliance record of M&I Savings Bank. In addition, the Board has considered information provided by Applicants about their compliance-risk-management systems.

The record of this proposal, including confidential supervisory information, indicates that HFC has taken steps to ensure compliance with fair lending and other consumer protection laws. Applicants have in place a formal fair lending policy and program that apply to their U.S. operations, including those operations involved in home mortgage and small business lending. Applicants provide internal compliance training. Their bank management, line-of-business, and compliance staffs attend outside conferences and seminars and other fair lending and consumer protection training sessions. Applicants have indicated that the combined institution will continue to have such policies and procedures on consummation of the proposal. In the fair lending reviews conducted at the most recent CRA examinations of HFC's and M&I's depository institutions, the appropriate federal supervisory agency did not report any evidence of illegal credit discrimination.

The Board also has considered the HMDA data in light of other information, including the overall performance records of the subsidiary banks of Applicants and M&I under the CRA. Their established efforts and records of performance demonstrate that the institutions are active in helping to meet the credit needs of their entire communities and are not excluding individuals or geographies on a prohibited basis.

C. Conclusion on Convenience and Needs and CRA Performance

The Board has considered carefully all the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by Applicants, public comments received on the proposal, and confidential supervisory information. Applicants represent that the proposal would result in increased credit availability and access to a broader array of financial products and services for customers of the combined organization. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant insured depository institutions are consistent with approval of the proposal.[37]

addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

[37] A commenter expressed concern that the proposed acquisition would result in a loss of jobs. The effect of a proposed transaction on employment in a community is not among the factors that the Board is authorized to consider under the BHC Act, and the federal banking agencies, courts, and the Congress consistently have interpreted the convenience and needs factor to relate to the effect of a proposal on the availability and quality of banking services in a community. *See*, e.g., *Wells Fargo & Company*, 82 *Federal Reserve Bulletin* 445, 457 (1996).

Nonbanking Activities

As noted above, Applicants also have filed a notice under sections 4(c)(8) and 4(j) of the BHC Act to acquire certain nonbanking subsidiaries of M&I, including M&I Savings Bank, and to engage in a number of other nonbanking activities that are permissible for bank holding companies under Regulation Y, including financial and investment advisory activities, agency transactional services, trust company functions, activities related to extending credit, community development activities, and extending credit and servicing loans.[38] The Board previously has determined by regulation that the operation of a savings association by a bank holding company, and the other nonbanking activities for which Applicants have requested approval, are closely related to banking for purposes of section 4(c)(8) of the BHC Act.[39]

As part of its evaluation of the public interest factors under section 4(j) of the BHC Act, the Board also must determine that Applicants' proposed acquisition of M&I's nonbanking subsidiaries "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."[40] As part of its evaluation of these factors, the Board has considered the financial condition and managerial resources of Applicants, their subsidiaries, and the companies to be acquired, as well as the effect of the proposed transaction on those resources. For the reasons discussed above, and based on all the facts of record, the Board concludes that financial and managerial considerations are consistent with approval.

The Board also has reviewed the competitive effects of Applicants' proposed acquisition of M&I's nonbanking depository subsidiary, M&I Savings Bank. For the reasons stated earlier, and based on all the facts of record, consummation of this proposal would be consistent with Board precedent and DOJ Guidelines in the banking markets where Applicants' subsidiary banks and M&I Savings Bank compete directly.

In addition, Applicants and M&I compete directly in investment advisory services, trust and custodial services, and community development services. The geographic markets for each of these nonbanking activities are regional or national in scope, except the market for community development, which is local. The record in this case indicates that there are numerous providers of each of these services and that Applicants' and M&I's levels of participation in those activities are relatively small. Based on all the facts of record, the Board concludes that consummation of the proposed nonbanking acquisitions is not likely to have any significantly adverse competitive effects.

The Board also has reviewed carefully the public benefits of the proposed acquisition of M&I's nonbank subsidiaries. Applicants have indicated that the expanded geographic scope of their nonbanking operations would provide added convenience to current and future customers of Applicants and M&I and that customers of both institutions would have access to a broader array of products and services.

For the reasons discussed above, and based on the entire record, the Board has determined that the conduct of the proposed nonbanking activities within the framework of Regulation Y and Board precedent is not likely to result in adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound

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[38] 12 U.S.C. §§ 1843(c)(8) and 1843(j); *see* 12 U.S.C. § 1843(i).

[39] 12 CFR 225.28(b)(1), (2), (4), (5), (6), (7), and (12). *See Appendix A.*

[40] 12 U.S.C. § 1843(j)(2)(A).

banking practices, that would outweigh the public benefits of the proposal, such as increased customer convenience and gains in efficiency. Accordingly, based on all the facts of record, the Board has determined that the balance of the public benefits under the standard of section 4(j)(2) of the BHC Act is consistent with approval.

Conclusion

Based on the foregoing, and in light of all the facts of record, the Board has determined that the applications and notices[41] should be, and hereby are, approved.[42] In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by Applicants with the conditions in this order and all the commitments made to the Board in connection with the proposal. For purposes of this action, these commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated before the fifteenth calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Chicago, acting pursuant to delegated authority.

By order of the Board of Governors, effective June 20, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke and Tarullo. Abstaining from this action: Governor Raskin.

Robert deV. Frierson
Deputy Secretary of the Board

Appendix A

Applicants propose to engage in the following nonbanking activities:

1. Acquiring and holding loans, in accordance with section 225.28(b)(1) of the Board's Regulation Y (12 CFR 225.28(b)(1));
2. Engaging in activities related to extending credit, including real estate settlement servicing, in accordance with section 225.28(b)(2)(viii) of the Board's Regulation Y (12 CFR 225.28(b)(2)(viii));

[41] Harris Bank also has given notice pursuant to section 25 of the FRA, 12 U.S.C. §§ 601604a, and section 211.3 of Regulation K, 12 CFR 211.3, to acquire the Cayman Islands branch of M&I Bank. The Board has considered the factors it is required to consider when reviewing a notice to establish a branch under section 25 of the FRA and, based on all the facts of record, finds these factors to be consistent with approval.

[42] Several commenters requested that the Board hold a public meeting or hearing on the proposal. Section 3(b) of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authorities for the bank to be acquired make a timely written recommendation of denial of the application (12 CFR 225.16(e)). The Board has not received such a recommendation from the appropriate supervisory authorities. The Board's regulations provide for a hearing under section 4 of the BHC Act if there are disputed issues of material fact that cannot be resolved in some other manner (12 CFR 225.25(a)(2)). Under its regulations, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony (12 CFR 262.3(3) and 262.25(d)). The Board has considered carefully the commenters' requests in light of all the facts of record. In the Board's view, the commenters had ample opportunity to submit views and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The requests fail to identify disputed issues of fact that are material to the Board's decision that would be clarified by a public meeting or hearing. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the requests for a public meeting or hearing on the proposal are denied.

3. Operating a savings association, in accordance with section 225.28(b)(4)(ii) of the Board's Regulation Y (12 CFR 225.28(b)(4)(ii));
4. Engaging in trust company functions, in accordance with section 225.28(b)(5) of the Board's Regulation Y (12 CFR 225.28(b)(5));
5. Engaging in financial and investment advisory activities, in accordance with section 225.28(b)(6) of the Board's Regulation Y (12 CFR 225.28(b)(6));
6. Providing agency transactional services, in accordance with section 225.28(b)(7)(i) of the Board's Regulation Y (12 CFR 225.28(b)(7)(i)); and
7. Engaging in community development activities, in accordance with section 225.28(b)(12) of the Board's Regulation Y (12 CFR 225.28(b)(12)).

Appendix B

Bank of Montreal and M&I Banking Markets Consistent with Board Precedent and DOJ Guidelines

Bank	Rank	Amount of Deposits (dollars)	Market Deposit Shares (percent)	Resulting HHI	Change in HHI	Remaining Number of Competitors
Arizona						
Phoenix—includes the Phoenix metropolitan area, including branches in the Phoenix Ranally Metropolitan Area ("RMA") and Fountain Hills, Gold Canyon, and Maricopa.						
Bank of Montreal Pre-Consummation	14	378.44 mil.	0.64	1,842	5	60
M&I	4	2138.57 mil.	3.61			
Bank of Montreal Post-Consummation	4	2517.01 mil.	4.25			
Tucson—includes the Tucson metropolitan area, including branches in the Tucson RMA and Green Valley.						
Bank of Montreal Pre-Consummation	17	28.87 mil.	0.25	1,703	2	18
M&I	6	353.06 mil.	3.04			
Bank of Montreal Post-Consummation	6	381.92 mil.	3.29			
Florida						
Naples— includes the county of Collier, excluding the town of Immokalee.						
Bank of Montreal Pre-Consummation	28	53.3 mil.	0.51	933	1	38
M&I	14	141.99 mil.	1.37			
Bank of Montreal Post-Consummation	13	195.29 mil.	1.88			
Sarasota—includes the counties of Manatee and Sarasota, excluding that portion of Sarasota County that is both east of the Myakka River and south of Interstate 75, which includes the town of North Port; the peninsular portion of the county of Charlotte west of the Myakka River (currently includes Englewood Beach, New Point Comfort, Grove City, Cape Haze, Rotonda, Rotonda West and Placida); and Gasparilla Island (the town of Boca Grande) in the county of Lee (all in Florida).						
Bank of Montreal Pre-Consummation	42	22.52 mil.	0.13	939	1	46
M&I	8	568.73 mil.	3.41			
Bank of Montreal Post-Consummation	8	591.25 mil.	3.54			
Indiana						
Indianapolis—includes the counties of Boone, Hamilton, Hancock, Hendricks, Johnson, Marion, Morgan, and Shelby; and Green township in the county of Madison (all in Indiana).						
Bank of Montreal Pre-Consummation	11	495.29 mil.	1.68	1,364	20	52
M&I	5	1791.2 mil.	6.07			
Bank of Montreal Post-Consummation	4	2286.49 mil.	7.75			
Wisconsin						
Green Bay—includes the counties of Brown and Kewaunee; Morgan, Abrams, Pensaukee, Chase, and Little Suamico townships in the county of Oconto; Angelica and Maple Grove townships in the county of Shawano; Oneida township in the county of Outagamie; and Cooperstown township in the county of Manitowoc (all in Wisconsin).						
Bank of Montreal Pre-Consummation	21	10.86 mil.	0.13	3,343	2	21
M&I	2	829.85 mil.	9.64			
Bank of Montreal Post-Consummation	2	840.71 mil.	9.76			
La Crosse—includes the county of La Crosse; the town of Glencoe in the county of Buffalo; the towns of Arcadia, Preston, Ettrick, and Gale in the county of Trempealeau; the towns of Curran, Springfield, Franklin, North Bend, and Melrose in the county of Jackson (all in Wisconsin); the county of Houston; and Honier, Richmond, Pleasant Hill, New Hartford, and Dresbach townships in the county of Winona (all in Minnesota).						
Bank of Montreal Pre-Consummation	22	14.07 mil.	0.57	767	8	25
M&I	6	177.95 mil.	7.17			
Bank of Montreal Post-Consummation	6	192.02 mil.	7.74			

(continued on next page)

Appendix B—*continued*

Bank of Montreal and M&I Banking Markets Consistent with Board Precedent and DOJ Guidelines—*continued*

Bank	Rank	Amount of Deposits (dollars)	Market Deposit Shares (percent)	Resulting HHI	Change in HHI	Remaining Number of Competitors
Madison—includes the county of Dane, excluding the eastern tier of townships (York, Medina, Deerfield, Christiana, and Albion); and Dekorra, Lowville, Otsego, Fountain Prairie, Columbus, Hampden, Leeds, Arlington, Lodi, and West Point townships in the county of Columbia (all in Wisconsin).						
Bank of Montreal Pre-Consummation	19	179.97 mil.	1.48	768	54	41
M&I	1	2217.29 mil.	18.22			
Bank of Montreal Post-Consummation	1	2397.26 mil.	19.7			
Milwaukee—includes the counties of Milwaukee, Ozaukee, and Waukesha; East Troy township in the county of Walworth; Waterford, Norway, and Raymond townships in the county of Racine; Ixonia township in the county of Jefferson; and Polk, Jackson, Richfield, and Germontown townships in the county of Washington (all in Wisconsin).						
Bank of Montreal Pre-Consummation	7	804.9 mil.	1.76	1886	114	59
M&I	1	14713.13 mil.	32.26			
Bank of Montreal Post-Consummation	1	15518.03 mil.	34.03			
Sauk County—includes the county of Sauk; Westford and Willow townships in the county of Richland; Wyoming and Arena townships in the county of Iowa; and Newport township in the county of Columbia (all in Wisconsin).						
Bank of Montreal Pre-Consummation	4	167.67 mil.	10.74	1639	215	16
M&I	5	156.33 mil.	10.01			
Bank of Montreal Post-Consummation	2	324 mil.	20.75			
Shawano—includes the county of Menominee; the county of Shawano, excluding Angelica, Maple Grove, Hutchins, Aniwa, Birnamwood, Wittenberg, and Germania townships; and Dupont, Larrabee, and Matteson townships in the county of Waupaca (all in Wisconsin).						
Bank of Montreal Pre-Consummation	10	8.01 mil.	1.27	1805	72	10
M&I	1	178.45 mil.	28.33			
Bank of Montreal Post-Consummation	1	186.46 mil.	29.6			
Sheboygan County—includes the county of Sheboygan, excluding Russell and Rhine townships (all in Wisconsin).						
Bank of Montreal Pre-Consummation	11	46.94 mil.	2.54	1237	48	16
M&I	4	175.23 mil.	9.48			
Bank of Montreal Post-Consummation	3	222.17 mil.	12.02			
West Bend—includes the county of Washington, excluding Polk, Jackson, Richfield, and Germantown townships (all in Wisconsin).						
Bank of Montreal Pre-Consummation	15	8.07 mil.	0.56	1133	24	15
M&I	1	306.26 mil.	21.42			
Bank of Montreal Post-Consummation	1	314.33 mil.	21.98			

Note: Deposit data are as of June 30, 2010. Deposit amounts are unweighted. Rankings, market deposit shares, and HHIs are based on thrift institution deposits weighted at 50 percent (M&I Savings Bank at 100 percent).

M&T Bank Corporation
Buffalo, New York

Manufacturers and Traders Trust Company
Buffalo, New York

Order Approving the Acquisition of a Bank Holding Company, Merger of Banks, and Establishment of Branches

M&T Bank Corporation ("M&T"), Buffalo, New York, a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire Wilmington Trust Corporation ("Wilmington") and thereby indirectly acquire its subsidiary bank, Wilmington Trust Company ("WT Bank"), both of Wilmington, Delaware.[2] M&T has also requested the Board's approval under sections 4(c)(8) and 4(j) of the BHC Act to acquire an indirect

1 12 U.S.C. § 1842.

2 M&T has formed a wholly owned subsidiary, MTB One, Inc. ("MTB One"), for purposes of acquiring Wilmington. MTB One will merge with and into Wilmington, with Wilmington surviving the merger and becoming a

interest in Wilmington's subsidiary savings association, Wilmington Trust FSB ("WTFSB"), Baltimore, Maryland, and Wilmington's subsidiary trust company, Wilmington Trust Fiduciary Service Company ("WTFSC"), Weehawken, New Jersey.[3] M&T also proposes to acquire certain other nonbanking subsidiaries of Wilmington in accordance with section 4(k) of the BHC Act.[4]

In addition, M&T's subsidiary state member bank, Manufacturers and Traders Trust Company ("M&T Bank"), Buffalo, has requested the Board's approval under section 18(c) of the Federal Deposit Insurance Act[5] ("Bank Merger Act") to purchase certain assets and assume certain liabilities from WT Bank and WTFSB. M&T Bank also has applied under section 9 of the Federal Reserve Act ("FRA") to establish and operate branches at the main office and branches of WT Bank and at the branches of WTFSB.[6]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (76 *FederalRegister* 2688 (2011)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in the BHC Act, the Bank Merger Act, and the FRA.

M&T, with total consolidated assets of $68.0 billion, is the 29th largest depository organization in the United States, controlling $47.3 billion in deposits.[7] M&T controls two subsidiary banks, M&T Bank and M&T Bank, National Association ("M&T Bank, N.A."), Oakfield, New York, that operate in seven states and the District of Columbia.[8] M&T is the second largest depository organization in Maryland, controlling deposits of approximately $14.6 billion. In Pennsylvania, M&T is the 6th largest depository organization, controlling deposits of $7.9 billion, and in Delaware, M&T is the 32nd largest depository organization, controlling deposits of $16 million.

Wilmington has total consolidated assets of approximately $11.0 billion and is the 86th largest depository organization in the United States, controlling $9.0 billion in deposits. Wilmington's subsidiary insured depository institutions, WT Bank and WTFSB,[9] operate in Delaware, Florida, Maryland, and Pennsylvania. In Delaware, Wilmington is the eighth largest depository organization, controlling deposits of $6.6 billion. Wilmington is the 15th largest depository organization in Maryland, controlling deposits of approximately $927 million. In Pennsylvania, Wilmington is the 79th largest depository organization, controlling deposits of $460 million. In Florida, Wilmington is the 316th largest depository organization, controlling deposits of $8.8 million.

On consummation of the proposal, M&T would become the 27th largest depository organization in the United States, with total consolidated assets of approximately $79 billion. M&T would control deposits of approximately $56.3 billion, which represent less than

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subsidiary of M&T. Immediately following the merger of MTB One into Wilmington, First Empire State Holding Company, an intermediate bank holding company within the M&T organization, will merge with and into Wilmington, with Wilmington surviving the merger.

[3] 12 U.S.C. §§ 1843(c)(8) and (j); 12 CFR 225.24. The Board previously has determined by regulation that the operation of a saving association and a trust company by a bank holding company is closely related to banking for the purposes of section 4(c)(8) of the BHC Act (12 CFR 225.28(b)(4)(ii) and (5)).

[4] 12 U.S.C. § 1843(k).

[5] 12 U.S.C. § 1828(c).

[6] 12 U.S.C. § 321.

[7] Asset and nationwide deposit-ranking data are as of December 31, 2010. Statewide deposit and ranking data are as of June 30, 2010, and reflect merger activity through April 16, 2010.

[8] M&T Bank operates in Delaware, Maryland, New Jersey, New York, Pennsylvania, Virginia, West Virginia, and the District of Columbia. M&T Bank, N.A., operates only in New York.

[9] For purposes of this order, insured depository institutions include commercial banks, savings banks, and savings associations.

1 percent of the total amount of deposits of insured depository institutions in the United States. In Maryland, M&T would remain the second largest depository organization, controlling deposits of approximately $15 billion, which represent approximately 13 percent of the total amount of deposits of insured depository institutions in the state. In Pennsylvania, M&T would remain the sixth largest depository organization, controlling deposits of approximately $8.4 billion, which represent approximately 2.9 percent of the total amount of deposits of insured depository institutions in the state. In Delaware, M&T would become the eighth largest depository organization, controlling deposits of approximately $6.7 billion, which represent approximately 2.3 percent of the total amount of deposits of insured depository institutions in the state. In Florida, M&T would become the 316th largest depository organization, controlling deposits of $8.8 million, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the state.

Interstate Analysis

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the bank holding company's home state if certain conditions are met. For purposes of the BHC Act, the home state of M&T is New York,[10] and WT Bank is located in Delaware.[11]

Based on a review of all the facts of record, including relevant state statutes, the Board finds that the conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[12] In light of all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

Section 102 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal Act") authorizes a bank to merge with another bank located in another state under certain conditions unless, after September 29, 1994, and before June 1, 1997, the home state of one of the banks involved in the transaction adopted a law that applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks.[13] For purposes of the Riegle-Neal Act, the home state of M&T Bank is New York, and the home state of WT Bank is Delaware.[14] Neither Delaware nor New York has adopted a law expressly prohibiting such interstate mergers. M&T Bank has provided a copy of its Bank Merger Act application to the relevant state agencies and stated that it has complied with state law. The proposal also complies with all the other requirements of the Riegle-Neal Act.[15] Accordingly, approval of the proposed transaction is consistent with the Riegle-Neal Act.

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[10] *See* 12 U.S.C. § 1842(d). A bank holding company's home state is the state in which the total deposits of all banking subsidiaries of such company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later.

[11] For purposes of section 3(d) of the BHC Act, the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch. *See* 12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and 1842(d)(2)(B). WT Bank operates only in Delaware.

[12] 12 U.S.C. §§ 1842(d)(1)(A)–(B) and 1842(d)(2)–(3). M&T is adequately capitalized and adequately managed, as defined by applicable law. WT Bank has been in existence and operated for the minimum period of time required by Delaware law and for more than five years. *See* 12 U.S.C. §§ 1842(d)(1)(B)(i)–(ii). On consummation of the proposal, M&T would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States (12 U.S.C. § 1842(d)(2)(A)). M&T also would control less than 30 percent of, and less than the applicable state deposit cap for, the total amount of deposits in insured depository institutions in the relevant states (12 U.S.C. §§ 1842(d)(2)(B)–(D)). All other requirements of section 3(d) of the BHC Act would be met on consummation of the proposal.

[13] *See* 12 U.S.C. § 1831u.

[14] See 12 U.S.C. § 1831u(a)(4) and (g)(4).

[15] *See* 12 U.S.C. § 1831u. M&T Bank is adequately capitalized and adequately managed, as defined in the Riegle-Neal Act. As noted above, on consummation of the proposal, M&T Bank and its affiliated insured depository institutions would control less than 10 percent of the total amount of deposits in insured depository institu-

Competitive Considerations

The BHC Act and the Bank Merger Act prohibit the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. Both statutes also prohibit the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[16] In addition, the Board must consider the competitive effects of a proposal to acquire a savings association under the public benefits factor of section 4(j) of the BHC Act.[17]

M&T and Wilmington have subsidiary depository institutions that compete directly in five banking markets: Baltimore, Maryland-Pennsylvania; Philadelphia, Pennsylvania-New Jersey; Sussex County, Delaware; Salisbury, Delaware-Maryland; and Wilmington, Delaware-Maryland. The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking markets, the relative shares of total deposits in depository institutions in the markets ("market deposits") controlled by the subsidiary depository institutions of M&T and by Wilmington,[18] the concentration levels of market deposits and the increase in those levels as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[19] and other characteristics of the markets.

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in all five banking markets.[20] On consummation of the proposal, one market would remain highly concentrated, and four markets would remain moderately concentrated, as measured by the HHI. The change in HHI in each market would be consistent with Board precedent and the thresholds in the DOJ Guidelines. In addition, numerous competitors would remain in all five banking markets.

The DOJ has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the transaction would not likely have a significantly adverse effect on competition in any relevant banking market. In addi-

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tions in the United States and less than 30 percent of the total amount of deposits in insured depository institutions in Delaware, Maryland, and Pennsylvania, respectively. All other requirements of section 102 of the Riegle-Neal Act would also be met on consummation of the proposal.

[16] 12 U.S.C. §§ 1842(c)(1) and 1828(c)(5).

[17] 12 U.S.C. § 1843(j)(2)(A).

[18] Deposit and market share data are as of June 30, 2010, adjusted to reflect mergers and acquisitions through March 30, 2011, and are based on calculations in which the deposits of thrift institutions are included at 50 percent, except for the deposits of thrift institutions controlled by bank holding companies, which are weighted at 100 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See*, e.g., *Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386, 387 (1989); *Provident Corporation*, 70 *Federal Reserve Bulletin* 743, 744 (1984). Thus, the Board regularly has included thrift institution deposits in the market share calculation on a 50 percent weighted basis. *See*, e.g., *First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52, 55 (1991).

[19] Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally would not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. Although the DOJ and the Federal Trade Commission recently issued revised Horizontal Merger Guidelines, the DOJ has confirmed that the DOJ Guidelines, which were issued in 1995, were not changed. Press Release, Department of Justice (August 19, 2010), *available at* www.justice.gov/opa/pr/2010/August/10-at-938.html.

[20] Those banking markets and the effects of the proposal on their concentrations of banking resources are described in the appendix.

tion, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any of the five banking markets where the subsidiary depository institutions of M&T and Wilmington compete directly or in any other relevant depository institution market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act and the Bank Merger Act require the Board to consider the financial and managerial resources and future prospects of the companies and banks involved in the proposal and certain other supervisory factors.[21] The Board also reviews the financial and managerial resources of the companies involved in a notice under section 4 of the BHC Act.[22] The Board has considered those factors in light of all the facts of record, including confidential supervisory and examination information from the relevant federal and state supervisors of the organizations involved in the proposal and other available financial information, including information provided by M&T and Wilmington.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary depository institutions and the organizations' significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered the financial factors of the proposal carefully. M&T and its subsidiary depository institutions are well capitalized and would remain so on consummation. WT Bank is also well capitalized. The proposed transaction is structured as a share exchange. Based on its review of the record, the Board finds that M&T has sufficient financial resources to effect the proposal.

The Board also has carefully considered the managerial resources of the organizations involved in the proposed transaction. The Board has reviewed the examination records of M&T, Wilmington, and their subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking law and with anti-money-laundering laws. M&T and its subsidiary depository institutions are considered to be well managed. The Board also has considered M&T's plans for implementing the proposal, including the proposed management after consummation.

In addition, the Board has considered the future prospects of the organizations involved in the proposal. As part of this evaluation, the Board considered information regarding how M&T would manage the integration of Wilmington into M&T. The Board also considered

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[21] 12 U.S.C. §§ 1842(c)(2)–(3) and 1828(c)(5).

[22] 12 U.S.C. § 1843(j)(4)(A)–(B).

M&T's experience in acquiring bank holding companies and successfully integrating them into its organization. The record indicates that M&T has the financial and managerial resources to serve as a source of strength to Wilmington and its subsidiary depository institutions.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act and the Bank Merger Act, the Board is required to consider the effects of the proposal on the convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[23] The Board must also review the records of performance under the CRA of the relevant insured depository institutions when acting on a notice under section 4 of the BHC Act to acquire voting securities of an insured savings association.[24]

The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[25]

The Board has considered carefully all the facts of record, including evaluations of the CRA performance records of M&T Bank and WT Bank, data reported by M&T Bank under the Home Mortgage Disclosure Act ("HMDA"),[26] other information provided by M&T, confidential supervisory information, and public comments received on the proposal. Some commenters commended M&T Bank for its relationship with community groups and for certain aspects of its CRA program but also made recommendations for M&T Bank to expand its community development programs.[27] In addition, other commenters alleged that M&T denied home mortgage loan applications of African American or Hispanic borrowers more frequently than those of nonminority applicants in certain areas.

A. CRA Performance Evaluations

As provided in the CRA, the Board has reviewed the convenience and needs factor in light of the evaluations by the appropriate federal supervisor of the CRA performance record of the relevant insured depository institution. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it

[23] 12 U.S.C. § 1842(c)(2); 12 U.S.C. § 2901 et seq.

[24] *See*, e.g., *North Fork Bancorporation, Inc.*, 86 *Federal Reserve Bulletin* 767 (2000).

[25] 12 U.S.C. § 2903.

[26] 12 U.S.C. § 2801 et seq.

[27] The Board consistently has stated that neither the CRA nor the federal banking agencies' CRA regulations require depository institutions to make pledges or enter into commitments. *See*, e.g., *The PNC Financial Services Group, Inc.*, 94 *Federal Reserve Bulletin*C38 (2008); *Wachovia Corporation*, 91 *Federal Reserve Bulletin* 77 (2005). In addition, the CRA does not require depository institutions to offer specific types of products or services. The Board focuses on the existing CRA and fair lending performance and compliance records of an applicant and the programs that an applicant has in place to serve the credit needs of its assessment area at the time the Board reviews a proposal under the convenience and needs factor.

represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[28]

M&T Bank received an "outstanding" rating at its most recent CRA performance evaluation by the Federal Reserve Bank of New York ("Reserve Bank"), as of May 12, 2008 ("2008 Evaluation").[29] WT Bank received an "outstanding" rating at its most recent CRA performance evaluation by the Federal Reserve Bank of Philadelphia, as of July 20, 2009.[30]

CRA Performance of M&T Bank. In addition to the overall "outstanding" rating that M&T Bank received in the 2008 Evaluation, the bank received separate overall ratings of "outstanding" or "satisfactory" in all the states and multistate metropolitan areas reviewed.[31] Examiners reported that M&T Bank's geographic distribution of loans was good. They also stated that the bank's distribution of loans to borrowers reflected a good penetration among customers of different income levels and among businesses of different revenue sizes. In addition, examiners noted that M&T Bank offered a Federal National Mortgage Association affordable mortgage product in all its assessment areas that had resulted in the origination of almost 1,000 mortgages totaling $89 million during the evaluation period.

In the 2008 Evaluation, examiners characterized M&T Bank as a leader in making community development loans in its assessment areas, reporting that the bank made more than 455 community development loans totaling $1.96 billion during the evaluation period. Examiners noted that the bank's community development lending volume generally exceeded similarly situated banks in the New York, Pennsylvania, and Maryland full-scope assessment areas.

Examiners rated M&T Bank's overall performance under the investment test as "outstanding." Qualifying community development investments totaled more than $246 million, representing an increase from its previous evaluation. Most of the investments were concentrated in the form of low-income-housing tax credits, which help to provide affordable housing to LMI borrowers, and 86 percent of the qualified community development investments supported development of affordable housing.

In addition, examiners concluded that the bank's performance under the service test was "outstanding." Examiners found that the M&T Bank's retail delivery systems were readily accessible to all portions of its assessment areas. They reported that 20 percent of M&T Bank's branches were in LMI tracts and that 19 percent of the bank's automated teller machines ("ATMs") were in LMI areas, which enhanced the bank's performance under the service test in those communities. Examiners also noted that M&T Bank's customers could use ATMs owned by institutions that had business relationships with the bank without paying a fee and that six of the ATMs were in LMI areas. In addition, examiners indicated that M&T Bank was a leader in providing community development services throughout its assessment areas, including sponsoring and participating in a significant number of seminars and presentations relating to affordable mortgages, small business assistance, and

[28] *See Interagency Questions and Answers Regarding Community Reinvestment*, 75 *Federal Register* 11642 at 11665 (2010).

[29] M&T's other bank subsidiary, M&T Bank, N.A. received a "satisfactory" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency, as of May 18, 2009. WTFSC is not an insured depository institution subject to the CRA (12 U.S.C. § 2902(2)).

[30] WTFSB received a "satisfactory" rating at its most recent CRA performance evaluation by the Office of Thrift Supervision, as of July 20, 2009.

[31] Examiners considered HMDA-related and CRA-reportable small business loans that were originated between January 1, 2006, and December 31, 2007. Examiners also reviewed community development loans, investments, services, and activities pertaining to the service test for the same period.

other banking education. These types of events provided technical assistance and training to LMI individuals, community organizations, small businesses, and housing agencies.

M&T indicated that M&T Bank's CRA staff would work with WT Bank's CRA staff to determine the most effective ways to integrate the CRA programs of the two banks going forward. In recognition of the fact that M&T Bank's assessment area in Delaware would significantly expand as a result of the proposed acquisition, M&T plans to retain WT Bank's CRA officer to provide uninterrupted, inmarket program oversight and support.

CRA Performance of WT Bank. As noted, WT Bank received an overall "outstanding" rating in its 2009 evaluation.[32] Under the lending test, WT Bank received an "outstanding" rating, and the examiners reported that the bank's geographic distribution of loans reflected an excellent penetration throughout its assessment areas and that the overall distribution of loans among borrowers of different income levels, especially LMI borrowers, also showed excellent penetration given the economic and demographic considerations in the assessment areas. The distribution of loans among businesses of different sizes, including small businesses, also reflected good penetration. Examiners noted WT Bank's participation in innovative and flexible lending programs that addressed the specific credit needs of LMI borrowers and small businesses in its assessment areas.

Examiners also noted that WT Bank made a significant number of community development loans in its assessment areas. During the evaluation period, the bank originated nine community development loans totaling $16.3 million to finance community development initiatives of which seven loans totaling $12.6 million supported affordable housing; one loan for $3.7 million supported economic development; and one loan for $84,000 supported the provision of community development services.

The bank received a "high satisfactory" rating under the investment test in the WT Bank 2009 Evaluation. Examiners found that WT Bank had a significant level of qualified community development investments and grants throughout its assessment areas. Investments of $24.7 million included support for affordable housing, and economic development and for the provision of community development services.

In the 2009 evaluation, WT Bank received an "outstanding" rating under the service test. Examiners found that branch delivery systems, as well as alternative delivery systems such as ATMs, telephone, and Internet banking, were accessible to essentially all portion of the bank's assessment areas. WT Bank's banking services did not vary in a way that inconvenienced portions of the bank's assessment areas, particularly LMI census tracts or borrowers. Examiners noted that WT Bank is a leader in providing community development services, including deposit accounts that provided greater access to banking services for LMI borrowers and small businesses.

B. HMDA and Fair Lending Record

The Board has carefully considered the fair lending records and HMDA data of M&T in light of public comment received on the proposal. Commenters alleged, based on 2009 HMDA data, that M&T had denied the conventional home mortgage loan applications of African American borrowers more frequently than those of nonminority applicants in Buffalo and Baltimore. Those commenters also alleged, again based on 2009 HMDA data, that M&T had denied refinancing loan applications of Hispanic borrowers in the metropolitan

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[32] The evaluation includes HMDA, small business lending, and small farm lending data reported from January 1, 2007, through December 31, 2008.

area encompassing New York City more frequently than those of nonminority applicants.[33]

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, denials, or pricing among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not M&T is excluding any racial or ethnic group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[34] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Moreover, the Board believes that all bank holding companies and their affiliates must conduct their mortgage lending operations without any abusive lending practices and in compliance with all consumer protection laws.

Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by M&T's subsidiary insured depository institutions. In particular, examiners did not find any evidence that M&T's subsidiary depository institutions had engaged in illegal discrimination or in any other illegal credit practices. In addition, the Board has considered information provided by M&T about its compliance risk-management systems.

The record of this proposal, including confidential supervisory information, indicates that M&T has taken steps to ensure compliance with fair lending and other consumer protection laws and regulations. M&T represents that the lending unit within M&T Bank's Centralized Compliance Department works in conjunction with compliance personnel to design and document compliance control procedures, monitor compliance within assigned business units, provide support with new products and business initiatives, design test scripts, analyze findings and develop action plans, determine requirements for new or revised regulations, and manage M&T's Fair Banking Program.

The Fair Banking Program is a coordinated and comprehensive effort within M&T Bank that includes oversight, training, procedures, monitoring and analysis, and testing. In addition, the program includes education and training, an annual fair lending audit, and a complaint-resolution process. M&T Bank also performs a second review of all denied residential mortgage applications to ensure the correctness of the action taken. M&T has stated that all appropriate measures will be taken to ensure that Wilmington's home mortgage lending activities will be integrated into the policies, procedures, and practices of the Centralized Compliance Department.

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[33] The Board reviewed HMDA data for 2009 for M&T Bank in the two markets, as well as in its combined assessment area for all types of HMDA-reportable lending on a combined basis.

[34] The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicant than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

The Board also has considered the HMDA data in light of other information, including the overall performance records of the subsidiary banks of M&T and Wilmington under the CRA. These established efforts and records of performance demonstrate that the institutions are active in helping to meet the credit needs of their entire communities.

C. Conclusion on Convenience and Needs and CRA Performance

The Board has considered carefully all the facts of record, including the evaluation of the CRA performance records of the institutions involved, information provided by M&T, public comments received on the proposal, and confidential supervisory information. M&T represents that the proposal will result in increased credit availability and access to a broader range of financial services for customers of M&T's subsidiary depository institutions and Wilmington's former customers. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant insured depository institutions are consistent with approval of the proposal.

Public Benefits

As noted above, M&T has filed a notice under sections 4(c)(8) and 4(j) of the BHC Act to acquire WTFSB and WTFSC, which engage in activities that the Board has determined by regulation are so closely related to banking as to be a proper incident thereto for purposes of section 4(c)(8) of the BHC Act.[35]

As part of its evaluation of the public interest factors under section 4(j) of the BHC Act, the Board also must determine that the proposed acquisitions by M&T "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."[36]

The record indicates that consummation of the proposal would create a stronger and more diversified financial services organization and would provide the current customers of M&T and Wilmington and future customers of the combined organization with expanded financial products and services. For the reasons discussed above, and based on the entire record, the Board has determined that the acquisition of the savings association and trust company within the framework of Regulation Y and Board precedent is not likely to result in significantly adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. Moreover, based on all the facts of record, the Board has concluded that consummation of the proposal can reasonably be expected to produce public benefits that would outweigh any likely adverse effects. Accordingly, the Board has determined that the balance of the public benefits under the standard of section 4(j)(2) of the BHC Act is consistent with approval.

Other Considerations

M&T Bank also has applied under section 9 of the FRA to establish and operate branches at the locations of the main office and branches of WT Bank and at the branches of WTFSB. The Board has assessed the factors it is required to consider when reviewing an

[35] *See* 12 CFR 225.28(b)(4)(ii) and (5).

[36] 12 U.S.C. § 1843(j)(2)(A).

application under section 9 of the FRA and finds those factors to be consistent with approval.

Conclusion

Based on the foregoing, and in light of all the facts of record, the Board has determined that the applications under section 3 of the BHC Act, the Bank Merger Act, and the FRA and the notice under section 4 of the BHC Act should be, and hereby are, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act, the Bank Merger Act, and the FRA. The Board's approval is specifically conditioned on compliance by M&T with the conditions in this order and all the commitments made to the Board in connection with the applications and notice and on receipt of all other regulatory approvals for the proposal.[37] The Board's approval of the proposed nonbanking activities is subject to all the conditions set forth in Regulation Y, including those in sections 225.7 and 225.25(c),[38] and to the Board's authority to require such modification or termination of the activities of a bank holding company or any of its subsidiaries as the Board finds necessary to ensure compliance with, and to prevent evasion of, the provisions of the BHC Act and the Board's regulations and orders issued thereunder. For purposes of this proposal, these commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Reserve Bank, acting pursuant to delegated authority.

By order of the Board of Governors, effective April 26, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke and Tarullo. Abstaining from this action: Governor Raskin.

Robert deV. Frierson
Deputy Secretary of the Board

[37] Some commenters requested that the Board hold a public meeting or hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a written recommendation of denial of the application. The Board has not received such a recommendation from a supervisory authority. The Board's regulations provide for a hearing under section 4 of the BHC Act if there are disputed issues of material fact that cannot be resolved in some other manner. *See* 12 CFR 225.25(a)(2). Under its regulations, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if a meeting or hearing is necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony. *See* 12 CFR 262.3(e) and 262.25(d). The Board has considered carefully the commenters' requests in light of all the facts of record. In the Board's view, the commenters had ample opportunity to submit views and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The requests fail to identify disputed issues of fact that are material to the Board's decision that would be clarified by a public meeting or hearing. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the requests for a public meeting or hearing on the proposal are denied.

[38] 12 CFR 225.7 and 225.25(c).

Appendix

M&T and Wilmington Banking Markets Consistent with Board Precedent and DOJ Guidelines

Bank	Rank	Amount of Deposits (dollars)	Market Deposit Shares (percent)	Resulting HHI	Change in HHI	Remaining Number of Competitors
Wilmington, DE—includes New Castle County, Delaware; and Cecil County, Maryland.						
M&T Pre-Consummation	17	37 mil.	9.2	4612	1	19
Wilmington	2	5.3 bil.	0.1			
M&T Post-Consummation	2	5.3 bil.	9.3			
Baltimore, MD-PA— includes Baltimore, MD-PA Ranally Metropolitan Area ("RMA"); the non-RMA portions of Harford and Carroll counties, Maryland (excluding the Washington, DC-MD-VA RMA portion); and Baltimore, Maryland.						
M&T Pre-Consummation	2	11.7 bil.	23.5	1659	88	72
Wilmington	9	927 mil.	1.9			
M&T Post-Consummation	2	12.6 bil.	25.4			
Philadelphia—includes Bucks, Chester, Delaware, Montgomery and Philadelphia counties, Pennsylvania; and Burlington, Camden, Cumberland, Gloucester, and Salem counties, New Jersey.						
M&T Pre-Consummation	21	648 mil.	0.5	1175	0	122
Wilmington	29	460 mil.	0.4			
M&T Post-Consummation	15	1.1 bil.	0.9			
Salisbury, MD-DE— includes the Salisbury, Maryland-Delaware RMA; and the non-RMA portion of Wicomico County, Maryland.						
M&T Pre-Consummation	5	152.8 mil.	10.3	1268	37	12
Wilmington	11	26.4 mil.	1.79			
M&T Post-Consummation	5	178.8 mil.	12.1			
Sussex, DE— includes Sussex County, Delaware (excluding the city of Milford and the Salisbury, MD-DE RMA portion).						
M&T Pre-Consummation	13	15.9 mil.	0.6	1768	35	13
Wilmington	1	817 mil.	30.4			
M&T Post-Consummation	1	833 mil.	31.0			

Note: Data are as of June 30, 2010. Deposit amounts are unweighted. All rankings, market deposit shares, and HHIs are based on thrift institution deposits weighted at 50 percent, except for the deposits of thrift institutions controlled by bank holding companies, which are weighted at 100 percent.

Orders Issued Under International Banking Act

Bank of Communications Co., Ltd.
Shanghai, People's Republic of China

Order Approving Establishment of a Branch

Bank of Communications Co., Ltd. ("BOCOM"), Shanghai, People's Republic of China, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 7(d) of the IBA[1] to establish a limited federal branch in San Francisco, California. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a branch in the United States.

Notice of the application, affording interested persons an opportunity to comment, has been published in a newspaper of general circulation in San Francisco, California (*The Recorder,* March 9, 2009). The time for filing comments has expired, and the Board has considered all comments received.

BOCOM, with total assets of approximately $599 billion, is the fifth largest bank in China.[2] The government of China owns approximately 43.8 percent of BOCOM's shares.[3]

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1 12 U.S.C. § 3105(d).

2 Asset and ranking data are as of December 31, 2010.

The Hongkong and Shanghai Banking Corporation Limited, Hong Kong, People's Republic of China, a subsidiary of HSBC Holdings plc, London, England, owns 19 percent of the shares of BOCOM. No other shareholder owns more than 5 percent of the shares of BOCOM.

BOCOM engages primarily in corporate and retail banking and treasury operations throughout China, including Hong Kong and Macau. Outside China, BOCOM operates branches in Japan, Singapore, South Korea, and Germany and a representative office in the United Kingdom. In the United States, BOCOM operates a federal branch in New York. BOCOM would meet the requirements for a qualifying foreign banking organization under Regulation K.[4]

The proposed San Francisco branch would engage in wholesale deposittaking, lending, trade finance, and other banking services. As a limited branch, it would be prohibited from accepting deposits from sources other than those permitted by section 5 of the IBA and section 25A of the Federal Reserve Act.[5]

Under the IBA and Regulation K, in acting on an application by a foreign bank to establish a branch, the Board must consider whether the foreign bank (1) engages directly in the business of banking outside the United States; (2) has furnished the Board with the information it needs to assess the application adequately; and (3) is subject to comprehensive supervision on a consolidated basis by its home-country supervisors.[6] The Board also considers additional standards as set forth in the IBA and Regulation K.[7]

The IBA includes a limited exception to the general standard relating to comprehensive, consolidated supervision.[8] This exception provides that, if the Board is unable to find that a foreign bank seeking to establish a branch, agency, or commercial lending company is

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3 The Ministry of Finance of the People's Republic of China owns approximately 26.5 percent, and the National Council for Social Security Fund of the People's Republic of China ("NCSFF") owns approximately 11.4 percent of BOCOM's total outstanding shares. HKSCC Nominees Limited, an indirect, wholly owned subsidiary of Hong Kong Exchanges and Clearing Limited, holds NCSFF's shares as its registered nominee. The remaining 6 percent is widely held among state-owned enterprises.

4 12 CFR 211.23(a).

5 BOCOM's home state is New York. Under section 5 of the IBA, a foreign bank may establish a branch outside its home state if the branch limits its deposit-taking to that of an Edge corporation operating under section 25A of the Federal Reserve Act (12 U.S.C. § 3103(a)(7)(A)). Under section 25A of the Federal Reserve Act, an Edge corporation may receive deposits outside the United States and only such deposits within the United States that are incidental to or for the purpose of carrying out transactions in foreign countries (12 U.S.C. § 615(a)). Regulation K defines the extent of permissible deposit-taking activities of Edge corporations (12 CFR 211.6(a)(1)).

6 12 U.S.C. § 3105(d)(2); 12 CFR 211.24. In assessing this standard, the Board considers, among other indicia of comprehensive, consolidated supervision, the extent to which the home-country supervisors (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. No single factor is essential, and other elements may inform the Board's determination.

7 12 U.S.C. § 3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3). The additional standards set forth in section 7 of the IBA and Regulation K include the following: whether the bank's home-country supervisor has consented to the establishment of the office; the financial and managerial resources of the bank; whether the appropriate supervisors in the home country may share information on the bank's operations with the Board; whether the bank and its U.S. affiliates are in compliance with U.S. law; the needs of the community; the bank's record of operation. The Board may also take into account, in the case of a foreign bank that presents a risk to the stability of the United States, whether the home country of the foreign bank has adopted, or is making demonstrable progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk (12 U.S.C. § 3105(d)(3)(E)).

8 12 U.S.C. § 3105(d)(6).

subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country, the Board may nevertheless approve the application provided that (i) the appropriate authorities in the home country of the foreign bank are actively working to establish arrangements for the consolidated supervision of such bank; and (ii) all other factors are consistent with approval.[9] In deciding whether to exercise its discretion to approve an application under authority of this exception, the Board must also consider whether the foreign bank has adopted and implemented procedures to combat money laundering.[10] The Board also may take into account whether the home country of the foreign bank is developing a legal regime to address money laundering or is participating in multilateral efforts to combat money laundering.[11] That is the standard applied by the Board in this case.

As noted above, BOCOM engages directly in the business of banking outside the United States. BOCOM also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

The Board is continuing to work actively with the appropriate supervisory authorities in China to understand their system for the consolidated supervision of BOCOM and other major Chinese banks. Those discussions are constructive and ongoing. Based on all the facts of record, the Board has determined that BOCOM's home-country supervisory authority is, at a minimum, actively working to establish arrangements for the consolidated supervision of BOCOM and that considerations relating to the steps taken by BOCOM and its home jurisdiction to combat money laundering are consistent with approval under this standard. The Board has approved applications from other Chinese banks to establish U.S. branches under this standard.[12]

The China Banking Regulatory Commission ("CBRC") is the principal supervisory authority of BOCOM, including its foreign subsidiaries and affiliates.[13] The CBRC has the authority to license banks, regulate their activities, and approve expansion, both domestically and abroad. The CBRC has no objection to BOCOM's establishment of the proposed branch. It supervises and regulates BOCOM, including its subsidiaries and foreign operations, through a combination of targeted on-site examinations and continuous consolidated off-site monitoring. Since its establishment in 2003, the CBRC has enhanced existing supervisory programs and developed new policies and procedures designed to create a framework for the consolidated supervision of banks in China.

On-site examinations by the CBRC cover, among other things, the major areas of operations: corporate governance and senior management responsibilities; capital adequacy; asset structure and asset quality (including structure and quality of loans); off-balance-sheet activities; earnings; liquidity; liability structure and funding sources; expansionary plans; internal controls (including accounting controls and administrative systems); legal compliance; accounting supervision and internal auditing (including accounting controls and administrative systems); and any other areas deemed necessary by the CBRC.

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[9] 12 U.S.C. § 3105(d)(6)(A).

[10] 12 U.S.C. § 3105(d)(6)(B).

[11] *Id*.

[12] *See China Merchants Bank Co., Ltd.*, 94 *Federal Reserve Bulletin* C24 (2008); *Industrial and Commercial Bank of China, Limited*, 94 *Federal Reserve Bulletin* C114 (2008); and *China Construction Bank Corporation*, 95 *Federal Reserve Bulletin* B54 (2009).

[13] Before April 2003, the People's Bank of China ("PBOC") acted both as China's central bank and its primary banking supervisor, including oversight of anti-money-laundering matters. In April 2003, the CBRC was established as the primary banking supervisor and assumed the majority of the PBOC's regulatory functions. The PBOC maintained its roles as China's central bank and the primary supervisor for anti-money-laundering matters.

Off-site monitoring is conducted through the review of required annual, semiannual, quarterly, or monthly reports on, among other things, asset quality, capital adequacy, liquidity, risk management, corporate governance, affiliate transactions, and internal controls.

BOCOM is required to be audited annually by an accounting firm approved by the PBOC, and the results are shared with the CBRC and the PBOC. The scope of the required audit includes a review of BOCOM's financial statements, asset quality, and internal controls. The CBRC may order a special audit at any time. In addition, in connection with its listing on the Shanghai and Hong Kong stock exchanges, BOCOM is required to have external audits conducted under both International Financial Reporting Standards and generally accepted accounting practices under Chinese law. BOCOM is required to publish its financial statements annually. BOCOM conducts internal audits of its offices and operations, including its overseas operations, generally on an annual schedule. The internal audit results are shared with the CBRC, the PBOC, and BOCOM's external auditors. The proposed branch would be subject to internal audits.

Chinese laws impose various prudential limitations on banks, including limits on transactions with affiliates and on large exposures. The CBRC is authorized to require any bank to provide information and to impose sanctions for failure to comply with such requests. The CBRC also has authority to impose administrative penalties, including warnings, fines, and removal from office, for violations of applicable laws and rules. Criminal violations are transferred to the judicial authorities for investigation and prosecution.

In recent years, the Chinese government has enhanced its anti-money-laundering regime. In 2005, it took initial steps to adopt an anti-money-laundering law, the PRC Anti-Money Laundering Law ("AML Law"). The AML Law and two related rules, the Rules for Anti-Money Laundering by Financial Institutions ("AML Rules") and the Administrative Rules for the Reporting of Large-Value and Suspicious Transactions by Financial Institutions ("LVT/STR Rules") were enacted in October 2006 and December 2006, respectively. The AML Law and AML Rules became effective on January 1, 2007, and the LVT/STR Rules became effective on March 1, 2007. Together, the law and two related rules establish a regulatory infrastructure to assist China's anti-money-laundering efforts.

An Anti-Money Laundering Bureau ("AML Bureau") was established within the PBOC in 2003[14] to coordinate anti-money-laundering efforts at the PBOC and among other agencies. The AML Bureau also supervised the creation of the China Anti-Money Laundering Monitoring and Analysis Center ("AML Center") in September 2004. The AML Center collects, monitors, analyzes, and disseminates suspicious transaction reports and large-value transaction reports. The AML Center sends suspicious transaction reports to the AML Bureau for further investigation. The PBOC issued additional rules in 2007 and 2008 providing clarification of, or further strengthening the implementation of, operating procedures, customer due diligence and risk classification, recordkeeping, AML monitoring and reporting of suspicious transactions to the AML Center, and the international remittance agency business. China improved its AML regime in 2009 by amending its criminal law to further criminalize money laundering activities and other financial crimes.

China participates in international fora that address the prevention of money laundering and terrorist financing. China is a member of the Financial Action Task Force ("FATF")[15] and is a party to the 1988 U.N. Convention Against the Illicit Traffic of Narcotics and Psy-

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[14] The AML Bureau conducts administrative investigations and handles violations of AML Rules. Money laundering cases are referred to the Ministry of Public Security, China's main law enforcement body, for investigation and prosecution.

[15] China became a member of FATF in June 2007.

chotropic Substances, the U.N. Convention Against Transnational Organized Crime, the U.N. Convention Against Corruption, and the U.N. International Convention for the Suppression of the Financing of Terrorism.

As noted, the PBOC is China's primary supervisor for anti-money-laundering matters. Like the CBRC, the PBOC supervises and regulates BOCOM through a combination of on-site examinations and off-site monitoring. Onsite examinations focus on BOCOM's compliance with anti-money-laundering laws and rules, including the AML Law, AML Rules, and LVT/STR Rules. Off-site monitoring is conducted through the review of periodic reports. In performing its responsibilities, the PBOC may require any bank to provide information and can impose administrative penalties for violations of applicable laws and rules.

The PBOC over time has increased requirements for its supervised institutions. In 2008, the PBOC promulgated a notice requiring the designation of a chief AML compliance officer as a high-level manager to ensure the provision of adequate AML resources and timely flow of information to employees with AML responsibility throughout the institution. The same notice also required the risk rating of customers, among other improvements in AML controls. The PBOC requires the filing of reports on suspicious activities and certain other transactions, and it recently has developed a policy of encouraging its supervised institutions to move from prescriptive criteria towards a more risk-based and subjective method of suspicious activity detection and reporting. In addition, banks are required to establish a customer identification system in accordance with applicable rules jointly promulgated by the PBOC and the three functional financial services regulators,[16] to record the identities of customers and information relating to each transaction, and to retain retail transaction documents and books. BOCOM has policies and procedures to comply with Chinese laws and rules regarding anti-money-laundering. BOCOM represents that it has taken additional steps on its own initiative to combat money laundering and other illegal activities. BOCOM states that it has implemented measures consistent with the recommendations of the FATF and that it has put in place policies, procedures, and controls to ensure ongoing compliance with all statutory and regulatory requirements, including designating anti-money-laundering compliance personnel and conducting routine employee training at all BOCOM branches. BOCOM's compliance with anti-money-laundering requirements is monitored by the PBOC and by BOCOM's internal and external auditors.

The Board has also considered carefully the financial and managerial factors in this case. China has adopted risk-based capital standards that are consistent with those established by the Basel Capital Accord ("Accord"). BOCOM's capital is in excess of the minimum levels that would be required by the Accord and is considered equivalent to capital that would be required of a U.S. banking organization. Managerial and other financial resources of BOCOM are consistent with approval, and BOCOM appears to have the experience and capacity to support the proposed branch. In addition, BOCOM has established controls and procedures for the proposed branch to ensure compliance with U.S. law. In particular, BOCOM has stated that it will apply strict anti-money-laundering policies and procedures at the branch consistent with U.S. law and regulation and will establish an internal control system at the branch consistent with U.S. requirements to ensure compliance with those policies and procedures.

With respect to access to information about BOCOM's operations, the Board has reviewed the restrictions on disclosure in relevant jurisdictions in which BOCOM operates and has

[16] Those regulators are the CBRC, China Securities Regulatory Commission, and China Insurance Regulatory Commission.

communicated with relevant government authorities regarding access to information. BOCOM has committed to make available to the Board such information on the operations of BOCOM and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act, and other applicable federal law. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, BOCOM has committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from third parties for disclosure of such information. In light of these commitments and other facts of record, and subject to the condition described below, the Board has determined that BOCOM has provided adequate assurances of access to any necessary information that the Board may request.

China has made progress toward adopting a system of financial regulation for its financial system to mitigate the risk to financial stability from its banks. The PBOC, CBRC, other financial supervisory agencies, and other agencies in China have taken joint measures to strengthen and improve macroeconomic management, promote financial reform, and maintain financial stability. China has established a system of preliminary indicators for monitoring financial stability, developed methodology and operational frameworks for monitoring financial risks, and published an annual *China Financial Stability Report* since 2005. The CBRC has established mechanisms to cooperate with supervisory authorities in at least 25 other countries for the supervision of cross-border banking. In addition, the PBOC and CBRC officially joined the Basel Committee on Banking Supervision on behalf of China and since their accession, have actively participated in the revision of Basel II and in working groups. China also is active in the ongoing work of the Financial Stability Board.

On the basis of all the facts of record, and subject to the commitments made by BOCOM, as well as the terms and conditions set forth in this order, BOCOM's application to establish a branch is hereby approved. Should any restrictions on access to information on the operations or activities of BOCOM and its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by BOCOM or its affiliates with applicable federal statutes, the Board may require termination of any of BOCOM's direct or indirect activities in the United States, or in the case of any such operation licensed by the Office of the Comptroller of the Currency ("OCC"), recommend termination of such operation. Approval of this application also is specifically conditioned on compliance by BOCOM with the commitments made in connection with this application and with the conditions in this order.[17] The commitments and conditions referred to above are conditions imposed in writing by the Board in connection with this decision and may be enforced in proceedings under 12 U.S.C. § 1818 against BOCOM and its affiliates.

By order of the Board of Governors, effective April 8, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, and Raskin.

Robert deV. Frierson
Deputy Secretary of the Board

[17] The Board's authority to approve the establishment of the proposed branch parallels the continuing authority of the OCC to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the OCC to license the proposed office of BOCOM in accordance with any terms or conditions that it may impose.

Bank of Taiwan
Taipei, Taiwan

Order Approving Establishment of a Branch

Bank of Taiwan, Taipei, Taiwan ("Bank"), a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 7(d) of the IBA[1] to upgrade its existing state-licensed agency to a state-licensed branch in New York, New York. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a branch in the United States.

Notice of the application, affording interested persons an opportunity to comment, has been published in a newspaper of general circulation in New York, New York (*New York Post,* December 30, 2010). The time for filing comments has expired, and the Board has considered all comments received.

Bank, with total assets of approximately $135 billion, is the largest commercial bank in Taiwan.[2] Taiwan Financial Holdings Co., Ltd., which is wholly owned by Taiwan's Ministry of Finance, owns all of Bank's shares. Bank offers a range of commercial, investment, and retail banking products. Outside Taiwan, Bank operates branches in Hong Kong, Johannesburg, London, Singapore, and Tokyo and a representative office in Shanghai. In addition to its current state-licensed agency, Bank operates a state-licensed branch in Los Angeles, California.[3] Bank meets the requirements for a qualifying foreign banking organization under Regulation K.[4]

The proposed branch would continue the current activities of the New York agency, which include financing, syndicated lending, purchasing and holding securities, remittances, and foreign exchange trading, and would commence engaging in wholesale deposit-taking.

Under the IBA and Regulation K, in acting on an application by a foreign bank to establish a branch, the Board must consider whether the foreign bank (1) engages directly in the business of banking outside the United States; (2) has furnished the Board with the information it needs to assess the application adequately; and (3) is subject to comprehensive supervision on a consolidated basis by its home-country supervisors.[5] The Board also considers additional standards as set forth in the IBA and Regulation K.[6]

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1 12 U.S.C. § 3105(d).

2 Asset and ranking data are as of March 31, 2011.

3 Bank's home state is California. Under section 5 of the IBA, a foreign bank may upgrade an agency outside its home state to a branch if such an upgrade is permitted under state law and all other factors are consistent with approval (12 U.S.C. § 3103(a)(7)(B)).

4 12 CFR 211.23(a).

5 12 U.S.C. § 3105(d)(2); 12 CFR 211.24. In assessing this standard, the Board considers, among other indicia of comprehensive, consolidated supervision, the extent to which the home-country supervisors (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; and (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. No single factor is essential, and other elements may inform the Board's determination.

6 12 U.S.C. § 3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3). The additional standards set forth in section 7 of the IBA and Regulation K include the following (1) whether the bank's home-country supervisor has consented to the establishment of the office; the financial and managerial resources of the bank; (2) whether the bank has procedures to combat money laundering, whether there is a legal regime in place in the home country to address

As noted above, Bank engages directly in the business of banking outside the United States. Bank also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

With respect to supervision by home-country authorities, the Board previously has determined that other banks in Taiwan are subject to home-country supervision on a consolidated basis by the Financial Supervisory Commission ("FSC"), which has primary responsibility for the regulation of financial institutions in Taiwan.[7] Bank is supervised by the FSC on substantially the same terms and conditions as those other banks. Based on all the facts of record, it has been determined that Bank continues to be subject to comprehensive supervision on a consolidated basis by its home-country supervisor.

The additional standards set forth in section 7 of the IBA and Regulation K have also been taken into account.[8] The FSC has no objection to the establishment of the proposed branch.

The Board has also considered carefully the financial and managerial factors in this case. Taiwan has adopted risk-based capital standards that are consistent with those established by the Basel Capital Accord ("Accord"). Bank's capital is in excess of the minimum levels that would be required by the Accord and is considered equivalent to capital that would be required of a U.S. banking organization. Managerial and other financial resources of Bank also are consistent with approval, and Bank appears to have the experience and capacity to support the proposed branch. In addition, Bank has established controls and procedures for the proposed branch to ensure compliance with U.S. law.

Taiwan has enacted laws and regulations to deter money laundering that are consistent with Financial Action Task Force recommendations. Money laundering is a criminal offense in Taiwan, and financial institutions are required to establish internal policies, procedures, and systems for the detection and prevention of money laundering throughout their worldwide operations. Bank has policies and procedures to comply with these laws and regulations, and Bank's compliance with applicable laws and regulations is monitored by governmental entities responsible for anti-money-laundering compliance.

With respect to access to information about Bank's operations, the Board has reviewed the restrictions on disclosure in relevant jurisdictions in which Bank operates and has communicated with relevant government authorities regarding access to information. Bank has committed to make available to the Board such information on the operations of Bank and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act, and other applicable federal law. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, Bank has committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from third parties for disclosure of such information. In light of these commitments and other facts of record, and subject to the condition

money laundering, and whether the home country is participating in multilateral efforts to combat money laundering; (3) whether the appropriate supervisors in the home country may share information on the bank's operations with the Board; and (4) whether the bank and its U.S. affiliates are in compliance with U.S. law; the needs of the community; the bank's record of operation. The Board may also take into account, in the case of a foreign bank that presents a risk to the stability of the United States, whether the home country of the foreign bank has adopted, or is making demonstrable progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk (12 U.S.C. § 3105(d)(3)(E)).

[7] *See*, e.g., *Industrial Bank of Taiwan Co., Ltd.*, 93 *Federal Reserve Bulletin* C62 (2007). Bank was found to be subject to comprehensive supervision on a consolidated basis by the Ministry of Finance and the Central Bank of China in 1993. *Bank of Taiwan*, 79 *Federal Reserve Bulletin* 541 (1993).

[8] *See*, *supra*, note 6.

described below, the Board has determined that Bank has provided adequate assurances of access to any necessary information that the Board may request.

Taiwan has made progress toward adopting a system of financial regulation for its financial system to mitigate the risk to financial stability from its banks. The FSC and the Taiwanese government have taken a number of measures to strengthen the overall financial supervisory regime. These measures include requiring financial institutions to improve the management of assets and liabilities and transparency of financial information. Financial institutions are also required to improve corporate governance, internal controls, and internal audit systems. The FSC also has implemented regulations governing prompt corrective action and market-exit mechanisms for troubled financial institutions and has tightened the anti-money-laundering regime for the financial sector. The FSC has established mechanisms to cooperate with supervisory authorities in other countries for the supervision of cross-border banking, and it actively participates in the activities of international organizations.

On the basis of all the facts of record, and subject to the commitments made by Bank, as well as the terms and conditions set forth in this order, Bank's application to establish a branch is hereby approved. Should any restrictions on access to information on the operations or activities of Bank and its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Bank or its affiliates with applicable federal statutes, the Board may require termination of any of Bank's direct or indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by Bank with the commitments made in connection with this application and with the conditions in this order.[9] The commitments and conditions referred to above are conditions imposed in writing by the Board in connection with this decision and may be enforced in proceedings under 12 U.S.C. § 1818 against Bank and its affiliates.

By order of the Board of Governors, effective June 27, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, and Raskin.

Jennifer J. Johnson
Secretary of the Board

[9] The Board's authority to approve the establishment of the proposed branch parallels the continuing authority of the state of New York to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the state of New York and its agent, the New York State Banking Department, to license the proposed branch of Bank in accordance with any terms or conditions that the New York State Banking Department may impose.

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Legal Developments: Third Quarter, 2011

Order Issued under Bank Holding Company Act

Order Issued under Section 3 of the Bank Holding Company Act

Comerica Incorporated
Dallas, Texas

Comerica Bank
Dallas, Texas

Order Approving the Acquisition of a Bank Holding Company, Merger of Banks, and Establishment of Branches

Comerica Incorporated, Dallas, Texas ("Comerica"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire Sterling Bancshares, Inc. ("Sterling") and thereby indirectly acquire its subsidiary bank, Sterling Bank, both of Houston, Texas.

In addition, Comerica's subsidiary state member bank, Comerica Bank, Dallas, has requested the Board's approval under section 18(c) of the Federal Deposit Insurance Act[2] ("Bank Merger Act") to merge with Sterling Bank, with Comerica Bank as the surviving entity. Comerica Bank also has applied under section 9 of the Federal Reserve Act ("FRA") to retain and operate branches at the locations of Sterling Bank's main office and branches.[3]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (76 *Federal Register* 14,010 (2011)).[4] As required by the Bank Merger Act, a report on the competitive effects of the merger was requested from the United States Attorney General, and a copy of the request was provided to the appropriate banking agency. The time for filing comments has expired, and the Board has considered the applications and all comments received in light of the factors set forth in section 3 of the BHC Act, the Bank Merger Act, and the FRA.[5]

Comerica, with total consolidated assets of approximately $55.2 billion, is the 32nd largest depository organization in the United States, controlling deposits of approximately $41.1 billion, which represent less than 1 percent of the total amount of deposits of insured

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[1] 12 U.S.C. § 1842.

[2] 12 U.S.C. § 1828(c).

[3] 12 U.S.C. § 321.

[4] 12 CFR 262.3(b).

[5] The Board received 44 comments supporting the proposal and 2 comments opposing the proposal.

depository institutions in the United States.[6] Comerica controls two subsidiary banks, Comerica Bank and Comerica Bank & Trust, National Association, Ann Arbor, Michigan, which operate in five states.[7] In Texas, Comerica is the 11th largest depository organization, controlling deposits of approximately $5.2 billion.

Sterling has total consolidated assets of approximately $5.1 billion and Sterling Bank operates only in Texas. Sterling is the 14th largest depository organization in the Texas, controlling deposits of approximately $4.1 billion.

On consummation of this proposal, Comerica would remain the 32nd largest depository organization in the United States, with total consolidated assets of approximately $60.3 billion. Comerica would control domestic deposits of approximately $45.3 billion, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States. In Texas, Comerica would become the 7th largest depository organization, controlling deposits of approximately $9.3 billion, which represent approximately 1.9 percent of deposits of insured depository institutions in the state.

Interstate Analysis

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the bank holding company's home state if certain conditions are met. For purposes of the BHC Act, the home state of Comerica is Michigan,[8] and Sterling is located in Texas.[9]

Based on a review of all the facts of record, including relevant state statutes, the Board finds that the conditions for an interstate acquisition enumerated in section 3(d) are met in this case.[10] In light of all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

Competitive Considerations

The BHC Act and the Bank Merger Act prohibit the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. Both statutes also prohibit the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly out-

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[6] Nationwide asset and deposit data are as of March 31, 2011. In this context, insured depository institutions include insured commercial banks, savings banks, and savings associations.

[7] Comerica Bank operates in Arizona, California, Florida, Michigan, and Texas. Comerica Bank & Trust, National Association operates only in Michigan.

[8] *See* 12 U.S.C. § 1842(d). A bank holding company's home state is the state in which the total deposits of all banking subsidiaries of such company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later.

[9] For purposes of section 3(d) of the BHC Act, the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch. *See* 12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and 1842(d)(2)(B).

[10] 12 U.S.C. §§ 1842(d)(1)(A)–(B) and 1842(d)(2)–(3). Comerica is adequately capitalized and adequately managed, as defined by applicable law. Sterling Bank has been in existence and operated for the minimum period of time required by Texas law and for more than five years. *See* 12 U.S.C. § 1842(d)(1)(B)(i)–(ii). On consummation of the proposal, Comerica would control less than 10 percent of the total amounts of deposits of insured depository institutions in the United States (12 U.S.C. § 1842(d)(2)(A)). Comerica also would control less than 30 percent of, and less than the applicable state deposit cap for, the total amount of deposits in insured depository institutions in the relevant state (12 U.S.C. § 1842(d)(2)(B)–(D)). All other requirements of section 3(d) of the BHC Act would be met on consummation of the proposal.

weighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[11]

Comerica and Sterling have subsidiary depository institutions that compete directly in the Dallas, Fort Worth, and Houston banking markets, all in Texas. The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking markets, the relative shares of total deposits in insured depository institutions in the markets ("market deposits") controlled by Comerica Bank and Sterling Bank,[12] the concentration level of market deposits and the increase in those levels, as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Competitive Review guidelines ("DOJ Bank Merger Guidelines"),[13] and other characteristics of the market.

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Bank Merger Guidelines in all three banking markets.[14] On consummation, one banking market would remain unconcentrated, one banking market would remain moderately concentrated, and one banking market would remain highly concentrated, as measured by the HHI. The change in the HHI in each market would be consistent with Board precedent and the thresholds in the DOJ Bank Merger Guidelines. In addition, numerous competitors would remain in each banking market.

The DOJ has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the transaction would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board has concluded that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any of the banking markets where the subsidiary depository institutions of Comerica and Sterling compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

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[11] 12 U.S.C. §§ 1842(c)(1) and 1828(c)(5).

[12] Deposit and market share data are as of June 30, 2010, adjusted to reflect mergers and acquisitions through March 31, 2011, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See*, *e.g.*, *Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift institution deposits in the market share calculation on a 50 percent weighted basis. *See*, *e.g.*, *First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991).

[13] Under the DOJ Bank Merger Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally would not be challenged (in the absence of other factors indicating anti-competitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. Although the DOJ and the Federal Trade Commission recently issued revised Horizontal Merger Guidelines, the DOJ has confirmed that its Bank Merger Guidelines, which were issued in 1995, were not modified. Press Release, Department of Justice (August 19, 2010), www.justice.gov/opa/pr/2010/August/10-at-938.html.

[14] Those banking markets and the effects of the proposal on the concentrations of banking resources are described in the appendix.

Financial, Managerial, and Other Supervisory Considerations

Section 3 of the BHC Act and the Bank Merger Act require the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors.[15] The Board has considered these factors carefully in light of all the facts of record, including confidential supervisory and examination information from the relevant federal and state supervisors of the organizations involved in the proposal, and publicly reported and other financial information, including information provided by Comerica and Sterling.[16]

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary depository institutions and the organizations' significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered the proposal carefully under the financial factors. Comerica, Sterling, and their subsidiary depository institutions are well capitalized and would remain so on consummation of the proposal. The proposed transaction is structured as a share exchange. Based on its review of the record, the Board finds that Comerica has sufficient financial resources to effect the proposal.

The Board also has considered the managerial resources of the organizations involved and of the proposed combined organization. The Board has reviewed the examination records of Comerica, Sterling, and their subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of other relevant bank supervisory agencies with the organizations and their records of compliance with applicable banking and anti-money-laundering laws. Comerica and its subsidiary depository institutions are considered to be well managed. The Board also has considered Comerica's plans for implementing the proposal, including the proposed management after consummation. In addition, the Board has considered the future prospects of the organizations involved in the proposal in light of financial and managerial resources and the proposed business plan.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors.[17]

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act and the Bank Merger Act, the Board is required to consider the effects of the proposal on the convenience and needs of

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[15] 12 U.S.C. §§ 1842(c)(2)–(3) and 1828(c)(5).

[16] A commenter expressed concern that consummation of the proposal could eliminate its ability to bring a lawsuit against Sterling or Sterling Bank and pursue complaints with other agencies. The jurisdiction of the courts and of other agencies is a matter beyond the statutory factors the Board is authorized to consider. *See Western Bancshares, Inc. v. Board of Governors,* 480 F.2d 749 (10th Cir. 1973).

[17] A commenter expressed concern about lawsuits by Sterling shareholders regarding the proposal. Those lawsuits have been dismissed.

the communities to be served and to take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[18]

The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[19]

The Board has considered carefully all the facts of record, including evaluations of the CRA performance of Sterling Bank and Comerica's subsidiary banks, data reported by Comerica under the Home Mortgage Disclosure Act ("HMDA"),[20] other information provided by Comerica, confidential supervisory information, and public comment received on the proposal. The Board received a number of comments commending Comerica for its lending and CRA activities, but one commenter criticized the performance of Comerica and Sterling in meeting the credit needs of borrowers in LMI areas in Houston.

A. CRA Performance Evaluation

As provided in the CRA, the Board has considered the convenience and needs factor in light of the evaluations by the appropriate federal supervisor of the CRA performance record of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[21]

Comerica Bank received an "outstanding" rating at its most recent CRA performance evaluation by the Federal Reserve Bank of Dallas ("Reserve Bank"), as of August 16, 2010 ("2010 Evaluation").[22] Sterling Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Deposit Insurance Corporation, as of February 4, 2009 ("2009 Evaluation"). Comerica has represented that Comerica Bank's current CRA program will be implemented at the combined organization following consummation of the proposal.

CRA Performance of Comerica Bank. In addition to the overall "outstanding" rating that Comerica Bank received in the 2010 Evaluation, it received separate overall ratings of "outstanding" or "satisfactory" in all the states reviewed.[23] Examiners characterized as excellent

[18] 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 1842(c)(2).

[19] 12 U.S.C. § 2903.

[20] 12 U.S.C. § 2801 et seq.

[21] *See Interagency Questions and Answers Regarding Community Reinvestment*, 75 *Federal Register* 11642 at 11665 (2010).

[22] Comerica's other subsidiary insured depository institution, Comerica Bank & Trust, National Association, is a trust company that does not grant credit to the public in the ordinary course of its business and, accordingly, is not subject to the CRA. *See* 12 CFR 25.11(c)(3).

[23] The evaluation period was from January 1, 2008, through December 31, 2009. In addition to reviewing HMDA-reportable lending, CRA-reportable lending, and community development lending, examiners reviewed Comerica Bank's home equity lending at its request because the bank had elected to collect data about such lending. *See* 12 CFR 228.22(a)(1). As of the end of the evaluation period, loans to businesses accounted for almost 72 percent of the bank's loan portfolio and residential real estate loans accounted for less than 7 percent. As a result, examiners gave the greatest weight in the 2010 Evaluation to CRA-reportable and community development lending.

the bank's overall performance in providing small business loans[24] in LMI census tracts in its assessment areas.[25] They also stated that the bank's overall distribution of small business loans to businesses of different sizes was good. With respect to Comerica Bank's home mortgage lending, examiners reported that the overall geographic distribution and distribution to borrowers of different income levels of those loans were good.

Examiners noted that the bank offers government and proprietary lending programs to help meet the credit needs of LMI borrowers and smaller, newer businesses. Micro business loans and Small Business Administration ("SBA") loans accounted for more than $102 million and $34 million, respectively, of the lending activity during the evaluation period. Examiners found that the bank had made a relatively high level of community development loans throughout its service area during the evaluation period, totaling more than $464 million.[26]

In the 2010 Evaluation, the bank received an overall "outstanding" rating under the investment test. Examiners reported that the bank invested more than $143 million in low-income-housing tax credit funds to address affordable housing needs in the bank's assessment areas. Bank also made more than $10.8 million in community development grants and donations in support of affordable housing, small business development, and organizations serving LMI areas and individuals.[27]

The bank received an overall "outstanding" rating under the service test in the 2010 Evaluation. Examiners reported that the bank's products and services were generally accessible to all businesses and individuals in the assessment areas.[28] Examiners characterized Comerica Bank as a leader in providing community development services, including financial literacy, affordable housing seminars, and economic development activities.[29]

CRA Performance of Sterling Bank. In the 2009 Evaluation, Sterling Bank was rated "low satisfactory" under the lending test.[30] In the bank's Houston assessment area, examiners reported that Sterling Bank's distribution of small business loans among census tracts of different income levels was reasonable in comparison to that of lenders in the aggregate, as was its distribution of small business loans to businesses of different sizes.[31] Examiners

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[24] In this context, a small business loan is a loan with an original amount of $1 million or less that is secured by nonfarm, nonresidential property or is a commercial or industrial loan to a borrower in the United States.

[25] Examiners reported that the extent of the bank's small business lending in LMI census tracts in the Houston area during the evaluation period compared very favorably with that of lenders in the aggregate. Lending data for lenders in the aggregate represent the cumulative lending for all financial institutions that have reported small business lending data in a particular area.

[26] Comerica Bank originated four community development loans totaling $1.6 million in the Houston area during the evaluation period. Examiners characterized this amount of lending as a low level of activity, given the need for and the opportunities to make such loans.

[27] Examiners characterized the bank's level of community development investment in its Houston assessment area as excellent by noting that the bank invested more than $14 million in low-income-housing tax credit projects in the area during the evaluation period.

[28] Examiners concluded that the bank's branches and ATMs are reasonably accessible to individuals and census tracts of different income levels in the bank's Houston assessment area. In addition, examiners stated that the bank's record of opening and closing branches within its Houston assessment area had not adversely affected accessibility of services to LMI individuals and census tracts.

[29] The 2010 Evaluation reported that the bank provided a relatively high level of community development services in its Houston assessment area during the evaluation period.

[30] The evaluation included HMDA-reportable and small business lending for 2006, 2007, and 2008. The evaluation period with respect to community development loans, investments, and services was from November 24, 2005, to February 24, 2008. The Houston assessment area accounted for more than 75 percent of the bank's deposits and more than 70 percent of the bank's loan originations during the evaluation period.

[31] During the evaluation period, Sterling Bank made significantly more small business loans than home mortgage loans. Accordingly, examiners placed more weight on the bank's small business lending in evaluating performance under the lending test.

stated that in this assessment area, the bank demonstrated a strong distribution of home purchase loans among census tracts with different income levels but had a poor distribution of home purchase loans among borrowers of different income levels.[32]

Examiners characterized the bank's participation in specialized loan programs in its Houston assessment area as good, noting that the bank originated 200 SBA loans totaling more than $118 million. Sterling Bank's level of community development lending in the Houston assessment area was described by examiners as satisfactory overall, and they noted that the bank originated 21 community development loans totaling more than $33 million.

The bank received an overall "high satisfactory" rating under the investment test in the 2009 Evaluation. The bank's qualified investments in its Houston assessment area totaled $17.1 million during the evaluation period, and examiners reported that the bank routinely made grants and donations to organizations that promoted community development.

In the 2009 Evaluation, Sterling Bank received an overall "outstanding" rating under the service test. Examiners described the bank as demonstrating outstanding responsiveness with respect to services in the Houston assessment area. Examiners stated that the bank's branch network in the assessment area provided ready accessibility to bank products and services and included seven full-service offices in moderate-income census tracts. The bank was characterized by examiners as a leader in providing community development services in the Houston assessment area. Examiners reported that the bank supported organizations promoting community development by allowing its personnel to serve as board members and to conduct fundraising, among other efforts.

B. Branch Closings

One commenter expressed concern that the proposed merger would lead to branch closures and adversely affect banking services in LMI areas. Comerica has represented that it has not decided whether to close any branches after consummation of the proposal but that any closures that do occur would be consolidations of branches located near each other.

The Board has considered that federal banking law provides a specific mechanism for addressing branch closings.[33] Federal law requires an insured depository institution to provide notice to the public and to the appropriate federal supervisory agency before closing a branch and to adopt a policy regarding branch closures. In the 2010 Evaluation, examiners found that Comerica Bank's record of opening or closing branches had not adversely affected the accessibility of the bank's services to LMI areas or LMI individuals. In addition, the Board notes that it will continue to review the branch closing record of Comerica Bank in the course of conducting CRA performance evaluations.

C. HMDA and Fair Lending Record

The Board has carefully considered the fair lending records and HMDA data of Comerica in light of public comment received on the proposal. A commenter alleged, based on pre-

[32] By contrast, examiners characterized Comerica Bank's distribution of HMDA-reportable loans in its Houston assessment area as excellent. As noted, Comerica has represented that Comerica Bank will implement its current CRA program at the combined organization following consummation of the proposal.

[33] Section 42 of the Federal Deposit Insurance Act, 12 U.S.C. § 1831r-1, as implemented by the Joint Policy Statement Regarding Branch Closings (64 *Federal Register* 34,844 (1999)), requires that a bank provide the public with at least 30 days' notice, and the appropriate federal supervisory agency and customers of the branch with at least 90 days' notice, before the date of the proposed branch closings. The bank also is required to provide reasons and other supporting data for the closure, consistent with the institution's written policy for branch closings.

liminary 2010 HMDA data,[34] that Comerica made high cost mortgage loans disproportionately to African American borrowers relative to nonminority borrowers.[35] The data indicate that of Comerica Bank's HMDA- reportable loans to minority borrowers in 2009, a higher percentage were high cost mortgage loans than was the case for lenders in the aggregate.[36]

The Board is concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Moreover, the Board believes that all bank holding companies and their affiliates must conduct their mortgage lending operations without any abusive lending practices and in compliance with all consumer protection laws.

The HMDA data also indicate that in Comerica Bank's Michigan assessment areas in 2009, which accounted for a substantial majority of the bank's mortgage lending in that year, minority borrowers represented a higher percentage of Comerica Bank's loan originations than was the case for lenders in the aggregate.[37] In addition, the Board notes that of the bank's HMDA reportable loans to minority borrowers in 2009, fewer than 13 percent were high cost mortgage loans.

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, denials, or pricing among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not Comerica is excluding any racial or ethnic group on a prohibited basis. The Board recognizes that HMDA data alone, even with the addition of pricing information, provide only limited information about the covered loans.[38] The HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide onsite evaluations of compliance with fair lending laws by Comerica Bank. In the 2010 Evaluation, examiners reported that they did not find any evidence that Comerica Bank had engaged in illegal discrimination or in any other illegal credit practices. In addition, the Board has considered information provided by Comerica about its compliance risk-management systems.

The record of this application, including confidential supervisory information, indicates that Comerica has taken steps to ensure compliance with fair lending and other consumer

[34] The Board reviewed HMDA data for 2008, 2009, and preliminary 2010 data for Comerica Bank in its statewide assessment areas for California, Michigan, and Texas.

[35] A "high cost mortgage loan" is a mortgage loan with an annual percentage rate that equals or exceeds the average prime offer rate for a comparable transaction by 1.5 percentage points if secured by a first lien on a dwelling or 3.5 percentage points if secured by a subordinate lien (12 CFR 203.4(a)(12).

[36] The lending data of the aggregate lenders represent the cumulative lending for all financial institutions that have reported HMDA data in a particular area.

[37] In 2009, mortgage loans in Comerica Bank's Michigan assessment areas accounted for approximately 71 percent of the bank's total HMDA-reportable loans. Aggregate HMDA data for 2010 are not yet available.

[38] The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

protection laws and regulations. Comerica represents that Comerica Bank has such compliance policies and procedures in place, including centralized underwriting of mortgage loans to minimize exceptions to lending criteria, and an additional review of mortgage application denials. In addition, Comerica Bank uses third-party analysis of mortgage underwriting and pricing, including regression and disparate impact modeling, and regularly reviews HMDA denial ratios and rate-spread distributions. Moreover, Comerica has stated that Sterling Bank's operations will be integrated into Comerica Bank's existing fair lending compliance program after consummation of the proposal.

The Board also has considered the HMDA data in light of other information, including the overall performance records of Comerica Bank and Sterling Bank under the CRA. These established efforts and records of performance demonstrate that the institutions are active in helping to meet the credit needs of their entire communities.

D. Conclusion on Convenience and Needs and CRA Performance

The Board has considered carefully all the facts of record, including reports of examination of the CRA records of Comerica Bank and Sterling Bank, information provided by Comerica, public comments received on the proposal, and confidential supervisory information, including records of compliance with consumer laws and regulations. Comerica has represented that consummation of the proposal would allow it to offer the full range of its current products and services to Sterling's customers.

Based on a review of the entire record, and for the reasons discussed above, the Board has concluded that considerations relating to the convenience and needs factor and the CRA performance records of the relevant insured depository institutions are consistent with approval of the proposal.

Other Considerations

Comerica Bank also has applied under section 9 of the FRA to establish and operate branches at the locations of the main office and branches of Sterling Bank. The Board has assessed the factors it is required to consider when reviewing an application under section 9 of the FRA and finds those factors to be consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the applications should be, and hereby are, approved.[39] In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under

[39] A commenter requested that the Board hold a public meeting or hearing on the proposal. Section 3(b) of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authorities for the bank to be acquired make a timely written recommendation of denial of the application (12 CFR 225.16(e)). The Board has not received such a recommendation from the appropriate supervisory authorities. Under its regulations, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if a meeting or hearing is necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony (12 CFR 262.3(e) and 262.25(d)). The Board has considered carefully the commenter's request in light of all the facts of record. In the Board's view, the commenter has had ample opportunity to submit views and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The request fails to identify disputed issues of fact that are material to the Board's decision that would be clarified by a public meeting or hearing. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the request for a public meeting or hearing on the proposal is denied.

the BHC Act, the Bank Merger Act, and the FRA.[40] The Board's approval is specifically conditioned on compliance by Comerica and Comerica Bank with the conditions in this order and all the commitments made to the Board in connection with the proposal. For purposes of this proposal, these commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Reserve Bank, acting pursuant to delegated authority.

By order of the Board of Governors, effective July 13, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, and Raskin.

Robert deV. Frierson
Deputy Secretary of the Board

Appendix

Comerica and Sterling Banking Markets Consistent with Board Precedent and DOJ Bank Merger Guidelines

Bank	Rank	Amount of Deposits (dollars)	Market Deposit Shares (percent)	Resulting HHI	Change in HHI	Remaining Number of Competitors
Dallas, Texas—includes Dallas and Rockwall counties; the southeastern quadrant of Denton County, including Denton and Lewisville; the southwestern quadrant of Collin County, including McKinney and Plano; the communities of Forney and Terrell in Kaufman County; and Midlothian, Waxahachie, and Ferris in Ellis County.						
Comerica Pre-Consummation	5	$3.29 bil.	2.8	1972	1	129
Sterling	38	$230 mil.	0.2			
Comerica Post-Consummation	5	$3.52 bil.	3.0			
Houston, Texas—includes Austin, Brazoria, Chambers, Fort Bend, Galveston, Harris, Liberty, Montgomery, San Jacinto, and Waller counties.						
Comerica Pre-Consummation	12	$1.4 bil.	1.2	1507	5	108
Sterling	6	$3.3 bil.	2.7			
Comerica Post-Consummation	6	$4.7 bil.	3.9			
Fort Worth, Texas—includes Tarrant, Johnson, and Wise counties; Parker County (excluding Mineral Wells); and the southwestern quadrant of Denton County, including Roanoke.						
Comerica Pre-Consummation	25	$171 mil.	.7	972	0	76
Sterling	61	$35 mil.	.1			
Comerica Post-Consummation	16	$206 mil.	.8			

Note: Data are as of June 30, 2010. All deposit amounts are unweighted. All rankings, market deposit shares, and HHIs are based on thrift institution deposits weighted at 50 percent.

[40] One commenter requested that the Board delay action on the proposal. As noted, the Board has accumulated a significant record in this case, including reports of examination, confidential supervisory information, public reports and information, and public comments. The commenter has had ample opportunity to submit its views and, in fact, has provided multiple written submissions that the Board has considered carefully in acting on the proposal. Based on a review of all the facts of record, the Board has concluded that the record in this case is sufficient to warrant action at this time and that no further delay in considering the proposal is necessary.

Orders Issued under International Banking Act

Banca Popolare di Vicenza S.C.p.A.
Vicenza, Italy

Order Approving Establishment of a Representative Office

Banca Popolare di Vicenza S.C.p.A. ("Bank"), Vicenza, Italy, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 10(a) of the IBA[1] to establish a representative office in New York, New York. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a representative office in the United States.

Notice of the application, affording interested persons an opportunity to comment, has been published in a newspaper of general circulation in New York City (*Daily News*, February 24, 2011). The time for filing comments has expired, and all comments received have been considered.

Bank is organized as a cooperative bank under Italian law and has approximately 60,000 shareholders. Bank's shares are widely held, and each shareholder holds less than 1 percent of the bank's shares.

Bank, with total consolidated assets of approximately $50.9 billion,[2] is the 11th largest bank in Italy by asset size.[3] Bank provides consumer banking and wholesale banking services to private individuals, professionals, and small- and medium-sized companies. Bank's foreign operations include a financial subsidiary in Ireland and four representative offices: two in China, one in India, and one in Brazil.

The proposed representative office would serve as a liaison between Bank and its customers.[4] The office would also conduct research and assemble credit information on companies; organize seminars, workshops, and conventions; solicit banking business for Bank; and assist its clients in obtaining banking and other services in the United States.

In acting on an application under the IBA and Regulation K by a foreign bank to establish a representative office, the Board must consider whether the foreign bank directly engages in the business of banking outside of the United States and whether the foreign bank has furnished to the Board the information it needs to adequately assess the application.[5] In addition, the Board shall take into account whether the foreign bank is subject to comprehensive supervision on a consolidated basis by its home-country supervisor.[6] The Board also considers additional standards set forth in the IBA and Regulation K.[7]

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1 12 U.S.C. § 3107(a).

2 Unless otherwise indicated, data are as of June 30, 2011.

3 Ranking data are as of December 31, 2009.

4 A representative office may engage in representational and administrative functions in connection with the banking activities of the foreign bank, including soliciting new business for the foreign bank, conducting research, acting as a liaison between the foreign bank's head office and customers in the United States, performing preliminary and servicing steps in connection with lending, and performing back-office functions. A representative office may not contract for any deposit or deposit-like liability, lend money, or engage in any other banking activity (12 CFR 211.24(d)(1)).

5 12 U.S.C. § 3107(a)(2).

6 *Id.*; 12 CFR 211.24(d)(2). In assessing the supervision standard, the Board considers, among other indicia of comprehensive, consolidated supervision, the extent to which the home-country supervisor (i) ensures that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtains information

As noted above, Bank engages directly in the business of banking outside the United States. Bank also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

With respect to supervision by home-country authorities, the Board previously has determined, in connection with applications involving other banks in Italy, that those banks were subject to home-country supervision on a consolidated basis by the Bank of Italy, the primary regulator of commercial banks in Italy.[8] Bank is supervised by the Bank of Italy on substantially the same terms and conditions as those other banks. Based on all the facts of record, including the above information, it has been determined that Bank is subject to comprehensive supervision on a consolidated basis by its home-country supervisor. The Bank of Italy has no objection to the proposed representative office.

With respect to the financial and managerial resources of Bank, taking into consideration Bank's record of operation in the home country, overall financial resources, and standing with the home-country supervisor, financial and managerial factors are consistent with approval. Bank appears to have the experience and capacity to support the proposed representative office and has established controls and procedures to ensure compliance with U.S. law, as well as controls and procedures for its worldwide operations generally.

Italy is a member of the Financial Action Task Force and subscribes to its recommendations on measures to combat money laundering. In accordance with those recommendations, Italy has enacted laws and created legislative and regulatory standards to deter money laundering, terrorist financing, and other illicit activities. Money laundering is a criminal offense in Italy, and credit institutions are required to establish internal policies, procedures, and systems for the detection and prevention of money laundering throughout their worldwide operations. Bank has policies and procedures to comply with these laws and regulations that are monitored by governmental entities responsible for anti-money-laundering compliance.

With respect to access to information about Bank's operations, the restrictions on disclosure in relevant jurisdictions in which Bank operates have been reviewed and relevant governmental authorities have been communicated with regarding access to information. Bank has committed to make available to the Board such information on the operations of Bank and any of its affiliates that the Board deems necessary to determine and enforce compli-

on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtains information on the dealings with and the relationship between the bank and its affiliates, both foreign and domestic; (iv) receives from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; and (v) evaluates prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. No single factor is essential, and other elements may inform the Board's determination.

[7] *See* 12 U.S.C. § 3105(d)(3)–(4); 12 CFR 211.24(c)(2). These standards include (1) whether the bank's home-country supervisor has consented to the establishment of the office; the financial and managerial resources of the bank; (2) whether the bank has procedures to combat money laundering, whether there is a legal regime in place in the home-country to address money laundering, and whether the home country is participating in multilateral efforts to combat money laundering; (3) whether the appropriate supervisors in the home country may share information on the bank's operations with the Board; and (4) whether the bank and its U.S. affiliates are in compliance with U.S. law; the needs of the community; and the bank's record of operation. *See also Standard Chartered Bank*, 95 *Federal Reserve Bulletin* B98 (2009). The Board may also, in the case of a foreign bank that presents a risk to the stability of the United States, take into account, to the extent appropriate, whether the home country of the foreign bank has adopted, or is making demonstrable progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk (12 U.S.C. § 3105(d)(3)(E)).

[8] *See*, e.g., Board letter to Luigi L. De Ghenghi dated September 25, 2007 (comprehensive consolidated supervision for Intesa Sanpaolo S.p.A.); *Banca di Roma, S.p.A.*, 2002 WL 1848520 (2002); *Banca Intesa, S.p.A.*, 86 *Federal Reserve Bulletin* 433 (2000).

ance with the IBA, the Bank Holding Company Act of 1956, as amended, and other applicable federal law. To the extent that providing such information to the Board may be prohibited by law or otherwise, Bank has committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from third parties for disclosure of such information. In addition, subject to certain conditions, Bank of Italy may share information on Bank's operations with other supervisors, including the Board. In light of these commitments and other facts of record, and subject to the conditions described below, it has been determined that Bank has provided adequate assurances of access to any necessary information that the Board may request.

Information relevant to the standard regarding risk to the stability of the United States financial system has also been reviewed. In particular, consideration has been given to the absolute and relative size of Bank in its home country, the scope of Bank's activities, including the type of activities it proposes to conduct in the United States and the potential for those activities to increase or transmit financial instability, and the framework in place for supervising Bank in its home country. Based on these and other factors, financial stability considerations in this proposal are consistent with approval.

Based on the foregoing and all the facts of record, and subject to commitments made by Bank to the Board, as well as the terms and conditions set forth in this order, Bank's application to establish the representative office is hereby approved by the Director of the Division of Banking Supervision and Regulation, with the concurrence of the General Counsel, pursuant to authority delegated by the Board.[9] Should any restrictions on access to information on the operations or activities of Bank and its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Bank or its affiliates with applicable federal statutes, the Board may require termination of any of Bank's direct or indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by Bank with the conditions imposed in this order and the commitments made to the Board in connection with this application.[10] For purposes of this action, these commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with the findings and decision herein and, as such, may be enforced in proceedings under applicable law.

By order, approved pursuant to authority delegated by the Board, effective September 27, 2011.

Robert deV. Frierson
Deputy Secretary of the Board

The Bank of Fukuoka, Ltd.
Fukuoka, Japan

Order Approving Establishment of a Representative Office

The Bank of Fukuoka, Ltd. ("Bank"), Fukuoka, Japan, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 10(a) of the IBA[1] to

[9] 12 CFR 265.7(d)(12).

[10] The Board's authority to approve the establishment of the proposed representative office parallels the continuing authority of the State of New York to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the State of New York or its agent, the New York State Banking Department, to license the proposed representative office of Bank in accordance with any terms or conditions that it may impose.

[1] 12 U.S.C. § 3107(a).

establish a representative office in New York, New York. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a representative office in the United States.

Notice of the application, affording interested persons an opportunity to comment, has been published in a newspaper of general circulation in New York, New York (*New York Daily News*, October 21, 2010). The time for filing comments has expired, and all comments received have been considered.

Bank, with total assets of approximately $117 billion, is the 13th largest bank in Japan by asset size.[2] Bank engages in a range of commercial and retail banking activities through its 166 domestic branches. Outside Japan, Bank operates three representative offices in China, including one in Hong Kong. Bank is wholly owned by Fukuoka Financial Group, Inc. ("FFG"), a Japanese financial holding company,[3] and Bank has no operations in the United States.[4]

The proposed representative office would act as a liaison between Bank and its U.S. customers and correspondent banks. The proposed representative office would also engage in other representational activities, including gathering information and conducting research.[5]

In acting on an application under the IBA and Regulation K by a foreign bank to establish a representative office, the Board must consider whether (1) the foreign bank has furnished to the Board the information it needs to assess the application adequately; (2) the foreign bank and any foreign bank parent engage directly in the business of banking outside of the United States; and (3) the foreign bank and any foreign bank parent are subject to comprehensive supervision on a consolidated basis by their home-country supervisor.[6] The Board may also consider additional standards set forth in the IBA and Regulation K.[7]

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[2] Asset and ranking data are as of June 30, 2011.

[3] Japan Trustee Services Bank, Ltd., a Japanese trust bank, owns 7.37 percent of the voting stock of FFG. No other shareholder owns 5 percent or more of the voting shares of FFG.

[4] In 1986, Bank opened a representative office in New York, New York, that was converted to a branch in 1989 and closed in 1999.

[5] A representative office may engage in representational and administrative functions in connection with the banking activities of the foreign bank, including soliciting new business for the foreign bank, conducting research, acting as a liaison between the foreign bank's head office and customers in the United States, performing preliminary and servicing steps in connection with lending, and performing back-office functions. A representative office may not contract for any deposit or deposit-like liability, lend money, or engage in any other banking activity (12 CFR 211.24(d)(1)).

[6] 12 U.S.C. § 3107(a)(2); 12 CFR 211.24(d)(2). In assessing the supervision standard, the Board considers, among other indicia of comprehensive, consolidated supervision, the extent to which the home-country supervisors (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtain information on the dealings with and the relationship between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; and (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. No single factor is essential, and other elements may inform the Board's determination.

[7] *See* 12 U.S.C. § 3105(d)(3)–(4); 12 CFR 211.24(c)(2). These standards include (1) whether the bank's home-country supervisor has consented to the establishment of the office; the financial and managerial resources of the bank; (2) whether the bank has procedures to combat money laundering, whether there is a legal regime in place in the home country to address money laundering, and whether the home country is participating in multilateral efforts to combat money laundering; (3) whether the appropriate supervisors in the home country may share information on the bank's operations with the Board; and (4) whether the bank and its U.S. affiliates are in compliance with U.S. law; the needs of the community; and the bank's record of operation. *See also Standard Chartered Bank,* 95 *Federal Reserve Bulletin* B98 (2009). The Board may also, in the case of a foreign bank that presents a risk to the stability of the United States, take into account, to the extent appropriate, whether

As noted above, Bank engages directly in the business of banking outside the United States. Bank also has provided the Board with the information necessary to assess the application through submissions that address the relevant issues.

With respect to supervision by home-country authorities, the Board has previously determined, in connection with applications involving other banks in Japan, that those banks were subject to home-country supervision on a consolidated basis by their home-country supervisor, Japan's Financial Services Agency ("FSA").[8] Bank is supervised by the FSA on substantially the same terms and conditions as those other banks. Based on all the facts of record, including the above information, it has been determined that Bank is subject to comprehensive supervision on a consolidated basis by its home-country supervisor. The FSA has no objection to the establishment of the proposed representative office.

With respect to the financial and managerial resources of Bank, taking into consideration Bank's record of operations in its home country, its overall financial resources, and its standing with its home-country supervisor, financial and managerial factors are consistent with approval of the proposed representative office. Bank appears to have the experience and capacity to support the proposed representative office and has established controls and procedures for the proposed representative office to ensure compliance with U.S. law, as well as controls and procedures for its worldwide operations generally.

Japan is a member of the Financial Action Task Force and subscribes to its recommendations on measures to combat money laundering and international terrorism. In accordance with those recommendations, Japan has enacted laws and created legislative and regulatory standards to deter money laundering, terrorist financing, and other illicit activities. Money laundering is a criminal offense in Japan, and Japanese financial institutions are required to establish internal policies, procedures, and systems for the detection and prevention of money laundering throughout their worldwide operations. Bank has policies and procedures to comply with these laws and regulations that are monitored by governmental entities responsible for anti-money-laundering compliance.

With respect to access to information about Bank operations, the restrictions on disclosure in relevant jurisdictions in which Bank operates have been reviewed and relevant government authorities have been communicated with regarding access to information. Bank and FFG have committed to make available to the Board such information on the operations of Bank and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act of 1956, as amended, and other applicable federal law. To the extent that providing such information to the Board may be prohibited by law or otherwise, Bank and FFG have committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from third parties for the disclosure of such information. In addition, subject to certain conditions, the FSA may share information on Bank's operations with other supervisors, including the Board. In light of these commitments and other facts of record, and subject to the condition described below, it has been determined that Bank and FFG have provided adequate assurances of access to any necessary information that the Board may request.

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the home country of the foreign bank has adopted, or is making demonstrable progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk (12 U.S.C. § 3105(d)(3)(E)).

[8] *See*, *e.g.*, *Mitsubishi UFJ Financial Group, Inc.*, 97 *Federal Reserve Bulletin* 10 (2011) (order dated June 14, 2011) and 95 *Federal Reserve Bulletin* B34 (2009); *Shizuoka Bank, Ltd.*, 94 *Federal Reserve Bulletin* C119 (2008); *eBANK Corporation*, 94 *Federal Reserve Bulletin* C68 (2008); *The Wakashio Bank, Limited*, 89 *Federal Reserve Bulletin* 237 (2003).

Information relevant to the standard regarding risk to the stability of the United States financial system has also been reviewed. In particular, consideration has been given to the absolute and relative size of Bank in its home country, the scope of Bank's activities, including the type of activities it proposes to conduct in the United States and the potential for those activities to increase or transmit financial instability, and the framework in place for supervising Bank in its home country. Based on these and other factors, financial stability considerations in this proposal are consistent with approval.

Based on the foregoing and all the facts of record, Bank's application to establish the proposed representative office is hereby approved by the Director of the Division of Banking Supervision and Regulation, with the concurrence of the General Counsel, pursuant to authority delegated by the Board.[9] Should any restrictions on access to information on the operations or activities of Bank and its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Bank or its affiliates with applicable federal statutes, the Board may require termination of any of Bank's direct or indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by Bank with the conditions imposed in this order and the commitments made to the Board in connection with this application.[10] For purposes of this action, these commitments and conditions are deemed to be conditions imposed in writing in connection with the findings and decision herein and, as such, may be enforced in proceedings under applicable law.

By order, approved pursuant to authority delegated by the Board, effective September 27, 2011.

Robert deV. Frierson
Deputy Secretary of the Board

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9 12 CFR 265.7(d)(12).

10 The Board's authority to approve the establishment of the proposed representative office parallels the continuing authority of the State of New York to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the State of New York or its agent, the New York State Banking Department, to license the proposed office of Bank in accordance with any terms or conditions that it may impose.

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