



Federal Reserve Bulletin

2013 Compilation

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM



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Federal Reserve BULLETIN

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Federal Reserve BULLETIN

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 2010 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/econresdata/statisticsdata.htm. 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

Mortgage Market Conditions and Borrower Outcomes: Evidence from the 2012 HMDA Data and Matched HMDA–Credit Record Data³

Neil Bhutta and Glenn B. Canner, of the Division of Research and Statistics, prepared this article. Shira Stolarsky and Madura Watanagase provided research assistance.

The Home Mortgage Disclosure Act of 1975 (HMDA) requires most mortgage lending institutions with offices in metropolitan areas to disclose to the public detailed information about their home-lending activity each year. 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.¹

HMDA was enacted to help members of the public determine whether financial institutions are serving the housing needs of their local communities and treating borrowers and loan applicants fairly, provide information that could facilitate the efforts of public entities to distribute funds to local communities for the purpose of attracting private investment, and help households decide where they may want to deposit their savings.² The data have proven to be valuable for research and are often used in public policy deliberations related to the mortgage market.

The 2012 HMDA data consist of information pertaining to more than 15.3 million applications for home loans resulting in nearly 9.8 million loans reported by 7,400 home lenders, including all of the nation's largest mortgage originators. Together, the home-purchase, refinance, and home-improvement loans reported represent most home lending nationwide and thus are broadly representative of all such lending in the United States.³

On July 21, 2011, rulemaking responsibility for HMDA was transferred from the Federal Reserve Board to the newly established Consumer Financial Protection Bureau (CFPB).⁴ The Federal Financial Institutions Examination Council (FFIEC) continues to be respon-

¹ A list of the items reported under HMDA for 2012 is provided in appendix A. The 2012 HMDA data reflect property locations using the census-tract geographic boundaries created for the 2010 decennial census. The 2012 HMDA data do not reflect recent updates to the list of metropolitan statistical areas (MSAs) published by the Office of Management and Budget. Reporters will use the updated list of MSAs in preparing their 2014 HMDA data. For further information, see Federal Financial Institutions Examination Council (2013), "OMB Announcement—Revised Delineations of MSAs," press release, February 28, www.ffiec.gov/hmda/OMB_MSA.htm.

² A brief history of HMDA is available at Federal Financial Institutions Examination Council, "History of HMDA," webpage, www.ffiec.gov/hmda/history2.htm.

³ 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.

⁴ For information about the Consumer Financial Protection Bureau, see www.consumerfinance.gov.

sible for collecting the HMDA data from reporting institutions and facilitating public access to the information.⁵ In September of each year, the FFIEC releases to the public summary disclosure tables pertaining to lending activity from the previous calendar year for each reporting lender as well as aggregations of home-lending activity for each metropolitan statistical area (MSA) and for the nation as a whole.⁶ The FFIEC also makes available to the public a data file containing virtually all of the reported information for each lending institution as well as a file that includes key demographic and housing-related data for each census tract drawn from census sources.⁷

One purpose of this article, similar to that of previous articles, is to describe mortgage market activity in 2012 and in prior years using the HMDA data.⁸ Notably, for their 2012 lending, covered institutions were directed to use the census-tract definitions created for the 2010 decennial census to identify property location, whereas in the previous 10 years, census-tract definitions based on the 2000 census were used. Moreover, in preparing public disclosures for the 2012 HMDA data, the FFIEC used census-tract population and housing characteristics derived from the 2010 decennial census and the 2006–10 American Community Survey (ACS).⁹ Because many census tracts have changed boundaries and have had substantial changes in their population and housing characteristics over the past decade, some caution needs to be exercised when comparing lending patterns across census tracts between 2012 and earlier years.¹⁰

⁵ 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.

⁶ MSAs have at least one urbanized area of 50,000 or more individuals plus adjacent geographies that have a high degree of economic and social integration with the core area as measured by information on commuting patterns. MSAs are composed of entire counties and include about 85 percent of the U.S. population. 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#ms. For the 2012 data, the FFIEC prepared and made available to the public 49,829 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. The costs incurred by the FFIEC to process the annual PMI data and make reports available to the public are borne by the PMI industry. All of the HMDA and PMI reports are available on the FFIEC’s reports website at www.ffiec.gov/reports.htm.

⁷ The only reported items not included in the HMDA 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.

⁸ 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 2012 and from the final HMDA data set for years prior to that. Consequently, numbers in this article for the years 2011 and earlier may differ somewhat from numbers calculated from the initial public release files.

⁹ The 2000 census distributed both short- and long-form questionnaires to households. The long-form questionnaire collected more-detailed information on population and housing characteristics about each household than the short form, and the long form was the source of several of the detailed characteristics of census tracts made available to the public. The 2010 census used only a short-form questionnaire; consequently, the FFIEC uses data from the annual ACS to identify many population and housing characteristics of census tracts. Because the annual ACS covers a relatively small sample of households, five years of aggregated annual ACS data are needed to provide reliable estimates of population and housing characteristics at the census-tract level of geography. The disclosure reports prepared by the FFIEC for the 2012 data use the same MSA definitions that were used for the 2011 data reports.

¹⁰ For a more complete discussion of the potential effects on interpreting lending patterns of the change from the 2000 to the 2010 census-tract delineations, see the section “Transition to the 2010 Census Data and Revised Census-Tract Boundaries” in Robert B. Avery, Neil Bhutta, Kenneth P. Brevoort, and Glenn B. Canner (2012), “The Mortgage Market in 2011: Highlights from the Data Reported under the Home Mortgage Disclosure Act,” *Federal Reserve Bulletin*, vol. 98 (December), pp. 1–46, www.federalreserve.gov/pubs/bulletin/2012/articles/HMDA/default.htm.

In addition to our review of the 2012 HMDA data, we present the results of a first look at a new data set composed of HMDA records matched to borrowers' credit records. The matched data provide an opportunity to explore many aspects of home lending that the HMDA data alone cannot address. In particular, we are able to compare the credit characteristics (for example, credit scores) at loan origination, and subsequent payment performance, by various HMDA attributes such as income, minority status, and type of lender. Also, because the credit record data are longitudinal and follow individuals rather than just their mortgages, we are able to study long-term outcomes of mortgage borrowers beyond performance on their mortgage, such as whether credit scores recover after delinquency at a different pace for different demographic groups. We focus on loans made in 2006, which reflect lending activity at the height of the recent housing boom, and loans made in 2010, which reflect the far more subdued market conditions that were still largely present in 2012. We examine credit profiles at origination and subsequent performance for both vintages, and they reveal how dramatically the lending environment has changed.

Our analysis of the annual HMDA data yields several key findings:

- The number of mortgage originations reported in the HMDA data for 2012 increased by about 2.7 million to 9.8 million, or 38 percent, from 2011, driven by a 54 percent increase in the number of refinance loans.
- Home-purchase lending increased at a more modest pace of 13 percent. Government-backed loans originated under programs such as the Federal Housing Administration (FHA) mortgage insurance program and the Department of Veterans Affairs (VA) loan guarantee program continue to play a major role, accounting for nearly 45 percent of first-lien, owner-occupant home-purchase loans.
- Home-purchase lending rose across all income and racial or ethnic groups, but to varying degrees. High-income, as well as non-Hispanic white and Asian, groups posted significantly larger gains than other groups. In contrast, the rise in refinance lending was more even across groups.
- Higher-priced lending (a proxy for subprime lending) remained subdued at about 3 percent of all loans, down from a high of about 28 percent in 2006. Similar to patterns observed in the past, black and Hispanic-white borrowers were more likely, and Asian borrowers less likely, to obtain higher-priced loans than were non-Hispanic white borrowers.
- As in previous years, denial rates were significantly higher for black and Hispanic-white applicants compared with Asian and non-Hispanic white applicants. The HMDA data do not provide sufficient information to determine the extent to which the differences in higher-priced lending and denials reflect illegal discrimination.

Some of the main findings from our analysis of the matched HMDA–credit record data are as follows:

- The credit scores of black and Hispanic-white mortgage borrowers at the time of loan origination tend to be lower, and their subsequent delinquency rates higher, compared with those of Asian and non-Hispanic white borrowers. Among home-purchase borrowers in 2006, for example, we find that over 20 percent of black and Hispanic-white borrowers became 60 days or more past due within two years of origination, compared with about 7 percent of non-Hispanic white borrowers and about 6 percent of Asian borrowers. Delinquency is highly correlated with credit score, local area house price declines, and higher-priced loan status, but substantive differences in delinquency rates across racial and ethnic groups remain after accounting for these variables.
- Loans to low- and moderate-income (LMI) borrowers made by banking institutions in

2006 within their Community Reinvestment Act (CRA) assessment areas—loans that the CRA encourages—had a delinquency rate that was lower than that for all loans combined and less than one-fourth the rate for all higher-priced loans of the same vintage. These findings are inconsistent with the notion that the CRA was a principal driver of the mortgage and financial crisis.

- The credit scores of individuals obtaining a mortgage were much higher in 2010 than in 2006, and delinquency rates on 2010 loans were much lower than those on 2006 loans. We estimate that the fraction of conventional (not government backed) home-purchase loans originated in 2010 that became 60 days or more past due within two years of origination was just 0.5 percent, about one-twentieth the rate for the 2006 vintage. The delinquency rate on 2010 FHA and VA home-purchase loans was 5 percent—significantly higher than that on 2010 conventional loans but lower than that on 2006 FHA and VA loans. Increases in credit scores and reductions in delinquency were substantial across borrowers of all demographic groups.
- The matched data allow back-end payment-to-income (PTI) ratios for mortgage borrowers to be estimated.¹¹ The fraction of borrowers with an estimated PTI ratio above 43 percent—the threshold level identified in the qualified mortgage rule adopted by the CFPB—declined between 2006 and 2010. In 2010, lower-income borrowers and black and Hispanic-white borrowers were more likely than other groups to have PTI ratios above 43 percent. That said, most home-purchase loans in 2010 with PTI ratios above 43 percent were government backed; under the current regulations, such loans could still be qualified mortgages despite exceeding the threshold.
- Declines in credit scores and their subsequent recovery through 2012 for those who became delinquent on the mortgages they took out in 2006 are very similar across racial and ethnic groups. Credit score recovery occurs only over a long period of time, on average, perhaps reflecting the severity of the financial stress faced by delinquent mortgage borrowers. Indeed, we also find that the majority of those who became delinquent on their mortgages were late on at least one nonmortgage account, such as credit cards or automobile loans. The rate of multiple delinquencies is largely invariant across demographic groups.

A Profile of the 2012 HMDA Data

For 2012, a total of 7,400 institutions reported on their home-lending activity under HMDA: 4,370 banking institutions; 2,004 credit unions; and 1,026 mortgage companies, 814 of which were not affiliated with a banking institution (these companies are referred to in this article as independent mortgage companies) (table 1). The number of reporting institutions fluctuates some from year to year because of changes in reporting requirements, primarily related to increases in the minimum asset level used to determine coverage.¹² Mergers, acquisitions, and failures also account for some of 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 2012, the number of reporting institutions fell

¹¹ As discussed later, the estimated PTI ratios from the matched data are likely to understate the actual PTI used in underwriting.

¹² For the 2013 reporting year (covering lending in 2012), the minimum asset size for purposes of coverage was \$41 million. The minimum asset size changes from year to year with changes in the Consumer Price Index for Urban Wage Earners and Clerical Workers. 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, 2000–12

Year	Depository institution			Mortgage company			All institutions
	Banking institution	Credit union	All	Independent	Affiliated ¹	All	
2000	4,721	1,691	6,412	981	332	1,313	7,725
2001	4,686	1,714	6,400	962	290	1,252	7,652
2002	4,698	1,799	6,497	986	310	1,296	7,793
2003	4,675	1,903	6,578	1,171	382	1,553	8,131
2004	4,962	2,030	6,992	1,317	544	1,861	8,853
2005	4,878	2,047	6,925	1,341	582	1,923	8,848
2006	4,846	2,037	6,883	1,334	685	2,019	8,902
2007	4,847	2,019	6,866	1,132	638	1,770	8,636
2008	4,855	2,026	6,881	957	550	1,507	8,388
2009	4,810	2,017	6,827	925	399	1,324	8,151
2010	4,677	2,041	6,718	848	371	1,219	7,937
2011	4,497	2,017	6,514	812	306	1,118	7,632
2012	4,370	2,004	6,374	814	212	1,026	7,400

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).

3 percent from 2011, continuing a downward trend since 2006, when HMDA coverage included just over 8,900 lenders.¹³

Reporting Institutions by Size and Mortgage Lending Activity

Although the number of home-lending institutions covered by HMDA is large, most reporters are small as measured by assets, and most receive few applications and extend few loans. For 2012, 56 percent of the depository institutions (banking institutions and credit unions) covered by HMDA had assets under \$250 million, and 71 percent of them reported information on fewer than 100 loans (data derived from table 2). Among all depository institutions, 50 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 (50 percent of the mortgage companies reported more than 1,000 loans, a share equal to more than five times that for depository institutions).

In the aggregate, reporting institutions submitted information on 15.3 million applications for home loans of all types in 2012, up about 30 percent from the total reported for 2011 but far below the 27.5 million applications processed in 2006, just before the housing market decline (data derived from table 3.A).¹⁴ The majority of loan applications are approved by lenders, and most approved applications 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

¹³ Seventeen institutions ceased operations partway through 2012, were not acquired by another reporting institution, and did not have any of their 2012 lending activity reported. These nonreporting companies accounted for only 0.08 percent of the 2011 loan application records submitted under HMDA and, consequently, likely extended few loans during the portion of 2012 in which they were operating.

¹⁴ In total, the 2012 data include about 477,000 requests for preapproval, of which about 182,000 resulted in subsequent loans. About 149,000 of the requests for preapproval were denied at the preapproval stage, and about 65,000 were approved at the preapproval stage by the lender but the consumer did not take further action.

Table 2. Number and distribution of home lenders, by type of lender and by number of loans, 2012

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														
Banking institution														
Less than 250	1,054	47.4	472	21.2	433	19.5	187	8.4	41	1.8	35	1.6	2,222	100
250–499	206	22.4	124	13.5	248	27.0	218	23.7	90	9.8	34	3.7	920	100
500–999	92	15.0	60	9.8	107	17.4	144	23.4	133	21.6	79	12.8	615	100
1,000 or more	53	9.0	25	4.2	47	7.9	67	11.3	93	15.7	307	51.9	592	100
All	1,405	32.3	681	15.7	835	19.2	616	14.2	357	8.2	455	10.5	4,349	100
Credit Union														
Less than 250	683	52.3	304	23.3	244	18.7	60	4.6	12	.9	2	.2	1,305	100
250–499	36	11.8	42	13.7	99	32.4	76	24.8	45	14.7	8	2.6	306	100
500–999	10	4.9	14	6.8	28	13.7	56	27.3	61	29.8	36	17.6	205	100
1,000 or more	1	.6	1	.6	6	3.4	19	10.6	44	24.6	108	60.3	179	100
All	730	36.6	361	18.1	377	18.9	211	10.6	162	8.1	154	7.7	1,995	100
All depository institutions														
Less than 250	1,737	49.2	776	22.0	677	19.2	247	7.0	53	1.5	37	1.0	3,527	100
250–499	242	19.7	166	13.5	347	28.3	294	24.0	135	11.0	42	3.4	1,226	100
500–999	102	12.4	74	9.0	135	16.5	200	24.4	194	23.7	115	14.0	820	100
1,000 or more	54	7.0	26	3.4	53	6.9	86	11.2	137	17.8	415	53.8	771	100
All	2,135	33.7	1,042	16.4	1,212	19.1	827	13.0	519	8.2	609	9.6	6,344	100
Mortgage company²														
All	104	10.4	45	4.5	88	8.8	129	12.9	138	13.8	497	49.7	1,001	100
All institutions	2,239	30.5	1,087	14.8	1,300	17.7	956	13.0	657	8.9	1,106	15.1	7,345	100

¹ Distribution sums horizontally. For example, the second column, first row shows that 47.4 percent of banking institutions with assets of less than \$250 million originated less than 50 loans in 2012.

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

2012, nearly 5 percent of all applications were approved but not accepted by the applicant (data not shown in tables). Overall, about 64 percent of the applications submitted in 2012 resulted in an extension of credit (data derived from tables 3.A and 3.B), an increase of about 4 percentage points from 2011.

The total number of loans reported in 2012, nearly 9.8 million (as shown in table 3.B), was about 38 percent larger than the number reported in 2011. Although notably larger in 2012 than in 2011, the number of reported loans remains well below the levels reached in the early and middle 2000s. For example, in 2001, nearly 14 million loans were extended by reporting institutions.

In addition to information on new loan extensions, the HMDA data include details about loans purchased by reporting institutions during the reporting year, although the purchased loans may have been originated at any point in time. For 2012, lenders reported information on about 3.2 million loans that they had purchased from other institutions, an increase of about 8 percent from 2011. Finally, lenders reported on roughly 213,000 requests for preapproval of home-purchase loans that did not result in a loan origination (as shown in table 3.A); preapprovals that resulted in loans are included in the count of loan extensions cited earlier.

Home-Purchase and Refinance Lending

The rise in lending activity from 2011 to 2012 was driven largely by a substantial rise in refinance lending. Home-purchase lending was up almost 13 percent but remained at a rela-

Table 3. Home loan activity of lending institutions covered under the Home Mortgage Disclosure Act, 2000–12**A. Applications, requests for preapproval, and purchased loans**

Number

Year	Applications received for home loans, by type of property				Requests for preapproval ²	Purchased loans	Total
	1–4 family			Multifamily ¹			
	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	4,216,589	9,982,768	831,504	26,141	216,865	4,301,021	19,574,888
2010	3,847,796	8,433,333	670,147	25,550	170,026	3,229,295	16,376,147
2011	3,630,284	7,390,690	686,788	35,048	185,943	2,944,662	14,873,415
2012	4,006,445	10,480,189	777,017	46,999	213,322	3,167,578	18,691,550

Note: Here and in subsequent tables, except as noted, data include first and junior liens, one- to four-family homes (site-built and manufactured properties), and owner- and non-owner-occupant loans.

¹ A multifamily property consists of five or more units.

² Consists of requests for preapproval that were denied by the lender or were accepted by the lender but not acted on 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.

tively subdued level of about 2.7 million loans, which is still well below the level achieved in 2000, let alone the levels achieved just prior to the Great Recession in 2005 and 2006 (although those levels tend to be inflated because they included a large number of junior-lien home-purchase loans). The increase in home-purchase lending from 2011 to 2012 is consistent with a reported increase from 2011 in the sales of both existing and new homes.¹⁵

The volume of refinance lending over time generally follows the path of interest rates (typically with a fairly short lag), expanding as mortgage rates decline and retrenching when rates increase. The interest rate environment over the past few years has generally been quite favorable for borrowers who have sought to refinance. In some cases, individuals have been able to refinance on more than one occasion to take advantage of declining interest rates. That said, many mortgage borrowers have not been able to refinance, either because they could not meet tightened credit-history-related underwriting standards or because of collateral-related issues, including situations in which the outstanding balance on their loan exceeded the home value.¹⁶

¹⁵ According to the Commerce Department, sales of new homes increased about 20 percent from 2011 levels, and, according to the National Association of Realtors, sales of existing homes were up about 9 percent (see www.commerce.gov and www.realtor.org).

¹⁶ See an analysis of the factors influencing refinance activity in Robert B. Avery, Neil Bhutta, Kenneth P. Brevoort, and Glenn B. Canner (2011), “The Mortgage Market in 2010: Highlights from the Data Reported under the Home Mortgage Disclosure Act,” *Federal Reserve Bulletin*, vol. 97 (December), pp. 1–60, www.federalreserve.gov/pubs/bulletin/2011/articles/HMDA/default.htm.

Table 3. Home loan activity of lending institutions covered under the Home Mortgage Disclosure Act, 2000–12**B. Loans****Number**

Year	Loans, by type of property				Total
	1–4 family			Multifamily ¹	
	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	2,792,939	5,772,078	389,981	18,974	8,973,972
2010	2,546,590	4,968,603	341,401	19,168	7,875,762
2011	2,416,854	4,311,870	339,427	27,111	7,095,262
2012	2,729,592	6,637,360	380,251	36,761	9,783,964

¹ See table 3.A, note 1.

The Home Affordable Refinance Program (HARP) was established in 2009 and assists homeowners who have a mortgage owned or guaranteed by Fannie Mae or Freddie Mac in financing their mortgage despite having low or negative equity. In the fall of 2011, certain changes were made to HARP in order to increase usage of the program, such as lowering certain fees and removing the 125 percent maximum loan-to-value ratio that had been in place.¹⁷

Compared with 2011, the number of reported refinance loans in 2012 was up about 54 percent, as mortgage interest rates on 30-year home loans dropped to well below 4 percent during the course of the year (table 3.B and figure 1). The peak month for refinance issuance was October, with nearly 680,000 loans, up from about 440,000 loans in January, as shown in figure 1.¹⁸ Refinances through HARP more than doubled in 2012 over 2011, to 1,074,755 from 438,228.¹⁹

Non-Owner-Occupant Lending

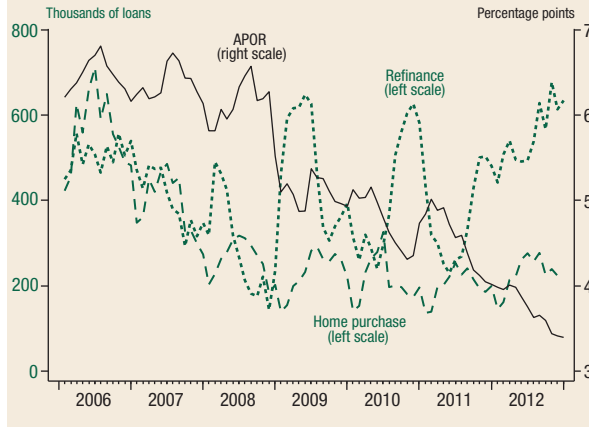
Mortgages used to finance the purchase of non-owner-occupied properties can include purchases of rental properties as well as vacation and second homes. The HMDA data help document the role of such lending over time, showing that growth in non-owner-occupant

¹⁷ For more information on changes to HARP and eligibility requirements, see Federal Housing Finance Agency (2012), *Refinance Report* (Washington: FHFA, December), www.fhfa.gov/webfiles/25033/Dec12RefiReport.pdf.

¹⁸ Lenders report the date on which they took action on an application. For originations, the “action date” is the closing date or date of origination for the loan. This date is used 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 interest rates being offered by lenders to prime borrowers. Since a loan’s pricing likely reflects the interest rate available at the time of the lock date, the timing of the loan volume and interest rate series may be slightly misaligned in the figure.

¹⁹ See Federal Housing Finance Agency, *Refinance Report*, in note 17.

Figure 1. Volume of home-purchase and refinance originations and average prime offer rate, by month, 2006–12



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).

lending outpaced that in home-purchase lending overall for one- to four-family homes (site-built and manufactured properties) from 2000 to 2006 (data derived from table 4). Beginning in 2007, non-owner-occupant home-purchase lending fell more sharply than home-purchase lending as a whole. Since 2009, however, non-owner-occupant home-purchase lending has grown more robustly than owner-occupant lending, with its share of home-purchase lending growing from just under 12 percent to nearly 15 percent in 2011. From 2011 to 2012, the non-owner-occupant share of home-purchase lending held steady.

Conventional versus Government-Backed Loans

Although the total number of home-purchase loans has fallen substantially since the middle of the previous decade, 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 (as shown in table 4). In 2009, the volume of nonconventional home-purchase lending reached its high-water mark, and such lending accounted for nearly 48 percent of the total. The increase in nonconventional lending over this period reflected several factors, including increased loan-size limits allowed under the FHA and VA lending programs and reduced access to conventional loans (including more-stringent underwriting and higher prices), particularly those that allowed the borrower to finance more than 80 percent of the property value.²⁰

Nonconventional lending continued to play an outsized role in the home-purchase loan market in 2012, although its share of the total market continued to fall from its 2009 high. Overall, the number of nonconventional home-purchase loans extended in 2012 was about 2 percent higher than in 2011; however, the nonconventional share of the total home-purchase loan market slipped from nearly 43 percent in 2011 to 38 percent in 2012.²¹ Among nonconventional lending programs, the number of reported FHA-insured home-purchase loans fell about 2 percent from 2011, but the number of VA-guaranteed loans rose 11 percent and those backed by the FSA or the RHS increased nearly 13 percent (data not shown in tables).

²⁰ Nonconventional loans play a small role in certain segments of the home-purchase market. For example, nonconventional loans accounted for less than 1 percent of the loans extended to non-owner occupants for the purchase of a home in 2012 (data derived from table 4).

²¹ The nonconventional share of the home-purchase market is larger if the focus is limited to owner-occupied dwellings. For 2012, the nonconventional share of owner-occupant home-purchase lending was 44 percent.

Table 4. Home loan applications and home loans for one- to four-family properties, by occupancy status of home and type of loan, 2000–12

Number								
Year	Applications				Loans			
	Owner occupied		Non-owner occupied		Owner occupied		Non-owner occupied	
	Conventional	Non-conventional ¹	Conventional	Non-conventional ¹	Conventional	Non-conventional ¹	Conventional	Non-conventional 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	2,017,982	1,966,335	442,409	6,711	1,174,648	1,323,966	290,560	3,765
2010	1,822,790	1,763,826	425,345	5,853	1,090,328	1,169,729	284,700	1,833
2011	1,791,526	1,558,447	461,481	4,768	1,076,446	1,025,827	313,138	1,443
2012	2,018,056	1,491,427	493,399	3,563	1,330,664	1,043,651	353,884	1,393
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	7,290,061	2,058,210	619,286	15,211	4,414,509	1,000,911	349,147	7,511
2010	6,325,488	1,449,925	642,401	15,519	3,948,746	655,574	356,183	8,100
2011	5,550,634	1,136,045	682,769	21,242	3,401,097	512,839	384,911	13,023
2012	7,742,152	1,640,334	1,032,851	64,852	5,054,553	919,372	621,804	41,631
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	743,968	28,536	58,754	246	349,993	11,256	28,568	164
2010	583,892	34,449	51,415	391	303,344	11,810	26,190	57
2011	581,023	38,194	60,763	6,808	293,735	14,392	27,768	3,532
2012	637,201	71,092	68,530	194	335,911	12,545	31,713	82

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.

Most mortgage refinancings involve conventional loans, but just as nonconventional lending has come to play an important role in the home-purchase lending market over the past couple of years, so its role in the refinance market has also become significant. In 2007 and earlier years, no more than 6 percent of refinance loans were nonconventional. Since then, the nonconventional share of refinance loans has been substantially higher, increasing from 12 percent in 2011 to 14 percent in 2012 as the number of reported nonconventional refinance loans rose nearly 83 percent over the same period (as shown in table 4).²² Among nonconventional loans, those backed by the VA increased 90 percent from 2011, while those backed by FHA insurance increased 78 percent.

Lending for Manufactured Homes

Beginning with the 2004 HMDA data, reporting institutions have distinguished between loans secured by site-built properties and those related to manufactured homes. Manufactured homes are an important segment of the housing market, accounting for about 8 percent of all one- to four-family housing units.²³ Manufactured-home lending differs along a number of dimensions from lending on site-built homes, in part because most of the homes are sold without land and are treated as chattel-secured lending, which typically carries higher interest rates and shorter terms to maturity than those on loans to purchase site-built homes.²⁴

Because manufactured homes typically are less expensive than site-built homes, they provide a low-cost housing option for households with more moderate incomes.²⁵ The 2012 HMDA data indicate that the mean first-lien, owner-occupant loan amount extended for the purchase of a manufactured home in 2012 was about \$67,000, compared with about \$220,000 for a site-built home, and that the mean income of borrowers purchasing manufactured homes that year was \$50,000, compared with \$95,000 for those borrowing to buy a site-built home (data not shown in tables).

The HMDA data indicate that the annual volume of manufactured-home lending fell more than 50 percent from 2006 to 2009, and, since then, the volume of such lending has been relatively stable (table 5). The 2012 data show an increase in home-purchase lending for manufactured homes of nearly 6 percent from 2011, a rate of increase that is about half that for site-built homes. As noted, 2012 was a very strong year for refinancing, and that activity carried over to the manufactured-home loan market, although the increase in refinance lending from 2011 was much smaller for loans backed by manufactured homes (up about 20 percent) than for those backed by site-built properties (up about 54 percent).

The Private Mortgage Insurance Market

Lenders typically require that a borrower seeking to purchase an owner-occupied property make a down payment of at least 20 percent of a home's value unless the borrower obtains

²² For more-detailed analysis on the rise of government-backed lending in recent years, see Avery and others, "The Mortgage Market in 2011," in note 10.

²³ See the 2011 American Housing Survey, which is available on the U.S. Census Bureau's website at www.census.gov/housing/ahs/data/national.html.

²⁴ A chattel mortgage loan (chattel loan) is a loan arrangement in which the lender provides credit for the purchase of an asset, such as a manufactured home, that is not considered a fixed property. In these arrangements, the lender holds the collateral for the duration of the loan. Once the chattel loan is repaid, the lien is extinguished.

²⁵ See NAHB Research Center, Inc. (1998), *Factory and Site-Built Housing: A Comparison for the 21st Century*, report prepared for the U.S. Department of Housing and Urban Development, available on the Manufactured Housing Institute's website at www.manufacturedhousing.org/developer_resources/factory_vs_sitebuilt.

Table 5. Loans on manufactured homes, by occupancy status of home and type of loan, 2004–12				
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	43,543	20,630	7,920	29
2010	44,856	17,086	7,655	29
2011	40,312	14,663	7,482	218
2012	44,697	14,005	7,705	24
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	37,001	21,768	6,002	73
2010	26,340	9,751	5,024	69
2011	25,299	8,919	4,765	161
2012	31,712	10,363	4,806	225
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	9,781	439	1,116	1
2010	8,012	427	999	2
2011	8,244	349	972	75
2012	8,814	251	1,026	0

¹ See table 4, note 1.

some type of third-party backing, such as private or government-provided mortgage insurance. For a borrower seeking a conventional loan with a low down payment, a lender can require that the borrower purchase mortgage insurance from a private mortgage insurance (PMI) company to protect the lender against default-related losses up to a contractually established percentage of the principal amount. PMI competes with FHA insurance and VA loan guarantees, and, consequently, the volume of PMI issued in a given year reflects not only the general state of the housing market and pricing and underwriting decisions by the PMI companies, but also pricing and underwriting decisions by the FHA and VA as well as loan-size limits applicable to these government programs. PMI also competes with lenders willing to extend junior-lien loans used in conjunction with the purchase of a home (junior-lien lending is discussed in the next section).

The five companies that reported data to the FFIEC for 2012 dominate the PMI industry.²⁶ For 2012, these PMI companies reported on nearly 657,000 applications for mortgage insurance leading to the issuance of 546,000 insurance policies, up from about 409,000 applications and 312,000 policies in 2011 (data derived from table 6). Although rebounding from 2011 levels, reported volumes of PMI issuance in 2012, as in recent years, have been substantially smaller than levels prior to 2009. The large reduction in PMI issuance reflects several factors, including tighter underwriting and higher prices adopted by the PMI companies (largely in response to elevated claims and losses experienced during the recent recession and the ongoing recovery) and, as noted, an expansion of government-backed lending.²⁷

Overall, nearly 60 percent of the PMI policies issued in 2012 covered home-purchase loans, and the remainder covered refinance mortgages (home-improvement loans are classified as refinance loans by the PMI reporters). Although the number of PMI policies issued increased for both home-purchase and refinance purposes from 2011 to 2012, the increase on a percentage basis was notably larger for refinancings, consistent with the relatively large increase in conventional refinance loans described earlier. Virtually all of the applications for PMI policies issued involved loans to purchase site-built properties, and almost all of the applications for PMI related to owner-occupied units.

The data reported by the PMI industry over the years have consistently shown that most applications for insurance are approved, as lenders are very familiar with the underwriting policies of the insurers and generally are not going to submit an application that is unlikely to be approved. Overall, about 3 percent of PMI applications were denied in 2012, down from about 5 percent in 2011 and over 10 percent in 2010 (data not shown in tables).²⁸ As with the HMDA data, PMI companies report the reason for denial. The three most commonly reported reasons cited by the PMI companies are related to issues with the collateral, the applicants' debt-to-income levels, or their credit histories.

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. 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 conventional loan to be

²⁶ In 1993, the Mortgage Insurance Companies of America, a trade association, asked the FFIEC to process data from the largest PMI companies on applications for mortgage insurance. These 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. In the PMI data, the reported disposition of an application for insurance reflects the actions of the PMI companies or, in the case of a withdrawal of an application, the action of the lender. Two firms that reported data covering activity in 2011, Republic Mortgage Insurance Company and PMI Mortgage Insurance Company, did not report activity for 2012, reflecting financial circumstances that prevented them from underwriting new policies. A third insurer, Triad Guaranty Insurance Corporation, last reported data for activity in 2009. Two additional mortgage insurance companies are relatively active issuers of new policies. Essent Guaranty, Inc., is a relatively new firm (having started operations in 2010), and CMG Mortgage Insurance Company has traditionally specialized in serving the needs of credit unions; combined, these two firms accounted for about 13 percent of the dollar volume of PMI policies written in 2012.

²⁷ For a more detailed analysis of the decline in PMI issuance, 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 (December), pp. A39-A77, www.federalreserve.gov/pubs/bulletin/2010/articles/2009HMDA/default.htm. For additional information about the PMI industry and its financial condition, see the Mortgage Insurance Companies of America's website at <http://micadc.org>.

²⁸ For the other applications that did not result in a policy being written, either the application was withdrawn, the application file closed because it was not completed, or the request was approved but no policy was issued.

Table 6. Private mortgage insurance applications and issuance for one- to four-family properties, by occupancy status of home and type of property, 2000–12

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	0
2011	245,677	219	11,547	8	193,215	89	8,272	0
2012	371,729	382	15,475	22	316,272	197	12,214	9
B. Refinance²								
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
2011	149,480	196	1,664	0	109,866	72	838	0
2012	266,100	333	2,514	5	216,029	155	1,575	1

¹ Before 2004, lenders did not distinguish between site-built and manufactured housing in reporting; totals for site-built and manufactured housing are shown in the "Site-built" column.

² Includes home-improvement loans. Private mortgage insurance companies do not distinguish between refinance loans and home-improvement loans in reporting. Loan totals are the sum of refinance and home-improvement loans.

n.a. Not available.

within the size limits required by Freddie Mac or Fannie Mae without requiring a larger down payment by the borrower on the primary loan.

Junior-lien loans that are taken out independently of a first lien are used for a variety of purposes, including to finance home-improvement projects, to repay other debts, or, in the case of open-ended home equity lines of credit, to provide a readily available source of credit that can be drawn on at the time the borrower needs the funds. Under the regulations that govern HMDA reporting, many standalone junior-lien loans are not reported because either the lender does not know the purpose of the loan or the reasons cited for the loan

are not ones that trigger a reporting requirement.²⁹ Nonetheless, the annual HMDA data provide an opportunity to monitor junior-lien lending related to home purchases or home improvements.

In the run-up to the Great Recession, large numbers of homebuyers used junior-lien loans to help purchase their homes. In 2006, close to 1.3 million junior liens used for the purchase of owner-occupied properties were reported under HMDA (table 7). This number fell by more than one-half in 2007, dropped sharply again in each of the two ensuing years, and decreased to about 42,000 or fewer such loans annually from 2010 to 2012. More than 1 million junior-lien loans were taken out to refinance loans backed by owner-occupied properties in 2006, and this number also fell substantially starting in 2007 and continued to fall, reaching a low point of roughly 73,000 loans in 2012.

The HMDA data also include information on junior-lien loans used for home improvement. In 2012, about 58,000 junior-lien loans were used for such a purpose, down from about 66,000 reported in 2011. Both the 2011 and 2012 totals are sharply below the historical high mark of nearly 570,000 reached in 2006.

Loan Sales

For each loan origination reported under HMDA in a given year, lenders report whether that loan was sold during the same year and what type of institution purchased the loan.³⁰ 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. Ginnie Mae and Farmer Mac focus on loans backed directly by government guarantees or insurance, while Fannie Mae and Freddie Mac purchase conventional loans that meet certain loan-size and underwriting standards.

Overall, about 80 percent of the first-lien home-purchase and refinance loans for one- to four-family properties originated in 2012 were reported as sold during the year (data not shown in tables).³¹ The share of originations that are sold varies some from year to year and by type and purpose of loan (table 8).³² For example, 71 percent of the conventional loans extended in 2012 for the purchase of owner-occupied one- to four-family dwellings were sold that year. In contrast, nearly 94 percent of the nonconventional loans used to purchase owner-occupied homes were reported as sold in 2012, with just over one-third reported as sold directly to a government-sponsored enterprise (including Ginnie Mae).³³

²⁹ Unless a junior lien is used for home purchase or explicitly for home improvements, or to refinance an existing lien, it is not reported under HMDA. Further, home equity lines of credit, many of which are junior liens, do not have to be reported in the HMDA data regardless of the purpose of the loan.

³⁰ 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 portfolio, leading the reported loan sales to understate the proportion of each year's originations that are eventually sold.

³¹ Because HMDA reporters are instructed to identify loan sales only if the sale occurs in the same calendar year as the origination, loans made toward the end of the year tend to have a low incidence of being reported as sold. For 2012, the fraction of loans originated in the first nine months of the year that were reported as sold was about 85 percent.

³² Some loans recorded as sold in the HMDA data are sold to affiliated institutions and thus are not true secondary-market sales. In 2012, about 3 percent of the loans recorded as sold in the HMDA data were sales to affiliates.

³³ Technically, Ginnie Mae does not purchase mortgages; rather, it provides guarantees for mortgage-backed securities composed of government-backed mortgages. The data indicate that commercial banks purchased about 35 percent of government-backed home-purchase mortgages in 2012. Banks may then put these loans into Ginnie Mae securities or hold them in portfolio.

Table 7. Home loans for one- to four-family properties, by occupancy status of home, type of loan, and lien status, 2004–12

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	1,132,424	42,224	...	1,322,489	1,477	...	288,526	2,034	...	3,756	9	...
2010	1,049,990	40,338	...	1,168,343	1,386	...	283,017	1,683	...	1,821	12	...
2011	1,036,112	40,334	...	1,024,696	1,131	...	311,831	1,307	...	1,438	5	...
2012	1,289,516	41,148	...	1,042,472	1,179	...	352,604	1,280	...	1,384	9	...
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	4,300,322	114,187	...	1,000,422	489	...	342,410	6,737	...	7,495	16	...
2010	3,860,760	87,986	...	655,334	240	...	350,458	5,725	...	8,092	8	...
2011	3,327,415	73,682	...	512,629	210	...	379,519	5,392	...	13,004	19	...
2012	4,981,604	72,949	...	919,183	189	...	616,610	5,194	...	41,620	11	...
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	166,865	84,414	98,714	8,197	2,541	518	19,961	3,193	5,414	99	28	37
2010	134,370	74,941	94,033	8,218	2,663	929	17,777	2,486	5,927	35	17	5
2011	129,851	60,423	103,461	7,116	2,949	4,327	18,491	2,257	7,020	64	45	3,423
2012	161,128	52,545	122,238	8,065	3,718	762	20,494	2,009	9,210	50	20	12

¹ See table 4, note 1.

² Data on unsecured loans are collected only for home-improvement loans under the Home Mortgage Disclosure Act.

... Not applicable.

The share of conventional loans made to non-owner occupants that are reported as sold is smaller than that of such loans made to owner occupants. Also, the vast majority of conventional loans extended for the purchase of manufactured homes are held in portfolio; only about 16 percent of such loans were sold in 2012 (data not shown in tables).

Borrower Incomes and Loan Amounts

Under 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 underwrit-

Table 8. Distribution of home loan sales for one- to four-family properties, by occupancy status of home and type of loan, 2000–12

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	70.1	40.1	91.4	35.0	56.4	34.7	88.9	35.2
2010	69.7	37.0	92.7	29.7	30.3	34.8	91.7	24.1
2011	68.9	34.2	93.5	33.4	61.9	34.5	80.3	35.2
2012	70.7	39.3	93.7	34.6	60.8	38.4	78.6	24.6
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	79.4	52.8	89.7	37.9	61.2	40.1	93.5	36.0
2010	76.8	46.1	90.2	37.8	65.4	40.3	90.5	43.8
2011	72.7	46.4	91.3	49.8	66.4	43.5	89.5	57.6
2012	77.1	55.4	92.3	57.0	73.2	56.4	91.9	69.6
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	24.9	17.8	63.4	38.9	17.7	13.4	56.1	9.8
2010	21.2	13.2	60.6	34.7	18.3	12.6	47.4	28.1
2011	19.1	11.4	45.3	26.8	19.8	13.4	.3	.1
2012	21.7	14.1	60.1	24.6	19.3	13.4	48.8	8.5

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.

Table 9. Cumulative distribution of home loans, by borrower income and by purpose and type of loan, 2012

Percent

Upper bound of borrower income (thousands of dollars) ¹	Home purchase					Refinance				
	FHA	VA	Conventional ²	Total	Memo: Higher priced ³	FHA	VA	Conventional ²	Total	Memo: Higher priced ³
24	4.9	.9	2.7	3.2	8.6	4.1	2.2	2.5	2.5	9.8
49	41.2	21.0	23.8	28.9	47.4	26.2	16.9	16.5	17.0	39.0
74	69.5	53.7	45.4	53.6	71.1	55.3	43.7	36.9	37.9	65.4
99	85.3	74.8	61.7	70.1	83.0	75.7	65.2	55.5	56.7	81.1
124	92.8	86.8	73.4	80.6	89.0	87.3	80.1	69.9	71.0	89.5
149	96.3	93.1	81.2	86.9	92.5	93.1	88.5	79.5	80.3	93.6
199	98.8	97.9	89.7	93.2	95.6	97.7	95.9	89.6	90.1	96.8
249	99.5	99.3	93.7	96.0	97.1	99.0	98.4	94.0	94.4	98.0
299	99.7	99.7	95.8	97.4	97.9	99.5	99.3	96.2	96.4	98.6
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	66.0	81.8	112.0	95.1	74.7	79.9	93.1	117.1	114.7	76.2
Median	56	71	81	70	52	70	81	91	90	59

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 Conventional loans plus some loans originated with a Farm Service Agency or Rural Housing Service guarantee.

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.

ing. Lenders do not necessarily collect and report loan applicants' entire income, because in some cases borrowers have more income than is needed to qualify for the loan.

Borrower Income

The vast majority of loan applications and loans reported under HMDA include income information. For example, in 2012, income information was not reported for less than 1 percent of the borrowers purchasing a home with a nonconventional loan and for 3 percent of those using a conventional loan (data not shown in tables). Income information is reported less often for refinance loans (about 10 percent of all such loans), particularly those that are nonconventional (about 55 percent of the FHA loans and 68 percent of the VA loans), most 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 applicant income can be evaluated in many ways, we focus here on patterns by loan product and purpose. For home-purchase or refinance lending, borrowers using FHA and VA loans have lower mean or median incomes than borrowers using other loans, despite the fact that the FHA (and VA) loan limits were increased substantially in 2008, potentially allowing the program to be used much more widely than by the LMI households that have been the traditional focus of the program (table 9). Although the share of FHA home-purchase borrowers with incomes above \$100,000 has roughly doubled since 2007 (the year before the increase in loan limits) to about 15 percent, the median income of borrowers obtaining FHA home-purchase loans was still more than 40 percent lower than that of borrowers getting conventional loans

Table 10. Cumulative distribution of home loans, by loan amount and by purpose and type of loan, 2012
Percent

Upper bound of loan amount (thousands of dollars) ¹	Home purchase					Refinance				
	FHA	VA	Conventional ²	Total	Memo: Higher priced ³	FHA	VA	Conventional ²	Total	Memo: Higher priced ³
24	.1	.0	.4	.2	2.5	.1	.0	.4	.3	3.8
49	1.6	.3	2.6	2.1	13.2	.9	.5	2.9	2.5	15.2
74	8.4	2.2	8.3	7.8	29.4	4.9	3.2	9.0	8.3	31.4
99	20.3	6.6	16.0	16.5	44.5	13.0	8.7	17.6	16.7	46.0
149	49.1	25.0	35.9	39.0	68.7	39.5	28.3	37.6	37.2	67.7
199	70.8	49.4	52.4	57.8	81.9	62.9	50.3	55.0	55.4	79.9
274	87.9	74.2	70.3	76.1	90.9	83.8	73.5	73.2	74.2	89.8
417	97.2	93.4	88.4	91.5	96.6	96.2	93.5	92.7	93.1	97.1
625	99.5	98.9	96.0	97.3	98.8	99.4	98.8	97.6	97.9	99.1
729	99.9	99.6	97.4	98.4	99.2	99.9	99.5	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	173.7	227.6	242.9	220.2	142.4	193.2	226.3	223.3	220.6	141.5
Median ¹	151	201	190	176	110	169	199	183	183	107
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.										

(data derived from table 9). The low down-payment requirements on FHA-insured loans—the average loan-to-value ratio for FHA home-purchase loans was 96 percent in 2012—may be continuing to attract borrowers with more moderate incomes.³⁴

Loan Amounts

Unlike the data on borrower incomes, all applications and loans reported in the HMDA data include the amount of the loan requested or extended. Loan amounts differ across loan types, with FHA or VA loans, on average, being notably smaller than conventional loans (table 10), although VA loans are notably larger than FHA loans. For example, on average, home-purchase loans backed by FHA insurance are only about 72 percent the size of conventional home-purchase loans, and about one-half of FHA loans are for amounts under \$150,000. However, an upward shift in the distribution of loan amounts for both FHA and VA home-purchase loans has occurred in the past several years, continuing into 2012 (data for only 2012 shown in tables). The shift reflects several factors, including the higher loan limits allowed under these programs.

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

In table 11, we categorize every loan application reported in 2012 into 25 distinct product categories characterized by type of loan and property, purpose of loan, and lien and

³⁴ See U.S. Department of Housing and Urban Development (2013), *Quarterly Report to Congress on FHA Single-Family Mutual Mortgage Insurance Fund Programs, FY 2012 Q4* (Washington: HUD, April 24), http://portal.hud.gov/hudportal/documents/huddoc?id=fhartc_q4_2013.pdf.

Table 11. Disposition of applications for home loans, and origination and pricing of loans, by type of home and type of loan, 2012

Type of home and loan	Applications			
	Number submitted	Acted upon by lender		
		Number	Number denied	Percent denied
1-4 FAMILY				
Nonbusiness related¹				
Owner occupied				
<i>Site built</i>				
Home purchase				
Conventional				
First lien	1,736,554	1,533,418	209,626	13.7
Junior lien	58,107	50,920	7,815	15.3
Government backed				
First lien	1,459,682	1,285,907	209,570	16.3
Junior lien	1,822	1,419	214	15.1
Refinance				
Conventional				
First lien	7,555,325	6,528,789	1,265,356	19.4
Junior lien	114,490	106,068	30,025	28.3
Government backed				
First lien	1,618,392	1,268,509	281,097	22.2
Junior lien	329	240	48	20.0
Home improvement				
Conventional				
First lien	248,329	225,580	58,660	26.0
Junior lien	115,480	107,699	50,724	47.1
Government backed				
First lien	14,361	11,136	2,942	26.4
Junior lien	10,977	8,395	4,442	52.9
Unsecured (conventional or government backed)	296,598	290,281	152,571	52.6
<i>Manufactured</i>				
Conventional, first lien				
Home purchase	221,091	215,086	120,425	56.0
Refinance	62,156	56,728	20,853	36.8
Other	71,902	63,333	22,922	36.2
Non-owner occupied²				
Conventional, first lien				
Home purchase	455,810	404,262	59,621	14.7
Refinance	994,283	845,957	211,487	25.0
Other	141,044	125,094	43,836	35.0
Business related¹				
Conventional, first lien				
Home purchase	37,215	36,290	1,204	3.3
Refinance	38,438	37,083	2,213	6.0
Other	11,266	10,504	805	7.7
MULTIFAMILY³				
Conventional, first lien				
Home purchase	14,714	13,735	1,308	9.5
Refinance	25,844	24,162	3,391	14.0
Other	6,441	6,039	809	13.4
Total	15,310,651	13,256,634	2,761,964	20.8

¹ 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.

² Includes applications and loans for which occupancy status was missing.

³ Includes business-related and nonbusiness-related applications and loans for owner-occupied and non-owner-occupied properties.

Table 11. Disposition of applications for home loans, and origination and pricing of loans, by type of home and type of loan, 2012—continued

Type of home and loan	Loans originated												Number of HOEPA-covered loans ⁵
	Number	Loans with APOR spread above the threshold ⁴											
		Number	Percent	Distribution, by percentage points of APOR spread							APOR spread (percentage points)		
				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 related¹													
Owner occupied													
<i>Site built</i>													
Home purchase													
Conventional													
First lien	1,243,784	39,405	3.2	40.7	20.4	13.5	15.8	5.4	4.3	2.6	2.2	...	
Junior lien	40,772	7,386	18.1	...	...	...	27.6	45.4	27.0	4.6	4.3	...
Government backed													
First lien	1,028,023	30,645	3.0	74.8	16.1	4.3	3.5	1.1	.2	1.9	1.7	...	
Junior lien	1,174	34	2.9	...	...	...	5.9	26.5	67.7	5.3	5.3	...
Refinance													
Conventional													
First lien	4,944,515	57,979	1.2	51.5	17.0	10.1	12.7	5.2	3.6	2.4	2.0	685	
Junior lien	70,791	9,631	13.6	...	...	...	29.5	41.7	28.9	4.7	4.3	167
Government backed													
First lien	907,654	25,993	2.9	22.9	6.7	14.7	48.5	6.9	.4	3.0	3.2	42	
Junior lien	185	12	6.5	...	...	...	8.3	33.3	58.3	5.1	5.4	0
Home improvement													
Conventional													
First lien	157,350	10,179	6.5	30.6	17.8	13.5	20.0	9.3	9.0	3.0	2.6	328	
Junior lien	51,882	7,105	13.7	...	...	...	30.9	35.6	33.5	4.8	4.4	152
Government backed													
First lien	7,437	1,098	14.8	18.4	7.0	14.4	53.3	5.2	1.7	3.0	3.2	4	
Junior lien	3,698	3,415	92.3	...	...	...	2.3	10.7	87.0	7.0	7.2	0
Unsecured (conventional or government backed)													
	117,719	...	...	...	...	...	...	...	...	...	...	...
<i>Manufactured</i>													
Conventional, first lien													
Home purchase	44,351	36,426	82.1	4.2	4.2	4.5	12.3	15.3	59.6	6.0	5.7	...	
Refinance	30,866	8,836	28.6	21.9	11.5	11.2	20.4	14.8	20.1	3.6	3.2	536	
Other	34,549	5,988	17.3	37.2	15.5	7.6	14.3	15.1	10.4	3.1	2.4	192	
Non-owner occupied²													
Conventional, first lien													
Home purchase	319,891	14,726	4.6	49.1	18.3	9.7	10.7	4.6	7.5	2.6	2.0	...	
Refinance	588,764	32,399	5.5	71.9	16.1	5.6	3.7	1.5	1.1	2.0	1.8	50	
Other	76,152	3,211	4.2	25.1	9.6	6.9	19.4	25.2	13.7	3.5	3.6	19	
Business related¹													
Conventional, first lien													
Home purchase	34,094	673	2.0	25.0	23.0	27.2	17.4	5.2	2.2	2.6	2.6	...	
Refinance	34,069	503	1.5	22.5	27.6	18.3	22.9	6.6	2.2	2.7	2.5	6	
Other	9,483	171	1.8	47.4	15.2	6.4	15.8	8.8	6.4	2.6	2.0	4	
MULTIFAMILY³													
Conventional, first lien													
Home purchase	11,757	137	1.2	36.5	27.7	12.4	16.1	5.8	1.5	2.4	2.1	0	
Refinance	19,966	280	1.4	46.8	25.0	12.9	9.6	3.6	2.1	2.4	2.1	0	
Other	5,038	24	.5	29.2	16.7	16.7	25.0	8.3	4.2	2.8	2.6	0	
Total	9,783,964	296,256	3.0	39.0	13.0	8.4	16.2	9.6	13.9	3.2	2.4	2,185	

⁴ 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.

⁵ Loans covered by the Home Ownership and Equity Protection Act of 1994 (HOEPA), which does not apply to home-purchase loans.
... Not applicable.

owner-occupancy status. 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 average prime offer rate (APOR) spreads for loans reported as higher priced.

Disposition of Applications

As noted, the 2012 HMDA data include information on about 15.3 million loan applications, nearly 87 percent of which were acted on by the lender (data derived from table 11). With respect to the disposition of applications, patterns of denial rates are largely consistent with what had been observed in earlier years.³⁵ In 2012, 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 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 13.7 percent in 2012, compared with a denial rate of 56 percent for such applications for owner-occupied manufactured homes.

Under the provisions of HMDA, reporting institutions may choose to report the reasons they provide consumers whose applications are turned down. Reporting institutions may cite up to three reasons for each denied application, although most of those that provide this information cite only one reason. An analysis of the reasons for denial provided to prospective borrowers whose applications for conventional credit for the purchase of owner-occupied homes were turned down finds that collateral-related issues and debt-to-income considerations were the two categories of reasons that have had the largest increases since 2006 (data not shown in tables). Debt-to-income issues were also cited somewhat more often for applications for FHA or VA home-purchase loans, but collateral was the category that had the largest percentage increase.

The Incidence of Higher-Priced Lending

Price-reporting rules under HMDA since late 2009 define higher-priced first-lien loans as those with an annual percentage rate (APR) of at least 1.5 percentage points above the APOR for loans of a similar type (for example, a 30-year fixed-rate mortgage).³⁶ The spread for junior-lien loans must be at least 3.5 percentage points for such loans to be con-

³⁵ The information provided in the tables is identical to that provided in analyses of earlier years of HMDA data. Comparisons of the numbers in the tables with those in tables from earlier years, including statistics on denial rates, can be made by consulting the following articles: Avery and others, "The Mortgage Market in 2011," in note 10; Avery and others, "The Mortgage Market in 2010," in note 16; Avery and others, "The 2009 HMDA Data," in note 27; 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 (April), pp. A169–A211, www.federalreserve.gov/pubs/bulletin/2010/articles/HMDA/default.htm. Also see Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner (2008), "The 2007 HMDA Data," *Federal Reserve Bulletin*, vol. 94 (December), pp. A107–A146, www.federalreserve.gov/pubs/bulletin/2008/articles/hmda/default.htm; Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner (2007), "The 2006 HMDA Data," *Federal Reserve Bulletin*, vol. 93 (December), pp. A73–A109, www.federalreserve.gov/pubs/bulletin/2007/articles/hmda/default.htm; 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 (September), pp. A123–A166, www.federalreserve.gov/pubs/bulletin/2006/hmda/default.htm; 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 (Summer), pp. 344–94, www.federalreserve.gov/pubs/bulletin/2005/summer05_hmda.pdf.

³⁶ For more information about the rule changes related to higher-priced lending and the ways in which they affect the incidence of reported higher-priced lending over time, see Avery and others, "The 2009 HMDA Data," in note 27.

sidered higher priced. 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.³⁷

The data show that the incidence of higher-priced lending across all products in 2012 was about 3 percent, down about 70 basis points, or 0.7 percentage points, from 2011 (as shown in table 11). The incidence varies across loan types, products, and purposes. First, among home-purchase loans, conventional loans tend to have a higher incidence of higher-priced lending than nonconventional loans, although the difference has narrowed in recent years. In 2012, among first-lien home-purchase loans for site-built homes, 3.2 percent of conventional loans had APRs above the price-reporting threshold, compared with 3.0 percent of nonconventional loans. (Among nonconventional loans, those backed by VA guarantees have a particularly low incidence of being higher priced: In 2012, only about 0.1 percent of the VA-guaranteed first-lien home-purchase loans were higher priced.)

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 2012, the incidence of higher-priced lending for conventional first-lien refinance loans was 1.2 percent, whereas for comparable junior-lien loans it was 13.6 percent. This relationship is found despite the fact that the threshold for reporting a 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 have a very elevated incidence of higher-priced lending. For 2012, 82 percent of the conventional first-lien loans used to purchase manufactured homes were higher priced.

The HMDA data also show that the incidence of higher-priced lending is related to borrower incomes and the amounts borrowed, with borrowers with lower incomes and those receiving smaller loans being more likely to obtain a higher-priced loan. For example, 54 percent of home-purchase loans were extended to borrowers with incomes under \$75,000, while such borrowers account for 71 percent of all higher-priced home-purchase loans (as shown in table 9). Data in table 10 indicate that, across loan amounts, about 17 percent of home-purchase loans were under \$100,000, whereas roughly 45 percent of higher-priced home-purchase loans were under that amount.

Rate Spreads for Higher-Priced Loans

In 2012, the mean APOR spread reported for higher-priced first-lien conventional loans for the purchase of an owner-occupied site-built home was about 2.6 percentage points, compared with about 1.9 percentage points for higher-priced first-lien nonconventional loans used for the same purpose (as shown in table 11). Average spreads for first-lien conventional and government-backed refinance loans were 2.4 percentage points and 3.0 percentage points, respectively. (In 2011, the incidence of higher-priced lending for nonconventional refinancings was nearly the same as it was for conventional refinance loans—about 2.5 percent.)

It is worth noting that most first-lien nonconventional loans for home purchase reported as higher priced in 2012 exceeded the HMDA price-reporting thresholds by only a small amount. Specifically, nearly 75 percent of the higher-priced nonconventional first-lien home-purchase loans had reported spreads between 150 and 199 basis points above the threshold. By comparison, only about 41 percent of the comparable conventional loans

³⁷ See Freddie Mac, “Weekly Primary Mortgage Market Survey (PMMS),” webpage, www.freddiemac.com/pmms; and Federal Financial Institutions Examination Council, “FFIEC Rate Spread Calculator,” webpage, www.ffiec.gov/ratespread/newcalc.aspx.

reported as higher priced had prices this close to the margin of reporting. In contrast, the share of higher-priced nonconventional refinancing loans with prices close to the margin of reporting (23 percent) is less than that of higher-priced conventional refinancing loans with such pricing (about 52 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 2012, the typical higher-priced conventional first-lien loan to purchase a manufactured home had a reported spread of about 6.0 percentage points, compared with an average spread of roughly 2.6 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.³⁸ For 2012, 524 lenders reported extending 2,185 loans covered by HOEPA (as shown in table 11; data regarding the number of lenders not shown in tables). In comparison, 574 lenders reported on 2,387 loans covered by HOEPA in 2011. In the aggregate, HOEPA-related lending made up less than 0.03 percent of all of the originations of home-secured refinancings and home-improvement loans reported for 2012 (data derived from tables).³⁹ Very few HOEPA loans are sold: Among the newly issued loans covered by HOEPA in 2012, only 5 were reported as sold to a secondary-market participant.

Lending across Population Groups and Neighborhoods

The HMDA data can be used to track changes in lending activity across different population groups and areas. In this section, we show changes in lending, from 2011 to 2012, to borrowers sorted by income, race and ethnicity, and the income or minority population characteristics of the areas where the borrowers reside.⁴⁰

As noted earlier, for purposes of reporting the 2012 HMDA data and facilitating their dissemination to the public by the FFIEC, there has been a switch from using census-tract geographic designations and population and housing data from the 2000 decennial census to using a combination of data from the 2010 decennial census and the 2006–10 ACS. This switch makes it challenging to study trends in lending across geographies from 2011 to 2012 because of sharp changes in the number of tracts classified in a given category. For example, the number of census tracts in the low-income category increased 40 percent, while the share of census tracts in which minorities make up less than 10 percent of the total population decreased about 10 percentage points (data not shown in tables).⁴¹

An alternative way to measure the changes in lending across census-tract categories between 2011 and 2012 is to use the subset of census tracts that had few or no changes in

³⁸ Unlike the threshold rules used to report higher-priced loans, the threshold rules to identify HOEPA loans did not change.

³⁹ HOEPA does not apply to home-purchase loans.

⁴⁰ Previous articles have reviewed changes in lending in earlier years. See, for example, Avery and others, “The Mortgage Market in 2011,” in note 10.

⁴¹ The share of the U.S. population in census tracts whose residents are predominantly non-Hispanic white dropped from nearly 33 percent in 2000 to about 23 percent in 2010.

their physical boundaries for the 2000 and 2010 decennial censuses (these tracts are referred to in this article as stable-boundary tracts). We categorized these tracts according to their income and minority status as used in the 2012 HMDA data and then calculated changes in lending that were free of reclassification effects for these tracts.⁴²

Changes in Lending across Populations, 2011 to 2012

As noted, home-purchase lending increased about 13 percent from 2011 to 2012. Virtually all population segments experienced gains, although the increase in activity was larger for some borrower groups than for others

(table 12Table12pt2.HomeLendingToDifferentPopul-34BB8FC2, first memo item).⁴³

Across racial or ethnic groups, the largest increase in home-purchase loan activity was experienced by Asians and non-Hispanic whites; the number of home-purchase loans extended to borrowers in each of these groups increased about 15 percent, while lending to blacks and Hispanic whites increased at a rate of less than half this value. Lending to all borrower income groups also increased, with the largest gains experienced by middle- or high-income households.

Ignoring the reclassification effect discussed earlier, we observe that the change in home-purchase lending by census-tract category between 2011 and 2012 was greatest in low-income census tracts (62 percent) and tracts with a high share of minorities in the population (67 percent in tracts with a minority share of 50 to 79 percent) (as shown in table 12, first memo item). However, focusing on the stable-boundary tracts and using a constant categorization, we find that home-purchase lending growth was actually weakest in the low-income category and in neighborhoods with a high minority share (table 12, second memo item).

Borrowers of all racial and ethnic groups and borrowers in all income segments experienced significant gains in refinance and home-improvement loan activity. Similarly, focusing on our adjusted measure of change, sizable increases in such lending were experienced across nearly all neighborhood types (as shown in table 12, second memo item).

Use of Loan Types across Populations

Populations differ considerably in their use of different types of loan products. Most notably, black, Hispanic white, and lower-income borrowers, and those residing in areas with larger shares of minority populations, use nonconventional loans to purchase homes to a greater extent than other groups. Greater reliance on nonconventional loans may reflect the relatively low down-payment requirements of the FHA and VA lending programs, which serve the needs of borrowers who have few assets to meet down-payment and closing-cost requirements.⁴⁴ The patterns of product incidence could also reflect the behavior of lenders to some extent; for example, concerns have been raised about the possibility that lenders steer borrowers in certain neighborhoods toward government-backed loans. The HMDA data indicate that all groups relied a bit less on nonconventional loans to purchase homes in 2012 than in 2011.

⁴² Stable-boundary tracts account for over 70 percent of all census tracts in the 2010 census, roughly two-thirds of the U.S. population resides in these census tracts, and they include about two-thirds of the 2012 home-purchase lending. Nonetheless, stable-boundary tracts may not be fully representative of all census tracts—in particular, they may be more reflective of slow-growing areas—so some caution should be used in drawing conclusions based on lending outcomes in this subset of census tracts.

⁴³ Changes in lending to different groups over the period 2006–10 were presented in a previous article. See Avery and others, “The Mortgage Market in 2010,” in note 16.

⁴⁴ Findings of the Federal Reserve Board’s Survey of Consumer Finances for 2010 indicate that liquid asset levels and financial wealth holdings for minorities and lower-income groups are substantially smaller than they are for non-Hispanic whites or higher-income populations. See Board of Governors of the Federal Reserve System, “2010 Survey of Consumer Finances,” webpage, www.federalreserve.gov/econresdata/scf/scf_2010.htm.

Table 12. Home lending to different populations, by characteristic of borrower and of census tract and by type and purpose of loan, 2011–12

Percent except as noted

Characteristic of borrower and of census tract	2011				2012				Memo: Percentage change in number of loans, 2011–12	Memo: Percentage change in number of loans in unchanged census tracts, 2011–12
	Conventional	Non-conventional ¹	Total	Memo: Number of loans	Conventional	Non-conventional ¹	Total	Memo: Number of loans		
A. Home purchase										
Borrower										
<i>Race other than white only²</i>										
American Indian or Alaska Native	36.5	63.5	100	9,435	40.4	59.6	100	10,252	8.7	18.7
Asian	74.3	25.7	100	104,626	78.1	21.9	100	120,681	15.3	16.6
Black or African American	21.6	78.4	100	113,591	24.6	75.4	100	119,533	5.2	7.5
Native Hawaiian or other Pacific Islander	35.1	64.9	100	6,661	39.6	60.4	100	6,811	2.3	5.1
<i>White, by ethnicity²</i>										
Hispanic white	29.2	70.8	100	195,778	33.0	67.0	100	209,749	7.1	11.8
Non-Hispanic white	53.3	46.7	100	1,417,339	58.2	41.8	100	1,629,611	15.0	21.9
<i>Income ratio (percent of area median)³</i>										
Low	39.9	60.1	100	254,828	44.6	55.4	100	277,827	9.0	12.7
Moderate	37.3	62.7	100	495,859	41.9	58.1	100	548,761	10.7	17.0
Middle	43.9	56.1	100	519,898	49.1	50.9	100	585,729	12.7	19.3
High	65.9	34.1	100	790,223	70.5	29.5	100	919,671	16.4	22.7
Census tract of property										
<i>Racial or ethnic composition (minorities as a percent of population)</i>										
Less than 10	56.4	43.6	100	767,580	61.5	38.5	100	558,225	-27.3	27.5
10–49	48.8	51.2	100	1,025,746	57.1	42.9	100	1,360,083	32.6	20.0
50–79	41.0	59.0	100	169,409	44.4	55.6	100	282,659	66.9	9.2
80–100	33.7	66.3	100	98,073	34.3	65.7	100	131,021	33.6	-4
<i>Income ratio (percent of area median)⁴</i>										
Low	45.0	55.0	100	21,128	46.0	54.0	100	34,311	62.4	5.8
Moderate	39.8	60.2	100	206,299	43.2	56.8	100	266,401	29.1	11.0
Middle	44.3	55.7	100	1,029,115	48.9	51.1	100	1,027,212	-2	20.8
High	60.7	39.3	100	791,254	65.3	34.7	100	989,973	25.1	21.1
B. Refinance										
Borrower										
<i>Race other than white only²</i>										
American Indian or Alaska Native	77.6	22.4	100	10,991	75.3	24.7	100	16,785	52.7	63.2
Asian	95.8	4.3	100	204,917	94.1	5.9	100	323,859	58.0	57.9
Black or African American	62.5	37.6	100	119,267	61.6	38.4	100	197,357	65.5	65.1
Native Hawaiian or other Pacific Islander	77.3	22.8	100	8,595	73.2	26.8	100	14,496	68.7	69.2
<i>White, by ethnicity²</i>										
Hispanic white	79.0	21.0	100	176,431	75.3	24.7	100	307,846	74.5	74.9
Non-Hispanic white	87.7	12.3	100	2,826,443	85.8	14.2	100	4,282,330	51.5	58.4
<i>Income ratio (percent of area median)³</i>										
Low	62.4	37.6	100	648,323	42.0	58.0	100	978,675	51.0	54.7
Moderate	87.9	12.1	100	529,877	90.4	9.6	100	829,141	56.5	62.9
Middle	89.1	10.9	100	821,444	91.0	9.0	100	1,289,873	57.0	63.4
High	93.7	6.3	100	1,840,400	94.4	5.6	100	2,803,098	52.3	57.7

Note: First-lien mortgages for owner-occupied one- to four-family homes.

¹ See table 4, note 1.

² Categories for race and ethnicity reflect the 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.

Table 12. Home lending to different populations, by characteristic of borrower and of census tract and by type and purpose of loan, 2011–12—continued

Percent except as noted

Characteristic of borrower and of census tract	2011				2012				Memo: Percentage change in number of loans, 2011–12	Memo: Percentage change in number of loans in unchanged census tracts, 2011–12
	Conventional	Non-conventional ¹	Total	Memo: Number of loans	Conventional	Non-conventional ¹	Total	Memo: Number of loans		
Census tract of property										
<i>Racial or ethnic composition (minorities as a percent of population)</i>										
Less than 10	88.6	11.4	100	1,662,511	88.1	11.9	100	1,564,181	-5.9	57.2
10–49	85.9	14.1	100	1,825,725	84.4	15.6	100	3,435,574	88.2	58.1
50–79	83.5	16.5	100	241,937	79.2	20.8	100	637,931	163.7	67.5
80–100	77.4	22.6	100	109,871	76.0	24.0	100	263,101	139.5	71.4
<i>Income ratio (percent of area median)⁴</i>										
Low	79.9	20.1	100	20,390	77.8	22.2	100	59,703	192.8	66.6
Moderate	80.3	19.7	100	264,107	78.0	22.0	100	538,499	103.9	69.0
Middle	83.8	16.2	100	1,779,036	81.6	18.4	100	2,484,346	39.6	63.7
High	90.7	9.3	100	1,753,976	88.3	11.7	100	2,793,475	59.3	53.0
C. Home improvement⁵										
Borrower										
<i>Race other than white only²</i>										
American Indian or Alaska Native	96.7	3.3	100	1,787	97.2	2.8	100	2,114	18.3	36.3
Asian	97.4	2.6	100	5,857	98.1	1.9	100	7,411	26.5	26.5
Black or African American	93.0	7.0	100	17,964	94.2	5.8	100	20,225	12.6	17.0
Native Hawaiian or other Pacific Islander	95.9	4.1	100	752	96.1	3.9	100	1,077	43.2	43.6
<i>White, by ethnicity²</i>										
Hispanic white	95.8	4.2	100	20,733	96.0	4.0	100	21,478	3.6	13.8
Non-Hispanic white	96.6	3.4	100	227,534	96.5	3.5	100	262,461	15.4	26.8
<i>Income ratio (percent of area median)³</i>										
Low	93.0	7.0	100	45,672	95.4	4.6	100	49,414	8.2	15.9
Moderate	95.1	4.9	100	61,778	96.5	3.5	100	68,330	10.6	20.7
Middle	95.2	4.8	100	75,804	96.2	3.8	100	85,884	13.3	23.9
High	96.4	3.6	100	124,873	96.9	3.1	100	144,828	16.0	27.5
Census tract of property										
<i>Racial or ethnic composition (minorities as a percent of population)</i>										
Less than 10	96.2	3.8	100	154,798	97.2	2.8	100	133,312	-13.9	33.2
10–49	94.8	5.2	100	116,021	96.0	4.0	100	163,078	40.6	22.9
50–79	92.8	7.2	100	17,742	95.4	4.6	100	28,077	58.3	26.1
80–100	93.4	6.6	100	19,566	95.6	4.4	100	23,989	22.6	31.2
<i>Income ratio (percent of area median)⁴</i>										
Low	87.5	12.5	100	3,393	94.9	5.1	100	6,281	85.1	27.2
Moderate	94.3	5.7	100	35,492	96.0	4.0	100	45,966	29.5	27.9
Middle	95.7	4.3	100	170,938	96.2	3.8	100	176,138	3.0	30.0
High	96.2	3.8	100	91,865	96.8	3.2	100	115,147	25.3	23.5

³ Borrower income is the total income relied on 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. "Low" is less than 50 percent of the median; "moderate" is 50 percent to 79 percent (in this article, "lower income" encompasses the low and moderate categories); "middle" is 80 percent to 119 percent; and "high" is 120 percent or more.

⁴ 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. "Low" is less than 50 percent of the median; "moderate" is 50 percent to 79 percent; "middle" is 80 percent to 119 percent; and "high" is 120 percent or more.

⁵ Consists of first- and junior-lien loans and loans without a lien.

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 Federal Reserve's decision to add pricing data for higher-priced loans in 2004, although such data serve other purposes, including to help identify lenders active in the higher-cost or higher-risk segments of the mortgage market and provide information on the volume and locations of borrowers receiving higher-priced loans.

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.⁴⁵ Analyses also have found that differences across groups in mean APR spreads paid by those with higher-priced loans were generally small.⁴⁶ Here we examine the 2012 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.

Comparisons of outcomes (for both loan pricing and denial rates) are shown for each racial, ethnic, or gender group. The analysis here distinguishes among three loan purposes (home purchase, refinance, and home improvement) and between two broad types of lending (conventional and nonconventional), reflecting the different underwriting standards and fees associated with these two broad loan product categories.

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

Overall, the reported incidence of higher-priced lending was about 50 basis points lower in 2012 than in 2011 (data for 2011 not shown in tables). Pricing relationships across population groups observed in the 2012 HMDA data are very similar to those found in the 2011 data. The 2012 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. These relationships hold both for home-purchase and refinance lending and for nonconventional loans (tables 13.A and 13.B). For example, for conventional home-purchase lending in 2012, the incidence of higher-priced lending was 6.7 percent for black borrowers, 7.4 percent for Hispanic white borrowers, and 1.3 percent for Asians, compared with 3.2 percent for non-Hispanic white borrowers. With regard to the gender of applicants, we find relatively small dif-

⁴⁵ 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"; all three references are in note 35.

⁴⁶ 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," Federal Reserve Bank of New York Staff Reports 368 (New York: Federal Reserve Bank of New York, April), www.newyorkfed.org/research/staff_reports/sr368.pdf; 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.

Table 13. Incidence of higher-priced lending, mean and median average prime offer rate spreads for loans, and denial rates, by type and purpose of application and by race, ethnicity, and sex of applicant, 2012

A. Conventional loan application

Race, ethnicity, and sex	Incidence of higher-priced lending (percent)		APOR spread (percentage points)				Denial rate (percent)	
	2011	2012	2011		2012		2011	2012
			Mean	Median	Mean	Median		
Home purchase								
Race other than white only¹								
American Indian or Alaska Native	8.06	8.04	2.95	2.51	2.94	2.59	26.0	25.5
Asian	1.32	1.27	2.41	2.11	2.37	2.18	15.3	14.5
Black or African American	7.92	6.70	2.49	1.96	2.70	2.10	33.0	32.0
Native Hawaiian or other Pacific Islander	2.83	1.74	2.25	1.86	2.59	2.08	21.6	20.4
Two or more minority races	2.28	2.01	2.68	2.33	2.27	1.85	25.6	27.9
Joint	2.98	2.27	2.50	2.14	2.56	2.13	13.1	11.9
Missing	1.69	1.28	2.30	1.89	2.19	1.85	20.1	18.0
White, by ethnicity¹								
Hispanic white	9.23	7.39	2.52	2.19	2.75	2.51	21.9	20.5
Non-Hispanic white	3.91	3.17	2.49	2.15	2.54	2.17	12.4	11.6
Sex								
One male	4.11	3.37	2.50	2.14	2.59	2.20	17.0	15.8
One female	3.78	2.98	2.42	2.01	2.48	2.11	16.7	15.4
Two males	7.20	5.87	2.56	2.37	2.55	2.29	18.7	17.2
Two females	4.98	3.82	2.52	2.13	2.62	2.22	18.5	16.2
Refinance								
Race other than white only¹								
American Indian or Alaska Native	3.21	2.56	2.79	2.18	2.73	2.16	36.2	32.7
Asian	.31	.28	2.43	1.97	1.99	1.71	19.3	17.1
Black or African American	4.25	2.86	2.99	2.08	2.62	1.98	40.5	34.7
Native Hawaiian or other Pacific Islander	1.18	.90	2.42	1.99	2.32	1.82	31.9	29.2
Two or more minority races	.85	1.03	1.98	1.79	2.15	1.68	33.0	30.4
Joint	1.04	.81	2.53	2.03	2.39	1.90	18.7	16.2
Missing	.75	.74	2.53	1.84	2.06	1.74	29.3	25.5
White, by ethnicity¹								
Hispanic white	2.74	1.87	2.73	2.11	2.51	2.00	30.1	26.1
Non-Hispanic white	1.65	1.22	2.54	2.07	2.42	2.00	20.0	17.4
Sex								
One male	1.83	1.39	2.59	2.06	2.40	1.94	26.7	23.0
One female	2.05	1.49	2.67	2.04	2.44	1.96	25.8	22.6
Two males	2.04	1.40	2.55	2.15	2.49	2.02	24.5	21.7
Two females	2.14	1.27	2.70	2.05	2.72	1.98	24.0	20.0

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, see text and table 9, note 3. Loans taken out jointly by a male and female are not shown 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 (APOR) spread, see table 11, note 4.

¹ See table 12, note 2.

Table 13. Incidence of higher-priced lending, mean and median average prime offer rate spreads for loans, and denial rates, by type and purpose of application and by race, ethnicity, and sex of applicant, 2012

B. Nonconventional loan application

Race, ethnicity, and sex	Incidence of higher-priced lending (percent)		APOR spread (percentage points)				Denial rate (percent)	
	2011	2012	2011		2012		2011	2012
			Mean	Median	Mean	Median		
Home purchase								
Race other than white only¹								
American Indian or Alaska Native	2.78	2.35	1.78	1.65	1.84	1.68	17.6	18.4
Asian	2.08	1.87	2.10	1.74	1.87	1.72	18.9	20.2
Black or African American	4.16	4.86	1.94	1.74	1.86	1.73	23.3	23.9
Native Hawaiian or other Pacific Islander	2.67	2.66	1.97	1.83	1.95	1.80	17.6	18.4
Two or more minority races	.88	1.15	2.07	1.69	1.74	1.71	21.0	24.5
Joint	1.76	1.59	1.96	1.76	1.97	1.73	13.2	15.1
Missing	2.89	2.82	2.21	1.74	1.89	1.72	21.8	22.1
White, by ethnicity¹								
Hispanic white	4.52	4.41	1.88	1.74	1.87	1.71	18.9	18.7
Non-Hispanic white	2.35	2.53	1.96	1.77	1.95	1.73	13.2	13.6
Sex								
One male	2.91	3.09	1.93	1.73	1.90	1.72	16.6	17.1
One female	3.88	4.20	1.99	1.75	1.89	1.73	16.9	17.0
Two males	2.95	2.90	1.90	1.76	1.81	1.71	20.4	20.1
Two females	3.25	3.33	1.85	1.71	1.81	1.70	19.5	18.0
Refinance								
Race other than white only¹								
American Indian or Alaska Native	5.01	2.86	2.49	2.51	2.99	3.22	35.4	27.7
Asian	3.98	1.71	2.35	2.28	2.93	3.04	32.5	22.2
Black or African American	10.74	5.48	2.63	2.57	3.16	3.31	38.8	29.4
Native Hawaiian or other Pacific Islander	3.45	2.59	2.44	2.34	2.97	3.09	30.3	24.6
Two or more minority races	4.53	2.56	2.25	2.06	3.39	3.37	39.6	30.6
Joint	2.76	1.41	2.37	2.19	2.96	2.60	24.7	18.1
Missing	2.31	.92	3.33	1.97	2.37	1.93	42.6	29.6
White, by ethnicity¹								
Hispanic white	6.90	3.08	2.49	2.35	2.64	2.70	30.4	22.3
Non-Hispanic white	5.93	2.92	2.44	2.28	2.98	3.17	28.7	19.6
Sex								
One male	4.72	2.36	2.60	2.29	2.92	3.09	33.6	23.8
One female	12.04	6.00	2.63	2.46	3.12	3.25	36.1	25.5
Two males	2.78	1.54	2.17	2.04	2.61	2.70	30.9	22.0
Two females	4.59	2.20	2.30	2.24	2.71	2.90	33.3	21.7

Note: See notes to table 13.A.

ferences in the incidence of higher-priced lending between single applicants of different genders.

Rate Spreads by Race, Ethnicity, and Sex

The 2012 data indicate that, among borrowers with higher-priced loans, the gross APOR spreads are similar across groups. This result holds for both conventional (table 13.A) and nonconventional lending (table 13.B). For example, for conventional home-purchase loans for owner-occupied properties, the gross mean APOR spread was 2.70 percentage points for black borrowers and 2.75 percentage points for Hispanic white borrowers, while it was 2.54 percentage points for non-Hispanic white borrowers and 2.37 percentage points for Asian borrowers. Gross differences across groups in APOR spreads for refinancings were about the same as for home-purchase lending. With regard to the gender of applicants, the 2012 data reveal only small differences in the gross APR spreads between single applicants of different genders.

Denial Rates by Race, Ethnicity, and Sex

HMDA data in previous years have consistently shown that denial rates vary across applicants grouped by race or ethnicity. This continues to be the case in 2012. As in past years, blacks and Hispanic whites had notably higher gross denial rates in 2012 than non-Hispanic whites, while the differences between Asians and non-Hispanic whites generally were fairly small by comparison (as shown in tables 13.A and 13.B). For example, the denial rates for conventional home-purchase loans were 32 percent for blacks, 20.5 percent for Hispanic whites, 14.5 percent for Asians, and 11.6 percent for non-Hispanic whites. Each of these rates were little changed from 2011. 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 notably smaller than for conventional home-purchase loans.

Some Limitations of the Data in Assessing Fair Lending Compliance

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 credit history (including credit scores), loan-to-value ratios, and differences in loan characteristics. 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 Fair Lending Examination Procedures.⁴⁷ 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

⁴⁷ The Interagency Fair Lending Examination Procedures are available at www.ffiec.gov/PDF/fairlend.pdf.

threshold; pricing differences may exist among loans below the threshold. This gap in the loan pricing information will be addressed when 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.

Analysis of Matched HMDA and Credit Bureau Data

In this section, we present the results from an analysis using an enhanced HMDA data set in which first-lien, owner-occupant home-purchase and refinance mortgages reported in the HMDA data have been matched to borrowers' consumer credit record information.⁴⁸ The matched data set provides an opportunity to explore many aspects of home lending that the HMDA data alone cannot address. Chief among these are the credit circumstances (for example, credit scores, nonmortgage debts, and monthly payments on loans) of mortgage borrowers prior to and at the time of loan origination and their subsequent payment performance on their mortgages and other loans.

Neither the HMDA data nor the credit record data include personal identifying information, but borrowers in the two data sets can be matched based on the mortgage loan information common to both data sets (details of the matching process are provided in appendix B, "Matching HMDA Records with Credit Bureau Records"). For this article, we present results from the matched 2006 and 2010 HMDA loan records; the process of matching data for additional years is ongoing. The 2006 matched data reflect lending activity at the height of the most recent housing boom, while the 2010 data reflect the far more subdued market conditions that were still largely present in 2012. The advantage of studying the 2010 data is that we are able to track payment performance over the subsequent 24 months.

The credit records available for matching come from the Federal Reserve Bank of New York Consumer Credit Panel/Equifax (CCP) data.⁴⁹ The CCP is a 5 percent, nationally representative sample of all individuals with a credit record and a valid Social Security number. Furthermore, the CCP data are a quarterly panel, tracking the same individuals over time.⁵⁰

Because the credit record data are a 5 percent sample of the full population, only a small fraction of HMDA loan records will be represented in the CCP. That said, because the HMDA data consist of several million loan records, the resulting matched data set is still quite large. For reasons discussed in appendix B, we attempted to match only those mortgages for owner-occupied properties in MSAs. Of such loans, we matched about 300,000 in each year, which is about 4 percent of all eligible HMDA loans and implies a match rate of about 60 percent (see appendix B for details of the calculation).

⁴⁸ For further information about credit records, see Robert B. Avery, Paul S. Calem, Glenn B. Canner, and Raphael W. Bostic (2003), "An Overview of Consumer Data and Credit Reporting," *Federal Reserve Bulletin*, vol. 89 (February), pp. 47–73, www.federalreserve.gov/pubs/bulletin/2003/0203lead.pdf.

⁴⁹ For further details, 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), www.newyorkfed.org/research/staff_reports/sr479.html.

⁵⁰ The sampling approach is designed to generate the same entry and exit behavior as is present in the population, with young individuals and immigrants entering the sample and deceased individuals and emigrants leaving the sample each quarter at the same rate as in the U.S. population, such that each quarterly snapshot continues to be nationally representative.

Although the 60 percent implied match rate is well below 100 percent, a comparison of the characteristics of the matched loans with the characteristics of the full HMDA data indicates that the matched loans provide a good representation of all HMDA records targeted for matching (table B.1, in appendix B).

Credit Characteristics and Performance by Borrower, Lender, and Loan Type

The HMDA data provide unique information on the race, ethnicity, and income of mortgage borrowers; the type of lender and loan purchaser; and loan pricing. Matching to the credit record data adds information on the credit profiles of borrowers. In addition, because of the panel nature of the CCP, we are able to track loans over time to measure performance. We report statistics derived from the credit records by various borrower, lender, and loan attributes identified from the HMDA data for the 2006 and 2010 sets of matched home-purchase and refinance loans (tables 14 and 15). Because the CCP samples individuals rather than mortgages, we weighted the data accordingly to account for the fact that joint mortgages (mortgages that have more than one borrower) have roughly twice the likelihood of being sampled in the CCP.

Credit Scores

Credit scores are a summary metric of the relative credit risk posed by current and prospective borrowers. Generic credit scores (sometimes referred to as bureau or credit history scores) are derived using credit records to predict the likelihood of default based on individuals' past experiences. Notably, credit scores rank-order individuals by the credit risk they pose within a given economic environment; they do not imply any particular future probability of default.⁵¹

The credit score statistics shown in tables 14 and 15 are measured at the end of the quarter prior to mortgage origination.⁵² Credit scores from this date were selected to better align with the information a loan underwriter may have been considering when evaluating the home loan application. Overall, the data show that credit scores differ significantly across various categories of borrowers and loans, and that the average credit scores of borrowers in 2010 were significantly higher than in 2006.

The first five rows of tables 14.A and 14.B show that in 2006, Asian borrowers had the highest average scores, while black mortgage borrowers had the lowest scores. Among home-purchase loans, Asian borrowers had an average score of 723, compared with 640 for black borrowers, and over 40 percent of black borrowers had a score below 620—a score threshold often associated with subprime lending—while just 7 percent of Asian borrowers fell below that level.⁵³ Credit scores also varied by the income and neighborhood character-

⁵¹ For a discussion of the reasons that credit scores do not predict the future default rate for any particular score, see Board of Governors of the Federal Reserve System (2007), *Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit* (Washington: Board of Governors, August), www.federalreserve.gov/boarddocs/rptcongress/creditscore/default.htm.

⁵² The credit score included in the CCP 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). Although the lender may have used a different score to underwrite the loan, it is likely that the scores used here are highly correlated with the scores used in underwriting.

⁵³ One drawback of our matched data set is that we observe the credit record information and credit score for only one of the two borrowers in a joint mortgage. Underwriters may select the lower of the two credit scores for the two applicants, whereas we match only one randomly selected applicant. Thus, for joint mortgages, the credit scores we observe may overstate the credit score used in underwriting to the extent that joint applicants

Table 14. Credit circumstances of mortgage borrowers, by purpose of loan and by demographic, lender, and loan characteristics, 2006**A. Home purchase**

Percent except as noted

Characteristic and status	Credit circumstances ¹									N
	Credit score		Consumer debt (dollars)		Back-end PTI		First-time home-buyer	Loan performance	Performance of delinquent mortgage borrowers on nonmortgage debt	
	Mean (points)	Share less than 620	Mean	Median	Median	Share greater than 43 percent				
Borrower										
Minority status²										
Asian	723	7	16,057	6,263	33	23	51	5.8	53	5,692
Black or African American	640	43	18,862	11,155	37	33	58	23.3	58	9,678
Hispanic white	673	23	16,841	8,850	37	30	51	21.4	54	11,927
Non-Hispanic white	712	13	20,442	12,256	33	25	40	6.7	57	89,673
All others ³	701	18	19,946	11,620	34	26	42	11.0	56	14,534
Income ratio (percent of area median)⁴										
LMI	677	26	12,343	6,539	39	39	62	12.3	55	30,845
Middle	692	20	17,638	12,088	35	26	49	10.2	58	34,663
High	722	10	25,485	15,538	30	17	28	8.3	56	61,705
Census tract of property										
Racial or ethnic composition (minorities as a percent of population)										
Less than 10	713	14	20,267	12,399	33	24	36	6.9	57	45,842
10–80	703	16	20,204	11,724	34	27	43	9.5	57	79,844
More than 80	659	32	15,383	7,193	36	28	61	23.0	54	5,814
Income ratio (percent of area median)⁵										
LMI	670	27	15,698	8,449	35	28	60	16.9	53	17,849
Middle	694	19	18,907	11,661	35	27	47	10.8	57	63,485
High	724	10	22,427	12,806	32	24	31	6.1	59	50,125
CRA assessment area⁶										
Outside of assessment area	700	17	20,202	12,073	34	26	43	10.9	55	46,702
LMI borrower or census tract	675	26	13,747	7,628	38	35	60	15.0	52	13,987
Within assessment area	718	11	19,459	10,279	33	24	42	5.0	55	41,717
LMI borrower or census tract	696	17	13,966	6,656	38	34	59	7.2	54	13,178

Note: First-lien mortgages for owner-occupied one- to four-family homes in metropolitan statistical areas.

¹ Credit score is the Equifax Risk Score 3.0 in the quarter before origination; consumer debt is the borrower's nonmortgage debt before origination; back-end payment-to-income (PTI) ratio is calculated using nonmortgage payments prior to origination plus mortgage payments after origination; first-time borrowers are those with no record of ever having a mortgage; and loan performance measure is the share of borrowers who were more than 60 days past due on their mortgages over a two-year period since origination.

² Borrowers are placed under only one category according to the race and ethnicity of the person listed first on the application.

³ All others consist of American Indian or Alaska Native, Native Hawaiian or other Pacific Islander, and applicants for whom race or ethnicity was not reported.

⁴ See table 12, note 3.

⁵ See table 12, note 4.

⁶ Includes only loans originated by depository institutions and their subsidiaries or affiliates.

istics of borrowers. Scores tended to be lower among LMI borrowers (those with incomes of less than 80 percent of area median family income) and those living in or moving into LMI neighborhoods (census tracts with median family income less than 80 percent of area median family income) or predominantly minority neighborhoods.

have significantly different credit scores. Moreover, to the extent that joint status is correlated with other borrower and loan characteristics, the differences shown in tables 14 and 15 may be exacerbated. For example, in 2006, 27 percent of black home-purchase borrowers had a co-applicant, compared with nearly 48 percent for non-Hispanic whites. That said, an examination of individually held mortgages indicates very similar score differences across race groups, suggesting that the results likely would be quite similar even if we observed both borrowers on joint mortgages.

Table 14. Credit circumstances of mortgage borrowers, by purpose of loan and by demographic, lender, and loan characteristics, 2006—continued**A. Home purchase—continued**

Percent except as noted

Characteristic and status	Credit circumstances ¹									
	Credit score		Consumer debt (dollars)		Back-end PTI		First-time home-buyer	Loan performance	Performance of delinquent mortgage borrowers on nonmortgage debt	N
	Mean (points)	Share less than 620	Mean	Median	Median	Share greater than 43 percent				
Type of lender										
Depository	713	12	20,162	11,103	33	25	41	6.7	55	56,522
Subsidiary or affiliate of depository	700	17	19,338	11,399	34	26	45	10.6	55	31,897
Credit union	728	7	18,621	11,642	33	25	41	2.1	54	3,100
Independent mortgage company	685	24	19,486	12,126	35	28	45	14.6	58	39,985
Type of loan										
Conventional	707	15	19,771	11,281	34	26	41	9.9	56	117,707
Higher priced	624	50	18,681	11,190	36	30	56	31.0	58	21,355
Not higher priced	727	6	20,047	11,305	33	25	37	4.5	53	96,352
FHA	643	37	17,526	11,741	36	26	67	13.5	57	9,248
VA, RHS, or FSA	678	23	22,644	17,691	37	32	57	6.7	62	4,549
Type of purchasing institution										
Not sold	708	15	20,637	10,942	33	25	42	8.6	57	24,900
Fannie Mae or Freddie Mac	725	7	18,550	10,676	33	25	37	4.1	55	36,598
Ginnie Mae or Farmer Mac	656	32	20,097	14,661	36	29	62	9.8	59	4,519
Private securitization	661	34	20,230	11,026	35	26	48	24.4	54	5,983
Bank or affiliate	707	14	20,501	12,006	34	26	43	9.0	53	22,316
Life insurance company or mortgage bank	682	25	19,151	11,840	34	26	45	15.0	57	13,092
Other	684	23	19,875	12,200	35	27	48	14.6	58	24,096
All	701	17	19,714	11,504	34	26	43	10.0	56	131,504

LMI: Low and moderate income; FHA: Federal Housing Administration; VA: Department of Veterans Affairs; RHS: Rural Housing Service; FSA: Farm Service Agency.

Source: FFIEC HMDA data matched to FRBNY Consumer Credit Panel/Equifax.

Credit scores differed by type of lender, type of loan, and secondary-market purchaser in 2006. The differences in credit scores along these dimensions reflect a wide range of factors, including differences in the populations served, product offerings, and underwriting standards. Among lenders, credit union borrowers had the highest average scores. Borrowers who obtained loans from independent mortgage companies had the lowest scores, especially refinance borrowers, for whom the average score was under 660. The elevated incidence of borrowers with lower credit scores from independent mortgage companies in the 2006 matched data is consistent with other research indicating that such lenders tended to originate larger shares of subprime and higher-priced credit than other institutions during this period.⁵⁴

Across loan types, scores were lowest for borrowers who obtained conventional higher-priced loans, with average scores of just 624 and 610 for home-purchase and refinance loans, respectively. Finally, loans held in portfolio and loans sold to Fannie Mae and Freddie Mac had the highest scores. In contrast, those sold into private securitization (frequently subprime loans) and to Ginnie Mae—predominantly FHA and VA loans—and Farmer Mac had the lowest scores.

⁵⁴ See Avery, Brevoort, and Canner, “The 2007 HMDA Data,” in note 35.

Table 14. Credit circumstances of mortgage borrowers, by purpose of loan and by demographic, lender, and loan characteristics, 2006**B. Refinance**

Percent except as noted

Characteristic and status	Credit circumstances ¹								
	Credit score		Consumer debt (dollars)		Back-end PTI		Loan performance	Performance of delinquent mortgage borrowers on nonmortgage debt	N
	Mean (points)	Share less than 620	Mean	Median	Median	Share greater than 43 percent			
Borrower									
Minority status²									
Asian	714	11	24,584	13,134	34	29	9.7	49	4,897
Black or African American	635	44	24,911	15,792	39	40	16.6	56	15,524
Hispanic white	667	27	20,683	12,342	37	35	17.2	55	16,526
Non-Hispanic white	695	19	26,769	17,040	35	31	9.2	55	102,078
All others ³	671	29	24,972	15,884	36	35	13.9	55	27,123
Income ratio (percent of area median)⁴									
LMI	663	32	15,883	9,907	43	50	11.9	52	38,845
Middle	674	27	22,419	15,918	37	34	11.7	55	45,447
High	699	18	34,074	22,550	31	21	11.5	57	74,229
Census tract of property									
Racial or ethnic composition (minorities as a percent of population)									
Less than 10	693	20	27,048	17,271	35	31	9.1	53	51,225
10–80	683	24	25,686	16,272	36	33	12.0	56	99,491
More than 80	648	37	20,748	11,978	37	37	16.0	55	15,424
Income ratio (percent of area median)⁵									
LMI	654	34	20,561	12,752	37	36	15.6	54	28,940
Middle	678	25	24,796	16,177	36	34	11.9	55	83,776
High	707	16	29,880	18,390	34	30	8.7	56	53,417
CRA assessment area⁶									
Outside of assessment area	678	25	26,391	17,219	37	35	11.8	54	58,553
LMI borrower or census tract	659	32	19,163	12,477	42	47	13.0	52	19,959
Within assessment area	712	12	25,307	15,164	33	29	5.3	54	48,376
LMI borrower or census tract	698	16	17,732	10,469	38	39	5.9	53	15,018
Type of lender									
Depository	705	14	25,538	15,475	33	29	7.3	54	65,646
Subsidiary or affiliate of depository	674	26	26,493	17,609	38	38	11.5	55	41,283
Credit union	725	8	25,131	16,527	34	31	1.8	56	5,111
Independent mortgage company	658	34	24,986	15,716	37	35	17.4	56	54,108
Type of loan									
Conventional	684	23	25,628	16,050	36	33	11.5	55	161,497
Higher priced	610	56	25,413	16,001	39	40	26.3	56	45,709
Not higher priced	715	9	25,719	16,080	34	30	5.3	53	115,788
FHA	630	44	23,440	17,884	39	39	13.7	56	4,077
VA, RHS, or FSA	651	36	25,682	21,916	39	37	10.1	63	574
Type of purchasing institution									
Not sold	690	21	26,362	16,525	34	30	9.5	55	45,086
Fannie Mae or Freddie Mac	717	9	23,583	15,309	35	31	3.9	52	35,460
Ginnie Mae or Farmer Mac	638	41	23,533	17,805	38	38	11.4	58	1,575
Private securitization	638	44	25,977	15,636	39	39	21.4	55	12,476
Bank or affiliate	687	21	26,280	16,749	36	34	10.8	54	26,384
Life insurance company or mortgage bank	657	35	25,395	16,062	36	34	16.8	56	21,187
Other	664	32	26,272	16,072	37	35	17.0	55	23,980
All	682	24	25,576	16,114	36	33	11.6	55	166,148

Note: See notes to table 14.A.

Table 15. Credit circumstances of mortgage borrowers, by purpose of loan and by demographic, lender, and loan characteristics, 2010**A. Home purchase**

Percent except as noted

Characteristic and status	Credit circumstances ¹									
	Credit score		Consumer debt (dollars)		Back-end PTI		First-time home-buyer	Loan performance	Performance of delinquent mortgage borrowers on nonmortgage debt	N
	Mean (points)	Share less than 620	Mean	Median	Median	Share greater than 43 percent				
Borrower										
Minority status²										
Asian	745	2.6	11,564	2,430	31	20	63	1.3	45	4,903
Black or African American	677	21.3	19,233	11,219	38	34	69	9.6	54	4,706
Hispanic white	701	11.2	13,804	6,861	37	32	68	4.4	54	6,816
Non-Hispanic white	734	5.4	18,415	9,751	31	21	48	2.4	52	59,764
All others ³	732	6.3	18,064	8,878	32	21	51	2.7	48	9,180
Income ratio (percent of area median)⁴										
LMI	707	10.7	11,661	5,817	38	34	70	4.7	55	26,954
Middle	726	6.8	17,437	10,689	32	20	54	2.8	50	22,226
High	752	2.8	24,098	12,407	26	12	32	1.2	45	35,422
Census tract of property										
Racial or ethnic composition (minorities as a percent of population)										
Less than 10	736	5.4	18,690	9,916	31	20	43	2.4	53	29,660
10–80	726	7.2	17,318	8,680	33	23	55	3.1	52	52,036
More than 80	701	11.8	14,606	5,910	37	31	77	5.6	48	3,661
Income ratio (percent of area median)⁵										
LMI	707	10.4	14,890	6,956	34	25	71	4.1	54	9,915
Middle	720	8.1	16,924	9,361	33	24	57	3.5	51	40,667
High	745	4.1	19,456	9,256	31	20	40	1.9	52	34,754
CRA assessment area⁶										
Outside of assessment area	726	7.3	18,525	9,992	32	22	50	3.1	53	17,092
LMI borrower or census tract	705	11.6	13,350	7,087	37	33	69	5.0	54	6,043
Within assessment area	734	5.7	17,603	7,884	31	20	51	2.3	52	36,522
LMI borrower or census tract	715	8.7	12,486	5,393	36	28	69	3.5	56	12,995
Type of lender										
Depository	732	6.1	17,892	8,425	31	20	51	2.4	52	43,977
Subsidiary or affiliate of depository	728	6.6	17,919	9,033	32	23	52	2.9	52	9,637
Credit union	754	2.5	16,167	7,939	27	14	43	.5	28	2,788
Independent mortgage company	720	8.3	17,362	9,886	35	26	55	3.9	52	28,967
Type of loan										
Conventional	764	1.2	15,673	4,734	27	13	37	.5	49	39,373
Higher priced	699	15.8	23,365	10,242	30	24	45	3.3	70	600
Not higher priced	765	1.0	15,557	4,685	27	13	37	.5	46	38,773
FHA	699	11.2	18,653	11,701	37	30	65	5.0	52	36,569
VA, RHS, or FSA	703	11.4	21,559	15,062	35	25	57	4.6	52	9,427
Type of purchasing institution										
Not sold	738	5.8	19,938	7,652	30	19	46	2.0	52	11,771
Fannie Mae or Freddie Mac	766	.6	13,931	4,355	27	13	38	.4	38	16,816
Ginnie Mae or Farmer Mac	701	11.6	19,391	12,397	36	27	63	4.3	56	14,452
Private securitization	729	7.5	17,534	8,918	31	20	54	3.9	41	411
Bank or affiliate	721	7.7	18,027	9,924	34	25	55	3.7	52	21,162
Life insurance company or mortgage bank	723	7.3	18,127	10,035	34	25	52	3.3	45	7,421
Other	719	8.3	17,426	10,148	34	25	56	3.9	53	13,336
All	728	6.8	17,654	9,023	32	22	52	3.0	52	85,369

Note: See notes to table 14.A.

Table 15. Credit circumstances of mortgage borrowers, by purpose of loan and by demographic, lender, and loan characteristics, 2010**B. Refinance**

Percent except as noted

Characteristic and status	Credit circumstances ¹								
	Credit score		Consumer debt (dollars)		Back-end PTI		Loan performance	Performance of delinquent mortgage borrowers on nonmortgage debt	N
	Mean (points)	Share less than 620	Mean	Median	Median	Share greater than 43 percent			
Borrower									
Minority status²									
Asian	784	1	12,369	3,089	26	15	.8	26	11,978
Black or African American	728	7	24,621	17,072	33	28	3.3	39	5,794
Hispanic white	754	3	18,432	10,667	32	26	2.3	33	7,477
Non-Hispanic white	773	1	19,315	9,993	26	15	1.2	35	164,346
All others ³	772	2	19,472	9,368	27	17	1.6	35	27,502
Income ratio (percent of area median)⁴									
LMI	760	3	12,329	5,866	36	34	2.0	38	36,240
Middle	769	2	16,457	9,367	29	16	1.3	34	48,140
High	783	1	22,479	11,000	22	8	.6	30	115,078
Census tract of property									
Racial or ethnic composition (minorities as a percent of population)									
Less than 10	772	1	19,827	10,644	26	14	1.2	37	93,427
10–80	772	2	18,583	8,842	27	17	1.4	34	118,479
More than 80	752	4	17,387	8,801	33	28	2.2	32	5,174
Income ratio (percent of area median)⁵									
LMI	753	4	18,341	9,671	30	21	2.5	37	14,894
Middle	765	2	19,103	10,627	28	17	1.6	34	95,198
High	781	1	19,159	8,637	25	14	.9	36	106,956
CRA assessment area⁶									
Outside of assessment area	769	2	19,865	10,629	27	15	1.4	37	43,472
LMI borrower or census tract	757	3	14,686	7,604	35	30	2.3	39	8,610
Within assessment area	775	1	18,739	8,875	26	16	1.2	33	112,477
LMI borrower or census tract	764	2	13,559	5,845	34	30	1.7	36	24,239
Type of lender									
Depository	774	2	19,076	9,341	26	16	1.3	34	136,092
Subsidiary or affiliate of depository	774	1	18,903	9,438	27	15	.9	36	19,857
Credit union	779	2	17,568	9,183	24	11	.5	31	14,283
Independent mortgage company	763	2	19,554	10,670	29	18	1.9	37	46,865
Type of loan									
Conventional	780	1	17,738	8,096	26	14	.7	31	188,085
Higher priced	698	19	27,295	16,639	32	28	3.7	47	1,055
Not higher priced	781	1	17,681	8,049	26	14	.7	31	187,030
FHA	717	6	26,494	19,270	36	31	5.3	37	22,764
VA, RHS, or FSA	725	7	29,493	22,711	33	24	4.1	45	6,248
Type of purchasing institution									
Not sold	776	2	19,555	9,031	25	13	.9	33	37,997
Fannie Mae or Freddie Mac	780	1	17,394	8,028	26	14	.8	32	92,510
Ginnie Mae or Farmer Mac	713	9	27,262	20,369	34	27	5.3	39	10,793
Private securitization	782	1	16,690	6,105	26	14	.4	33	1,153
Bank or affiliate	771	1	19,235	9,980	28	18	1.5	35	42,636
Life insurance company or mortgage bank	761	2	20,771	11,929	29	19	1.9	37	13,930
Other	767	2	19,814	10,506	28	17	1.6	35	18,078
All	772	2	19,071	9,629	27	16	1.3	35	217,097

Note: See notes to table 14.A.

From 2006 to 2010, average credit scores rose significantly across all categories of borrowers, loans, and lenders. Overall, the average score rose from 701 to 728 for home-purchase loans and from 682 to 772 for refinance loans. The increase in borrower credit scores may reflect not only tightening in credit standards since 2006, but also changes in the demand for mortgage credit. For example, demand among borrowers with lower scores may have weakened more than that of borrowers with higher scores if lower-score borrowers were more adversely affected by the recession. The relatively large increase in the scores of refinance borrowers between 2006 and 2010 likely reflects, in part, a change in the composition of borrowers seeking to refinance. Specifically, in 2006, when the interest rate environment was relatively unfavorable, evidence suggests that those electing to refinance were doing so primarily to extract equity, and the matched data indicate that such borrowers had relatively low scores. In contrast, in 2010, the low-interest-rate environment appears to have attracted a much larger share of the most creditworthy borrowers looking to refinance simply to reduce their monthly payments.⁵⁵

Other Debts and Payment Obligations

The merged data set allowed us to measure other debts owed, in addition to the mortgage matched in the enhanced database. The second and third columns in tables 14 and 15 show mean and median consumer debt balances reported in the CCP in the quarter prior to origination of the mortgage. Consumer debt consists of all reported balances owed other than those associated with mortgage debt, such as bank credit card and retail card balances, vehicle loans, student loans, and consumer installment loans. The next two columns provide information on back-end PTI ratios, combining payments data on all types of debt from the CCP and borrower income data from the HMDA information. The payments data are based on what lenders and servicers report to Equifax, which typically reflects the payment-due amount on monthly account statements. For mortgages, this amount may include payments for property taxes and insurance, if collected by the servicer. We report median PTI ratios as well as the share of borrowers with a PTI ratio exceeding 43 percent. Under the Dodd-Frank Act as implemented by the CFPB, loans with a PTI ratio exceeding 43 percent could fall outside the definition of a qualified mortgage, and lenders making such loans could face heightened legal risk in the event of borrower default.⁵⁶

It is important to note that the PTI ratios we calculated are likely to understate the PTI ratios used in underwriting for two main reasons. First, for joint mortgages, because we matched the credit record information of only one (randomly selected) borrower, the consumer debts and payments we calculated exclude individually held debts of other, unmatched co-borrowers. Second, nondebt obligations, such as child-support or alimony payments, may be included by underwriters in PTI calculations, but such obligations are not available in credit record data and thus could not be included in our calculations.

Although the estimated PTI ratio understates true PTI ratios, over one-fourth of home-purchase borrowers in 2006 exceeded the 43 percent threshold, as did about one-third of refinance borrowers.⁵⁷ In 2010, these numbers were lower, especially for refinance borrow-

⁵⁵ According to Freddie Mac, nearly 90 percent of the 2006 refinance loans in its portfolio were estimated to involve taking cash out, compared with less than 30 percent in 2010. See Freddie Mac, *Cash-out Refinance Report* (McLean, Va.: Freddie Mac), www.freddiemac.com/news/finance/refi_archives.htm.

⁵⁶ Some loans, such as those eligible for FHA insurance, VA guarantees, or purchase by Fannie Mae or Freddie Mac, would be exempt from the 43 percent PTI rule. See the final rule of the Consumer Financial Protection Bureau on ability-to-repay standards under the Truth in Lending Act (Regulation Z), which is available at www.federalregister.gov/articles/2013/06/12/2013-13173/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z.

⁵⁷ The PTI statistics in tables 14 and 15 reflect nonmortgage payments just before mortgage origination plus mortgage payments just after origination, but we also examined total payments after origination to assess

ers, for whom the proportion was only about 16 percent. For home-purchase loans in 2010, 22 percent had PTI ratios above 43 percent, but about 70 percent of these loans were government backed (data derived from table 15.A), and such loans could still be qualified mortgages despite exceeding the threshold under the current regulations. Within a given year and loan purpose, black and Hispanic-white borrowers, LMI borrowers, and those using FHA or VA loans tend to have the highest likelihoods of having PTI ratios in excess of 43 percent.

First-Time Homebuyers

Using the CCP data, we can estimate the fraction of home-purchase loans to first-time homebuyers as the share of home-purchase borrowers who have no record in the credit bureau data of ever having a mortgage.⁵⁸ In both 2006 and 2010, the incidence of first-time homebuying was higher among minority and LMI groups, groups that tend to have lower credit scores and higher PTI ratios. FHA and VA loans are more likely to be used by first-time homebuyers than are conventional loans, although in 2006 conventional higher-priced loans had a higher-than-average incidence of first-time homebuyers. Perhaps surprisingly, the fraction of home-purchase loans to first-time homebuyers increased markedly from 2006 to 2010. The *relative* strength of first-time homebuying (home-purchase lending overall was very weak in 2010) may reflect several factors, including temporary federal tax incentives for such activity available in 2010 and the possibility that many potential repeat buyers were saddled with underwater properties hindering their mobility.⁵⁹

Loan Performance

Credit record data allow users to construct an array of performance measures ranging from payments made as scheduled or minor delinquencies (such as payments 30 days in arrears) to metrics of more-serious payment problems (such as payments 120 or more days past due or an account in collections or foreclosure). Here we focus on one widely used metric of performance—the share of mortgage borrowers whose payments fell behind 60 days or more at any point within two years of taking out their loan. In combination with the HMDA data, differences in payment experiences can be explored across population and neighborhood groups, types of loans, and types of lenders.

Varying payment performance across populations can reflect a range of factors, including differences in employment circumstances after loan closing (for example, a reduction in hours and earnings), changes in family circumstances (such as divorce or illness), and differences in wealth that may be drawn on to make payments when unforeseen events arise. Home price changes may also affect payment performance, as declines in home values may alter borrower incentives to continue making scheduled payments, limit refinance opportunities that may allow some borrowers to lower their monthly payments, or hinder the ability to sell one's home in the event of financial distress. In addition, payment performance may depend on the features and pricing of the home loan itself. For example, loans of similar amounts to similar borrowers that carry higher interest rates impose a higher monthly payment burden and may place the borrower at greater risk of default.

whether refinance loans were used to consolidate debts and reduce the total payment burden. On average, no such effect was found.

⁵⁸ To the extent that home-purchase borrowers have owned a home in the past that was not financed by a reportable mortgage, our measure will overstate the true share of first-time homebuyers.

⁵⁹ Home purchases through April 30, 2010, that were closed before September 30, 2010, may have been eligible for the first-time homebuyer tax credit. See Internal Revenue Service, "First-Time Homebuyer Credit," webpage, www.irs.gov/uac/First-Time-Homebuyer-Credit-1.

The matched data reveal significant differences in the payment performance of different populations grouped by race or ethnicity, income, and neighborhood demographic characteristics (see the “Loan performance” columns of tables 14 and 15). The data indicate that black and Hispanic-white borrowers are more likely to fall behind on their payments than other racial or ethnic groups. In addition, delinquency tends to be negatively correlated with borrower and neighborhood income, although in 2006, the relationship with borrower income was less pronounced. For example, in 2006, the difference in delinquency rates between LMI- and high-income home-purchase borrowers was about 4 percentage points, while the difference in delinquency rates between those in LMI- and high-income census tracts was 11 percentage points. One factor that may be pushing up the default rate of high-income borrowers is misreporting of income on loan applications (by borrowers or loan officers) at the height of the housing boom, as indicated in previous research.⁶⁰ In other words, many borrowers classified as high income in 2006 may actually have had lower incomes than stated on applications, and these borrowers may have had a relatively high likelihood of default.

Conventional higher-priced loans posted the worst performance of any category listed in table 14, at over three times the overall delinquency rate for home-purchase loans (31 percent compared with 10 percent) and more than double the rate for refinance loans (26 percent compared with 12 percent). This outcome may not be surprising given the credit scores of borrowers in this category; 50 percent of home-purchase borrowers using higher-priced loans had a score below 620. That said, we later show that the poor performance of higher-priced loans cannot be explained entirely by credit scores. In other words, the fact that a loan is higher priced may convey additional information about risk that is not captured by scores alone.

The performance of loans originated in 2010 improved dramatically compared with those originated in 2006. The two-year delinquency rate for home-purchase and refinance loans originated in 2010 was just 3 percent and 1 percent, respectively. FHA and VA loans had the highest delinquency rates across loan products; conventional loans (all types combined) experienced delinquencies well below 1 percent, implying almost no risk-taking in the non-government-backed mortgage market in the aftermath of the financial crisis.

Performance of Delinquent Mortgagors on Other Debt Obligations

As noted, the matched data provide an opportunity to review the performance of mortgage borrowers on their other credit obligations. For this article, we focus on the share of individuals who were delinquent on their mortgage at any point during the two-year period from origination and who were also late on their payments to at least one other debt obligation as of the two-year anniversary of taking out their home loan. Evidence of delinquency on multiple accounts speaks to the severity of financial distress that may have led to mortgage delinquency. For the 2006 cohort of delinquent mortgage borrowers, over half of them were also delinquent on at least one nonmortgage debt obligation at the two-year mark after opening their mortgage (however, some borrowers have no other accounts on which to be delinquent; excluding such borrowers, the fraction of delinquent mortgagors with a nonmortgage delinquency rises to nearly two-thirds). There is remarkably little variation in performance across borrower, neighborhood, loan, or lender type. For the 2010 cohort, about half of the home-purchase borrowers were delinquent on at least one of their other debt obligations, while, among those obtaining a refinance loan, the share was notably lower at 35 percent. The share of 2010 delinquent mortgage borrowers who were in arrears on other credit obligations varies to some extent across groups. In particular,

⁶⁰ See Avery and others, “The Mortgage Market in 2011,” in note 10.

Asians, higher-income borrowers, and borrowers who obtained their home loan from a credit union or whose loan was purchased by Fannie Mae or Freddie Mac performed better on their other debt obligations than other groups.

Borrower Characteristics, Loan Performance, and the Community Reinvestment Act

The Congress enacted the CRA to encourage federally insured banking institutions to help meet the credit needs of their local communities in a manner consistent with safe and sound lending practices. The CRA-related lending activities of banking institutions have been closely scrutinized by regulators, researchers, and the general public, especially recently as questions have been raised about the link between the CRA and the financial crisis. In previous research, using HMDA data alone, we have shown that in the run-up to the Great Recession, the share of all higher-priced loans originated by banking institutions in their assessment areas—the geographic areas of focus in CRA enforcement exams—was small.⁶¹ The matched HMDA–CCP data provide unique, complementary information on the financial characteristics of borrowers and the performance of loans extended by banking institutions inside their assessment areas.

In both 2006 and 2010, average credit scores were somewhat higher for loans originated by banking institutions (and their nondepository subsidiaries) for properties inside their assessment areas compared with outside, and PTI ratios also tended to be lower for loans on properties inside such areas than for those on properties outside them. Of course, the CRA emphasizes lending to LMI populations within assessment areas, and similar patterns hold for such loans. For example, in 2006, the average credit score for home-purchase loans to LMI borrowers or neighborhoods inside CRA assessment areas was 21 points higher than for loans to LMI borrowers outside such areas (696 versus 675). Further, the data also indicate that the delinquency rate of loans extended to LMI borrowers originated in 2006 by banking institutions for properties outside their assessment areas was more than twice the rate of loans originated for homes inside their assessment areas. For example, outside-assessment-area home-purchase loans had a delinquency rate of 15 percent, compared with just 7 percent for inside-assessment-area loans.

Further analysis (not shown) suggests that the difference in performance of loans inside and outside of assessment areas seems to largely reflect the likelihood that the banking organizations that tended to make loans outside of their assessment areas in 2006 also tended to make riskier loans in general. In other words, the performance of inside- and outside-assessment-area loans *within* a given bank tends to be quite similar.

Finally, the delinquency rates for 2006 home-purchase and refinance loans that the CRA promotes—those extended to LMI borrowers inside banks' assessment areas—were significantly lower than the 10 percent and 12 percent rates, respectively, for all home-purchase and refinance loans originated in 2006. Moreover, CRA-targeted loans performed more than four times better than higher-priced loans originated in 2006. The relatively low delinquency rate of loans encouraged by the CRA is inconsistent with the notion that the CRA was a principal driver of the mortgage and financial crisis.

⁶¹ See Neil Bhutta and Glenn B. Canner (2009), "Did the CRA Cause the Mortgage Market Meltdown?" Federal Reserve Bank of Minneapolis, *Community Dividend* (March), www.minneapolisfed.org/publications_papers/pub_display.cfm?id=4136.

Explaining Differences in Loan Performance across Groups

As discussed in the previous section, the matched data reveal substantial differences in loan performance (delinquency rates) across borrowers grouped by their race and ethnicity. For example, the delinquency rate for Asian homebuyers in 2006 was less than 6 percent, compared with over 23 percent for black homebuyers (as shown in table 14.A). This section explores the extent to which the racial and ethnic differences in performance can be explained by factors such as credit scores, house price declines, and mortgage pricing (under the assumption that price reflects risk).⁶² We compare performance across population groups within 12 relatively narrow categories defined by higher-priced loan status, credit score range at origination (under 620, 620–719, and 720 or over), and geography (whether or not properties were located in “housing bust” counties, where house prices declined most sharply).⁶³ The analysis also distinguishes between home-purchase and refinance loans.

Focusing first on home-purchase loans in figure 2.A, we find that the three variables used to define the 12 categories appear to be highly correlated with loan performance. In each panel, performance improves dramatically as credit scores rise, conditional on race and ethnicity. In addition, performance in housing-bust counties consistently lags that in other counties, conditional on score, price, and race or ethnicity. Finally, for any given score, geographic, and racial or ethnic group, the performance of borrowers with non-higher-priced loans exceeds that of borrowers with higher-priced loans. This finding suggests that price helps capture information about risk not observed in the matched data, such as down-payment size or an indication of whether income and assets were fully documented during the application process. It has also been hypothesized that some lenders extended loans with higher prices that were not justified on the basis of risk, and that the higher payment burden eventually led to default.

Across racial and ethnic groups, notable differences in performance were found even within each narrow category. For example, Hispanic white borrowers tended to post higher delinquency rates than other groups within each score-by-price category in the housing-bust counties. In addition, black borrowers with credit scores below 620 in non-housing-bust counties experienced higher delinquency rates than borrowers in other racial and ethnic groups. Further research is needed to better understand why differences in loan payment performance persist after accounting for score, location, and higher-priced status of the loan. These differences may be due in part to minorities being treated differently in the marketplace, which has been raised by many as a serious concern, and several legal actions have alleged discriminatory behavior on the part of lenders during the boom. At the same time, it is important to keep in mind that the matched data used here exclude some key variables that might be correlated with both loan performance and minority status, such as available financial resources and post-origination employment experiences.⁶⁴

⁶² For an in-depth analysis, using similar data, of factors affecting mortgage default across racial and ethnic groups, see Patrick Bayer, Fernando Ferreira, and Stephen L. Ross (2013), “The Vulnerability of Minority Homeowners in the Housing Boom and Bust,” NBER Working Paper Series 19020 (Cambridge, Mass.: National Bureau of Economic Research, May).

⁶³ Housing-bust counties are defined as the 25 percent of counties with the steepest house price declines from December 2006 to December 2008 according to data from CoreLogic. The CoreLogic data cover the vast majority of MSA counties. Those loans for properties in areas not covered by CoreLogic (under 3 percent of loans) were included in the set of “other counties.” Housing-bust counties consist largely of counties in Arizona, California, Florida, and Nevada, as well as a number of counties in Maryland, Michigan, and Minnesota. See appendix figure C.1 for a map of housing-bust counties.

⁶⁴ When we account more precisely for location, loan pricing, and credit score in a multivariate regression, we find sizable and statistically significant differences in loan performance for blacks and Hispanic whites relative to non-Hispanic whites. In future work, we will explore the effect of other factors that may bear on loan performance.

Figure 2.A. Delinquency rates on 2006 home-purchase loans, by minority status, higher-priced loan status, location, and credit score



With respect to refinance loans, the patterns within and across panels once again indicate that the three variables used to define the 12 categories are highly correlated with performance (figure 2.B). Interestingly, unlike the outcomes for home-purchase loans, differences in performance across racial and ethnic groups within categories are more muted.

Long-Term Outcomes for 2006 Home-Purchase Borrowers

The panel structure of the CCP provides an opportunity to study the long-term outcomes of those who purchased their homes at the height of the housing boom. Many of these borrowers experienced sharp declines in the value of their homes, as well as employment-related effects of the severe recession, soon after they bought their homes. Earlier sections documented significant differences in performance on mortgages in the first two years after origination across different populations. Here we look at variation in the probability of having a mortgage six or more years after origination of a 2006 home-purchase loan (as of the end of 2012). Borrowers who became delinquent may have been able to recover from the delinquency (by curing their delinquency or modifying their mortgage) and stay in their home, while others may have lost or sold the home they bought in 2006 but have been able

One caveat to keep in mind when looking at figures 2.A and 2.B is that in cutting the data into 12 categories, some cells have relatively few observations, which may contribute to the variability observed. In particular, the relatively small number of Asian borrowers in some cells can lead to fairly imprecise estimates of their delinquency rates (see appendix tables C.1.A and C.1.B for observation counts in each cell).



to get another mortgage to buy a new home more recently.⁶⁵ We also examine whether the credit score dynamics—score declines and score recovery—of those who missed payments on their mortgages differ by borrower race and ethnicity.⁶⁶

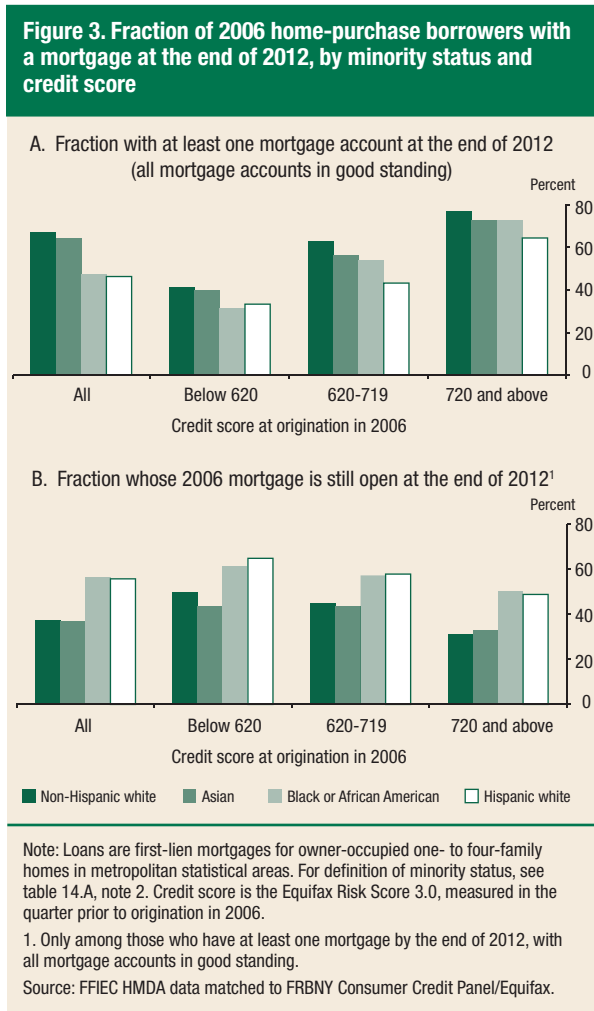
Mortgage Status in 2012 for 2006 Homebuyers

The matched data indicate that many of the 2006 borrowers appear to no longer have a mortgage, and the data further indicate that black and Hispanic-white borrowers who purchased their homes in 2006 are far less likely than Asians and non-Hispanic whites to have mortgages (with all mortgage debt in good standing) as of the end of 2012 (figure 3).⁶⁷ Well over 60 percent of Asian and non-Hispanic-white borrowers still have a mortgage, compared with about 50 percent of black and Hispanic-white borrowers (figure 3, panel A). This difference likely reflects the higher delinquency rate of blacks and Hispanic whites on their 2006 mortgages and difficulties delinquent borrowers may have faced in getting another mortgage subsequently. This difficulty could stem not only from the tightened

⁶⁵ The term “curing” refers to situations in which borrowers who are delinquent on their home loans take steps to cover the payments in arrears.

⁶⁶ Previous research has examined score dynamics before and after foreclosure. See Kenneth P. Brevoort and Cheryl R. Cooper (2010), “Foreclosure’s Wake: The Credit Experiences of Individuals Following Foreclosure,” Finance and Economics Discussion Series 2010-59 (Washington: Board of Governors of the Federal Reserve System, November), www.federalreserve.gov/pubs/feds/2010/index.html. The results here provide new information on score dynamics by race and ethnicity.

⁶⁷ One data-related factor that might be biasing downward the fraction of borrowers who appear to still have a mortgage is the potential lag in reporting new loans to the credit bureaus. Many borrowers refinanced in 2012, especially toward the end of the year. Borrowers who refinanced at the end of the year may appear to have no mortgage because the new loan has not yet been reported to Equifax, while the previous loan may have been reported as closed.



credit standards prevailing since the recession, but also from financial difficulties that once-delinquent borrowers may continue to face (for example, long unemployment spells). Alternatively, those who went through default may also now prefer to rent rather than own. Figure 3 also indicates that accounting for credit score at the time of origination of the 2006 loan helps explain some, but not all, of these differences.

The matched data also indicate that, among those who still have a mortgage as of the end of 2012, black and Hispanic-white borrowers are much more likely to have the same loan they opened in 2006, even conditional on credit score at origination (figure 3, panel B). Moreover, these differences persist after also accounting for current credit score as well as geographic location. This finding might suggest that some minority groups have been less likely to refinance their loans and benefit from the relatively low interest rates in recent years. However, one possible mitigating factor could be that black and Hispanic-white borrowers

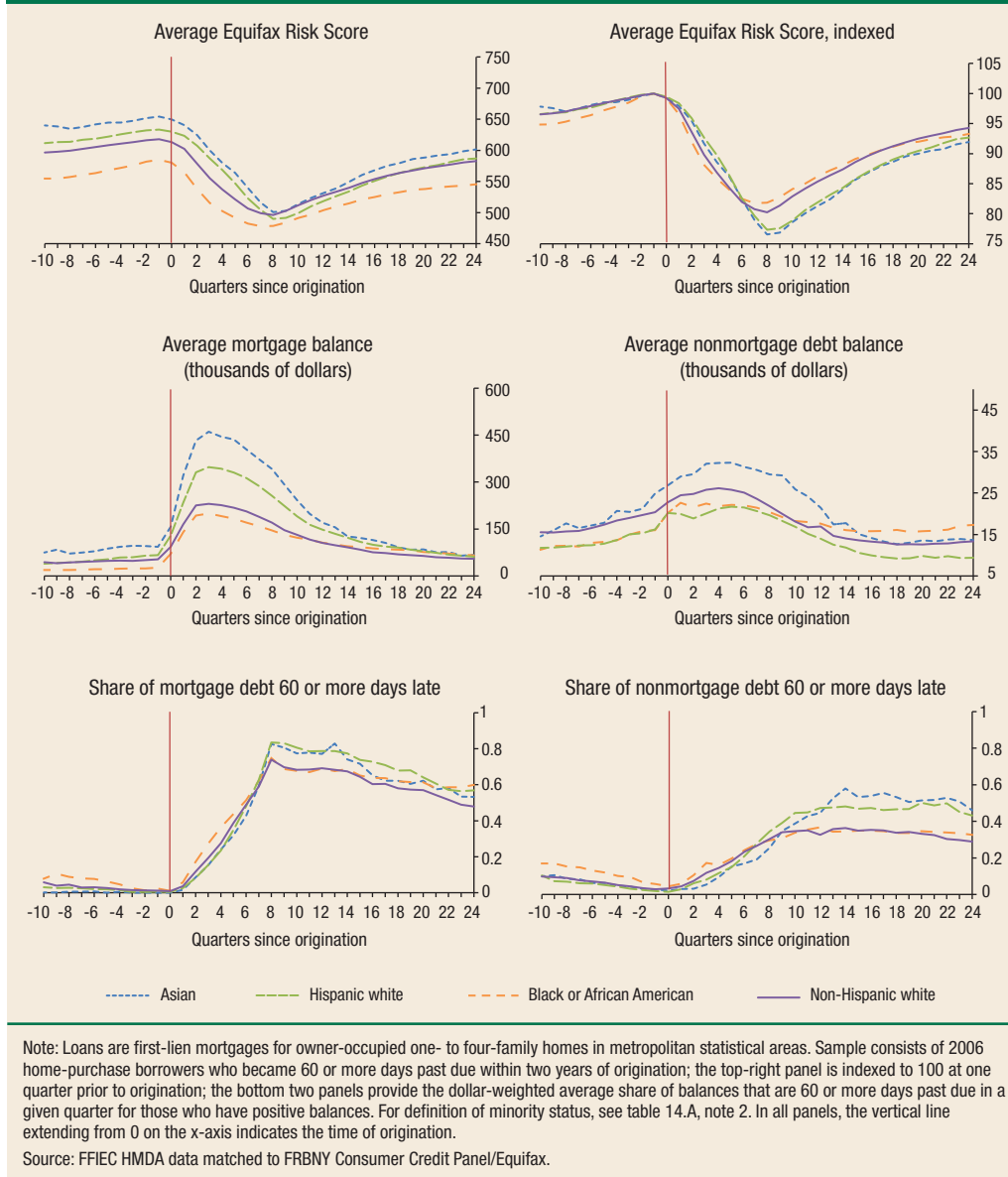
might be more likely to have an adjustable-rate mortgage whose payments have adjusted downward since 2006. A more precise understanding of the reasons for this difference across groups requires additional data and further investigation.

Credit Score Dynamics of Delinquent Mortgage Borrowers

Finally, we explore credit score dynamics leading up to and after loan origination in 2006 for borrowers who fell behind by 60 days or more on their mortgages within two years of origination. The top-left panel in figure 4 shows the time path of average credit scores for delinquent mortgagors by the four main racial or ethnic groups, with the vertical line indicating the time of origination. Credit scores peaked just prior to loan origination and then dropped sharply soon after that as borrowers became delinquent. Scores then began to recover but, on average, were still slightly lower 24 quarters (6 years) after origination than they were in the quarter just before origination. The slow recovery of scores may reflect the severity and ongoing financial stress that delinquent mortgage borrowers faced.

The top-right panel indexes scores to 100 in the quarter prior to origination to more easily compare score drops and recoveries across groups. This panel shows that Asian and Hispanic-white borrowers had a somewhat larger drop in their credit scores, on average, and score recovery was quite similar for all groups, with scores at 90 percent to 95 percent of their peak value six years after origination. In figure 5, we limit the sample to those who

Figure 4. Dynamics of credit scores and debt for delinquent 2006 home-purchase borrowers, by minority status

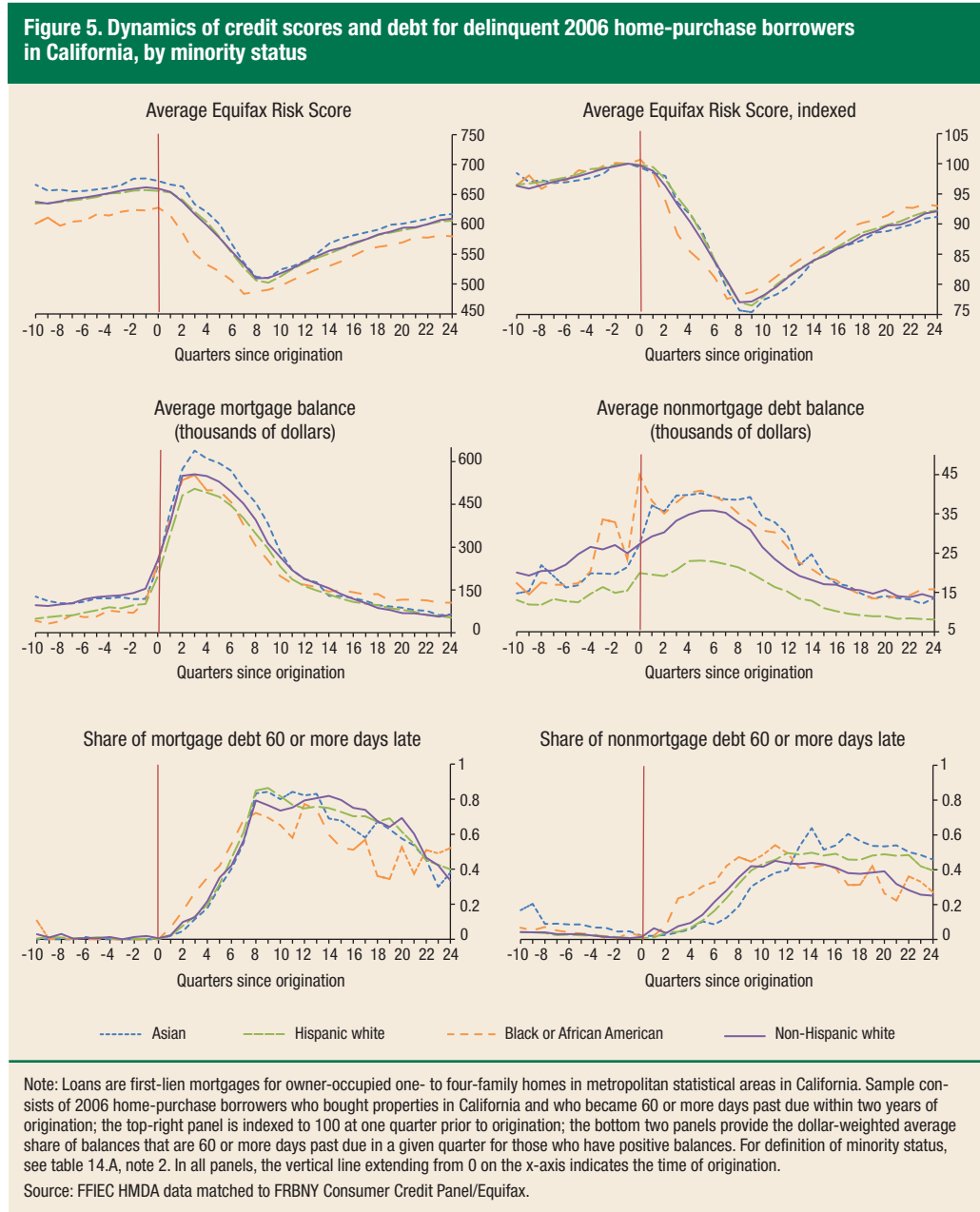


purchased properties in California in order to help equalize the housing and economic environment, and we find here that score patterns after origination were nearly identical across groups.

The middle two panels of figures 4 and 5 show the evolution of reported average mortgage and nonmortgage balances.⁶⁸ Average mortgage balances rose sharply just after origination and, after six years, dropped back to the low levels prior to origination for all groups.⁶⁹

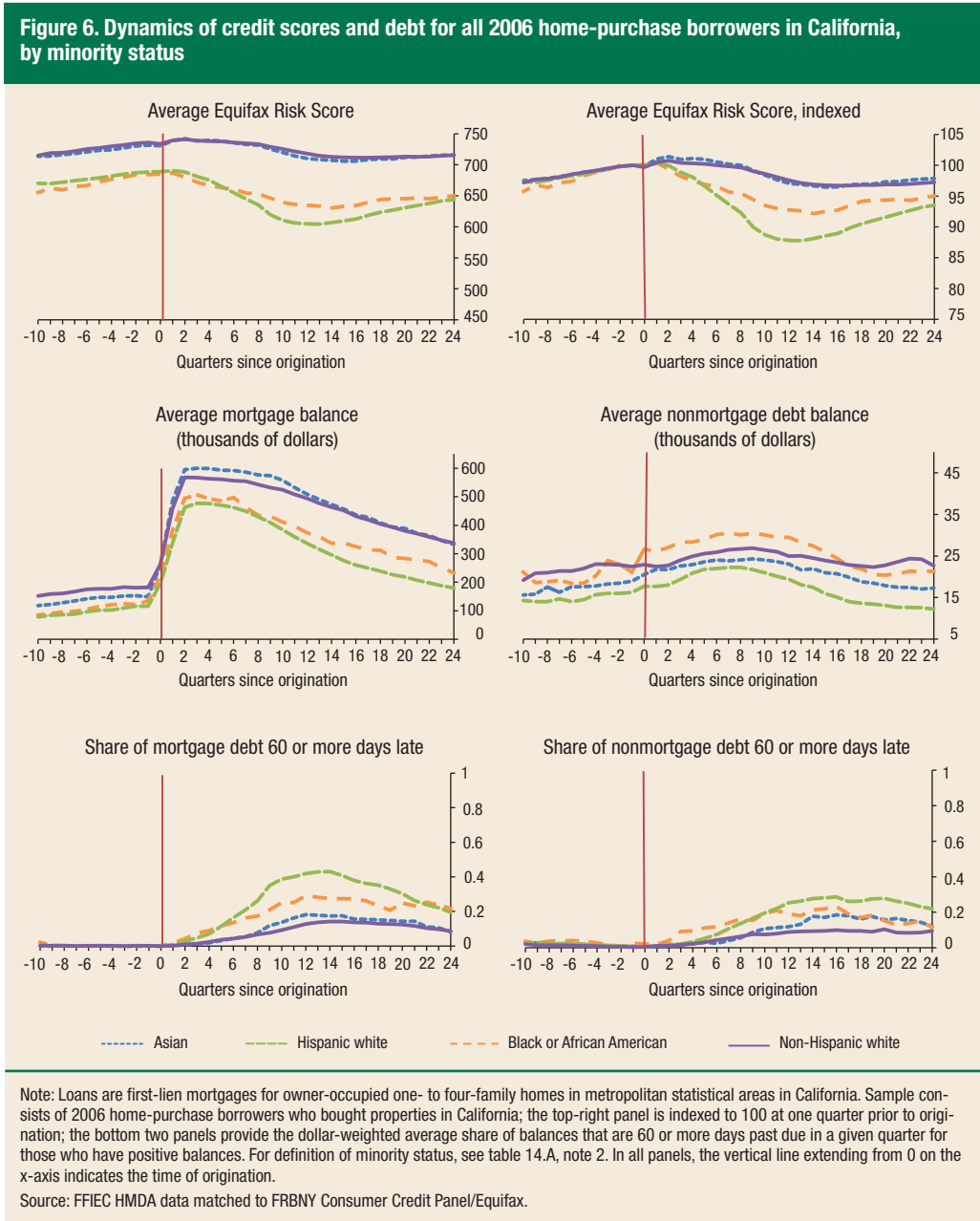
⁶⁸ Mortgage balances peak three quarters *after* origination, in part because new loans often are reported to the credit-reporting agencies with a lag. As discussed in appendix B, we match only borrowers in the CCP whose mortgage was reported within two quarters of origination. Borrowers may also take out junior liens or draw on lines of credit soon after origination, pushing overall mortgage balances higher.

⁶⁹ Averages shown in figures 4, 5, and 6 are for a constant sample of individuals who took a loan in 2006, and



Nonmortgage balances also peaked just after origination and then fell significantly. In figure 5, where we limit the sample to California borrowers, there is less dispersion in peak mortgage and nonmortgage debt across demographic groups, with one exception: Peak nonmortgage debt of Hispanic whites was about half that of other groups. Moreover, the pattern of nonmortgage debt accumulation by Hispanic whites who became delinquent on their mortgages was similar to average accumulation by all Hispanic white borrowers in California, irrespective of delinquency status (figure 6). In contrast, nonmortgage debt accumulation for delinquent borrowers of other racial and ethnic groups was far more pronounced when compared with the averages of the groups at large. This finding suggests

thus they include zero balances at points in time when these individuals do not have any mortgages outstanding.



that the factors driving mortgage defaults among Hispanic white borrowers may have differed from other groups and may be related to the unexplained difference in performance by Hispanic white borrowers documented in figure 2.A.

Subsequent falling levels of debt and aging of delinquencies likely are factors contributing to score recovery over time. The bottom two panels of figures 4 and 5 show that delinquency remains elevated through the end of the observation period, but these delinquencies reflect the payment status only of those who continue to carry substantial debt.⁷⁰

⁷⁰ Although the sample in figures 4 and 5 consists only of those borrowers who became delinquent on their mortgages that we linked to the HMDA data, the delinquency rate on mortgage debt in the bottom-left panel does not reach 100 percent for two reasons. First, some borrowers may become delinquent early on within the first two years and then cure. Second, some borrowers could have other mortgages on which they remain current.

Future Analysis

As our initial analysis of the matched HMDA–CCP data indicate, these data offer an opportunity to investigate a wide range of issues related to home lending. Although the matched data do not include all factors that researchers seek when investigating consumers’ borrowing experiences, merging the credit records with the HMDA data provides a significant step forward in this regard and will serve as the basis for future research.

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

Appendix B: Matching HMDA Records with Credit Bureau Records

For this article, we created a new data set that connects borrowers included in the HMDA loan records—that is, those reported under the Home Mortgage Disclosure Act of 1975—to their credit bureau information from Equifax, one of the three major consumer credit-reporting agencies in the United States. Specifically, the credit records available to us for matching come from the Federal Reserve Bank of New York Consumer Credit Panel/Equifax (CCP) data.⁷¹ The CCP is a 5 percent, nationally representative sample of all individuals with a credit record and a valid Social Security number. Furthermore, the CCP data are a quarterly panel, tracking the same individuals over time. The sampling approach is designed to generate the same entry and exit behavior as is present in the population, with young individuals and immigrants entering the sample and deceased individuals and emigrants leaving the sample each quarter at the same rate as in the U.S. population, such that each quarterly snapshot is nationally representative.

Neither the HMDA data nor the credit record data include personal identifying information, but borrowers in the two data sets can be matched based on the mortgage loan information common to both data sets—specifically, loan amount, month of loan origination, and census-tract location. Because we have access to the confidential version of the HMDA data, we observe origination dates, while the CCP contains detailed trade-line information on each open mortgage account a consumer has in any given quarter, including the loan amount and month opened.⁷² The CCP also provides the census-tract locations of consumers' reported *mailing* addresses each quarter. In contrast, the HMDA records provide the census-tract location of the property securing the mortgage. For this reason, we attempted to match only borrowers in the HMDA records who obtained loans for owner-occupied properties—where mailing and property locations are likely to coincide.

In order to match a given year of HMDA records to the credit records, we started with all first-lien HMDA home-purchase and refinance originations that were for one- to four-family owner-occupied properties in metropolitan statistical areas (MSAs). We limited the data to MSAs because the HMDA data are more fully representative of lending in such areas.⁷³ We also excluded from the HMDA data, prior to matching, the roughly 15 percent of loans that are not unique in terms of location, origination month, and loan amount. In the CCP data, we identified all individuals whose most recent closed-end mortgage loan was opened two quarters ago, as new loans tend to be reported to credit bureaus with a lag. Thus, consumers in the CCP who have a record, as of the third quarter of 2006, of opening a mortgage in the first quarter of 2006 would be eligible to be matched to the HMDA records from the first quarter of 2006; those who have a record, as of the fourth quarter of 2006, of opening a mortgage in the second quarter of 2006 would be eligible to be matched to the HMDA records from the second quarter of 2006; and so on. Once we connected a HMDA record to an individual in the CCP, we could track that individual in the CCP over time.

Because the credit record data are only a 5 percent sample of the full population, only a fraction of HMDA loan records will be represented in the CCP. Of the HMDA loans eligible to be matched in 2006 and 2010, 4.4 percent were matched, implying a match rate of about 60 percent. To see this result, first note that about 13.7 million HMDA records were eligible for matching in the two years (including the roughly 15 percent of non-unique records). Of these records, 48 percent had co-borrowers, and such loans have twice the probability (or more, if there are more than two borrowers) of showing up in the CCP as

⁷¹ For further details, see note 49 of the main text.

⁷² The term “trade lines” refers to the records of credit accounts that are reflected in credit record files.

⁷³ See Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner (2007), “Opportunities and Issues in Using HMDA Data,” *Journal of Real Estate Research*, vol. 29 (October–December), pp. 351–79.

individual mortgages, since sampling for the CCP is done at the individual level. Thus, the maximum number of matches we could expect (assuming that all lenders report mortgages to Equifax) is about 1 million ($13.7 \text{ million} \times 0.05 \times 1.48$). We actually obtained 600,118 matches, or about 60 percent of the maximum possible.

Several factors contributed to the implied match rate being below 100 percent. First, as noted, about 15 percent of HMDA records were not unique and thus could not be matched. Second, we used only those mortgages in the CCP that were reported at two quarters after origination; some mortgages may have been reported after three quarters or more, and these mortgages were not matched. And, third, although we used only loans related to owner-occupied properties, property location (from the HMDA data) and mailing location (from the CCP) do not always coincide. For example, some homebuyers use a post office box that is located in a different census tract than their home.

Our main concern with the matched sample is whether it accurately represents the pool of mortgage originations. So long as nonmatches occur mostly for random reasons, the 60 percent match rate should not pose a problem. Table B.1 compares summary statistics from the full 2006 and 2010 HMDA data with the matched samples. In general, the statistics line up quite closely, somewhat more so in 2010 than in 2006. Overall, the matched data are likely to provide a good representation of first-lien, owner-occupant, one- to four-family home-purchase and refinance lending in U.S. metropolitan areas during 2006 and 2010.

Table B.1. Comparison of full 2006 and 2010 HMDA data sets with matched samples

Percent except as noted

Characteristic and status	2006		2010	
	Full	Matched	Full	Matched
Amount of loan (thousands of dollars)¹				
Mean	240	226	225	221
Median	190	180	185	184
Borrower				
Income (thousands of dollars)²				
Mean	97	89	109	105
Median	74	70	83	83
LMI share	24	27	25	25
Minority status³				
Asian	4.3	3.6	6.2	5.7
Black or African American	10.0	9.5	4.3	4.1
Hispanic white	12.4	10.3	5.6	5.0
Non-Hispanic white	59.2	62.6	72.1	73.1
All others ⁴	14.1	14.0	11.8	12.1
Location of borrowers				
Share in lower-income neighborhood	18.1	17.1	9.2	9.1
Share in CRA assessment area ⁵	44.1	45.3	69.5	71.0
Share of borrowers in Arizona, California, Florida, or Nevada	29.7	27.3	20.9	20.4
Type of lender				
Depository	38.2	40.1	56.7	58.4
Nonbank subsidiary or affiliate of a depository	23.2	24.7	9.8	9.9
Credit union	2.7	2.5	6.0	5.4
Independent mortgage company	35.9	32.7	27.4	26.3
Loan characteristic				
Nonconventional ⁶	5.5	6.0	27.1	27.0
Higher priced	26.5	24.3	1.6	.8
Home purchase	49.6	44.4	32.7	30.7
Memo:				
Number of loans	7,748,853	297,652	5,926,374	302,466

Note: "Full" columns show statistics from HMDA data for first-lien home-purchase and refinance originations for one- to four-family owner-occupied properties in metropolitan statistical areas. "Matched" columns show statistics from HMDA data matched to the FRBNY Consumer Credit Panel/Equifax data.

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

² Income amounts are reported under HMDA to the nearest \$1,000.

³ Borrowers are placed under only one category according to the race and ethnicity of the person listed first on the application.

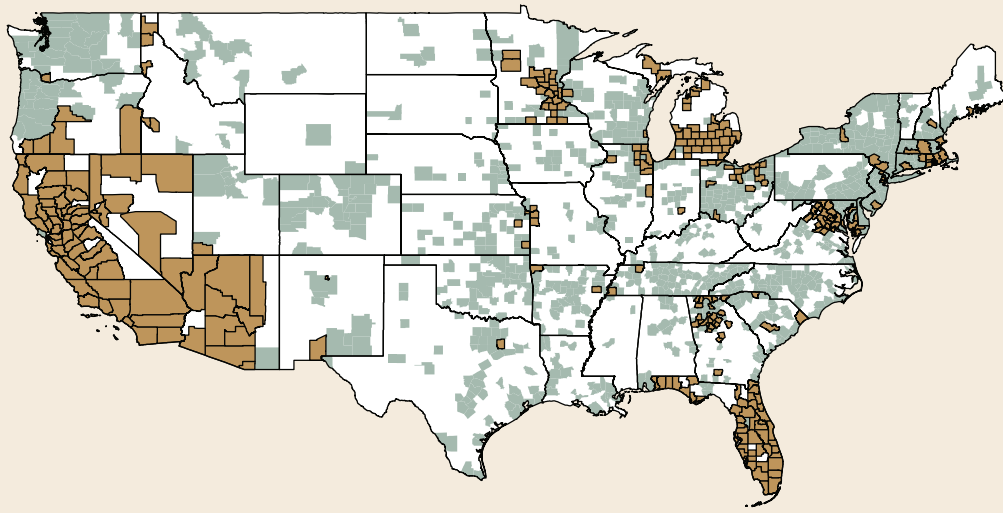
⁴ All others consist of American Indian or Alaska Native, Native Hawaiian or other Pacific Islander, and applicants for whom race or ethnicity was not reported.

⁵ Includes only loans originated by depository institutions and their subsidiaries or affiliates.

⁶ 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.

LMI: Low and moderate income; CRA: Community Reinvestment Act.

Source: FFIEC HMDA data matched to FRBNY Consumer Credit Panel/Equifax.

Figure C.1. Housing-bust counties

Note: Gold areas identify housing-bust counties, which are defined as the 25 percent of counties with the steepest house price declines from December 2006 to December 2008; light green areas identify non-housing-bust counties; and white areas indicate that data are not available.
Source: House price index data from CoreLogic.

Table C.1. Delinquency rates for 2006 borrowers, by purpose of loan and by minority status, higher-priced loan status, location, and credit score**A. Home purchase**

Percent except as noted

Minority status ¹	Credit score								
	Below 620			620–719			720 and above		
	<i>N</i>	Share	Delinq. rate	<i>N</i>	Share	Delinq. rate	<i>N</i>	Share	Delinq. rate
Higher-priced loans in housing-bust counties²									
Asian	99	1.7	40.8	144	2.5	33.9	43	.8	13.7
Black or African American	837	8.6	51.3	369	3.8	34.2	89	.9	13.0
Hispanic white	1,043	8.7	52.0	1,152	9.7	42.8	319	2.7	25.0
Non-Hispanic white	1,633	1.8	43.1	1,317	1.5	22.4	454	.5	6.6
All others ³	525	3.6	50.4	495	3.4	36.4	151	1.0	16.9
Higher-priced loans in other counties									
Asian	83	1.5	26.3	113	2.0	22.1	44	.8	5.6
Black or African American	1,709	17.7	44.4	572	5.9	19.8	121	1.3	3.4
Hispanic white	847	7.1	31.8	626	5.2	17.0	145	1.2	4.9
Non-Hispanic white	3,724	4.2	32.6	2,481	2.8	14.5	758	.8	3.5
All others ³	980	6.7	35.2	542	3.7	17.7	132	.9	5.4
Non-higher-priced loans in housing-bust counties²									
Asian	117	2.1	12.6	627	11.0	7.4	1,336	23.5	3.5
Black or African American	496	5.1	32.5	825	8.5	11.7	559	5.8	3.0
Hispanic white	586	4.9	33.1	1,734	14.5	20.6	1,590	13.3	9.6
Non-Hispanic white	1,881	2.1	21.0	7,257	8.1	8.7	14,218	15.9	1.8
All others ³	373	2.6	25.0	1,452	10.0	10.7	2,593	17.8	2.6
Non-higher-priced loans in other counties									
Asian	213	3.7	11.1	947	16.6	2.9	1,926	33.8	.4
Black or African American	1,310	13.5	25.2	1,647	17.0	8.5	1,144	11.8	2.3
Hispanic white	893	7.5	16.0	1,621	13.6	6.0	1,371	11.5	1.4
Non-Hispanic white	5,271	5.9	15.7	17,574	19.6	4.3	33,105	36.9	.5
All others ³	760	5.2	16.2	2,263	15.6	4.2	4,268	29.4	.6

Note: First-lien mortgages for owner-occupied one- to four-family homes in metropolitan statistical areas. Delinquency rate refers to the fraction of borrowers who became 60 or more days past due within two years of origination; shares in the table refer to the percentage of a given racial or ethnic group within the price-location-score cell.

The number of borrowers, by minority status, is as follows: Asian, 5,692; black or African American, 9,678; Hispanic white, 11,927; non-Hispanic white, 89,673; and all others (see note 3), 14,534.

¹ Borrowers are placed under only one category according to the race and ethnicity of the person listed first on the application.

² For definition of housing-bust counties, see note to figure C.1.

³ All others consist of American Indian or Alaska Native, Native Hawaiian or other Pacific Islander, and applicants for whom race or ethnicity was not reported.

Source: FFIEC HMDA data matched to FRBNY Consumer Credit Panel/Equifax.

Table C.1. Delinquency rates for 2006 borrowers, by purpose of loan and by minority status, higher-priced loan status, location, and credit score**B. Refinance**

Percent except as noted

Minority status ¹	Credit score								
	Below 620			620–719			720 and above		
	<i>N</i>	Share	Delinq. rate	<i>N</i>	Share	Delinq. rate	<i>N</i>	Share	Delinq. rate
Higher-priced loans in housing-bust counties²									
Asian	191	3.9	46.0	200	4.1	33.0	103	2.1	16.6
Black or African American	2,006	12.9	37.8	956	6.2	21.4	147	.9	10.6
Hispanic white	2,148	13.0	39.8	1,494	9.0	31.3	410	2.5	19.2
Non-Hispanic white	5,073	5.0	36.1	3,386	3.3	25.8	963	.9	9.7
All others ³	2,728	10.1	39.6	1,532	5.6	26.5	371	1.4	10.1
Higher-priced loans in other counties									
Asian	128	2.6	22.7	142	2.9	22.2	39	.8	9.8
Black or African American	2,978	19.2	25.6	1,267	8.2	13.9	194	1.2	2.8
Hispanic white	866	5.2	26.3	582	3.5	21.5	127	.8	13.7
Non-Hispanic white	7,251	7.1	27.2	4,842	4.7	14.1	1,292	1.3	3.6
All others ³	2,677	9.9	28.8	1,418	5.2	16.6	315	1.2	4.7
Non-higher-priced loans in housing-bust counties²									
Asian	140	2.9	16.4	834	17.0	11.2	1,737	35.5	3.6
Black or African American	832	5.4	19.5	1,794	11.6	7.5	1,202	7.7	2.7
Hispanic white	1,135	6.9	19.5	3,941	23.8	11.4	3,469	21.0	4.9
Non-Hispanic white	3,068	3.0	18.9	13,115	12.8	8.3	20,606	20.2	2.0
All others ³	1,276	4.7	18.7	4,249	15.7	9.3	5,195	19.2	2.1
Non-higher-priced loans in other counties									
Asian	92	1.9	8.6	502	10.3	4.6	789	16.1	.9
Black or African American	954	6.1	16.4	2,013	13.0	5.7	1,181	7.6	1.4
Hispanic white	355	2.1	13.4	1,135	6.9	6.6	864	5.2	3.0
Non-Hispanic white	3,668	3.6	14.1	15,244	14.9	4.6	23,570	23.1	.9
All others ³	938	3.5	15.9	2,839	10.5	5.7	3,585	13.2	1.3

Note: See notes to table C.1.A.

Consumer Experiences with Credit Cards

Glenn B. Canner and Gregory Elliehausen, of the Division of Research and Statistics, prepared this article. Shira E. Stolarsky and Madura Watanagase provided research assistance.

By offering consumers both a means to pay for goods and services and a source of credit to finance such purchases, credit cards have become the most widely used credit instrument in the United States. As a payment device, credit cards are a ready substitute for checks, cash, and debit cards for most types of purchases. Credit cards facilitate transactions that would otherwise be difficult or costly, such as purchases over the Internet, by telephone, or outside the country. As a source of unsecured credit, credit cards provide consumers the option to finance at their discretion the purchase of an item over time without having to provide the creditor some form of collateral such as real estate or a vehicle. Moreover, the small required minimum payments on credit card balances allow consumers to determine themselves how quickly they want to repay the borrowed funds. Credit cards have other benefits as well, such as security protections on card transactions and rewards for use. All of these features have been valuable to consumers and have helped promote the widespread holding and use of credit cards.

Recent fluctuations in economic activity and changes in the regulation of credit cards have greatly affected the credit card market. As a consequence of the Great Recession and the slow economic recovery that has ensued, many consumers have experienced difficult financial circumstances.¹ During much of this period large numbers of consumers fell behind on their credit card payments, causing delinquency and charge-off rates to rise sharply. As a further sign of weakness in the market, outstanding balances on revolving credit, nearly all of which is credit card debt, fell for the longest consecutive number of months since national statistics have been kept and have only recently begun to rebound slowly. The situation has improved markedly since the end of the recession, particularly regarding the incidence of delinquency and default, but some of the effects of the downturn still linger, such as reduced levels of borrowing and more-restrictive underwriting.

The credit card market has been further buffeted by new consumer protection regulations, most notably the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the Credit Card Act).² The Credit Card Act sought to improve disclosure of account terms and conditions to consumers. The act also restricts a number of card issuer practices that the Congress deemed to be unfair, deceptive, or not sufficiently transparent. The provisions of the Credit Card Act were implemented in phases, but all are now in effect. Among the provisions of the act are limits on “penalty” fees for making late payments or exceeding credit limits; rules that specify how creditors must allocate consumer payments to outstanding balances; and restrictions on certain risk-management practices by card issuers, particularly limiting their ability to raise the interest rate on an outstanding balance unless the account payments are significantly in arrears or the interest rate on the account is variable (tied to an index). Each of these provisions affects the revenues and costs of card issuers. (For further details about the provisions of the Credit Card Act, see the box “The Credit Card Accountability Responsibility and Disclosure Act.”)

¹ The Great Recession dates from December 2007 through June 2009.

² The Credit Card Act (Pub. L. No. 111-24, 123 Stat. 1734 (2009)) was signed into law on May 22, 2009.

The Credit Card Accountability Responsibility and Disclosure Act

The Credit Card Accountability Responsibility and Disclosure Act of 2009 (the Credit Card Act) is a federal statute intended to establish fair and transparent practices for the extension of credit under open-end credit plans, including credit card accounts. The Credit Card Act amended the Truth in Lending Act of 1968 (TILA) and was implemented under the Federal Reserve Board's Regulation Z in three phases, with implementation dates of August 20, 2009; February 22, 2010; and August 22, 2010, for the various provisions.¹ Responsibility for TILA transferred from the Federal Reserve Board to the Consumer Financial Protection Bureau on July 21, 2011.

Historically, TILA relied primarily on mandatory dissemination of standardized information to protect consumers, based on the premise that if creditors provide clear, complete, and conspicuous disclosure of account terms and conditions, consumers can make informed choices about their use of credit, and that such informed use encourages consumer shopping and promotes competition. The act and subsequent amendments contained a few substantive restrictions, but by and large the regulation created disclosure requirements.

Over time, however, advocates for substantive regulation became influential. These advocates argued that certain common underwriting, pricing, and risk-management practices in the industry were not transparent and were fundamentally unfair to cardholders. They argued further that such practices may have contributed to consumers' becoming excessively indebted and incurring substantial and unnecessary expenses. As these practices were widespread and difficult for consumers to understand, advocates for substantive regulation argued that disclosures would be ineffective to address them. Many provisions of the Credit Card Act are motivated by such arguments.

The Credit Card Act is comprehensive in its reach, touching on nearly all aspects of card issuers' interactions with prospective and current cardholders. The act modifies the disclosures that consumers receive both before an account is established and once the account has been opened. Among the changes is the introduction of disclosures related to minimum payments, including a disclosure of how long it would take to pay off a balance if the cardholder made only the required minimum monthly payments. The act contains many substantive requirements addressing practices that the Congress deemed to be unfair or deceptive, including so-called universal default.² Through some of its key provisions, the act

- requires card issuers to provide account holders a reasonable period of time to pay their bills
- establishes a hierarchy for the allocation of payments received in excess of the required minimum payment, requiring that balances incurring the highest rate of interest be paid off first
- requires cardholders to give permission to card issuers to allow transactions that would cause the cardholders to exceed their credit limit
- bans increases in interest rates on balances incurred in the first year after an account is opened and restricts increases of interest rates on existing balances incurred in subsequent years; in particular, issuers may not increase interest rates on existing balances unless the account falls significantly in arrears
- limits the amount of fees charged for making late payments or for exceeding credit limits
- limits fees on cards with low credit limits
- restricts marketing and underwriting practices regarding cards issued to consumers under 21 years of age
- requires issuers to consider a consumer's ability to pay before any account is established or a credit limit is increased
- enhances disclosures and restricts inactivity fees for gift cards and other stored-value cards

¹ Regulation Z—Truth in Lending, 12 C.F.R. pt. 226 (1981).

² Universal default is the former practice whereby an issuer would raise the interest rate on a customer's credit card account, including balances currently owed, based on factors not directly related to the cardholder's account with that issuer. For example, an issuer might raise the interest rate on a cardholder's account if he or she fell behind on payments on other debts, including those with other creditors.

Card issuers have responded to the changing economic conditions and regulatory environment by altering the prices and terms offered on credit cards, the size of credit lines made available to cardholders, and the marketing of and access to their products. Some of these adjustments are likely to continue to play out over time as card issuers evaluate the effects of their responses and consumers' reactions to these changes.

This article examines consumers' behavior, experiences, and attitudes with regard to credit cards in the aftermath of these economic and regulatory changes. Much of the data for this article are from a Federal Reserve–sponsored nationwide consumer survey conducted in February 2012 by the Thomson Reuters/University of Michigan Surveys of Consumers (Surveys of Consumers). Many of the questions posed in the survey were identical or similar to those asked on earlier surveys also sponsored by the Federal Reserve, making it possible to track changes over time in consumer knowledge, behavior, and attitudes about credit cards and to gain a more complete understanding of consumer experiences with this important financial product.³ Because consumer attitudes and experiences with credit cards as reflected in responses to consumer surveys may be affected by conditions in the broader economy, we first present information from various sources about conditions in the credit card market prior to the consumer survey that was conducted in February 2012. Among the sources are credit record data and credit scores derived from these data, which shed light on recent changes in the credit card market, particularly as these changes relate to payment performance and access to credit.⁴ We then examine responses to the consumer survey, taking into account some of the important differences found in how consumers use their credit cards and in their financial and other circumstances.

The majority of credit cards are general-purpose cards or so-called bankcards issued under the Visa, MasterCard, Discover, or American Express brand. The rest of the credit card market consists largely of cards issued by stores and by gas companies. Unless otherwise noted, most of the analysis that follows focuses on bankcards, as their general-purpose capability distinguishes them from the various other types of credit cards and from charge cards.⁵

The following list highlights several prominent findings from our analysis:

1. Credit cards are an important method of payment and a significant source of consumer credit. In the United States in 2011, bankcards were used for nearly 22 billion transactions valued at an estimated \$2.1 trillion. Revolving credit outstanding was

³ For a review of findings from earlier Federal Reserve–sponsored surveys focused on consumer use of credit cards, see Thomas A. Durkin (2000), “Credit Cards: Use and Consumer Attitudes, 1970–2000,” *Federal Reserve Bulletin*, vol. 86 (September), pp. 623–34, www.federalreserve.gov/pubs/bulletin/2000/00index.htm; Thomas A. Durkin (2002), “Consumers and Credit Disclosures: Credit Cards and Credit Insurance,” *Federal Reserve Bulletin*, vol. 88 (April), pp. 201–13, www.federalreserve.gov/pubs/bulletin/2002/02index.htm; and Thomas A. Durkin (2006), “Credit Card Disclosures, Solicitations, and Privacy Notices: Survey Results of Consumer Knowledge and Behavior,” *Federal Reserve Bulletin*, vol. 92 (August), pp. A109–A121, www.federalreserve.gov/pubs/bulletin/2006/06index.htm. Also see Board of Governors of the Federal Reserve System (2006), *Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and Their Effects on Consumer Debt and Insolvency* (Washington: Board of Governors, June), www.federalreserve.gov/publications/other-reports/default.htm.

⁴ The credit scores used here indicate the likelihood of serious delinquency, bankruptcy, or another derogatory event over the next two years based on the information in an individual's credit report. In most credit scoring systems and for the scores used here, lower scores represent a greater risk of default than higher scores. For a comprehensive discussion of credit scores, see Board of Governors of the Federal Reserve System (2007), *Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit* (Washington: Board of Governors, August), www.federalreserve.gov/publications/other-reports/default.htm.

⁵ Charge cards, which are primarily a means of payment, have been available since the beginning of the 20th century. Charge cards provide temporary credit for up to a month but do not have the revolving feature that distinguishes credit cards. See Lewis Mandell (1972), *Credit Card Use in the United States* (Ann Arbor: Institute for Social Research, University of Michigan).

\$847 billion and constituted 32 percent of all consumer credit outstanding at the end of 2011.

2. The Great Recession triggered a significant upswing in delinquencies and charge-offs on credit cards, although cardholder payment performance has improved markedly since then. The delinquency rate for bankcards reached 5 percent of the number of outstanding accounts in June 2009, then receded to about 3 percent by the end of 2011.
3. Credit card issuers have responded to the recent economic difficulties in several ways. One response has been to reduce potential losses by reducing the size of credit lines made available to cardholders and by closing accounts. Another response has been to curtail promotional activities, particularly mail solicitations, and to reorient such activities to individuals who pose less credit risk.
4. The share of individuals with credit records holding at least one bankcard was for many years quite stable, at about 80 percent, until the onset of the Great Recession. Since then the incidence of cardholding has fallen to about 72 percent. The reduction in the incidence of cardholding appears to have come from individuals in all credit score groups, although the largest percentage declines were among those with scores that are associated with elevated default rates. Both the Great Recession and regulatory restrictions on risk-management practices likely contributed.
5. Overall, about one-fourth of cardholders surveyed in 2012 reported having an adverse experience related to credit cards in the previous year, such as having an application for a credit card turned down, receiving a lower credit limit than requested, or experiencing an increase in interest rates or fees. For many of these cardholders, these events appear to have been associated with late payments or inactive accounts.
6. Cardholders who had adverse experiences were more likely to have a negative opinion of bankcards than cardholders who did not have adverse experiences. Even so, most cardholders who had adverse experiences were satisfied with their own accounts and believed that their credit card companies treated them fairly.
7. Consumer surveys reveal a trend since 2000 toward greater use of bankcards as a payment medium rather than as a source of credit. In 2000, 50 percent of bankcard holders said that they almost always paid the balance they owed in full; in 2012, the proportion rose to 62 percent. Much of the increase in the share of cardholders who reported that they typically paid in full has occurred since the recent recession and the implementation of the new credit card regulations. The proliferation of rewards cards likely contributed to the increase in the transactions use of credit cards.
8. Opinions about credit card use have polarized since the 1970s, with larger shares of cardholders expressing unqualified views that card use is either a “good thing” or a “bad thing.” The share of cardholders who viewed card use as a bad thing rose substantially between 2000 and 2012, while the share of cardholders viewing card use as a good thing was little changed. Many of the negative views appear to stem from respondents’ beliefs that credit cards cause problems for other individuals, not for themselves.
9. Despite the increase in negative views, nearly all cardholders continued to believe that credit card companies provide a useful service to consumers. Similarly, almost all cardholders believed that their own credit card companies treated them fairly, and almost all were satisfied in their dealings with the companies, although only about half of the respondents held these beliefs strongly. Most cardholders believed that they could easily get a bankcard from another company if they were not treated well. These beliefs were also strong among cardholders who had experienced adverse actions in the previous year, as mentioned earlier.
10. The share of consumers who believe that Truth in Lending statements are complicated has trended upward over the years. This changing view seems consistent with developments in the credit card market that have led to more-complex product offerings and fee and interest rate structures and, as a consequence, to longer and more-detailed disclosures.

11. In 2012, most of the new cardholders surveyed said that they read account disclosure information and filed it away for possible future use. Those cardholders who were most likely to revolve balances frequently were more likely than others to find disclosure information useful, because much of it involves credit costs and terms that relate to how they use their cards.
12. Cardholder awareness of annual percentage rates (APRs) was high generally, but it was highest among those individuals who used their cards as a source of credit. These findings, which echo those of past consumer surveys, make sense, as these are the cardholders who incur interest payments.
13. Most cardholders who hardly ever paid their monthly balance in full or who made only the required minimum payments believed that credit cards made managing their finances less difficult and were satisfied with their accounts. This belief does not seem to support the hypothesis that consumers overestimate their ability to repay their credit card debt.
14. New disclosures appear to have had little effect on the share of cardholders who make only the required minimum payments.

Disclosures and Consumer Protection

Protecting consumers in their financial transactions has been a long-standing goal of government policy. At the federal level, the Truth in Lending Act of 1968 (TILA) was the first in a series of statutes seeking to protect consumers in their use of credit.⁶ Historically, TILA's focus has been on requiring clear and consistent disclosure of key terms of credit arrangements and associated credit costs. In this regard, TILA prescribes uniform methods for computing the cost of credit across different loan products, disclosing credit terms, and resolving errors such as those related to billing and payments. TILA has been amended over the years, most recently by the Credit Card Act with regard to its provisions on credit cards.

A primary goal of TILA is to promote the informed use of credit by consumers. Well-informed consumers are less likely to overextend themselves in their use of credit and are more likely to shop among creditors, helping to ensure that they do not pay excessively high prices or receive unfavorable credit terms. TILA also prohibits or limits certain practices deemed to be unfair or deceptive. For example, in the credit card arena, issuers face limits on the imposition of penalty fees and over-the-limit charges and may not reprice outstanding balances except in limited circumstances, such as when the interest rate on the account is variable or when the cardholder is significantly in arrears on his or her payments.

Historically, credit card lending has been profitable and issuers have competed intensely to acquire new customers, retain existing cardholders, and encourage more-intensive use of their product.⁷ Competition has taken many forms as issuers have targeted specific populations to encourage use of cards as a source of credit (for example, by raising credit limits and by offering attractive interest rates on balance transfers) and as a payment device (for example, by offering a variety of rewards tied to card use and generally forgoing annual fees). Issuers have also been aggressive in the use of information to better manage the credit risks associated with credit card lending and to price their products. For example, issuers

⁶ Truth in Lending Act, tit. I, Pub. L. No. 90-321, 82 Stat. 146 (1968). For a comprehensive review of TILA, see Thomas A. Durkin and Gregory Elliehausen (2011), *Truth in Lending: Theory, History, and a Way Forward* (New York: Oxford University Press).

⁷ See Board of Governors of the Federal Reserve System (2013), *Report to the Congress on the Profitability of Credit Card Operations of Depository Institutions* (Washington: Board of Governors, June), www.federalreserve.gov/publications/other-reports/credit-card-profitability-2013.htm.

routinely review customers' credit records and other information to decide whether to modify the size of credit lines made available to the customers. Issuers also consider a variety of information when determining which individuals should receive solicitations for credit. Overall, credit card pricing and product features have become more complex over time; while offering new opportunities to consumers, the greater complexity has also presented challenges to consumers in selecting and using cards.

Not only has complexity made it more difficult for consumers to completely understand credit card terms and features, but also the way that issuers have used information has, in some cases, been controversial and may have affected consumers' attitudes about credit card issuers and their products. For example, the use of widely diverse information about a cardholder's financial situation to reprice outstanding balances, as opposed to the use of such information just to price new borrowing, became a controversial practice and was generally prohibited by the Credit Card Act. In addition, the large volume of credit card mail solicitations and other highly visible marketing programs may have fueled a perception that issuers' lending practices were too lenient and encouraged excessive borrowing.

Economic Conditions and Credit Cards

Consumer experiences and attitudes toward credit cards, as reflected in consumer surveys, may be influenced by general economic conditions; consumers' own financial circumstances; the experiences of friends, family members, and acquaintances; and general knowledge conveyed by media reports about the credit card market. Consumers with steady employment and rising incomes, for example, may have different experiences with and perceptions of credit card companies and their products than consumers with stagnant incomes or uncertain employment circumstances, especially if economic hardship results in difficulties in managing debts and making timely payments. The former likely receive regular solicitations from credit card issuers offering favorable terms, larger credit lines and rewards, or other benefits; the latter may face limited access to credit, elevated prices, and reductions in the credit lines made available on their existing accounts.

The following sections describe changes in credit card holding and use over time and issuer responses to the recent developments in the credit card market and the broader economy. This review provides background information for our analysis of responses to the February 2012 survey regarding consumers' recent experiences with and attitudes toward credit cards.

Credit Card Holding and Use

Although credit card holding increased rapidly after the introduction of credit cards in the 1950s, credit card-related borrowing accounted for a very small share of consumer credit for many years. As of 1970 just over half of U.S. households had one or more credit cards.⁸ At that time, revolving credit totaled only \$5.1 billion (\$29.4 billion in constant 2012 dollars) and accounted for just 3.8 percent of total consumer credit outstanding (figure 1).⁹

⁸ Authors' calculations from the 1970 Survey of Consumer Finances, conducted by the Survey Research Center at the University of Michigan. For more information about the survey, see University of Michigan, "About the Survey," http://press.sca.isr.umich.edu/press/about_survey (accessed October 28, 2013). The Survey of Consumer Finances first included questions on credit cards in 1970.

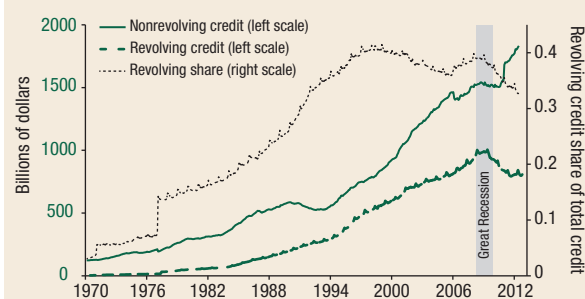
⁹ The Federal Reserve publishes estimates of consumer credit each month. See Board of Governors of the Federal Reserve System, Statistical Release G.19, "Consumer Credit," www.federalreserve.gov/releases/g19/Current/. Revolving consumer credit consists of balances owed on credit cards and on unsecured personal lines of credit; it does not include home equity lines of credit or mortgage debt. The Federal Reserve first enumerated revolving consumer credit separately in 1968.

Credit card holding and use grew substantially in subsequent years. By 1977, nearly 63 percent of households had credit cards, and revolving credit had increased to \$39.3 billion (\$144.1 billion in constant 2012 dollars), a nearly five-fold increase in constant dollars; however, it still accounted for only a relatively small share of consumer credit.

Less-restrictive interest rate regulation in the early 1980s allowed credit card issuers to charge interest rates that enabled them to expand lending to consumers with higher credit risk and to offer credit cards as a substitute for other types of credit, such as small personal installment loans.¹⁰ In addition, technological advances in information processing greatly enhanced the ability of issuers to evaluate the credit risk of individuals applying for credit cards and to monitor the behavior of existing customers.¹¹ Issuers' ability to quickly and relatively inexpensively judge the credit risk of prospective borrowers and current customers and to monitor how cardholders use their products allowed them to compete aggressively for new customers, provide larger credit lines, and offer product terms and features better tailored to the needs of consumers. While the innovations that allowed issuers to expand availability and provide distinctive features made the credit card a more useful and attractive product, the increased complexity that ensued also raised concerns, including whether consumers could fully understand the terms and conditions of their cards and whether low minimum-payment requirements encouraged some card users to borrow excessively.¹²

Credit cards have become an important method of payment and a significant source of consumer credit.¹³ In 2011, bankcards were used for over 22 billion transactions involving purchases of goods and services valued at an estimated \$2.1 trillion.¹⁴ Although down about 16 percent from its historical high, revolving credit outstanding was \$847.3 billion and constituted 32 percent of consumer credit outstanding at the end of 2011 (derived from figure 1). Part of the growth in revolving credit has come from the substitution of credit card debt for some types of nonrevolving consumer credit, especially loans previously used to finance purchases of relatively less expensive household durables, such as fur-

Figure 1. Outstanding consumer credit, January 1970–January 2012



Note: Consumer credit excludes loans secured by real estate. Revolving debt consists of balances owed on credit cards and unsecured revolving lines of credit. Nonrevolving debt consists of student loans, automobile credit, and other non-real-estate debt. The shaded bar indicates the period of the Great Recession as defined by the National Bureau of Economic Research. Source: Federal Reserve Board, Statistical Release G.19, "Consumer Credit."

¹⁰ The Supreme Court's decision in *Marquette National Bank of Minneapolis v. First of Omaha Service Corporation*, 439 U.S. 299 (1978), allowed banks to charge out-of-state borrowers local rates. In 1980, South Dakota deregulated interest rates, and Delaware did so in 1981. Many other states deregulated interest rates in the next year.

¹¹ For a discussion, see Board of Governors, *Report to the Congress on Credit Scoring*, in note 4.

¹² See, for example, Government Accountability Office (2006), *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, report to the Congress, GAO-06-929 (Washington: GAO, September), www.gao.gov/products/GAO-06-929.

¹³ For a comprehensive discussion of the role of credit cards as a medium for payment, see Kevin Foster, Erik Meijer, Scott Schuh, and Michael A. Zabek (2011), "The 2009 Survey of Consumer Payment Choice," Public Policy Discussion Series 11-1 (Boston: Federal Reserve Bank of Boston, April), www.bos.frb.org/economic/ppdp/2011/ppdp1101.htm.

¹⁴ Estimates are derived from the *Nilson Report*. See HSN Consultants Inc. (2012), *Nilson Report*, no. 988 (February), table entitled "U.S. General Purpose Credit Cards," p. 10. The figures exclude charge cards, such as the Diners Club card or the American Express charge card (as distinct from American Express credit cards).

niture, home appliances, and entertainment devices. Also contributing to the growth in revolving credit was an increase in the use of so-called convenience credit—that is, credit used for transaction purposes such that monthly charges are paid in full at the end of the billing cycle.¹⁵

Most publicly available information about credit card holding and use is about individuals; however, since many financing decisions are made at the family level and attitudes and perspectives about credit cards may be formed based on collective experience, it is useful to consider the credit card–related activities of families. As of 2010, 68 percent of families had one or more credit cards (table 1).¹⁶ That equated to about 152 million consumers (roughly two-thirds of individuals age 18 or older) holding about 520 million credit cards.¹⁷ In 2010, about 39 percent of families with credit cards did not pay off their full statement balance each month, but rather paid a portion so that they carried an outstanding balance forward on their next statement.¹⁸ Most families carrying credit card debt owed relatively small amounts. The median amount owed by families carrying debt on their credit cards was about \$2,600; the average amount, however, was notably larger, at \$7,100.

Credit Card Behavior and Credit Risk

The financial and other circumstances of individuals affect both their demand for credit cards and the willingness of issuers to provide them with this form of payment device and credit instrument. In general, the willingness of lenders to supply unsecured credit—the type of credit provided through bankcard borrowing—is inversely related to the credit risk posed by consumers. At very high levels of credit risk, issuers may be unwilling to extend any credit at all or will severely restrict the size of lines made available and price such credit accordingly. Consumers who have demonstrated difficulty handling credit in the past and

Table 1. Family holdings of debt, by type of debt, 2010 Survey of Consumer Finances

Item	Any debt	Secured by residential property		Installment loans	Nonmortgage lines of credit	Other ²	Credit card ³	
		Primary residence	Other ¹				All ⁴	Share with positive balance
Percentage of families holding debt	74.9	47.0	5.4	46.3	2.1	6.4	68.0	39.4
Median value of holdings for families holding debt (thousands of 2010 dollars)	70.3	110.0	97.0	12.7	6.0	4.5	...	2.7
Share of all debt	100.0	74.1	9.8	11.2	1.0	1.1	...	2.9

¹ Second or vacation homes and investment properties.

² Consists primarily of single-payment loans.

³ Balances owed after last payment.

⁴ Includes households that have credit cards but that do not have any credit card debt. Among households with a credit card, 95.7 percent hold a bankcard.

... Not applicable.

Source: Federal Reserve Board, Survey of Consumer Finances.

¹⁵ See Kathleen W. Johnson, “Convenience or Necessity? Understanding the Recent Rise in Credit Card Debt,” Finance and Economics Discussion Series 2004-47 (Washington: Board of Governors of the Federal Reserve System, September), www.federalreserve.gov/pubs/feds/2004/200447/200447abs.html.

¹⁶ See Jesse Bricker, Arthur B. Kennickell, Kevin B. Moore, and John Sabelhaus (2012), “Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances,” *Federal Reserve Bulletin*, vol. 98 (June), www.federalreserve.gov/pubs/bulletin/2012/default.htm.

¹⁷ The estimate of the number of bankcards is from HSN Consultants Inc., *Nilson Report*, in note 14.

¹⁸ See Bricker and others, “Changes in U.S. Family Finances from 2007 to 2010,” in note 16.

those using large amounts of credit relative to their income and wealth are generally riskier than consumers who have good payment histories or use smaller amounts of credit.

Consumers who pose an elevated credit risk often seek credit to support greater current consumption and sometimes resort to unsecured, high-rate credit products, which may include some bankcards, to augment their secured borrowing. In seeking to augment their borrowing, such consumers signal that they pose a higher risk of default and often find it difficult to obtain additional credit. One sign that a consumer is seeking additional credit is the presence of inquiries for credit in his or her credit record data.¹⁹ For example, individuals who have relatively low credit scores have a notably higher incidence of credit inquiries in their files than those with higher credit scores, and they typically have more inquiries indicating that they are actively searching for more credit. As of the end of 2011, 68 percent of individuals with credit scores in the lowest 20 percent of the score distribution had a record of a credit inquiry in the previous 12 months in their credit history files, and, on average, these individuals had 3.3 inquiries (data not shown in tables). By comparison, less than 30 percent of those with credit scores in the top 20 percent of the score distribution had an inquiry in the previous 12 months, and, on average, these individuals had 1.6 inquiries.

The result of these opposing supply and demand effects—the reluctance of lenders to extend unsecured credit to individuals who pose a higher credit risk and the elevated demand for such credit by such individuals—can be seen by examining data from a nationally representative sample of individuals drawn from credit record files.²⁰ Several relationships are revealed by an analysis of the credit record data. First, the share of individuals holding at least one bankcard was for many years quite stable, at about 80 percent, until the onset of the Great Recession; afterward, the incidence of cardholding fell to about 72 percent in 2010 (table 2).²¹ (Note that the unit of observation in credit record data is the individual, not the household as in earlier analyses.) The reduction in the incidence of cardholding appears to have come from individuals in all credit score groups, although the largest percentage declines were among those with scores in the two lowest credit score quartiles (derived from data in table 2). Second, the incidence of cardholding is notably smaller in the two lowest credit score quartiles than in the two highest. At the end of 2011, about 53 percent of those in the lowest score quartile and about 65 percent of those in the second-lowest score quartile held a bankcard, compared with about 80 percent of those in the third quartile and 90 percent of those in the highest. The lower incidence of cardholding among those with lower scores means that most individuals with bankcards have fairly high credit scores: At the end of 2011, roughly 60 percent of all bankcard holders had a credit score that placed them in the top two quartiles of the score distribution.

In the years leading up to and into the recession, bankcard holders across the credit risk

¹⁹ A credit inquiry arises when a consumer has sought credit from a lender and that lender seeks information on the consumer's credit history by contacting the credit-reporting company. Inquiries that arise when a consumer is reviewing his or her own credit record are treated differently by those assessing the creditworthiness of the consumer and are not used in calculating a credit score.

²⁰ The credit record data used here are from the Federal Reserve Bank of New York Consumer Credit Panel/Equifax (CCP) data. For a description of 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), www.newyorkfed.org/research/staff_reports/sr479.html. The data are provided each quarter by Equifax, Inc., one of the three national consumer-reporting agencies, and are derived from a nationally representative sample of the credit records of individuals. For the CCP the same individuals are tracked over time. As individuals drop out of the sample (for example, because of death) they are replaced in a manner that continues to provide a nationally representative sample. The data are anonymous; all personally identifying information (including name, Social Security number, and residential address) is excluded from the data received by the Federal Reserve.

²¹ For the analysis here, individuals are considered to have had a bankcard during a given year if they had such an account at any point during that year.

Table 2. Share of individuals holding bankcards, by credit score quartile, 2001–11

Percent

Year	Credit score quartile ¹				
	Lowest	Second	Third	Highest	All
2001	71	79	85	90	81
2002	71	78	84	89	80
2003	69	76	84	90	80
2004	67	76	84	90	79
2005	67	76	84	91	79
2006	65	76	84	91	79
2007	67	76	85	91	80
2008	65	76	86	91	79
2009	57	69	83	89	74
2010	54	65	80	90	72
2011	53	65	81	90	72

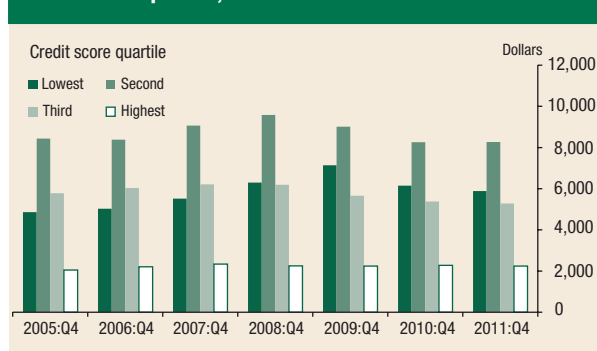
¹ Credit score quartiles are based on the credit score distribution at the end of the previous year.

Source: FRBNY Consumer Credit Panel/Equifax.

spectrum increased their revolving debt. Since then, all groups have reduced such borrowing (figure 2). This behavioral pattern reflects the long-standing observation that consumers borrow more heavily during economic expansions, when prospects are good, and pay down debts during recessions.²² Determining the extent to which changes in outstanding debt over the current business cycle are driven by creditor actions or by consumer behavior is difficult. However, because the bankcard holders with the highest credit scores are the least likely to face lender-imposed constraints on borrowing, arguably the relatively small reduction in debt (about 6 percent from its peak at the end of 2007) by cardholders in the highest score quartile is most likely driven by consumer choice.

Payment Performance and the Great Recession

Although delinquency rates on credit cards tend to be relatively high even in good economic times, the recent recession triggered a significant upswing in delinquencies and charge-offs. The delinquency rate on bankcards reached just over 5 percent of the number of outstanding accounts in June 2009 (the official end of the Great Recession), receding to about 3 percent by the end of 2011 (figure 3).²³ In contrast, delinquency rates on closed-end consumer credit (such as automobile

Figure 2. Average total bankcard balance outstanding, by credit score quartile, 2005–11

Note: See notes to table 2.

²² See George Katona (1975), *Psychological Economics* (New York: Elsevier), or, more recently, Dean Maki (2002), “The Growth of Consumer Credit and the Household Debt Service Burden,” in Thomas A. Durkin and Michael E. Staten, eds., *The Impact of Public Policy on Consumer Credit* (Boston: Kluwer Academic Publishers), pp. 43–63.

²³ Delinquency rates rose even more sharply when stated in dollar terms than when measured by the percentage of accounts. The elevated charge-offs associated with the Great Recession resulted in card issuers’ experiencing negative returns on credit card activities in 2009, the first time issuers had had negative returns since at least

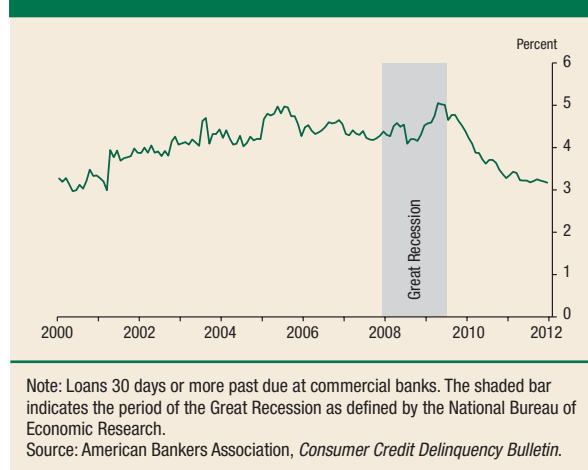
loans) peaked at about 4 percent during the recession before falling to about 2 to 3 percent during the recovery.

Although a delinquency rate of 5 percent of bankcard accounts might suggest that payment problems arise for only a relatively small share of bankcard holders, a snapshot view such as this understates the extent of payment problems that individuals experience. First, the measure of the share of bankcard accounts that are currently delinquent tends to downplay the proportion of active accounts that experienced difficulties because it includes in the denominator accounts that are dormant or inactive but still open and available for use at the consumer's discretion. Second, many more individuals experience some payment problem over an interval of time, such as a year or more, than at any single point in time (for example, at the end of a calendar quarter). The difference between the two measures reflects the fact that many individuals who experience a problem at some point get their payments back on track and that lenders close and charge off an account after an extended period of delinquency.

Therefore, to gain a more comprehensive view of payment performance during the years of the Great Recession and the early recovery, we determined the number of cardholders who experienced some payment problem at any point during that period. For the analysis, we tracked a sample of individuals who were consistently included in the credit record files from the end of 2007 through the end of 2011 (this population is referred to here as the *constant panel*). Over this entire four-year period, about 20 percent of individuals with a bankcard in the constant panel fell behind on payments on one or more such cards by 30 days or more *at least once* (data not shown in tables). By comparison, at the end of 2009 (on a randomly selected single date within this four-year period), only 10 percent of individuals with a bankcard in the constant panel were in arrears by 30 days or more on at least one of their cards.

One unusual aspect of cardholder behavior during the Great Recession was that consumers' hierarchy of debt payments seemed to change. In the past, when consumers experienced financial distress, they tended to fall behind on their credit card accounts before other debts. During the Great Recession, many cardholders continued to make their card payments as scheduled even as they fell behind on their mortgages. In all likelihood, delinquency rates on credit cards would have been worse had cardholders followed their historical payment hierarchy.²⁴

Figure 3. Credit card delinquency rate, 2000–11



1986. See Board of Governors of the Federal Reserve System (2011), *Report to the Congress on the Profitability of Credit Card Operations of Depository Institutions* (Washington: Board of Governors, June), www.federalreserve.gov/publications/other-reports/credit-card-profitability-2011.htm.

²⁴ Ezra D. Becker (2011), "A Perspective on Credit Card Usage and Consumer Performance," paper presented at the Consumer Financial Protection Bureau conference on the Credit Card Act, Washington, D.C., February 22, www.consumerfinance.gov/credit-cards/credit-card-act/card-act-conference-key-findings.

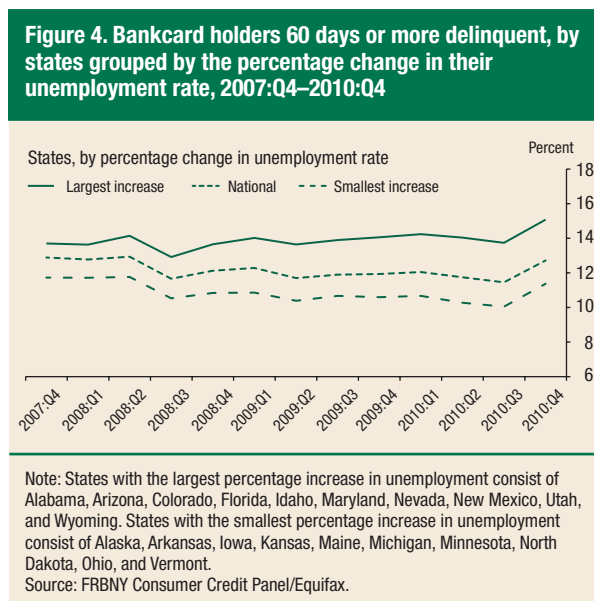
Geographic Differences in Bankcard Delinquencies

The Federal Reserve Bank of New York Consumer Credit Panel/Equifax (CCP) data can offer further insight into the payment experiences of cardholders. Although the Great Recession and the ensuing recovery have been national phenomena, cardholders in different areas of the country have experienced considerably different economic environments, which may have affected their willingness or ability to meet their debt obligations, including credit card payments. As noted, the economic environments different individuals have encountered and their personal experiences may have influenced their responses to the February 2012 consumer survey.

To gain insight into the extent to which different economic environments may have influenced bankcard holder behavior, we examined cardholder payment performance across groups of states categorized according to changes in their job market conditions. For this exercise, we compared the rates of delinquency lasting 60 days or more among cardholders residing in states that experienced particularly poor employment markets with the delinquency rates of those residing in states that had relatively better outcomes. Specifically, we compared the bankcard delinquency rates of the residents of the 10 states that experienced the largest percentage increase in their unemployment rate from the end of 2007 to the end of 2010 with the delinquency rates of the residents of the 10 states that experienced the smallest percentage increase over this period.²⁵ The bankcard delinquency rate for the nation as a whole was calculated as a point of reference.

The analysis reveals variation in bankcard performance across the two groups of states as the Great Recession took hold and during the initial phases of the ensuing recovery. As one might expect, bankcard holders in states that experienced the largest percentage increase in their unemployment rate had worse payment performance than bankcard holders in the states that experienced the smallest increase in unemployment. From the end of 2007 to the

end of 2010, bankcard holders in the 10 states with the poorest job performance experienced about a 10 percent increase in the rate of delinquency lasting 60 days or more, compared with a 3 percent decrease for bankcard holders in the 10 states with the strongest job markets. These outcomes are derived from the data portrayed in figure 4, which show a widening of the gap in delinquency rates between cardholders in the states that experienced poor employment outcomes and those in states with better outcomes.



²⁵ An alternative approach to distinguishing states that had particularly poor employment conditions from those with relatively good conditions is to consider the absolute increase in each state's unemployment rate, as opposed to the percentage increase. Analysis using this approach yielded time patterns that were quite similar, showing that states that had poor job market outcomes according to this metric also had notably worse bankcard delinquency rate outcomes than other states (data not shown in tables).

Issuer Responses

Credit card issuers have responded to the recent economic difficulties, new regulations, and other events in a variety of ways. One response has been to reprice many accounts, most notably by increasing the interest rates charged on revolving balances for some cardholders. Also in the pricing realm, issuers have altered their fee schedules for cardholders who make late payments or exceed their credit limits. Issuers have also curtailed potential losses by reducing the size of credit lines made available to cardholders and by closing some accounts.²⁶ Another response has been to reduce or reorient promotional activities, particularly away from those consumers judged to pose elevated credit risk. Each of these responses is explored below.

Repricing

Over the past few years issuers have repriced millions of bankcard accounts. Data representing a subset of the largest bankcard issuers indicate that many accounts experienced an increase in interest rates as a consequence of either late payments or changes in terms around the time when bankcard delinquencies increased coincident with the Great Recession and when the Credit Card Act rulemaking was in play. However, the share of accounts experiencing interest rate increases as a penalty or because of a change in terms dropped substantially once the provisions of the Credit Card Act took effect. For example, about 4 percent of bankcard accounts experienced an increase in their APR because of a penalty or change in terms each quarter in the first half of 2008, but this share dropped to about 1.5 percent each quarter by the second half of 2010.²⁷ Also, the incidence of late fees and the typical amount of such fees fell once the provisions of the Credit Card Act became effective.²⁸

Credit Limits

The data show that in the aggregate, credit limits on credit cards grew steadily in the period before the Great Recession, reaching a peak of about \$3.7 trillion in the third quarter of 2008 before falling to about \$2.7 trillion at the end of 2011 (data not shown in tables).²⁹ As the economy has recovered, aggregate credit limits have grown modestly, but they still remain about 25 percent below their peak value. Consistent with the large drop in the aggregate dollar amount of credit lines made available, credit record data also indicate that

²⁶ The Senior Loan Officer Opinion Survey on Bank Lending Practices, sponsored by the Federal Reserve, indicates that most credit card issuers were reducing credit limits during the recession, but since that time the share curtailing limits has fallen sharply back to the levels seen during the years preceding the financial crisis and recession. See Board of Governors of the Federal Reserve System (various dates), "Senior Loan Officer Opinion Survey on Bank Lending Practices," Board of Governors, www.federalreserve.gov/boarddocs/SnloanSurvey. During the recession issuers also closed many dormant or little-used accounts as well as accounts that had become delinquent. This move represented an aggressive response by issuers to the difficult economic environment; inactive or little-used accounts pose considerable risk of loss while offering little potential for profit, as cardholders may draw on them as emergency lines of credit when they are in financial distress.

²⁷ See Consumer Financial Protection Bureau (2013), *CARD Act Report: A Review of the Impact of the CARD Act on the Consumer Credit Card Market* (Washington: CFPB, October), www.consumerfinance.gov/reports/card-act-report. For additional research into the effects of the Credit Card Act, see Sumit Agarwal, Souphala Chomsisengphet, Neale Mahoney, and Johannes Stroebel (2013), "Regulating Consumer Financial Products: Evidence from Credit Cards," NBER Working Paper Series 19484 (Cambridge, Mass.: National Bureau of Economic Research, September), www.nber.org/papers/w19484.

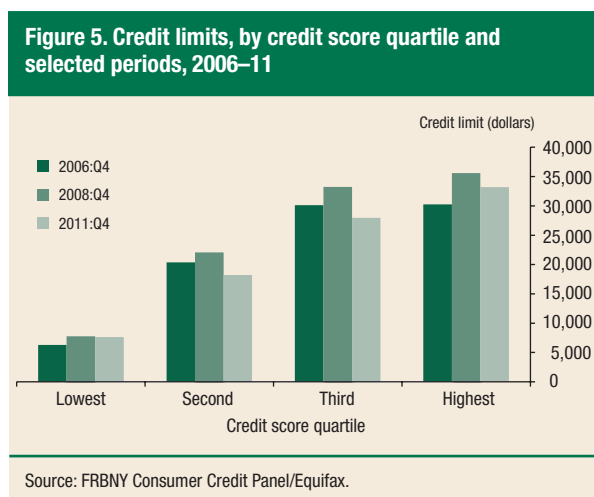
²⁸ See the slides regarding changes in penalty fees and over-the-limit fees in Jennifer Faulkner (2011), "The CARD Act—One Year Later: Impact on Pricing Fees" (Washington: Department of the Treasury, Office of the Comptroller of the Currency, Administrator of National Banks), <http://files.consumerfinance.gov/f/2011/03/OCC-Presentation.pdf>.

²⁹ Estimates are based on credit records included in the CCP data. See Federal Reserve Bank of New York (2012), "Delinquent Debt Shrinks While Real Estate Debt Continues to Fall," press release, February 27, www.newyorkfed.org/newsevents/news/research/2012/an120227.html.

issuers have reduced limits on millions of credit card accounts, particularly accounts that were inactive or little used by cardholders. These data indicate that about 60 percent of the individuals who had at least one bankcard at the end of 2007 experienced a reduction in the aggregate limit available on all of their bankcards by the end of 2011. This estimate includes those individuals who had at least one bankcard account closed, which, all else being equal, would result in a lower aggregate limit.³⁰

Credit record data provide further insight into changes in individuals' aggregate credit limits in recent years. A review of these data finds that average aggregate dollar limits on bankcards vary with the credit risk posed by the cardholder and respond to changing economic circumstances. Individuals with lower credit scores have substantially smaller aggregate limits available to them than do individuals with higher scores. For example, at the end of 2011, bankcard holders with credit scores that placed them in the lowest quartile of all people with credit scores had an average aggregate credit limit across all of their bankcards of about \$7,600 (figure 5). By contrast, those with scores that placed them in the highest quartile typically had an aggregate credit limit of about \$33,200. This pattern holds across time; the data show the same basic relationship for each of the years reviewed. Credit record data also indicate that bankcard issuers curtailed limits (including by closing accounts) as the recession took hold, particularly for those with better credit scores. The cut in limits for those with higher scores may have been larger because such individuals tend to use their cards less and to have larger numbers of cards that they rarely use.

Credit limit curtailments did not appear to result in widespread constraints on cardholder access to credit. Despite the curtailment of credit lines, the credit record data indicate that at the end of 2011, in the aggregate, individuals were using only about one-fourth of the total dollar amount available on their lines under bank-issued credit card plans (data not shown in tables). Of course, such aggregate estimates mask considerable variability; some bankcard holders have very low rates of utilization (calculated as outstanding balances on



all cards divided by the sum of the credit limits on all cards), while others are near or even over their limits as reflected in the credit record data.³¹ For example, credit record data indicate that at the end of 2011 roughly one-fourth of bankcard holders had balances that were 80 percent or more of their available credit limit across all bankcards.³² At the other extreme, about half of bankcard holders were using less than 20 percent of their available limit.

The changes in credit limits experienced by cardholders over the past

³⁰ The incidence of line curtailment presented here is based on an analysis that tracked the same individuals from the end of 2007 to the end of 2011. Some additional individuals may have entered the credit record files between these dates and also experienced a reduction in their total available bankcard limit. Statistics are derived from the CCP data.

³¹ Utilization rates calculated from credit record data may exceed 100 percent on a single account or in the aggregate across all of an individual's accounts. An individual may be allowed to exceed his or her limit by a card issuer, or the reported limit in the credit record data may not accurately reflect the current limit if it has changed since the last time it was reported to the credit bureau.

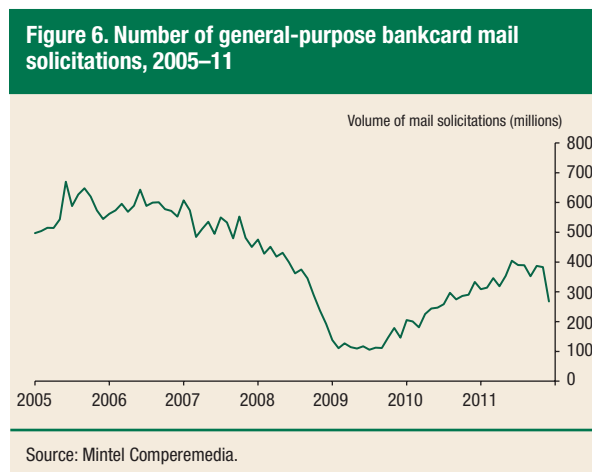
³² Statistics are derived from the CCP data.

few years are likely to influence consumers' attitudes about their cards and their issuers. In general, reductions in credit limits are not likely to be well received by some consumers, although the extent to which such changes meaningfully affect their financial circumstances very much depends on their particular situation. Cardholders who experience line reductions on inactive or little-used cards but have other accounts with available capacity are less likely to be upset than cardholders who were using their accounts to the fullest extent possible. Indeed, restrictions on inactive or little-used accounts may hardly be noticed.

Solicitations

Direct mail solicitation is an important channel for card issuers to acquire new credit card accounts and retain existing accounts.³³ After reaching an all-time annual high of 6.8 billion in 2005, mail solicitations for general-purpose credit cards fell sharply as the Great Recession took hold (derived from figure 6).³⁴ The effects of the weak economic environment, including surging delinquencies and losses on credit card activities, led card issuers to mail only about 1.5 billion solicitations in 2009. Industry data indicate that the retrenchment in mail solicitations began to reverse in the latter portion of 2009, as prospects for economic recovery improved. Mailing volumes continued to recover throughout 2010, increasing 128 percent from December 2009 to December 2010 (data not shown in tables). Overall, nearly 3.0 billion mail solicitations were sent out in 2010, and another 4.2 billion in 2011.

Whether measured before, during, or after the most recent recession, the number of mail solicitations has been large. However, aggregate mail-volume figures reflect the receipt of multiple offers by the same individual, sometimes for the same card from the same card issuer. Another way to portray the extent of mail solicitations and their reach into the overall population is to measure the *penetration rate*—that is, the share of individuals who received at least one credit card mailing during a given period (for example, over the course of a month or a calendar quarter). A portion of the mail solicitation data available for such an analysis has been linked to the credit records of the individuals receiving the solici-



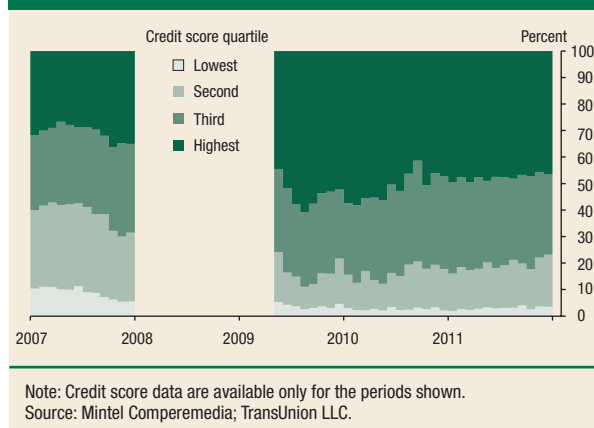
tations, so it is possible to assess the change over time in mailings to individuals grouped into credit score quartiles.³⁵ The mail solicitation data available for this analysis that include credit scores are limited to mailings received in calendar year 2007 and from the middle of 2009 onward; our analysis used data through the end of 2011. We considered both the overall penetration rate (beginning in 2007) and the distribution of mailings received by individuals grouped into credit score quartiles

³³ Other key channels for new account acquisition include the Internet and branch office interactions.

³⁴ The Federal Reserve receives data from Mintel Comperemedia (Mintel) on mailings received by a nationally representative sample of 8,000 consumers each month. Mintel asks these consumers to forward all incoming mail containing credit solicitations, such as offers of credit cards, home equity loans, and so on. The mail solicitations shown in figure 6 are monthly, and they include solicitations for general-purpose credit cards and exclude those for retail cards.

³⁵ Credit scores are available for most but not all individuals who participated in the mail survey conducted by Mintel.

Figure 7. Share of bankcard mail solicitations, by credit score quartile, 2007–11



individuals posing a higher expected risk of default (those with lower credit scores). In June 2007, about 11 percent of credit card solicitations were sent to individuals with credit scores in the lowest quartile (figure 7). Mailings to such individuals fell sharply after that, reaching a low point in January 2011, when only 2 percent of mailings were sent to individuals with the lowest scores. More broadly, the share of all mailings sent to individuals with credit scores in the bottom half of the score distribution fell from 43 percent in June 2007 to only 16 percent in January 2011. After the beginning of 2011, card issuers' risk tolerance appears to have recovered some, as the share of mailings received by those in the bottom half of the score distribution increased, reaching 23 percent in December 2011.

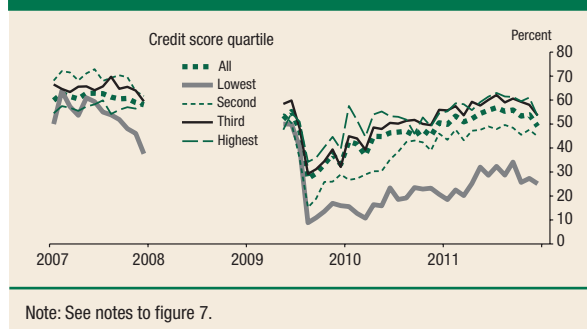
Another way to demonstrate the changing risk tolerance of issuers of general-purpose credit cards is to consider the share of individuals in each credit score quartile who received a mail solicitation. Consistent with the overall volume of mailings, all score groups experienced a falloff in solicitations as the recession emerged, but those in the lower score bands experienced a much sharper decline. The data show that in June 2007 about 59 percent of individuals with scores in the bottom quartile received at least one mail solicitation; by January 2011 that share had fallen to 19 percent (figure 8). By comparison, in June 2007, about 58 percent of those with scores in the highest quartile received a solicitation; in January 2011 that figure was about 55 percent. Mailings to individuals with credit scores in the lowest two quartiles recovered some over the course of 2011 after reaching their low points.

Although the volume of credit card mail solicitations is quite large, only a very small proportion of such solicitations result in an application for or the establishment of a new credit card account. To learn more about those who actually establish a new credit card account, one must look at data beyond mailings of solicitations for new cards. Using nationally representative samples of the credit records drawn as of June 30, 2007, and at the ends of 2008 and 2010, it is possible to profile the characteristics of individuals opening new bankcard accounts at dif-

for the months in which the data are available.

The share of individuals receiving general-purpose credit card mail offers has varied over time, primarily reflecting broad economic conditions. The penetration rate reached about 63 percent of individuals around the middle of 2007 before falling to a low point of 27 percent in August 2009 as issuers responded to increasing delinquencies and losses in the credit card market (data not shown in tables). The mail solicitation data also reveal a sharp reduction once the recession took hold in offers to

Figure 8. Share of individuals in each credit score quartile receiving bankcard mail solicitations, 2007–11



ferent points in the business cycle.³⁶ These credit record data show that as the economy slid into recession there was a notable decrease in the share of individuals taking out new accounts who had credit scores in the lowest quartile, a pattern consistent with the change in mail solicitations. For example, over the six-month time frame of July to December 2008, 15 percent of the individuals opening new bankcard accounts had scores that fell in the lowest credit score quartile, a share down notably from the period preceding the recession: During the July to December 2006 period, the share of individuals opening new bankcard accounts with credit scores in the lowest quartile was 20 percent (table 3).

Table 3. Establishment of new bankcard accounts, by credit score quartile, July through December, 2006, 2008, and 2010

Account opening date	Credit score quartile				
	Lowest	Second	Third	Highest	Total
July–December 2006	20.2	33.1	28.1	18.6	100.0
July–December 2008	14.5	30.2	32.6	22.7	100.0
July–December 2010	12.7	28.1	31.4	27.8	100.0

Source: TransUnion LLC.

Findings from Consumer Surveys

Taken together, the data presented earlier reveal wide differences in credit card–related experiences and outcomes for individuals across a number of dimensions, including the economic conditions of their state of residence and one key measure of the credit risk they pose—their credit score. The following sections highlight findings from the February 2012 Survey of Consumers. The findings here indicate that credit risk was an important determinant of consumers’ responses to the recession and the Credit Card Act. The survey responses identify consumers whose payment practices make them risky. Such patterns include hardly ever paying balances in full and hardly ever making more than minimum payments, behaviors that are associated with incurring relatively high credit card balances and making late payments relatively often. An examination of such cardholders’ awareness of APRs, use of information, and decision processes provides insights on questions such as whether they systematically overestimate their ability to repay and whether their decisions are purposive and thoughtful.

Trends in Bankcard Holder Behavior, 2000 to 2012

Although bankcard holding declined somewhat in the wake of the recent recession and the implementation of the Credit Card Act, the majority of U.S. households continue to hold bankcards. Among households holding bankcards, the share having more than one such card (about one-fourth) has not changed much in recent years (table 4). However, the per-

³⁶ The credit record data used for the analysis of new account acquisition are from TransUnion, one of the three national consumer credit-reporting companies, and are derived from a nationally representative sample of the credit records of individuals. The data used in this analysis rely on the portion of the sample of credit records that tracks the same individuals over time. The data are anonymous; all personally identifying information (including name, Social Security number, and residential address) is excluded from the data received by the Federal Reserve. The data provide extensive information on each credit account in an individual’s credit record, including the date the account was opened. The account opening date allows the identification of newly established accounts. Credit scores are available only as of the time the samples were drawn, so they may differ somewhat from the scores as of the time the accounts were opened. Some individuals drop out of the panel and are replaced by a representative draw from those who newly entered the credit record files during the time periods between the dates on which the samples were drawn. For details about the nature of the TransUnion credit record data used here, see Board of Governors, *Report to the Congress on Credit Scoring*, in note 4.

Table 4. Cardholding information and behavior or attitudes of holders of bankcards, selected years, 2000–12

Percent

Behavior or attitude	2000	2001	2004	2005	2012
Number of bank-type cards					
One	40	31	25	27	27
Two	29	28	32	30	31
Three	13	19	21	22	21
Four	9	11	10	8	11
Five or more	9	11	12	13	10
Total	100	100	100	100	100
Balance owed after latest payment (in constant 2012 dollars)					
0	35	40	45	40	50
1–1,499	32	23	21	20	16
1,500–4,999	15	17	15	16	16
5,000 or more	18	20	20	24	19
Total	100	100	100	100	100
Has card that provides rewards	n.a.	n.a.	n.a.	n.a.	73
Adequacy of available credit					
Too much	n.a.	n.a.	n.a.	n.a.	44
Just enough	n.a.	n.a.	n.a.	n.a.	52
Too little	n.a.	n.a.	n.a.	n.a.	3
Do not know	n.a.	n.a.	n.a.	n.a.	1
Total					100
Usual payment behavior					
Almost always pays in full	50	n.a.	n.a.	54	62
Sometimes pays in full	19	n.a.	n.a.	14	16
Hardly ever pays in full	31	n.a.	n.a.	32	22
Total	100			100	100
Payments more than minimum					
Almost always	80	n.a.	n.a.	n.a.	75
Sometimes	11	n.a.	n.a.	n.a.	14
Hardly ever	9	n.a.	n.a.	n.a.	11
Total	100				100
Memo: Continues using the card when paying the minimum	7	n.a.	n.a.	n.a.	16
Makes payments using the Internet	n.a.	n.a.	n.a.	n.a.	48
Cards' effect on managing finances					
Makes less difficult	n.a.	72	n.a.	n.a.	82
No different	n.a.	16	n.a.	n.a.	8
Makes more difficult	n.a.	10	n.a.	n.a.	8
Do not know	n.a.	3	n.a.	n.a.	2
Total		100			100
Paid a late fee in the past 12 months	41	30	n.a.	n.a.	27
Satisfaction with bank-type cards					
Very satisfied	n.a.	48	n.a.	n.a.	47
Somewhat satisfied	n.a.	42	n.a.	n.a.	37
Not satisfied or dissatisfied	n.a.	5	n.a.	n.a.	7
Somewhat dissatisfied	n.a.	5	n.a.	n.a.	7
Very dissatisfied	n.a.	1	n.a.	n.a.	1
Total		100			100
Memo: Has bank-type card	72	72	68	73	67

Note: Components may not sum to 100 because of rounding.

n.a. Not available.

Source: Thomson Reuters/University of Michigan Surveys of Consumers.

centage of households having five or more bankcards appears to have decreased slightly (3 percentage points) since 2005.

The Surveys of Consumers reveal a trend since 2000 toward greater use of bankcards as a transaction medium rather than as a source of credit. In 2000, only 35 percent of bankcard holders reported that they paid their latest statement balance in full; in the 2012 survey this figure was 50 percent. Bankcard holders' reports of their habitual or usual behavior indicate the same trend. In 2000, 50 percent of bankcard holders said that they almost always paid the balance they owed in full; in 2012 the proportion was 62 percent. Part of the increase in transactions use has occurred since the recent recession and the implementation of the new credit card regulations. The percentage of bankcard holders who paid their latest statement balance in full increased 10 percentage points between 2005 and 2012. The proliferation of rewards cards likely contributed to the increase in the transactions use of credit cards. We do not have data for earlier years, but nearly three-fourths of bankcard holders reported that they had one or more cards with reward features in 2012.³⁷

The increase in transactions use may also include broader adoption of this pattern of use among bankcard holders who previously owed relatively small amounts of bankcard debt. In 2000, 32 percent of bankcard holders owed \$1 to \$4,999 (in constant 2012 dollars) after their most recent payment; in 2012, the share had fallen to 16 percent. Once revolving balances are repaid, cardholders may continue to use their bankcards for the sake of convenience in making transactions and in order to receive credits for rewards while paying balances in full on their monthly statements.

The share of bankcard holders with relatively large amounts of bankcard debt is little changed since 2000. In that year, 33 percent of bankcard holders had \$1,500 or more of bankcard debt, and 18 percent had \$5,000 or more. In 2012, 35 percent had \$1,500 or more of bankcard debt, and 19 percent had \$5,000 or more. Use of relatively large amounts of debt was more common shortly before the recent recession than in 2000 or 2012, however. In 2005, 40 percent of bankcard holders had \$1,500 or more of bankcard debt, and 24 percent had \$5,000 or more.³⁸ That credit card debt was greater before the recession reflects the long-standing observation that consumers borrow more heavily during economic expansions, when prospects are good, and pay down debts during recessions.

The feature of bankcard credit that allows cardholders to repay debt largely at their own discretion provides them with considerable flexibility in managing their accounts but is somewhat controversial. Critics of the feature contend that it leads some consumers to overestimate their ability to repay their credit card debt, causing them to consistently make

³⁷ The fact that some cardholders report that they almost always pay in full but also report that they currently owe bankcard debt is not necessarily a contradiction. At any point in time, a cardholder who normally pays the statement balance in full may have borrowed. The prearranged line of credit provided by a bankcard may be a convenient and economical source of short-term credit. See Dagobert L. Brito and Peter R. Hartley (1995), "Consumer Rationality and Credit Cards," *Journal of Political Economy*, vol. 103 (April), pp. 400–33. Another incentive for cardholders to carry a balance is a 0 percent promotional rate, which has been a common incentive used by issuers to acquire new accounts. Even the most steadfast transactions user might rationally carry a balance for the duration of a zero-interest-rate period.

³⁸ Just before the recession, data from the 2007 Survey of Consumer Finances indicated that 41 percent of bankcard holders had \$1,500 or more of bankcard debt, and 26 percent had \$5,000 or more. See Brian K. Bucks, Arthur B. Kennickell, Traci L. Mach, and Kevin B. Moore (2009), "Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin*, vol. 95 (February), www.federalreserve.gov/pubs/bulletin/2009/articles/scf/default.htm.

only minimum payments and incur high finance charges for long periods of time.³⁹ The Credit Card Act addressed this concern by requiring new disclosures on monthly statements intended to encourage bankcard holders to make more than minimum payments. It is not evident from the survey results, however, that the new disclosure rules have altered consumer behavior. In 2012, 11 percent of bankcard holders said that they hardly ever made more than minimum payments, and 14 percent said that they sometimes made more than minimum payments.⁴⁰ This pattern is little different from the one revealed in the 2000 survey, which found that 9 percent of bankcard holders hardly ever made more than minimum payments and 11 percent sometimes made more than minimum payments. The next subsection discusses in greater detail consumers' use of information and credit card payment behavior using data from the 2012 survey.

Consumers' Decisionmaking and Their Credit Cards

Economic theory typically focuses on the outcomes of decisions but provides little insight into the decision process underlying the behavior of consumers. To better understand consumers' credit use behavior—in particular, the extent to which their behavior is purposive and thoughtful—researchers have turned to the cognitive information processing model of the decision process developed by psychologists. Psychologists model the decision process as a series of steps, involving recognition of a problem, evaluation of alternatives with internal search (that is, retrieval from memory of information on past experiences) and external search (choice, and evaluation of the outcome. For any individual, the decision process varies from one decision to another. An individual evaluating a new or unfamiliar product may gain little from internal search and move quickly to the external search stage. If an individual has sufficient information from past experience to evaluate alternatives, external search may not occur. Extended search tends to occur when the product is relatively expensive, long lived, or infrequently purchased or has both desirable and undesirable features; the consumer's need for the product is not urgent; or previous experience with the product has proven unsatisfactory.⁴¹ This subsection examines aspects of bankcard holders' decision process, especially their access to and use of information about such cards.

Bankcards have features that can lead to limited or extended decision processes depending on how cardholders choose to use their cards. When they use their cards primarily as a convenient means of payment, the decision process may be limited or even habitual. Use is likely to be frequent, and the cost to the cardholder is generally negligible. When they use their cards as a means of financing purchases over time, the decision process is more likely to be extensive and to occur over an extended period. Bankcard credit is expensive relative to secured credit, and the debt may be outstanding for several months or even longer. The ability to borrow additional amounts and to decide on the repayment rate at the cardhold-

³⁹ See, for example, Lawrence M. Ausubel (1991), "The Failure of Competition in the Credit Card Market," *American Economic Review*, vol. 81 (March), pp. 50–81; Oren Bar-Gill (2004), "Seduction by Plastic," *Northwestern University Law Review*, vol. 98 (4), pp. 1373–434; and Michael S. Barr, Sendhil Mullainathan, and Eldar Shafir (2012), "Behaviorally Informed Regulation," in Michael S. Barr, ed., *No Slack: The Financial Lives of Low-Income Americans* (Washington: Brookings Institution Press), pp. 246–78.

⁴⁰ Durkin ("Credit Card Disclosures," in note 3) argues that the disclosure of the number of months it will take the cardholder to repay the balance in full when making only minimum payments (one of the Credit Card Act disclosures) is informative only if bankcard holders both make the minimum payments and stop making additional charges on the bankcard. Examining actual account transaction data, he found such behavior on only a very few accounts. Thus, one might expect little effect from the disclosure. Empirical evidence from a recent experimental study suggests that Credit Card Act disclosures are not effective in increasing credit card payments. See Daniel Navarro-Martinez, Linda Court Salisbury, Katherine Lemon, Neil Stuart, William J. Matthews, and Adam J. L. Harris (2011), "Minimum Required Payment and Supplemental Information Disclosure Effects on Consumer Debt Repayment Decisions," in "Consumer Financial Decision Making," special issue, *Journal of Marketing Research*, vol. 48 (November), pp. S60–S77.

⁴¹ For further discussion, see Roger D. Blackwell, Paul W. Mineard, and James F. Engel (2006), *Consumer Behavior*, 10th ed. (Stamford, Conn.: Thomson South-Western).

er’s discretion can be viewed as both good (offering flexibility) and bad (enabling cardholders to borrow excessively and repay too slowly). These considerations suggest that the decision process of cardholders who almost always pay in full may differ from that of cardholders who sometimes or hardly ever pay in full.

An individual’s attitudes about alternatives for purchase and consumption reflect his or her orientations toward or against those alternatives. These orientations may affect subsequent information processing and behavior. The 2012 survey asked respondents whether they thought using credit cards was a “good thing” or a “bad thing.” Their attitudes toward credit cards differed by their credit behavior. Cardholders making greater use of their credit cards for borrowing were likely to view credit cards as bad: Considerably more than half of cardholders who hardly ever paid in full and of those who sometimes or hardly ever made more than minimum payments said that credit cards were bad or bad with qualifications (table 5). In contrast, cardholders who sometimes or almost always paid in full were more divided in their views. A little more than half of each group said that credit cards were good or good with qualifications. Nearly all of the rest of these cardholders said that credit cards were bad or bad with qualifications. The more critical view of credit cards among those who hardly ever paid in full and those who sometimes or hardly ever paid more than the minimum suggests that these heavy credit users may be predisposed to undertake more deliberative decision processes than transactions users, although the qualified positive responses of transactions users also suggest that they, too, may be deliberative.

Presumably, use of information on account terms is part of cardholders’ deliberative process. Because awareness of price is a prerequisite for informed use of credit, price disclosure is a key component of federal disclosure rules for consumer credit and a focal point for researchers studying the effect of awareness of price on credit decisions.⁴² Since the implementation of TILA in 1968, the price of credit has been measured by the APR, and researchers have used survey reports of APRs to investigate consumer awareness of credit costs. Because the APRs reported by respondents in interview surveys cannot be checked against the rates they actually pay, researchers have relied on the concept of “awareness zones” to measure knowledge of APRs. If a respondent reports an APR within a range

Table 5. Attitudes toward credit cards, by payment behavior, 2012
Percent aware

Attitude toward credit cards	Usual payment behavior			Payments more than minimum	
	Almost always pays in full	Sometimes pays in full	Hardly ever pays in full	Almost always pays more than minimum	Sometimes or hardly ever pays more than minimum ¹
Good or good with qualifications	52	54	28	41	34
Both good and bad	3	1	1	1	†
Bad or bad with qualifications	45	45	71	58	66
Total	100	100	100	100	100

¹ Weighted sample size is less than 50.
† Less than 0.5.
Source: Thomson Reuters/University of Michigan Surveys of Consumers.

⁴² The fact that consumers can recall information does not necessarily mean that they used the information in making a decision, and that they have forgotten information does not necessarily mean that they were not aware of it at the time a decision was made. However, information that is useful is more likely to be retained in memory than information that is not useful. For discussion, see George S. Day (1976), “Assessing the Effects of Information Disclosure Requirements,” *Journal of Marketing*, vol. 40 (April), pp. 42–52.

that is deemed reasonable based on the distribution of actual market rates, the respondent is classified as “aware.” If the respondent reports a rate that is outside the range or answers “do not know,” the respondent is classified as “unaware.”

This article uses the same awareness zones as those used to assess responses to the January 2000 Survey of Consumers in a *Federal Reserve Bulletin* article published the same year.⁴³ In that article, two definitions of awareness were considered. The first was a narrow definition, in which respondents reporting interest rates greater than 7.9 percent were classified as aware, and respondents reporting rates of 7.9 percent or lower or saying that they did not know the rate were classified as unaware. The second alternative was a broad definition recognizing that low teaser rates were common in the marketplace at that time, so reports of rates below 7.9 percent may have been accurate. Under the broad definition, respondents reporting any interest rate were classified as aware, and respondents reporting that they did not know their rate were classified as unaware.

Regardless of the definition considered, cardholders’ awareness of APRs was very high in the 2012 survey. Among cardholders who sometimes paid in full, 92 percent were aware under the narrow definition, and 96 percent were aware under the broad definition (table 6). Eighty percent of cardholders who hardly ever paid in full were aware under the narrow definition. But if one allows for the possibility that these cardholders may have been paying low teaser rates—that is, if one adopts the broad definition—then up to 95 percent of cardholders who hardly ever paid in full may have been aware. The payment-behavior cohort with the lowest levels of awareness was the group of cardholders who almost always paid in full. Eighty-one percent of these cardholders were aware under the narrow definition, and 88 percent were aware under the broad definition. Cardholders who almost always paid in full were least likely to pay finance charges and therefore least likely to need to know their APR. Since APR information is not pertinent to their behavior, they may not retain the information in memory. In contrast, nearly all of the cardholders who actually paid finance charges were aware of their APR.

To further examine the role of information in the decision process, the survey asked cardholders how often they reviewed the APR information in their monthly statements. Cardholders who sometimes paid card balances in full were the payment behavior group who most frequently reviewed APR information; 53 percent of these respondents reported reviewing APR information every month (table 7). Cardholders who hardly ever paid in full were less likely than cardholders who sometimes paid in full to review APR information every month (44 percent), but the two groups were about equally likely to review APR information at least quarterly (77 percent and 80 percent, calculated as the sum of the first three rows in

Table 6. Awareness of annual percentage rates, by awareness definition and payment behavior, 2012

Percent aware

Awareness definition	Usual payment behavior			Payments more than minimum	
	Almost always pays in full	Sometimes pays in full	Hardly ever pays in full	Almost always pays more than minimum	Sometimes or hardly ever pays more than minimum ¹
Narrow	81	92	80	84	90
Broad	88	96	95	95	99

Note: For explanation of awareness definition, see text.

¹ Weighted sample size is less than 50.

Source: Thomson Reuters/University of Michigan Surveys of Consumers.

⁴³ See Durkin, “Credit Cards,” in note 3.

Table 7. Frequency with which monthly statement information on annual percentage rate is reviewed, by payment behavior, 2012

Percent					
Frequency of review	Usual payment behavior			Payments more than minimum	
	Almost always pays in full	Sometimes pays in full	Hardly ever pays in full	Almost always pays more than minimum	Sometimes or hardly ever pays more than minimum ¹
Every month	34	53	44	49	45
Every other month	5	14	10	11	14
4–5 times a year	10	13	23	19	20
Less than 4 times a year	51	20	23	22	21
Do not know	†	†	†	†	†
Total	100	100	100	100	100

Note: Components may not sum to 100 because of rounding.

¹ Weighted sample size is less than 50.

† Less than 0.5.

Source: Thomson Reuters/University of Michigan Surveys of Consumers.

columns 3 and 2, respectively). In contrast, only 34 percent of cardholders who almost always paid in full reported reviewing APR information every month, and just 49 percent of them reviewed APR information at least quarterly. These patterns indicate that cardholders who make decisions on whether or not to borrow and how much to borrow are the ones most likely to review price information frequently.⁴⁴ This finding is consistent with the hypothesis that borrowers are more likely to be deliberative than transactions users.

Cardholders were then asked whether the disclosed APR or the disclosed dollar finance charge on their monthly billing statement affected their decision to use credit in any way. Cardholders who sometimes or hardly ever paid balances in full were more likely than cardholders who almost always paid in full to report that the APR or the finance charge affected their decisions (table 8). Again, as cardholders who almost always pay in full hardly ever incur finance charges, it makes sense that information on the APR and the finance charge would not be especially relevant for them. For cardholders who sometimes or hardly ever paid in full, the finance charge was more likely than the APR to affect their decisions. About half of cardholders who sometimes or hardly ever paid in full said that the APR or the finance charge (or both) affected their decisions.

Table 8. Effect of annual percentage rate and finance charge information on consumer decisions, 2012

Percent reporting that information affects behavior					
Item	Usual payment behavior			Payments more than minimum	
	Almost always pays in full	Sometimes pays in full	Hardly ever pays in full	Almost always pays more than minimum	Sometimes or hardly ever pays more than minimum ¹
Annual percentage rate (APR)	17	30	32	31	32
Finance charge	18	48	40	41	51
APR or finance charge	24	52	50	51	51

¹ Weighted sample size is less than 50.

Source: Thomson Reuters/University of Michigan Surveys of Consumers.

⁴⁴ Cardholders were also asked how often they reviewed descriptive material in their monthly statements. Cardholders reported reviewing descriptive material less frequently than APR information (about 1 in 10 reviewed descriptive material each month), and the frequency distributions of the three payment-behavior groups were similar (data not shown in tables).

Table 9. Effect of annual percentage rate and finance charge information on decisions to use credit, 2012

Percent of mentions

Effect on decision	APR information		Finance charge information	
	Almost always pays in full ¹	Sometimes or hardly ever pays in full	Almost always pays in full ¹	Sometimes or hardly ever pays in full
Paid off faster	33	11	22	19
Limited card use	23	20	17	31
Influenced decision on whether to use cash or credit	22	28	20	19
Decided which card to use	14	12	12	8
Stopped using credit cards	4	14	5	7
Changed spending habits	†	8	14	9
Other	5	8	10	7
Total	100	100	100	100

¹ Weighted sample size is less than 50.

† Less than 0.5.

APR Annual percentage rate.

Source: Thomson Reuters/University of Michigan Surveys of Consumers.

When asked in what way their decision to use credit was affected, most cardholders indicated that the APR or finance charge information influenced their decisions on whether or not to use credit or how much credit to use (table 9). However, only a relatively small share of cardholders changed their spending habits or stopped using credit cards altogether because of this information, and relatively few cardholders used the information to choose which card to use. Although the percentages vary, these conclusions hold for responses about both APR and finance charge information and do not differ substantively by cardholders' payment behavior.

Bankcard holders who used credit cards for the purpose of borrowing were somewhat more likely than transactions users to believe that obtaining information on credit terms is easy, perhaps because borrowers were more likely to use such information. Half of bankcard holders who sometimes or hardly ever paid in full reported that obtaining information on credit terms was at least somewhat easy, compared with 44 percent of cardholders who almost always paid in full (table 10). While a significant minority of cardholders found

Table 10. Ease of obtaining useful information on credit card terms, by payment behavior, 2012

Percent

Ease of obtaining useful information	Usual payment behavior			Payments more than minimum	
	Almost always pays in full	Sometimes pays in full	Hardly ever pays in full	Almost always pays more than minimum	Sometimes or hardly ever pays more than minimum ¹
Very easy	8	8	6	9	†
Somewhat easy	36	42	44	43	43
Somewhat difficult	43	43	37	38	44
Very difficult	13	7	11	10	8
Do not know	1	†	3	1	5
Total	100	100	100	100	100

Note: Components may not sum to 100 because of rounding.

¹ Weighted sample size is less than 50.

† Less than 0.5.

Source: Thomson Reuters/University of Michigan Surveys of Consumers.

obtaining information on credit terms somewhat difficult, only a relatively small share of cardholders overall found it very difficult.

Bankcard holders’ responses to a question asking whether credit cards make managing finances less difficult or more difficult provide evidence of cardholders’ post-purchase evaluations of credit cards. Bankcard holders did generally believe that credit cards made managing their finances less difficult, and this belief was more widely held in 2012 than earlier (see table 4). Eighty-two percent of bankcard holders in 2012 said that bankcards made managing finances less difficult, compared with 72 percent in the 2001 survey. Only small percentages of respondents to both the 2012 and 2001 surveys believed that credit cards made managing their finances more difficult (8 percent and 10 percent, respectively).⁴⁵ A belief that cards make managing one’s finances less difficult would seem inconsistent with the view that cards induce consumers to overestimate their ability to repay.

Hardly ever paying balances in full, and sometimes or hardly ever making more than minimum payments, is behavior that might occur if cardholders overestimate their ability to repay credit card debt. If so, and if paying high finance charges over long periods of time burdens them, then these cardholders might be expected to believe that credit cards make managing their finances more difficult. Responses to the 2012 survey do not provide much support for this hypothesis, however (table 11). Eighty-seven percent of cardholders who only sometimes paid in full and 85 percent of cardholders who hardly ever paid in full said that credit cards made managing their finances less difficult (compared with 80 percent of those who almost always paid in full). Among the cardholders who sometimes or hardly ever paid more than the minimum, 90 percent believed that credit cards made managing their finances less difficult. The percentage of cardholders who said they believed that credit cards made managing their finances more difficult increases as cardholders’ tendency to pay in full becomes less frequent, but even among cardholders who hardly ever paid in full, only a relatively small share (14 percent) believed that credit cards made managing their finances more difficult.

Cardholders reported a high degree of satisfaction with their bankcards. Satisfaction was greatest for cardholders who almost always paid in full; among these respondents,

Table 11. Effect of credit cards on managing finances, by payment behavior, 2012

Percent

Cards’ effect on managing finances	Usual payment behavior			Payments more than minimum	
	Almost always pays in full	Sometimes pays in full	Hardly ever pays in full	Almost always pays more than minimum	Sometimes or hardly ever pays more than minimum ¹
Less difficult	80	87	85	85	90
No different	13	†	†	†	†
More difficult	5	11	14	13	10
Do not know	2	2	1	2	†
Total	100	100	100	100	100

Note: Components may not sum to 100 because of rounding.
¹ Weighted sample size is less than 50.
 † Less than 0.5.
 Source: Thomson Reuters/University of Michigan Surveys of Consumers.

⁴⁵ The ability to manage credit card accounts using the Internet may be one factor contributing to the rise in the percentage of bankcard holders who believed that bankcards made managing their finances easier. In 2012, 48 percent of bankcard holders reported having made a credit card payment using the Internet. Financial services have become more widely available on the Internet since 2000.

58 percent were very satisfied and 92 percent were at least somewhat satisfied (table 12). Satisfaction was lowest for cardholders who hardly ever paid in full or made minimum payments. Even so, many more than half (68 percent) of these cardholders were at least somewhat satisfied, and only a small share were very dissatisfied. Considering that by far the majority of cardholders said that cards made managing their finances easier, these high levels of satisfaction are not surprising. That the satisfaction levels of more constrained cardholders—that is, cardholders who hardly ever paid in full or made minimum payments—were somewhat lower than those of other cardholders may reflect that some of these constrained cardholders may have experienced difficulty in servicing their debts, relatively high interest costs, and adverse actions taken by credit card companies.⁴⁶

New Accounts

Cardholders may have used bankcards for many years, and their behavior may have become habitual, especially if they use bankcards as a convenient means of payment rather than as a source of credit. Examining behavior on recently opened accounts may provide insights on behavior before usage patterns have become established and possibly habitual.

Sixteen percent of cardholders responding to the 2012 survey had opened a new bankcard account in the previous 12 months. Reasons for opening a new account differed significantly by cardholders' payment behavior. Reasons related to availability and rates were reported most frequently by bankcard holders who only sometimes or hardly ever paid in full. Twenty-six percent of cardholders opening a new account who sometimes or hardly ever paid in full reported opening the account to rebuild or increase their available credit, and 19 percent opened the account to obtain a lower or zero interest rate (table 13). These responses are consistent with their payment behavior. The desire to receive rewards was mentioned most frequently by cardholders who almost always paid in full. Beyond the convenience in making payments, transactions users might reasonably be expected to seek cards with more generous rewards. Cardholders who almost always paid in full did not mention opening new accounts to rebuild or increase credit availability. Only 11 percent of

Table 12. Satisfaction with credit cards, by payment behavior, 2012

Percent

Degree of satisfaction	Usual payment behavior			Payments more than minimum	
	Almost always pays in full	Sometimes pays in full	Hardly ever pays in full	Almost always pays more than minimum	Sometimes or hardly ever pays more than minimum ¹
Very satisfied	58	38	27	36	19
Somewhat satisfied	34	44	41	40	49
Neither satisfied nor dissatisfied	4	8	15	11	16
Somewhat dissatisfied	4	11	13	12	12
Very dissatisfied	1	†	4	1	5
Total	100	100	100	100	100

Note: Components may not sum to 100 because of rounding.

¹ Weighted sample size is less than 50.

† Less than 0.5.

Source: Thomson Reuters/University of Michigan Surveys of Consumers.

⁴⁶ Cardholders who hardly ever paid in full were 2.5 times more likely to have paid a late fee and 2.4 times more likely to have experienced an adverse event in the past 12 months than cardholders who almost always paid in full (data not shown in tables). Cardholders who sometimes paid in full were 1.6 times more likely to have paid a late fee and 1.4 times more likely to have experienced an adverse event than cardholders who almost always paid in full. Adverse events include credit limit reductions, account closures, interest rate increases, and denials of limit increase requests or new account applications.

Table 13. Reason for opening a new account in the previous 12 months, by payment behavior, 2012

Percent

Reason	Distribution
Cardholders who sometimes or hardly ever pay in full¹	
Make a specific purchase	35
Rebuild or increase available credit	26
Obtain a lower/zero interest rate	19
Receive rewards	8
Receive purchase discount	6
Other	6
Total	100
Cardholders who almost always pay in full	
Receive rewards	33
Make specific purchase	14
Receive purchase discount	13
Obtain lower/zero interest rate	11
Bank offered account	10
Life-cycle consideration (for example, college, marriage, retirement)	7
Other	11
Total	100

Note: Components may not sum to 100 because of rounding.
¹ Weighted sample size is less than 50.
 Source: Thomson Reuters/University of Michigan Surveys of Consumers.

these cardholders opened an account to obtain a lower or zero interest rate, which transactions users might rationally do on occasion.

Both groups reported opening new accounts for specific purchases, and making a specific purchase was the reason most frequently reported by bankcard holders who sometimes or hardly ever paid in full (35 percent). Bankcard holders who almost always paid in full mentioned opening a new account to make a specific purchase far less frequently (14 percent). The relatively heavy reliance on new accounts by cardholders who sometimes or hardly ever paid in full further suggests the importance of credit availability for this group.

The reason for opening a new account most frequently mentioned by bankcard holders who almost always paid in full was to receive rewards (33 percent). Cardholders who sometimes or hardly ever paid in full also opened new accounts to receive rewards, but much less frequently (8 percent). Thirteen percent of cardholders who almost always paid in full and 6 percent of cardholders who sometimes or hardly ever paid in full opened new accounts to receive purchase discounts.

For both cardholders who almost always paid in full and cardholders who sometimes or hardly ever paid in full, the source of initial information about the new account was most frequently a salesperson in a store—28 percent and 36 percent, respectively (table 14). This result reflects the prevalence of accounts opened to make specific purchases or obtain purchase discounts or also, for the latter group, to receive low or zero interest rates. Mail solicitations were important sources of information for cardholders who sometimes or hardly ever paid in full; 33 percent of these respondents initially learned about an account from a mail solicitation. This percentage is three times greater than the share of cardholders who almost always paid in full who received initial information from mail solicitations. That those who revolve balances are more likely than transactions users to respond to mail solicitations is consistent with the observation that respondents to mail solicitations are riskier than nonrespondents, which supports the hypothesis of adverse selection in the

Table 14. Source of initial information about new account, by payment behavior, 2012

Percent

Source	Almost always pays in full	Sometimes or hardly ever pays in full
Mail solicitation	11	33
Internet	22	13
Salesman in store	28	36
Telephone solicitation	9	5
Bank employee	23	14
Other	7	†
Total	100	100

Note: Weighted sample size is less than 50. Components may not sum to 100 because of rounding.

† Less than 0.5.

Source: Thomson Reuters/University of Michigan Surveys of Consumers.

credit card market.⁴⁷ Cardholders who almost always paid in full were more likely to obtain initial information from a bank employee or the Internet.

Cardholders who had opened a new account were asked a series of questions about the information they received when they opened the account. The first question asked how carefully they read the information. A little more than two-thirds of those who almost always paid in full and nearly three-fourths of those who sometimes or hardly ever paid in full read the account disclosure information at least somewhat carefully (table 15).⁴⁸ Regardless of payment behavior, by far the majority of new cardholders filed the information away for possible future use, including some cardholders who did not read the infor-

Table 15. Use of information received at account opening, by payment behavior, 2012

Percent

Item	Almost always pays in full	Sometimes or hardly ever pays in full
How carefully account information was read		
Very carefully	24	28
Somewhat carefully	44	46
Not very carefully	18	13
Not carefully at all	15	14
Total	100	100
Filed information in case needed later	79	81
Usefulness of information		
Very useful	18	33
Somewhat useful	16	52
Not very useful	48	15
Not at all useful	17	†
Total	100	100

Note: Weighted sample size is less than 50. Components may not sum to 100 because of rounding.

† Less than 0.5.

Source: Thomson Reuters/University of Michigan Surveys of Consumers.

⁴⁷ See Lawrence Ausubel (1999), "Adverse Selection in the Credit Card Market," working paper (College Park: University of Maryland, June), www.ausubel.com/creditcard-papers.htm.

⁴⁸ The somewhat lower levels of satisfaction of cardholders who sometimes or hardly ever paid in full, discussed in the previous subsection, may have contributed to the higher percentage of these cardholders who carefully read account disclosure information. As mentioned, research on consumer behavior indicates that dissatisfaction tends to lead to more-extended decision processes.

mation very carefully. A larger share of cardholders who sometimes or hardly ever paid in full than of cardholders who almost always paid in full found the information at least somewhat useful (85 percent versus 34 percent).

It is not surprising that cardholders who use the credit feature of credit cards are more likely than others to find account disclosure information useful, because much of this information involves credit costs and terms and is mandated by TILA. Cardholders who always pay in full have little need for information on credit costs and terms. Responses to a follow-up question asking what makes the information useful or not useful support this view. About one-fourth of cardholders who sometimes or hardly ever paid in full found the information about interest rates useful, and one-third reported that the information helped them understand the account or was useful as a reference (data not shown in tables). These responses were far less frequent for cardholders who almost always paid in full. About one-fourth of cardholders who almost always paid in full said that the information was irrelevant precisely because they paid in full. Also, cardholders who almost always paid in full frequently said that they already knew the information or that they never needed to use the information. Even though these consumers reported that they did not find the account opening information useful, many read the information at least somewhat carefully, and most kept the information for later use.

Adverse Experiences with Credit Card Companies

The February 2012 Survey of Consumers questioned bankcard holders about adverse experiences involving their credit cards during the 12-month period prior to the interview. Adverse experiences were defined to include actions such as denials or limitations of credit and increases in interest rates or fees. Some of these events may have been prompted by the high delinquency rates and credit losses experienced by card issuers during the recession or by regulatory changes, including those related to allowable risk-management practices and various forms of consumer protection. This section investigates the prevalence of adverse actions and examines how they may have affected consumer attitudes toward credit.

Overall, 26 percent of cardholders reported having an adverse experience in the past year (data not shown in tables). Previous Surveys of Consumers did not ask about adverse experiences, so a benchmark is not readily available. The credit record data described earlier confirm that a large share of cardholders experienced an adverse event over the past several years. Many of the limitations of credit imposed by card issuers were in response to consumer-initiated requests. For example, 17 percent of cardholders applied for a new bankcard in the past year (table 16). Of those applying, 9 percent were turned down. Six percent of cardholders requested an increase in a credit line; of those, 36 percent received less than the amount requested. However, by far the majority of the cardholders who received less credit than requested also reported that they had made a late payment on the account in the previous 12 months.

Some limitations were initiated by the credit card companies in conjunction with managing their existing account relationships. Five percent of cardholders reported that a credit card company had reduced the credit limit on an existing account in the past 12 months. In part, credit limit reductions were prompted by account inactivity (accounting for 23 percent of the line reductions reported) or late payments (21 percent).⁴⁹ In addition, 5 percent of cardholders reported that a credit card company had closed one of their accounts in the past year.

⁴⁹ Analysis of credit record data indicates that of the bankcard holders who fell behind on their payments by 30 days or more at least once from the end of 2007 to the end of 2010, over two-thirds subsequently experienced a reduction in their aggregate credit limit across all of their cards.

Table 16. Adverse experiences with credit card companies in past 12 months, 2012

Percent of bankcard holders unless otherwise noted

Experience	Percent
Applied for new bankcard	17
<i>Of those applying for a new card</i>	
Cardholders who were denied	9
Requested an increase in credit limit	6
<i>Of those who requested an increase</i>	
Cardholders who received less than requested ¹	36
<i>Of those receiving less than requested</i>	
Cardholders who had a late payment on the account in the past 12 months ¹	80
Credit card company reduced credit limit	5
<i>Of those having credit limit reduction</i>	
Cardholders who did not use the account in the past 12 months	23
Cardholders who had a late payment on the account in the past 12 months	21
Had account that was closed by the credit card company	5
<i>Of those having accounts closed</i>	
Cardholders who did not use closed account in the past 12 months ¹	51
Cardholders who had a late payment on the closed account in the past 12 months ¹	38
Credit card company increased interest rate/margin	14
<i>Of those having a rate/margin increase</i>	
Cardholders who did not use account in the past 12 months	21
Cardholders who had a late payment on the account in the past 12 months	34
Credit card company increased or added annual fee for account	7

¹ Weighted sample size is less than 50.

Source: Thomson Reuters/University of Michigan Surveys of Consumers.

Just over half of these cardholders said that the closed account was inactive during that period, and 38 percent said that they had made late payments on the closed account.

Such turndowns and limitations do not necessarily impose a binding constraint on the consumer. For example, a cardholder who has been turned down can apply for a different credit card and perhaps receive approval (although the terms may be less favorable than those for the denied account), or a cardholder may choose to borrow a greater proportion of his or her available credit line. Closures and reductions in credit limits affecting inactive accounts in particular would seem not to be binding.

Some cardholders had experienced increases in interest rates or annual fees in the previous 12 months. Increases in interest rates (or margins, for variable-rate accounts) were reported by 14 percent of cardholders. A considerable share of the rate increases may be attributed to the credit card companies' reassessment of the customers' risk: Just over one-third of cardholders said that they had made late payments in the past year on the accounts that received interest rate increases. Changes in annual fees were less frequent than interest rate increases; 7 percent of cardholders reported an increased or additional annual fee for a bankcard account.

Not surprisingly, adverse experiences significantly influenced cardholders' opinions. Cardholders who had adverse experiences were more likely to have a negative opinion of credit cards than cardholders who did not have adverse experiences: 57 percent of the former and 49 percent of the latter said that credit cards were "bad" or "bad with qualifications" (table 17). Cardholders who had adverse experiences were over three and a half times more

Table 17. Opinions about credit cards and credit card companies, by adverse experiences in the past 12 months, 2012

Percent		
Opinion	Had any adverse experience	Did not have an adverse experience
Opinion about credit cards		
Good or good with qualifications	40	50
Both good and bad	2	2
Bad with qualifications or bad	57	49
Total	100	100
Cardholders' satisfaction with own accounts		
Very satisfied	35	52
Somewhat satisfied	41	36
Not particularly satisfied or dissatisfied	8	7
Somewhat dissatisfied	15	4
Very dissatisfied	3	1
Total	100	100
Cardholders' agreement that their own credit card companies treat them fairly		
Strongly agree	32	51
Agree somewhat	57	43
Disagree somewhat	5	5
Strongly disagree	5	2
Total	100	100
Cardholders' agreement that they can easily get a card from another company if they are not treated well		
Strongly agree	54	57
Agree somewhat	33	35
Disagree somewhat	5	6
Strongly disagree	9	2
Total	100	100

Note: Components may not sum to 100 because of rounding.
Source: Thomson Reuters/University of Michigan Surveys of Consumers.

likely to be somewhat or very dissatisfied with their own accounts than cardholders who did not have adverse experiences (18 percent and 5 percent, respectively). However, it is notable that by far the majority of cardholders who had adverse experiences were satisfied with their own accounts and believed that their credit card companies treated them fairly (although they held these opinions less strongly than cardholders who did not have adverse experiences). Also notable is that cardholders who had adverse experiences believed that they had options available to them: Eighty-seven percent of cardholders who had adverse experiences believed that they could easily get a bankcard from another company if they were not treated well. This share is only slightly smaller than the 92 percent of cardholders who did not have adverse experiences who believed that they could easily get a card from another company.

In sum, the survey responses pick up the incidence of credit limitations and interest rate increases that credit card companies implemented in response to changes in macro-economic conditions, cardholder behavior, and regulatory initiatives. Overall, one-fourth of cardholders had experienced adverse events over the previous year. The lack of a benchmark precludes us from saying whether this incidence of adverse events differs from the rate that obtained before the Great Recession and the implementation of the Credit Card Act. And it is not necessarily the case that every cardholder who had an adverse experience

was forced to use less credit or paid higher interest or fees, although some clearly did. While having adverse experiences was associated with cardholders' feeling less satisfaction with their own accounts and having less positive opinions of credit cards in general, most cardholders who had adverse experiences were satisfied with their own accounts. And by far the majority of cardholders with adverse experiences, like other cardholders, believed that their credit card companies treated them fairly and that they could easily get a card from another company if they were not treated well.

Changes in Attitudes in the Aftermath of the Recession and the Credit Card Act

As mentioned, individuals' attitudes reflect their orientations toward or against alternatives for purchase and consumption, which may affect their behavior. Changes in attitudes may thus change behavior. The question on the Surveys of Consumers asking respondents whether using credit cards is a good or a bad thing has been asked several times over the years, beginning with the 1970 survey. As consumers have gained experience with credit cards, their opinions about credit card use have polarized. In 1970 about 65 percent of cardholders and 71 percent of consumers overall expressed an unqualified view that card use was either a "good thing" or a "bad thing" (table 18). In 2012 more than 95 percent of both cardholders and consumers overall expressed unqualified views about credit cards. Notably, the share of cardholders who viewed card use as a bad thing rose substantially between 2000 and 2012, while the share of cardholders viewing card use as a good thing was little changed.

Also notable is that the percentage of bankcard holders who said that credit card use was bad increased among those who hardly ever paid in full and those who hardly ever paid more than the minimum monthly payment. These behaviors can be relatively risky, making these consumers vulnerable to financial difficulties. Between 2000 and 2012, the percentage of cardholders who hardly ever paid balances in full and said that credit card use is bad increased 12 percentage points, from 59 percent to 71 percent, and the share of cardholders who hardly ever paid more than the minimum payment due rose 10 percentage points, from 63 percent to 73 percent (data not shown in tables). In contrast, among cardholders who almost always paid in full, the percentage viewing credit card use as bad did not change materially between 2000 and 2012. The change in attitudes of the former groups may reflect their experiences with delinquencies, which rose dramatically in the recent recession, and may have inhibited subsequent growth in revolving debt.

Table 18. Opinions about the use of credit cards, 1970, 1977, 2000, and 2012

Percent

Opinion	1970		1977		2000		2012	
	All families	Have bank-type cards	All families	Have bank-type cards	All families	Have bank-type cards	All families	Have bank-type cards
Good	28	45	39	54	33	42	40	46
Good, with qualifications	13	17	19	20	10	9	2	2
Both good and bad	12	14	11	8	6	5	2	2
Bad, with qualifications	4	4	4	3	1	1	†	†
Bad	43	20	27	14	51	42	56	51
Total	100	100	100	100	100	100	100	100

Note: Components may not sum to 100 because of rounding.

† Less than 0.5.

Source: For 1970 and 1977, Federal Reserve Board, Survey of Consumer Finances; for 2000 and 2012, Thomson Reuters/University of Michigan Surveys of Consumers.

Survey responses can reflect not only an individual's own experiences but also his or her perceptions of the experiences of other individuals. Cardholders' views about the ability of other consumers to manage credit cards wisely may account for some of the negative opinions of credit card use. These views are informed, at least in part, by media coverage of consumer credit, which tends to be stimulated by recessions and is largely negative.⁵⁰

Over 60 percent of cardholders believed strongly that credit card companies made too much credit available to most people, and 75 percent believed strongly that solicitations offering low rates for a short time confuse many people (table 19). These beliefs were held a little less strongly in 2012 than they were in 2000: The percentages of cardholders agreeing

Table 19. Attitudes of holders of bank-type credit cards toward credit cards and card issuers, 2012

Percent

Attitude	Agree strongly	Agree somewhat	Disagree somewhat	Disagree strongly	Total
Specific practices of card issuers					
The interest rates charged on credit cards are reasonable.	6	13	25	55	100
Credit card billing statements are accurate.	58	34	6	2	100
Card issuers and consumers in general					
Credit card companies make too much credit available to most people.	61	28	7	3	100
Sending solicitations that offer low rates but for only a short time probably misleads a lot of people.	75	20	4	2	100
Credit card companies make it hard for people to get out of debt.	61	27	7	5	100
Credit card companies should not be allowed to issue credit cards to college students.	33	21	31	16	100
Overspending is the fault of consumers, not the credit card companies.	57	30	9	4	100
Card issuers and me					
I am generally satisfied in my dealings with my credit card companies.	51	44	4	1	100
My credit card companies treat me fairly.	46	47	5	3	100
It is easy to get a credit card from another company if I am not treated well.	56	34	6	4	100
General satisfaction or dissatisfaction					
Credit card companies provide a useful service to consumers.	47	46	5	2	100
Most people are satisfied in their dealings with credit card companies.	9	41	28	21	100
Consumers would be better off if there were no credit cards.	14	25	35	26	100
Information availability					
Information on the statement on how long it would take to pay off the balance if I make only the minimum payment [would be/is] useful to me. ¹	51	27	10	12	100
Mailings and other ads that offer a low rate at first followed by a higher rate are confusing to me.	35	19	17	29	100

Note: Components may not sum to 100 because of rounding.

¹ The question read "would be" in 2000 and "is" in 2012. This change reflects a revision to Truth in Lending that requires disclosure of months to repay if only the minimum payment is made.

Source: Thomson Reuters/University of Michigan Surveys of Consumers.

⁵⁰ Thomas A. Durkin and Zachariah Jonasson (2002), "An Empirical Evaluation of the Content and Cycle of Financial Reporting: The Case of Consumer Credit," Working Paper 64 (Washington: Credit Research Center, Georgetown University, April).

somewhat with these statements increased 8 percentage points and 6 percentage points, respectively, between 2000 and 2012 (table 20). However, the percentage of cardholders strongly believing that credit card companies made getting out of debt difficult increased about 6 percentage points, to 61 percent, over this time period.

Despite their pessimistic views about other consumers, cardholders were fairly confident in their own dealings with credit card companies. Almost all cardholders believed that their credit card companies treated them fairly and were satisfied in their dealings with credit card companies, although only about half of the respondents held these beliefs strongly. The vast majority of all cardholders also felt confident that they could obtain credit from another credit card company if they became dissatisfied with any of their present card providers. The survey responses suggest that in 2012 many cardholders were a little less positive in their attitudes toward credit card companies and less confident of the ease of obtaining a credit card from another company than they had been in 2000. These opinions

Table 20. Changes in attitudes of holders of bank-type credit cards toward credit cards and card issuers, 2000–12

Percentage points

Attitude	Agree strongly	Agree somewhat	Disagree somewhat	Disagree strongly	Overall
Specific practices of card issuers					
The interest rates charged on credit cards are reasonable.	3	-3	-1	0	-1
Credit card billing statements are accurate.	4	-5	1	0	0
Card issuers and consumers in general					
Credit card companies make too much credit available to most people.	-6	8	-2	-1	-1
Sending solicitations that offer low rates but only for a short time probably misleads a lot of people.	-4	6	0	-1	1
Credit card companies make it hard for people to get out of debt.	6	0	-3	-4	-1
Credit card companies should not be allowed to issue credit cards to college students.	3	-4	8	-6	1
Overspending is the fault of consumers, not the credit card companies.	-6	2	3	0	-1
Card issuers and me					
I am generally satisfied in my dealings with my credit card companies.	0	4	-2	-3	-1
My credit card companies treat me fairly.	-8	11	-1	-1	1
It is easy to get a credit card from another company if I am not treated well.	-7	11	-4	0	0
General satisfaction or dissatisfaction					
Credit card companies provide a useful service to consumers.	3	-2	-1	0	0
Most people are satisfied in their dealings with credit card companies.	-6	-13	8	10	-1
Consumers would be better off if there were no credit cards.	-1	-1	5	-3	0
Information availability					
Information on the statement on how long it would take to pay off the balance if I make only the minimum payment [would be/is] useful to me. ¹	-14	3	3	8	0
Mailings and other ads that offer a low rate at first followed by a higher rate are confusing to me.	-1	-6	2	5	0

¹ The question read "would be" in 2000 and "is" in 2012. This change reflects a revision to Truth in Lending that requires disclosure of months to repay if only the minimum payment is made.

Source: Thomson Reuters/University of Michigan Surveys of Consumers.

seem consistent with the tightening of credit standards associated with the recession and the Credit Card Act.

Cardholders believe that credit cards are useful to consumers generally. In 2012, nearly all cardholders believed that credit card companies provide a useful service to consumers. More than 60 percent of cardholders disagreed with the statement that consumers would be better off if there were no credit cards, and most of the rest did not feel strongly that this statement was true. These beliefs were little changed from 2000.

Cardholders were decidedly more negative in their assessments of other consumers' satisfaction than of their own satisfaction with their credit card companies: Twenty-eight percent of cardholders disagreed somewhat and 21 percent disagreed strongly with the statement that most consumers were satisfied in their dealings with credit card companies. These assessments stand in stark contrast to their assessments of their own satisfaction with their own credit card issuers (only 4 percent disagreed somewhat and 1 percent disagreed strongly with the statement that they were satisfied in their dealings with their credit card companies; table 19) and are significantly more negative than those reported in 2000 (increases of 8 percentage points for cardholders who disagreed somewhat and 10 percentage points for cardholders who disagreed strongly that most consumers are satisfied in their dealings with credit card companies; table 20).

Information and Truth in Lending

On several occasions since 1977, Federal Reserve–sponsored Surveys of Consumers have asked consumers about their views regarding disclosures required by TILA. One series of questions asked consumers about the extent to which they agreed or disagreed with several statements about these disclosures. First, cardholders were asked whether they agreed or disagreed with the statement, “Truth in Lending statements are complicated.” Agreement with this statement has trended upward over the years. In 1977, 38 percent of cardholders agreed strongly with this statement, and 73 percent agreed strongly or somewhat (table 21). In 2012, the percentage of consumers agreeing strongly with the statement increased to 52 percent, and the percentage agreeing strongly or somewhat increased to 86 percent.

The second statement on which respondents gave their opinion was, “Some information in Truth in Lending statements is not very helpful.” Responses were similar to those for the first statement. The percentage of cardholders who agreed at least somewhat with this statement has also trended upward, from 59 percent in 1977 to 66 percent in 2001 and, most recently, 75 percent in 2012. These perceptions seem consistent with developments in the card market. Credit card regulation has tended to require disclosure of more information as new credit card products have been developed and features have been added to existing products. Also, some required disclosures may confuse consumers because the disclosures rely on unstated assumptions about consumers' future behavior.⁵¹

A third question asked whether cardholders agreed or disagreed with the statement, “Truth in Lending makes people more confident when dealing with creditors.” Seventy-three percent of cardholders agreed somewhat or strongly with this statement in 1977. The percentage agreeing somewhat or strongly fell gradually over the next 24 years to 67 percent in 2001. The percentage agreeing somewhat or strongly fell 10 percentage points further in the 2000s to 57 percent in 2012.

⁵¹ Some of the issues are whether a feature is a characteristic of credit or an ancillary product, how to disclose items that depend on unknown future events, and how to disclose the price of credit when credit is obtained jointly with the product. For discussion, see Durkin and Elliehausen, *Truth in Lending*, in note 6.

Table 21. Consumers' agreement with observations about Truth in Lending statements, selected years, 1977–2012

Percent						
Statement and opinion	1977	1981	1994	1997	2001	2012
Truth in Lending statements are complicated.						
Agree strongly	38	31	41	49	45	52
Agree somewhat	35	37	36	32	30	34
Disagree somewhat	11	18	13	11	9	10
Disagree strongly	5	8	5	5	8	3
Do not know	12	6	5	2	8	1
Total	100	100	100	100	100	100
Some information on Truth in Lending statements is not very helpful.						
Agree strongly	20	16	21	23	28	33
Agree somewhat	39	41	43	42	38	42
Disagree somewhat	16	23	19	21	18	17
Disagree strongly	5	6	9	10	7	7
Do not know	20	14	8	3	9	2
Total	100	100	100	100	100	100
Truth in Lending makes people more confident when dealing with creditors.						
Agree strongly	31	28	24	26	26	15
Agree somewhat	42	44	46	43	41	42
Disagree somewhat	12	14	17	19	15	24
Disagree strongly	5	6	8	10	11	17
Do not know	11	8	5	2	7	1
Total	100	100	100	100	100	100
Most people read their Truth in Lending statements carefully.						
Agree strongly	8	7	9	7	19	6
Agree somewhat	19	24	26	22	30	14
Disagree somewhat	33	38	34	35	22	26
Disagree strongly	31	26	27	34	24	53
Do not know	9	5	4	1	5	†
Total	100	100	100	100	100	100

Note: Components may not sum to 100 because of rounding.

† Less than 0.5.

Source: Thomson Reuters/University of Michigan Surveys of Consumers.

Finally, cardholders were asked for their opinion on the statement, “Most people read their Truth in Lending statements carefully.” Agreement with this statement trended upward from 1977 to 2001 but fell dramatically from 49 percent in 2001 to 20 percent in 2012. The change in the percentage of cardholders who disagreed strongly with the statement was equally dramatic: It increased from 24 percent in 2001 to 53 percent in 2012. The disclosure law’s requirements have been accretive since its inception. It appears that as perceptions of TILA’s complexity and doubts about the usefulness of some of the disclosures it requires have increased, cardholders’ attitudes toward the law have become less positive over the years.⁵²

⁵² See Durkin and Elliehausen, *Truth in Lending*, in note 6.

Legal Developments: Fourth Quarter, 2012

Orders Issued Under Bank Holding Company Act

Orders Issued Under Section 3 of the Bank Holding Company Act

Mitsubishi UFJ Financial Group, Inc.
 Tokyo, Japan

The Bank of Tokyo-Mitsubishi UFJ, Ltd.
 Tokyo, Japan

UnionBanCal Corporation
 San Francisco, California

Order Approving the Acquisition of a Bank Holding Company and the Merger of Bank Holding Companies
FRB Order No. 2012-12 (November 14, 2012)

Mitsubishi UFJ Financial Group, Inc. (“MUFG”) and its wholly owned subsidiaries, The Bank of Tokyo-Mitsubishi UFJ, Ltd. (“BTMU”) and UnionBanCal Corporation (“UnionBanCal”) and, collectively with MUFG and BTMU, “Applicants”), have requested the Board’s approval under section 3 of the Bank Holding Company Act (“BHC Act”)¹ to acquire Pacific Capital Bancorp (“Pacific Capital”) and thereby indirectly acquire its subsidiary bank, Santa Barbara Bank & Trust, N.A. (“SBBT”), both of Santa Barbara, California. In addition, UnionBanCal has requested the Board’s approval under section 3 of the BHC Act to merge with Pacific Capital.²

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (77 *Federal Register* 23249 (April 18, 2012)). 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 \$2.8 trillion, is the largest banking organization in Japan.³ MUFG engages in banking activities in the United States through BTMU and Mitsubishi UFJ Trust and Banking Corporation (“MUTB”), also of Tokyo.⁴ BTMU controls UnionBanCal and operates branches, an agency, and representative offices

¹ 12 U.S.C. § 1842.

² After the transaction, Applicants plan to merge SBBT with and into UnionBanCal’s only subsidiary depository institution, Union Bank N.A. (“Union Bank”), San Francisco. The Office of the Comptroller of the Currency (“OCC”) has approved the proposed merger of SBBT with and into Union Bank, pursuant to the Bank Merger Act and the National Bank Act. 12 U.S.C. § 1828(c) and 12 U.S.C. § 215a.

³ National deposit, asset, and ranking data are as of June 30, 2012.

⁴ MUFG also owns a noncontrolling interest in Morgan Stanley, New York, New York.

in several states.⁵ 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 \$63.7 billion in the United States,⁶ which represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States.⁷ MUFG and BTMU are qualifying foreign banking organizations and on consummation of the proposal would continue to meet the requirements for a qualifying foreign banking organization under Regulation K.⁸

UnionBanCal, with total consolidated assets of approximately \$87.9 billion, is the 20th largest depository organization in the United States, controlling deposits of approximately \$63.7 billion, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States. Union Bank operates branches in California, Oregon, Texas, and Washington, and one branch in Illinois and in New York. Union Bank is the fourth largest insured depository organization in California, controlling deposits of approximately \$53.4 billion, which represent 6.0 percent of the total amount of deposits of insured depository institutions in the state.⁹

Pacific Capital, with total consolidated assets of approximately \$5.9 billion, controls SBBT, which operates only in California. SBBT is the 19th largest insured depository institution in California, controlling deposits of \$4.7 billion, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the state.

On consummation of the proposal, MUFG would control deposits of approximately \$68.6 billion, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States. Union Bank would become the 17th largest depository organization in the United States, with consolidated deposits of approximately \$68.6 billion. In California, Union Bank would remain the fourth largest depository organization, controlling deposits of approximately \$58.1 billion, representing approximately 6.6 percent of deposits of insured depository institutions in the state.

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 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.¹⁰ The Board has considered the competitive effects of the proposal in light of all the facts of record. UnionBanCal and Pacific Capital compete directly in 10 banking markets in California.

⁵ BTMU operates branches in California, Illinois, and New York; an agency in Texas; and representative offices in California, the District of Columbia, Georgia, Kentucky, Minnesota, New Jersey, Texas, and Washington. In California, BTMU has a branch in Los Angeles and a representative office in San Francisco.

⁶ National deposit data include deposits controlled by MUFG’s depository institution subsidiaries that are insured by the Federal Deposit Insurance Corporation (“FDIC”). If deposits held in branches that are not insured by the FDIC are included, MUFG controls deposits of approximately \$132 billion in the United States.

⁷ MUFG also engages in nonbanking activities, including securities underwriting and dealing, in the United States through various subsidiaries.

⁸ 12 CFR 211.23(a).

⁹ State deposit, asset, and ranking data are as of June 30, 2011.

¹⁰ 12 U.S.C. § 1842(c)(1).

A. Competitive Effects in Banking Markets

The Board has reviewed the competitive effects of the proposal in those banking markets. In particular, the Board has considered the number of competitors that would remain in the banking markets, the relative shares of total deposits in the depository institutions in the markets (“market deposits”) controlled by UnionBanCal and Pacific Capital,¹¹ the concentration level of market deposits and the increase in that level as measured by the Herfindahl-Hirschman Index (“HHI”) under the Department of Justice Merger Competitive Review Guidelines (“DOJ Bank Merger Guidelines”),¹² and other characteristics of the markets.

Banking Markets within Established Guidelines. Consummation of the proposal would be consistent with Board precedent and within the DOJ Bank Merger Guidelines in nine of the ten banking markets in which UnionBanCal and Pacific Capital’s subsidiary banks compete directly.¹³ On consummation of the proposal, two markets would remain highly concentrated and seven markets would remain moderately concentrated, as measured by the HHI. The change in HHI in the two highly concentrated markets would be small and consistent with Board precedent and the thresholds in the DOJ Bank Merger Guidelines. In the seven moderately concentrated markets, the change in HHI also would be consistent with Board precedent and the thresholds in the DOJ Bank Merger Guidelines. In each of these banking markets, numerous competitors would remain.

Banking Market Warranting Special Scrutiny. The structural effects of the proposal in the Lompoc, California banking market warrant a detailed review because the concentration level on consummation would exceed the threshold levels in the DOJ Bank Merger Guidelines.¹⁴ Union Bank is the fifth largest of eight depository institutions in the market and controls deposits of \$45.4 million, representing 11.7 percent of market deposits. SBBT is the largest depository institution in the market and controls deposits of \$111.9 million, representing 28.9 percent of market deposits. On consummation of the proposal, Union Bank would become the largest depository institution in the market, with deposits of \$157.3 million, representing 40.6 percent of market deposits. The HHI for the market would increase 676 points to 2429.

In evaluating the competitive effects of this proposal in the Lompoc banking market, the Board has considered the presence of a large and active credit union operating in the market. CoastHills Federal Credit Union (“CoastHills”), with more than \$540 million in total

¹¹ Deposit and market share data are as of June 30, 2011, adjusted to reflect mergers and acquisitions through April 16, 2012, 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 deposits in the market share calculation on a 50 percent weighted basis. See, e.g., *First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991).

¹² 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 DOJ and the Federal Trade Commission recently issued revised Horizontal Merger Guidelines, 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.

¹³ These banking markets and the effects of the proposal on the concentration of banking resources in them are described in the appendix.

¹⁴ The Lompoc banking market is defined as the City of Lompoc, Mission Hills, Vandenberg Air Force Base, and Vandenberg Village.

deposits, offers open membership to all the residents in the market.¹⁵ It operates three street-level branches in the market, two of which are easily accessible to the general population.¹⁶ CoastHills offers a full range of retail banking products and offers a wide range of business loan products and other banking services. Accordingly, the Board has concluded that deposits controlled by the credit union should be included in market share calculations with a 50 percent weight. Accounting for these weighted deposits, UnionBanCal would control 30.95 percent of market deposits, and the HHI would increase 393 points to 1977 on consummation of the proposal.

A number of circumstances mitigate the potential anticompetitive effects of the transaction. The market would remain balanced and competitive, as evidenced by the number of competitors, the type of competitors, and the market structure.¹⁷ After consummation of the proposal, seven competitors, including CoastHills, would remain in the market. In addition to UnionBanCal, three competitors would each control more than 10 percent of market deposits. CoastHills would control 23.8 percent of market deposits, and two other competitors would control 13.1 percent and 11.7 percent of the market's deposits, respectively. Three other competitors would control between 5 percent and 10 percent of market deposits. In addition, the Lompoc banking market is relatively attractive for entry, as evidenced by recent bank entry and economic characteristics of the market. In 2005, a community bank entered Lompoc from a neighboring market. Since its entry into the Lompoc banking market, the community bank's deposits in the market have increased from \$1 million to \$29 million.

Economic characteristics of the Lompoc banking market also suggest that the market is reasonably attractive for entry. Several local economic development initiatives have recently been completed, are underway, or are proposed. For instance, the Lompoc Valley Medical Center, a 60-bed general acute-care hospital and a 110-bed skilled nursing facility, opened in 2010. In addition, a local community college is scheduled to complete a \$38 million expansion in Lompoc in 2013 that will host the college's police, fire, emergency medical services, and environmental technology programs.¹⁸ These initiatives suggest that the potential for employment growth in the Lompoc banking market is reasonably strong.

The Board concludes that the foregoing considerations, including the number and size of competitors that would remain in the Lompoc banking market after consummation, the structure of the market, and the market's attractiveness for entry, mitigate the transaction's potential for anticompetitive effects.

B. 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 consummation of the proposal would not likely have a significantly adverse effect on competition in any relevant banking market. In

¹⁵ CoastHills offers open membership to anyone who lives, works, worships, or attends school in San Luis Obispo County or northern Santa Barbara County, which includes the Lompoc banking market.

¹⁶ The third street-level branch is at the Vandenberg Air Force Base and accessible only to employees of the base.

¹⁷ In addition, an alternative measure of market concentration suggests that the increase in the concentration of the market for small business loans in the Lompoc banking market as a result of the proposal would be smaller than the increase in the concentration in the market for deposits.

¹⁸ The college serves all of northern Santa Barbara County, a portion of eastern San Luis Obispo County, and part of Ventura County and has approximately 1,300 employees. In addition, the Lompoc city council is negotiating the construction of a private space center on city-owned land that could create approximately 1,700 jobs and attract up to 500,000 visitors annually. See santamariatimes.com/news/local/article_00e58bda-5775-11e0-ab45-001cc4c03286.html.

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 the 10 banking markets where UnionBanCal and Pacific Capital compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

Other Section 3(c) Considerations

Section 3(c) of the BHC Act requires the Board to take into consideration a number of other factors in acting on bank acquisition applications: financial and managerial resources (including consideration of the competence, experience, and integrity of officers, directors, and principal shareholders) and future prospects of the company and banks concerned; effectiveness of the company in combatting money laundering; the convenience and needs of the community to be served; and the extent to which the proposal would result in greater or more concentrated risks to the stability of the United States banking or financial system. Section 3(c) 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.¹⁹

The Board has considered all these factors and, as described below, has determined that all considerations are consistent with approval of the application. The review was conducted 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, information provided by Applicants, and public comments received on the proposal. In addition, the Board has consulted with the Japanese Financial Services Agency (“JFSA”), the agency with primary responsibility for the supervision and regulation of Japanese banking organizations.

A. Financial, Managerial, and Other Supervisory Considerations

In evaluating financial factors in expansionary 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. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. The Board 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 on the transaction. The Board also considers the ability of the organization to absorb the costs of the proposal and the proposed integration of the operations of the institutions. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important.

The Board has considered the financial factors of the proposal. The capital levels of MUFG and BTMU 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.²⁰ In addition, UnionBanCal and Union Bank are

¹⁹ 12 U.S.C. § 1842(c)(3)(A).

²⁰ The Board considered the total and tier 1 risk-based capital ratios and the ratio of tier 1 capital to total consolidated assets of both MUFG and BTMU.

well capitalized and would remain so on consummation of the proposed acquisition. MUFG's reported asset-quality indicators, including nonperforming loans and reserves for loan losses, are consistent with approval of the proposal. MUFG's earnings performance also is consistent with approval.

The proposed transaction is structured as a cash purchase of shares for a total of approximately \$1.5 billion. UnionBanCal will use existing resources to fund the purchase of shares and has sufficient financial resources to effect the acquisition. Applicants appear to have adequate resources to absorb the costs of the proposal and the proposed integration of the institutions' operations.

The Board also has considered the managerial resources of the organizations involved. The Board has reviewed the examination records of Applicants, Union Bank, Pacific Capital, and SBBT, 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.²¹

Applicants and Union Bank are all considered to be well managed.²² Union Bank has a demonstrated record of successfully integrating organizations into its operations and risk-management systems following acquisitions, including its integrations of Frontier Bank and Tamalpais Bank in 2010. Applicants propose to devote significant financial and other resources to address all aspects of the post-acquisition integration process for this proposal. Applicants would implement UnionBanCal's and Union Bank's risk-management policies, procedures, and controls at the combined organization. Applicants' management has the experience and resources to ensure that the combined organization operates in a safe and sound manner.

The Board has reviewed the restrictions on disclosure in the relevant jurisdictions in which Applicants operate. In addition, Applicants have committed that, to the extent not prohibited by applicable law, they will make available to the Board such information on their operations and the operations of their affiliates that the Board deems necessary to determine and enforce compliance with the BHC Act, the International Banking Act, and other applicable federal laws. Applicants also have committed to cooperate with the Board to obtain any waivers or exemptions that may be necessary to enable them or their affiliates to make such information available to the Board. Based on all facts of record, the Board has concluded that Applicants have provided adequate assurances of access to any appropriate information the Board may request.

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.

²¹ The Board has consulted with relevant state, federal, and international agencies regarding the assessments by those agencies of the Applicants' programs for compliance with anti-money-laundering laws and will continue to monitor those programs and agency assessments.

²² A commenter asserted that the Swiss Competition Commission ("SCC") is investigating possible manipulation of LIBOR and other rates by traders of various banks, including BTMU. Applicants acknowledged that BTMU has received a questionnaire from the SCC and is cooperating with its investigation. Along with other banks on the rate-setting panels for LIBOR and other interest rates, MUFG and BTMU are subject to investigations by various regulatory bodies in the United States and abroad that have responsibility and authority for investigating allegations of market manipulation activities. The Board is monitoring the course of the investigations and will consider, to the extent of the Board's authority, the findings in those investigations as they develop.

B. Supervision or Regulation on a Consolidated Basis

In evaluating this application and as required by section 3 of the BHC Act, the Board considered whether MUFG, BTMU, and any other foreign bank involved in the acquisition are subject to comprehensive supervision or regulation on a consolidated basis by appropriate authorities in their home country.²³

The JFSA is the supervisor of Japanese banking organizations, including holding companies such as MUFG. The Board previously has determined that MUFG, BTMU, and MUTB are subject to comprehensive supervision on a consolidated basis by their home country supervisor.²⁴ MUFG, BTMU, and MUTB continue to be supervised by the JFSA on substantially the same terms and conditions. Based on this finding and all the facts of record, the Board has concluded that MUFG, BTMU, and MUTB continue to be subject to comprehensive supervision on a consolidated basis by their home country supervisor.

C. Convenience and Needs Considerations

Under section 3, 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”).²⁵ 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,²⁶ 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.²⁷

The Board has considered all the facts of record, including reports of examination of the CRA performance records of Union Bank and SBBT, data reported by Union Bank and SBBT under the CRA and the Home Mortgage Disclosure Act (“HMDA”),²⁸ other information provided by Applicants, confidential supervisory information, and public comments received on the proposal. Fifteen community groups submitted comments in support of the proposal. Those commenters generally commended Union Bank’s performance under the CRA, particularly its support for community development and small business programs through loans, investments, grants, donated space, and corporate volunteers. Four commenters expressed concerns about Union Bank’s mortgage, small business, and consumer lending records. Those commenters generally asserted that Union Bank had not engaged in an adequate amount of home mortgage lending to LMI and minority

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 is subject to consolidated home country supervision if the foreign bank is supervised or regulated in such a manner that its home country supervisor receives sufficient information on the worldwide operations of the foreign bank (including the relationships of the bank to any affiliate) to assess the foreign bank’s overall financial condition and compliance with law and regulation. 12 CFR 211.24(c)(1)(ii).

²⁴ *See Mitsubishi UFJ Financial Group, Inc.* (Order dated June 14, 2011), 97 *Federal Reserve Bulletin* 10 (2nd Quar. 2011). *See also Mitsubishi Tokyo Financial Group, Inc.*, 87 *Federal Reserve Bulletin* 349 (2001) (order involving predecessors to MUFG, BTMU, and MUTB).

²⁵ 12 U.S.C. § 1842(c)(2); 12 U.S.C. § 2901 *et seq.*

²⁶ 12 U.S.C. § 2901(b).

²⁷ 12 U.S.C. § 2903.

²⁸ 12 U.S.C. § 2801 *et seq.*

borrowers. Some of the commenters also criticized Union Bank as failing to meet the needs of small and minority-owned businesses.²⁹

1. Records of Performance Under the CRA

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.³⁰ The CRA requires that the appropriate federal financial supervisor for a depository institution prepare a written evaluation of the institution's record of meeting the credit needs of its entire community, including LMI neighborhoods.³¹ 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.

*CRA Performance of Union Bank.*³² Union Bank was assigned an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of June 1, 2009 ("UB Evaluation").³³ The bank received a "high satisfactory" rating on the lending test and "outstanding" ratings on both the investment and service tests.³⁴ As described in detail below, Union Bank has responded to the credit needs of the entire communities that the bank serves, such as affordable housing for LMI geographies and borrowers, through extensive transactions associated with community development loans, investments, and services, in addition to its direct lending. As noted above, a number of commenters, including community groups and advocates, highlighted programs and efforts of Union Bank that supported the CRA ratings of Union Bank.

In the UB Evaluation, examiners noted that Union Bank's lending under the CRA focused on small business lending and that the bank offered various special loan programs designed to accommodate small business needs and to foster their development. These programs include the Business Diversity Lending program, which provides easier access to credit for women-owned, minority-owned, and disabled-veteran-owned small businesses, programs related to the Small Business Administration ("SBA"), and programs related to state initiatives.

Union Bank also engages in residential mortgage lending. Union Bank's primary residential mortgage lending product is a jumbo, interest-only mortgage loan with a low loan-to-value ("LTV") ratio. In addition, Union Bank offers non-jumbo, adjustable rate mortgages and a non-jumbo, fixed-rate product for LMI borrowers under its Economic

²⁹ One commenter also questioned Union Bank's efforts in awarding contracts to minority-owned businesses. Although the Board fully supports programs designed to promote equal opportunity in contracting, the comment about contracting practices is beyond the factors the Board is authorized to consider under the BHC Act. See, e.g., *Bank of America Corporation*, 94 *Federal Reserve Bulletin* C81 (2008).

³⁰ See *Interagency Questions and Answers Regarding Community Reinvestment*, 75 *Federal Register* 11642 at 11665 (2010).

³¹ 12 U.S.C. § 2906.

³² As noted above, MUFU indirectly controls MUTB USA, which is a limited-purpose bank for purposes of the CRA. MUTB USA received a "satisfactory" rating at its most recent CRA performance evaluation by the FDIC, as of December 18, 2006.

³³ The period for the UB Evaluation was January 1, 2005, through December 31, 2008.

³⁴ Union Bank's performance in California was given considerably more weight than its performance in other states that are part of Union Bank's assessment area to reflect the fact that 99 percent of the bank's deposits were booked in branches in California. In reaching their conclusions on Union Bank's CRA performance, examiners took into account significant housing affordability barriers that exist in California that have an effect on a lender's ability to originate home mortgage loans to LMI borrowers. Other states included in the evaluation were Oregon and Washington.

Opportunity Mortgage (“EOM”) program,³⁵ which permits higher LTV ratios, higher debt-to-income ratios, and lending to borrowers with limited credit histories. Union Bank’s emphasis on residential mortgage lending has increased since the UB Evaluation. Currently, more than half of Union Bank’s combined commercial, mortgage, and consumer lending portfolio is comprised of residential mortgage loans.³⁶

Union Bank received a “high satisfactory” on the lending test in the UB Evaluation. Examiners stated that the lending test ratings were influenced most by the bank’s small business lending and, to a lesser extent, its home mortgage purchase lending.³⁷ Examiners noted that Union Bank had good lending activity and characterized its distribution of loans among geographies of different income levels as good. Examiners reported that the bank’s distribution of small business loans among businesses of different revenue sizes and geographies was good.³⁸

In evaluating Union Bank’s HMDA-reportable mortgage lending and reaching conclusions regarding the bank’s record of meeting the credit needs of its entire community, examiners took into account the high housing costs in California and noted that those costs present severe challenges for a financial institution to lend to LMI borrowers. Examiners found that the bank’s overall distribution for HMDA-reportable mortgage loans to borrowers of various income levels was poor. However, examiners also noted that Union Bank had developed the EOM program to help address affordable housing and the needs of LMI borrowers and that during the evaluation period, the bank originated 1,613 loans totaling more than \$263 million through the EOM program. Examiners also stated that Union Bank exhibited an adequate geographic distribution of HMDA-reportable mortgage loans.

In addition, examiners gave significant weight to Union Bank’s community development lending activities that provided and supported affordable housing to LMI geographies and borrowers. Examiners commended Union Bank’s \$1.8 billion of community development lending and noted that Union Bank emphasized affordable housing loans, which the examiners identified as meeting an important community need. Examiners noted that Union Bank provided financing for 9,030 units of affordable housing in its full-scope assessment areas during the evaluation period that benefitted LMI geographies or borrowers.

Since the UB Evaluation, the bank has maintained a substantial amount of community development and small business lending. Union Bank represented that it originated approximately \$1.1 billion in community development loans in 2011 in California, Oregon, and Washington. In addition, Union Bank represented that it increased its small business lending through various SBA programs in its assessment areas from \$32.5 million in 2009 to \$93.1 million in 2011.³⁹

³⁵ Union Bank’s EOM product is intended to compete with loans insured by the Federal Housing Administration.

³⁶ As a portfolio lender, Union Bank’s general practice is to retain loans in its portfolio until maturity.

³⁷ Examiners noted that, consistent with Union Bank’s focus on small business lending during the evaluation period, the bank had a low volume of HMDA-reportable home lending activity in its assessment areas.

³⁸ In this context, “small business loans” are loans with original amounts of \$1 million or less that either are secured by nonfarm, nonresidential properties or are classified as commercial and industrial loans. A commenter asserted that Union Bank has not provided sufficient lending to African-American-owned small businesses. The Board reviewed data on Union Bank’s CRA-reportable small business lending in 2008, 2009, 2010, and 2011. The data generally support the findings of examiners regarding Union Bank’s small business lending and indicate that the percentage of the bank’s CRA reportable small business loans that were made in minority census tracts generally approximated or exceeded that of lenders in the aggregate.

³⁹ One commenter asserted that Union Bank’s SBA lending does not benefit very small businesses that need small- to mid-size loans. The commenter asserted that the average size of Union Bank’s SBA 7(a) and 504 program loans is more than \$1 million and that Union Bank has stopped offering SBA Express loans. The Board reviewed data provided by Applicants on Union Bank’s SBA lending. The data indicate that the average size of

In 2011, Union Bank implemented a revised lending strategy intended to increase lending to minorities, in minority residential areas, and in LMI communities. Union Bank represented that it has developed relationships with minority realtor trade organizations and advertises its products in multicultural media across radio, mainstream newspapers, targeted ethnic newspapers, and English and Spanish websites.⁴⁰ The bank also has created the new position of Head of Multicultural & CRA Business Development, added multicultural- and CRA-focused loan officers and sales teams, and increased to 85 the number of brokers approved to originate EOM loans, 9 of whom primarily serve LMI and minority markets.

In addition, Union Bank made several changes to the EOM product in 2011 to make the product more attractive to LMI borrowers. Among other changes, the bank increased the maximum LTV ratio in certain counties, lowered the minimum down payment needed without private mortgage insurance, and raised the maximum borrower income threshold for the EOM program. As discussed below, this revised lending strategy resulted in an increase in Union Bank's lending to minorities, in minority residential areas, and in LMI communities.

Examiners assigned Union Bank an "outstanding" rating under the investment test in the UB Evaluation. During the evaluation period, Union Bank made more than 2,800 investments, including grants and contributions, totaling more than \$379 million. Examiners noted that much of Union Bank's investments, grants, and contributions were focused on affordable housing for LMI households, and the vast majority of the investments were in tax-credit equity funds that financed projects for more than 1,000 affordable housing units. Examiners commended Union Bank for its innovative program of packaging its investments in Low-Income-Housing Tax Credits ("LIHTC") into Union Bank Guaranteed Tax Credit Funds and then selling participations in the funds to other financial institutions. Examiners noted that this program enables smaller financial institutions to participate in LIHTC investments and reduces Union Bank's overall investment balances, thereby allowing the bank to explore new investment opportunities.

Union Bank has maintained a substantial level of community development investments in its assessment areas since the UB Evaluation. Union Bank represented that it has committed approximately \$370 million in CRA-qualified investments to 41 projects since January 2010. In addition, Union Bank represented that it has approved funding for two new investments in small business investment companies and the launch of a new program to support community development financial institutions.

Examiners also assigned an "outstanding" rating under the service test in the UB Evaluation. Examiners found that Union Bank's overall branch distribution was excellent and that Union Bank's products and services were readily accessible to geographies and individuals

Union Bank's SBA 7(a) and 504 loans was approximately \$427,000 in 2011, and the average size of all Union Bank's SBA program loans was approximately \$308,000. Further, although Union Bank has reduced the number of SBA Express loans it originated from 348 in 2009 to 90 in 2011, Union Bank has increased the number of SBA 7(a) and 504 loans from 29 in 2009 to 212 in 2011. Union Bank represented that the reduction in the origination of SBA Express loans, which carry only a 50 percent guarantee from the SBA, was the result of the bank adjusting its credit policy standards in light of the deteriorating performance of its portfolio during the economic downturn. In addition, data on Union Bank's CRA-reportable small business lending in 2011 indicate that Union Bank originated or purchased 6,699 loans to businesses in California with gross revenues of \$1 million or less and that these loans averaged approximately \$44,000 each.

⁴⁰ A commenter asserted that Union Bank spent less money advertising in African American media outlets compared with other types of media. The Board reviewed Union Bank's advertising practices and examination records and consulted with the OCC and Consumer Financial Protection Bureau ("CFPB"), which have responsibility for enforcing the bank's compliance with fair lending laws. The record does not suggest that Union Bank's advertising practices are discriminatory.

of different income levels. Examiners commended Union Bank's Cash & Save program, which combines traditional banking products and services with check cashing services to serve LMI individuals who do not typically use traditional banking services.⁴¹ Examiners also reported that Union Bank provided a high level of community development services that had an overall positive impact in all the bank's full-scope assessment areas. In addition, examiners praised Union Bank's leadership efforts in its involvement with the Bank on California program, which helps LMI individuals open bank accounts, and the Community Based Financing program, which assists developing small businesses in gaining access to banking services and capital.

Since the UB Evaluation, Union Bank has maintained a substantial level of community development services in its assessment areas. In 2011, Union Bank expanded the number of branches that offer Cash & Save services from 16 to 29. In addition, the distribution of Union Bank's branches continues to approximate the overall population distribution within its assessment areas.⁴² Further, Union Bank represented that its employees donated more than 53,000 hours of volunteer service in 2011, an increase of more than 175 percent over the bank's total in 2010.

The OCC is conducting a new CRA performance evaluation of Union Bank as of June 4, 2012. The Board has consulted with the OCC regarding the ongoing evaluation.

CRA Performance of SBBT. SBBT received an overall "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of September 11, 2007 ("SBBT Evaluation").⁴³ In the SBBT Evaluation, the bank received "outstanding" ratings on the lending and investment tests and a "high satisfactory" rating on the service test. Examiners reported that SBBT's overall lending activity was excellent and reflected good responsiveness in relation to the credit needs of the bank's assessment areas.⁴⁴ Examiners also noted that SBBT's level of community development loans was excellent. Further, examiners reported that SBBT's distribution of branches provided an excellent response to the needs of LMI geographies and individuals. Examiners also noted that the bank provided a satisfactory level of retail services throughout its assessment areas. In addition, examiners reported that SBBT provided a satisfactory level of community development services that are responsive to community needs throughout its assessment areas. Union Bank expects to

⁴¹ A commenter asserted that the data cited in the UB Evaluation relating to the percentage of Cash & Save customers who successfully transition to traditional bank products were incorrect. Applicants represented that the data cited in the evaluation referred to the percentage of one branch's Cash & Save customers, rather than the overall percentage of the bank's Cash & Save customers. Examiners from the OCC confirmed that the material factor in Union Bank's "outstanding" rating under the service test was that the bank provides alternative banking services through its Cash & Save program and that the conversion of a particular percentage of Cash & Save customers to traditional checking account services was not a critical evaluative factor under the service test.

⁴² A commenter expressed general concern that the proposed acquisition would lead to branch closings. Applicants have stated that they have not made any decisions regarding potential branch closures or consolidations. The Board has considered that 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 and to adopt a policy regarding branch closures. *See* 12 U.S.C. § 1831r-1; Joint Policy Statement Regarding Branch Closings (64 *Federal Register* 34844 (1999)). The Board has reviewed Applicants' branch closing policy in connection with this application and notes that the OCC will continue to review the branch closing record of Union Bank in the course of conducting CRA performance evaluations.

⁴³ Before May 26, 2011, SBBT was named Pacific Capital Bank, N.A. The period for the SBBT Evaluation was January 1, 2003, through December 31, 2006.

⁴⁴ A commenter alleged that SBBT has a long history of issuing high-cost tax refund anticipation loans ("RALs"). SBBT has not originated RALs since 2009, and SBBT sold the business line responsible for issuing RALs in 2010. Applicants represented that Union Bank has no plans to offer RALs after consummation of the proposal.

implement its CRA policies and procedures at the combined organization after the merger of SBBT into Union Bank.

2. HMDA Analysis and Fair Lending Record

The Board has considered the records of Union Bank and SBBT in complying with fair lending and other consumer protection laws. Several commenters cited HMDA data and alleged that Union Bank disproportionately excluded or denied minority and LMI applicants for home mortgage loans. As part of its consideration of Union Bank's compliance with fair lending and other consumer protection laws, the Board has reviewed HMDA data from 2009, 2010, and 2011 reported by Union Bank.

The HMDA data for 2009, 2010, and 2011 indicate that the percentages of Union Bank's total HMDA-reportable applications from and loans to African American, Hispanic, and Asian individuals were below the percentages for lenders in the aggregate in Union Bank's combined assessment areas. For instance, the HMDA data show that in its combined assessment areas in 2010, Union Bank originated 0.9 percent, 3.6 percent, and 5.2 percent of its total HMDA-reportable mortgage loans to African Americans, Hispanics, and Asians, respectively, while lenders in the aggregate originated 2 percent, 9.6 percent, and 14.5 percent of their total HMDA-reportable mortgage loans to African Americans, Hispanics, and Asians, respectively. Union Bank also generally lagged lenders in the aggregate in the percentages of applications from and loans to LMI individuals and borrowers in predominantly LMI areas in its combined assessment areas.

In addition, the HMDA data for 2009, 2010, and 2011 indicate that an above-average proportion of Union Bank's home mortgage applications lack information regarding the applicant's race. For instance, in 2011, 28.5 percent of Union Bank's home mortgage applications in its combined CRA assessment areas lacked information regarding the applicant's race compared with 16.2 percent for lenders in the aggregate.⁴⁵ Union Bank is undertaking efforts to reinforce the training it provides to processors, loan officers, and brokers in order to reinforce the requirement to collect information from loan applicants regarding their race.

A significant portion of Union Bank's HMDA-reportable mortgage loan originations are jumbo, interest-only loans with low LTV ratios.⁴⁶ In contrast to apparent weaknesses in lending evident from the aggregate HMDA data, these data also demonstrate that the percentage of Union Bank's jumbo loan originations to African American and Hispanic borrowers significantly exceeded the percentages for lenders in the aggregate in Union Bank's combined assessment areas in California. For instance, in 2011, approximately 1.6 percent and 9.8 percent of Union Bank's jumbo loan originations were to African American and Hispanic borrowers, respectively, compared with 0.6 percent and 2.7 percent for lenders in the aggregate.

⁴⁵ In 2010, Union Bank did not obtain racially identifying information from 27.4 percent of its loan originations compared with 16.5 percent of lenders in the aggregate. For loans above \$900,000, which approximates the average amount of a Union Bank jumbo loan, Union Bank did not obtain information regarding race on 29 percent of originations in 2010, while lenders in the aggregate did not obtain such information on 25 percent. Union Bank represented that jumbo loan applications lack information regarding race more often than conventional loan applications because a higher proportion of jumbo loan applications are received by phone or mail, and the only method of obtaining the information regarding race is if the customer elects to submit it. Union Bank contends that its greater overall disparity compared with lenders in the aggregate is due to the fact that the majority of Union Bank's loan applications are for jumbo loans.

⁴⁶ For instance, almost 80 percent of Union Bank's lending in the Los Angeles and San Francisco markets in 2010 consisted of jumbo loans.

The HMDA data also reflect overall improvements in the number of mortgage loans the bank originated during 2011 to African Americans, Hispanics, Asians, and individuals residing in predominantly minority and LMI census tracts. In addition, in connection with the revised lending strategy adopted by Union Bank discussed above, the bank's loan originations to minority and LMI borrowers and communities increased from the first quarter of 2011 to the first quarter of 2012. Data provided by the bank indicate that, within this timeframe, its loans to African American, Hispanic, and Asian borrowers increased by 36 percent, 61 percent, and 43, respectively. Loans to African American, Hispanic, and Asian borrowers who are LMI individuals increased by 100 percent, 45 percent, and 218 percent, respectively. Loans to African American, Hispanic, and Asian borrowers in LMI census tracts increased by 200 percent, 86 percent, and 118 percent, respectively.

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. 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, HMDA data alone do not provide a sufficient basis on which to conclude whether Union Bank has excluded or imposed higher costs on any group on a prohibited basis.

Because of the limitations of HMDA data, the Board has considered, along with these data, other information, including examination reports that provide on-site evaluations of compliance with fair lending and other consumer protection laws and regulations by Union Bank. The Board also has consulted with the OCC and CFPB about this proposal and the record of Union Bank with fair lending and other consumer protection laws and regulations since the UB Evaluation.

Examiners noted in the UB Evaluation that they found no evidence of prohibited discriminatory or other illegal credit practices or of substantive violations of fair lending laws. Union Bank is subject to continuous supervision by its supervisory agencies, and it has undergone a number of reviews for compliance with consumer protection and fair lending laws, regulations, and statutes since the UB Evaluation. Such reviews incorporate additional data beyond the HMDA data reported annually and include reviews of loan files, the stated policies and procedures of the institution, and assessments of the bank's actual practices.⁴⁷ The fair lending reviews include assessments of Union Bank's underwriting, pricing, and advertising and marketing programs, and examiners have found no evidence of discouragement or discrimination on any prohibited basis.

The Board has reviewed Union Bank's compliance programs and conferred with the OCC and CFPB regarding Union Bank's programs. Union Bank has taken steps to ensure compliance with fair lending laws, including instituting policies and procedures to help ensure compliance with all fair lending and other consumer protection laws and regulations.⁴⁸ Union Bank's compliance programs include a second-review process, regular internal

⁴⁷ HMDA data are also taken into account in the assessment of a relevant depository institution's record of compliance with the CRA by its primary federal supervisor. Accordingly, the OCC considered HMDA data for Union Bank in the UB Evaluation. As noted above, Union Bank received an "outstanding" CRA rating at its most recent CRA performance evaluation, and examiners found that Union Bank met its CRA obligations through its direct lending efforts, as well as through extensive transactions associated with community development loans, investments, and services.

⁴⁸ A commenter asserted that Union Bank's checking account overdraft practices are unfair. In November 2011, Union Bank agreed to settle a class action lawsuit that alleged that it unfairly sequenced the order in which it posted debit card transactions and ATM withdrawals to customer checking accounts. Pursuant to the settlement, Union Bank agreed to pay \$35 million to checking account holders who were charged overdraft and other fees as a result of the sequencing policies. In August 2010, Union Bank changed its sequencing policy so

examinations, and compliance self-assessments. The bank also provides fair lending training to all newly hired sales and operational staff and conducts annual fair lending training for all employees. Union Bank reviews and manages all complaints with respect to fair lending and unfair, deceptive, or abusive acts and practices.

For its mortgage lending business, Union Bank relies on a wholesale channel of approved mortgage brokers in addition to its in-house retail channel.⁴⁹ Union Bank controls fair lending risks in its wholesale channel through a broker approval process whereby the bank reviews fair lending lawsuits, judgments, or settlements against the broker and requires annual broker certification of compliance with all applicable laws and regulations. The bank also uses contractual provisions under which approved brokers receive a straight percentage of the loan amount regardless of a borrower's race, age, or gender, with the exception that in a small percentage of loans, the broker may choose to receive borrower-paid compensation. To monitor pricing and ensure nondiscriminatory pricing in the wholesale channel, Union Bank performs standard pricing analysis.

In 2011, Union Bank hired a new chief compliance officer and centralized its compliance function by combining its business unit compliance groups with its corporate compliance group. The new, centralized compliance function coordinates compliance activities across business lines and has established enterprise-wide compliance standards. As noted above, these enhancements already have resulted in improvements to compliance with fair lending requirements. Applicants have represented that, on consummation of the proposal, SBBT's compliance function will be integrated into Union Bank's centralized compliance management system.

3. Convenience and Needs of the Communities Served by SBBT

Applicants represent that the proposal will benefit the convenience and needs of the communities currently served by SBBT in several ways. Union Bank intends to offer its treasury management, capital markets, and other services to SBBT's corporate clients. Further, Union Bank expects to enhance SBBT's small business products with longer-term real estate financing and access to SBA products, which currently are not offered by SBBT. In addition, due to increased automation, Union Bank expects to process small business loan applications in approximately half the time that SBBT took to process such applications. Union Bank also intends to extend to SBBT's client base its Business Diversity Lending Program, which, as noted above, provides easier access to credit for women-owned, minority-owned, and disabled-veteran-owned small businesses. In addition, consummation of the proposal would provide customers of Union Bank and SBBT with access to a larger ATM network.

4. Conclusion on Convenience and Needs Considerations

The Board has considered all the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by Applicants, and confidential supervisory information. Based on the Board's analysis of the HMDA data, evaluation of Union Bank's mortgage lending operations and compliance programs, review of

that debit card transactions and ATM withdrawals are posted from low to high dollar amounts. In addition, Union Bank provides consumer financial education about avoiding overdrafts to its customers with repeat overdrafts.

⁴⁹ In 2010, Union Bank received 59.2 percent of its total home mortgage applications through its wholesale channel. Union Bank's reliance on the wholesale channel was moderately lower in 2011, with 50.4 percent of its applications occurring through that channel. Loan originations closely corresponded to the proportion of applications received by channel, with 59.8 percent and 52.7 percent of originations in 2010 and 2011, respectively, occurring through the bank's wholesale channel.

examination reports, and consultations with the OCC and CFPB, the Board believes that, on balance, the convenience and needs factor, including the CRA record of the insured depository institutions involved in this transaction, is consistent with approval of the application. The Board also believes that there are opportunities for Union Bank to continue to improve its outreach and mortgage lending to minority and LMI individuals and to borrowers in LMI communities, and the Board will continue to monitor that performance, along with the OCC.

D. Financial Stability

The Dodd-Frank Act amended section 3 of the BHC Act to require the Board to consider “the extent to which a proposed acquisition, merger, or consolidation would result in greater or more concentrated risk to the stability of the United States banking or financial system.”⁵⁰

To assess the likely effect of a proposed transaction on the stability of the U.S. banking or financial system, the Board considers a variety of metrics that capture the systemic “footprint” of the resulting firm and the incremental effect of the transaction on the systemic footprint of the acquiring firm. These metrics include measures of the size of the resulting firm; availability of substitute providers for any critical products and services offered by the resulting firm; interconnectedness of the resulting firm with the banking or financial system; extent to which the resulting firm contributes to the complexity of the financial system; and extent of the cross-border activities of the resulting firm.⁵¹ These categories are not exhaustive, and additional categories could inform the Board’s decision. In addition to these quantitative measures, the Board considers qualitative factors, such as the opacity and complexity of an institution’s internal organization, that are indicative of the relative degree of difficulty of resolving the resulting firm. A financial institution that can be resolved in an orderly manner is less likely to inflict material damage to the broader economy.⁵²

Analysis of the Financial Stability Impact of this Proposal

In this case, the Board has evaluated the proposal, including considering the metrics noted above, to determine whether the proposal presents a significant risk to the stability of the U.S. banking or financial system. The Board reviewed publicly available data, data compiled through the supervisory process, and data obtained through information requests to the institutions involved in the proposal, as well as qualitative information.

The Board has considered the effect of the proposed acquisition on MUFG’s systemic footprint. Pacific Capital controls approximately 0.05 percent of the total deposits in the United States and ranks between 156th and 200th among U.S. financial institutions in deposits, assets, liabilities, and leverage exposures. Pacific Capital is engaged in traditional commercial banking activities and is not meaningfully interconnected with the rest of the USFS, nor does it engage in any cross-border activities or serve as a significant provider of any critical products or services. As a result of the acquisition, MUFG would remain the 17th largest financial institution in the United States by deposit size, controlling less than

⁵⁰ Section 604(d) of the Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376, codified at 12 U.S.C. § 1842(c)(7).

⁵¹ Many of the metrics considered by the Board measure an institution’s activities relative to the U.S. financial system (“USFS”).

⁵² For further discussion of the financial stability standard, see *Capital One Financial Corporation*, FRB Order No. 2012-2 (Feb. 14, 2012).

1 percent of FDIC-insured deposits in the United States.⁵³ MUFG would continue to rank as about the 20th largest financial institution in the United States based on its share of U.S. assets, liabilities, and leverage exposures. MUFG's share of the other metrics relative to the USFS is either commensurate with or far lower than its share of the size-based metrics and would not materially change as a result of the acquisition. The acquisition of Pacific Capital would not introduce additional difficulties in a resolution of MUFG's U.S. or global operations.⁵⁴

In light of all the facts and circumstances, this transaction would not appear to result in meaningfully greater or more concentrated risks to the stability of the United States banking or financial system. Based on these and all the other facts of record, the Board has determined that considerations relating to financial stability are consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has approved the proposed transaction.⁵⁵ 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 all the commitments made to and relied on by the Board in connection with the application and on receipt of all other regulatory approvals. 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, 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 November 14, 2012.

⁵³ Taking into account uninsured deposits controlled by MUFG's U.S. branches, MUFG would remain the ninth largest U.S. financial institution in the United States after consummation.

⁵⁴ MUFG has \$2.57 trillion in global assets, and its global operations are concentrated outside the United States and on providing Japanese corporate clients and other multinational, nonfinancial firms with loans and other commercial banking services in the countries in which those entities operate. In evaluating MUFG's U.S. and global operations, the Board considered MUFG's significant but noncontrolling investments in U.S. entities such as Morgan Stanley, New York, New York. See *Mitsubishi UFJ Financial Group, Inc.* (Order dated June 14, 2011), 97 *Federal Reserve Bulletin* 10 (2nd Quar. 2011).

⁵⁵ 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 authority for the bank to be acquired makes a timely written recommendation of denial of the application. 12 CFR 225.16(e). 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 the commenters' requests in light of all the facts of record. In the Board's view, the commenters have had ample opportunity to submit their views and, in fact, submitted written comments that the Board has considered in acting on the proposal. The commenters' requests fail to demonstrate why written comments do not present their 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 requests for a public meeting or hearing on the proposal are denied.

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

Robert deV. Frierson
Secretary of the Board

Appendix

UnionBanCal/Pacific Capital Banking Markets in California Consistent with Board Precedent and DOJ Bank Merger Guidelines

Bank	Rank	Amount of deposits	Market Deposit Shares (%)	Resulting HHI	Change in HHI	Remaining Number of Competitors
Los Angeles – includes the Los Angeles Ranally Metropolitan Area (“RMA”), Acton, and Rosamond.						
UnionBanCal Pre-Consummation	3	\$32.6B	10.1	1003	1	145
Pacific Capital	84	\$172M	0.1			
UnionBanCal Post-Consummation	3	\$32.7B	10.1			
Monterey-Seaside-Marina – includes the Monterey-Seaside-Marina RMA.						
UnionBanCal Pre-Consummation	8	\$114M	2.9	2071	60	11
Pacific Capital	4	\$403M	10.3			
UnionBanCal Post-Consummation	4	\$517M	13.2			
Oxnard-Thousand Oaks-Ventura – includes the Oxnard-Thousand Oaks-Ventura RMA, Fillmore, and Piru.						
UnionBanCal Pre-Consummation	18	\$111M	0.8	1465	11	26
Pacific Capital	5	\$842M	6.3			
UnionBanCal Post-Consummation	4	\$953M	7.1			
Salinas – includes the Salinas RMA, Gonzales, and Soledad.						
UnionBanCal Pre-Consummation	6	\$115M	3.8	1718	68	10
Pacific Capital	5	\$276M	9			
UnionBanCal Post-Consummation	4	\$391M	12.8			
San Francisco-Oakland-San Jose – includes the San Francisco-Oakland-San Jose RMA, Byron, Hollister, San Juan Bautista, Pescadero, and Point Reyes Station.						
UnionBanCal Pre-Consummation	8	\$7.7B	2.4	2137	1	88
Pacific Capital	26	\$507M	0.2			
UnionBanCal Post-Consummation	8	\$8.2B	2.6			
San Luis Obispo – includes the San Luis Obispo RMA, Arroyo Grande, Atascadero, Cambria, Cayucos, Grover Beach, Grover City, Los Osos, Morro Bay, Paso Robles, Pismo Beach, and Templeton.						
UnionBanCal Pre-Consummation	14	\$87M	1.8	1273	10	13
Pacific Capital	8	\$140M	2.9			
UnionBanCal Post-Consummation	7	\$227M	4.6			
Santa Barbara – includes the Santa Barbara RMA, Buellton, Los Olivos, Santa Ynez, and Solvang.						
UnionBanCal Pre-Consummation	17	\$49M	0.6	1416	32	16
Pacific Capital	1	\$2.0B	25.9			
UnionBanCal Post-Consummation	1	\$2.1B	26.5			
Santa Maria – includes the Santa Maria RMA and Guadalupe.						
UnionBanCal Pre-Consummation	11	\$30M	1.7	1595	14	12
Pacific Capital	7	\$71M	4			
UnionBanCal Post-Consummation	7	\$100M	5.7			
Watsonville – includes the Watsonville RMA.						
UnionBanCal Pre-Consummation	5	\$84M	10.2	1692	290	8
Pacific Capital	3	\$117M	14.2			
UnionBanCal Post-Consummation	1	\$201M	24.4			

Data are as of June 30, 2011. All amounts of deposits are unweighted. All rankings, market deposit shares, and HHIs are based on thrift deposits weighted at 50 percent. Data do not include BTMU's branch in the Los Angeles banking market. This branch is not insured by the FDIC and generally cannot accept retail deposits. Moreover, the branch does not control a significant share of the Los Angeles banking market.

River Valley Bancorp

Madison, Indiana

Order Approving the Formation of a Bank Holding Company

FRB Order No. 2012-10 (October 17, 2012)

River Valley Bancorp (“RVB”), Madison, has requested the Board’s approval under section 3 of the Bank Holding Company Act (“BHC Act”)¹ to acquire Dupont State Bank (“Dupont”), Dupont, both of Indiana, and to become a bank holding company.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (77 *Federal Register* 3774 (2012)). 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.

RVB, with total consolidated assets of approximately \$408 million,² is currently a savings and loan holding company that owns all of River Valley Financial Bank (“River Valley”), Madison, Indiana, a federal savings association. River Valley is the 53rd largest insured depository institution in Indiana, controlling approximately \$293 million in deposits.³ As part of this proposal, River Valley would be merged into Dupont, the resulting bank would be renamed River Valley Financial Bank, and RVB would become a bank holding company.

Dupont is the 127th largest insured depository institution in Indiana, controlling deposits of approximately \$72.9 million. Dupont controls \$82.6 million of total assets. Dupont is currently wholly owned by Citizens Union Bancorp of Shelbyville, Inc. (“Citizens Union”), Shelbyville, Kentucky.

Under the proposed transaction, RVB would purchase Dupont from Citizens Union and merge River Valley into Dupont, with the resulting institution renamed River Valley Financial Bank. On consummation of this proposal, the resulting bank would become the 41st largest insured depository organization in Indiana, controlling deposits of approximately \$365.9 million, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the state.

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 market. 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.⁴

¹ 12 U.S.C. § 1842.

² Asset data are as of June 30, 2012.

³ State- and market-level deposit and ranking data are as of June 30, 2011, updated to reflect mergers, acquisitions, and branch transactions through May 2, 2012. In this context, insured depository institutions include commercial banks, savings associations, and savings banks.

⁴ 12 U.S.C. § 1842(c)(1).

River Valley and Dupont compete directly in the Madison, Indiana, banking market (“Madison banking market”).⁵ River Valley operates four branches in the market: three in or around the town of Madison in the southern part of the market and one in the town of Hanover, Indiana, which is southwest of Madison. Dupont has one office in Dupont in the northern part of the market. The Board has reviewed the competitive effects of the proposal in this banking market in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking market, the relative shares of total deposits in insured depository institutions in the market (“market deposits”) controlled by River Valley and Dupont,⁶ 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 Competitive Review Guidelines (“DOJ Bank Merger Guidelines”),⁷ and other characteristics of the market.

River Valley is the largest insured depository institution in the Madison banking market, controlling deposits of approximately \$235.2 million, which represent approximately 43.6 percent of market deposits. Dupont is the fifth largest insured depository institution in the market, controlling deposits of approximately \$14.5 million, which represent approximately 2.7 percent of market deposits. As these data indicate, the acquisition represents a relatively small, incremental change in River Valley’s share of market deposits. On consummation of the proposed merger, the resulting institution would remain the largest insured depository institution in the market, controlling deposits of approximately \$249.7 million, which would represent approximately 46.3 percent of the market deposits. The HHI would increase by 234 points to 3284.

The Board has considered 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 Madison banking market.⁸ A number of factors indicate that the increase in concentration in this banking market, as measured by the HHI and the market share of the combined organization, overstates the potential competitive effects of the proposal in the market. Three community credit unions exert a competitive influence in the Madison bank-

⁵ The banking market is defined as Jefferson County, Indiana, and the Milton census county division in Trimble County, Kentucky.

⁶ Deposit and market share data are based on calculations in which the deposits of River Valley, the only thrift institution in the market, are included 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 (1989); National City Corporation, 70 Federal Reserve Bulletin 743 (1984)*. Thus, the Board regularly has included thrift deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc., 77 Federal Reserve Bulletin 52 (1991)*. However, where, as here, the facts and circumstances of a banking market indicate that a particular thrift serves as a significant source of commercial loans and provides a broad range of consumer, mortgage, and other banking products, the Board has concluded that competition from such a thrift closely approximates competition from a commercial bank and that deposits controlled by the institution should be weighted at 100 percent in market-share calculations. *See, e.g., Regions Financial Corporation, 93 Federal Reserve Bulletin C16 (2007); Banknorth Group, Inc., 75 Federal Reserve Bulletin 703 (1989)*. In this case, River Valley’s commercial and industrial and agricultural loan portfolios are similar to those of other commercial banks in the market, as measured in terms of the ratios of those types of loans to total loans and assets. Moreover, River Valley proposes to merge into a bank at consummation of this proposal. Thus, a full weighting more accurately reflects the competitive environment in this case.

⁷ 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 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.

⁸ The number and strength of the factors necessary to mitigate the competitive effects of a proposal depend on the size of the increase and resulting level of concentration in a banking market. *See NationsBank Corp.*, 84 *Federal Reserve Bulletin* 129 (1998).

ing market.⁹ Each institution offers a wide range of consumer products, operates street-level branches, and has memberships open to almost all the residents in the market. Their operations in this banking market mitigate, in part, the potential competitive effects of the proposal. The three community credit unions control approximately \$30.1 million in deposits in the market on a 50 percent weighted basis, which represents approximately 5 percent of market deposits. Accounting for the revised weightings of these deposits, River Valley would control approximately 43.8 percent of market deposits on consummation of the proposal, and the HHI would increase by 210 points to 2959.

Three other insured commercial bank competitors and a total of six other insured depository institutions (including the credit unions) would remain in this rural market. Some of the other competitors have a significant presence in the market. The second largest competitor after consummation would be a large regional bank that would control approximately 25.5 percent of market deposits, if credit union deposits are weighted at 50 percent. The third largest competitor would control approximately 18 percent of market deposits. The fourth largest competitor is in the process of being acquired by a large regional commercial bank.

In addition, the record indicates that the Madison banking market may be attractive for entry and expansion by bank competitors. In 2005, the large regional institution that is currently the second largest bank competitor entered the market through acquisition of a smaller depository institution that operated only in this market. The third largest bank competitor in the market has begun construction of a new branch in this market, indicating its intention to expand. Finally, as noted, the smallest remaining bank competitor is being acquired by a large regional bank.

The features of the Madison banking market and the location of the applicant and target in the market also suggest that HHI calculations are likely to overstate the competitive effects of the merger. All the banking activity in the market, except for Dupont's activities, is centered around the town of Madison and the populous southern portion of the market. In contrast, Dupont only operates in, and is the only depository institution that operates in, the rural, sparsely populated, northernmost part of the market. Although the Board has concluded that the northern and southern parts of this area should be included in the same banking market due to economic ties between them, those ties are mostly one way. For example, a high percentage, but very small number, of individuals residing in the northern part of the market commute to Madison in the south. Neither a high percentage nor a large number of individuals make the reverse trip. This characteristic of the market suggests that the elimination of Dupont as a competitor in the northern part of the market is unlikely to have substantial effects on competition. To the extent that the combination of River Valley and Dupont has an effect on competition in the northern portion of the market, that effect should be lessened by the other mitigating factors noted above.

The Board has reviewed carefully all the facts of record and has considered those facts in light of Board precedent. The pro forma market share in the Madison banking market is relatively high in this case. The change in concentration in the market, however, only marginally exceeds the DOJ Bank Merger Guidelines, and other factors in this market suggest that this proposal is not likely to have a significantly adverse effect on competition in the Madison banking market.

⁹ 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); *Allied Irish Banks, p.l.c. and M&T Bank Corporation*, 93 *Federal Reserve Bulletin* C11 (2007); *Regions Financial Corporation*, 93 *Federal Reserve Bulletin* C16 (2007); *Wachovia Corporation*, 92 *Federal Reserve Bulletin* C183 (2006).

The DOJ has reviewed the potential competitive effects of the proposal and has advised the Board that consummation of the proposal would not likely have a significantly adverse effect on competition in any relevant banking market. The appropriate federal banking agency has been afforded an opportunity to comment and has not objected to the proposal.

For the reasons discussed in this order and based on all the facts of record, the Board has determined that competitive factors are consistent with approval of the proposal.

Other Section 3(c) Considerations

Section 3(c) of the BHC Act requires the Board to take into consideration a number of other factors in acting on bank acquisition applications. Those factors include: the financial and managerial resources (including consideration of the competence, experience, and integrity of the officers, directors, and principal shareholders) and future prospects of the company and banks concerned; effectiveness of the company in combatting money laundering; the convenience and needs of the community to be served; and the extent to which the proposal would result in greater or more concentrated risks to the stability of the United States banking or financial system. The Board has considered all these factors and, as described below, has determined that all considerations are consistent with approval of the application. The review was conducted 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 RVB.

A. Financial, Managerial, and Other Supervisory Considerations

In evaluating financial factors in expansionary 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. As part of this review, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. The Board assesses 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 also considers the ability of the organization to absorb the costs of the proposal and the proposed integration of the operations of the institutions. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important.

RVB and River Valley are well capitalized and will remain so on consummation of the proposed acquisition. RVB is a shell holding company, with River Valley accounting for almost all of RVB's consolidated assets. The proposed transaction is a bank merger structured as a cash purchase of shares. RVB will fund the purchase from cash on hand. RVB is in stable financial condition, and the asset quality and earnings of River Valley are consistent with approval. On a pro forma basis, the acquisition of Dupont would not adversely impact RVB's operations. Based on its review of the record, the Board finds that the organization 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 RVB, River Valley, and Dupont, 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 the organizations' records of compliance with applicable banking and anti-money-

laundering laws. The Board also has considered RVB's plans for implementing the proposal.

RVB and River Valley are considered to be well managed. The boards of directors and senior management of RVB and River Valley are considered experienced and capable. RVB's existing risk-management program and its directorate and senior management are considered to be satisfactory. The directors and senior management of RVB and River Valley, and the risk-management program of RVB, would not change as a result 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.

B. Convenience and Needs Considerations

Under section 3, 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").¹⁰ The CRA requires 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,¹¹ 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.¹²

The Board has considered all the facts of record, including evaluations of the CRA performance of River Valley and Dupont, other information provided by RVB, and confidential supervisory information.

As provided in the CRA, the Board has considered the convenience and needs factor in light of examinations by the appropriate federal supervisors of the CRA performance records of the relevant institutions.¹³ 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. River Valley received a "satisfactory" rating at its most recent CRA performance evaluation by the Office of Thrift Supervision, as of February 2, 2010, and Dupont received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Deposit Insurance Corporation, as of February 16, 2011. Examiners found no evidence of illegal credit discrimination during these evaluations.

River Valley and Dupont have established records of assisting in meeting the credit needs of their communities. At River Valley's 2010 CRA evaluation, examiners determined that the bank's loan-to-deposit ratio was very good and that its lending levels were consistently above average. Dupont's 2011 CRA performance evaluation noted that the bank's level of lending, as reflected by its loan-to-deposit ratio, was excellent and demonstrated that the bank was using the deposits obtained from its assessment area to fund loans.

¹⁰ 12 U.S.C. § 1842(c)(2); 12 U.S.C. § 2901 *et seq.*

¹¹ 12 U.S.C. § 2901(b).

¹² 12 U.S.C. § 2903.

¹³ See Interagency Questions and Answers Regarding Community Reinvestment, 75 *Federal Register* 11642 at 11665 (2010).

RVB has represented that it will continue to meet the credit needs of its communities in the same manner as it has in the past. RVB also has represented that the merged entity would provide convenient and accessible service to the retail market through extended banking hours, as well as access to its ATMs and drive-thru facilities.

The Board has considered all the facts of record, including reports of examination of the CRA records of River Valley and Dupont, information provided by RVB, and confidential supervisory information, including current records of compliance with consumer laws and regulations.

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.

C. Financial Stability

The Board has also considered information relevant to risks to the stability of the United States banking or financial system. The proposed investment represents a *de minimis* transaction for financial stability purposes, and the proposed transaction would not materially increase the interconnectedness or complexity of RVB. The Board, therefore, concludes that financial stability considerations in this proposal are consistent with approval.

D. Conclusion on Section 3(c) Factors

Based on all the facts of record, including those described above, the Board has determined that all of the factors it must consider under section 3(c) of the BHC Act 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 RVB with all the conditions imposed in this order and the commitments made to the Board in connection with the application, including receipt of all required regulatory approvals. 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, or later than three months thereafter, unless such period is extended for good cause by the Board or the Federal Reserve Bank of St. Louis, acting pursuant to delegated authority.

By order of the Board of Governors, effective October 17, 2012.

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

Robert deV. Frierson
Secretary of the Board

Sumitomo Mitsui Financial Group, Inc.
Tokyo, Japan

Sumitomo Mitsui Banking Corporation
Tokyo, Japan

Order Approving Acquisition of Shares of a Bank Holding Company
FRB Order No. 2012-11 (October 31, 2012)

Sumitomo Mitsui Financial Group, Inc. (“SMFG”) and Sumitomo Mitsui Banking Corporation (“SMBC”), both of Tokyo, Japan (collectively, “Applicants”), foreign banking organizations that are bank holding companies under the Bank Holding Company Act of 1956, as amended (“BHC Act”),¹ have requested the Board’s approval under section 3(a) of the BHC Act to acquire up to 9.9 percent of the voting shares of The Bank of East Asia, Limited (“BEA”), Hong Kong SAR, People’s Republic of China, a foreign banking organization that is a bank holding company under the BHC Act by virtue of its ownership of The Bank of East Asia (U.S.A.) National Association (“BEA USA”), New York, New York.²

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (76 *Federal Register* 70722 (November 15, 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.

SMFG, with total assets of approximately \$1.7 trillion, is the third largest banking organization in Japan.³ SMFG, through its subsidiaries, including SMBC, engages in a broad range of banking and financial services throughout Japan, Asia, the United Kingdom, and North and South America. Outside Japan, SMFG owns subsidiary banks in the United Kingdom, Brazil, Canada, People’s Republic of China, Indonesia, Russia, and Malaysia, and SMBC operates branches in more than a dozen additional countries. In the United States, Applicants own Manufacturers Bank, Los Angeles, California, with consolidated assets of \$2.1 billion and deposits of approximately \$1.6 billion. Manufacturers Bank engages in retail and commercial banking in the United States through 10 branches in California. SMBC operates uninsured state branches in New York City, Los Angeles, and San Francisco and representative offices in Houston and Jersey City. Applicants also maintain nonbanking subsidiaries in the United States.⁴ SMFG and SMBC are each a qualifying foreign banking organization and, upon consummation of the proposal, would continue to

¹ 12 U.S.C. § 1842.

² 12 CFR 225.11(c)(1). BEA and its subsidiary, East Asia Holding Company, Inc., New York, New York, are bank holding companies by virtue of their ownership of 20 percent of the voting shares of BEA-USA. With the Board’s prior approval, the Industrial and Commercial Bank of China Limited (“ICBC”), Beijing, People’s Republic of China, recently acquired 80 percent of the voting shares of BEA-USA from BEA. See *Industrial and Commercial Bank of China Limited*, FRB Order No. 2012-4 (May 9, 2012). BEA has an option to sell the remaining shares of BEA-USA to ICBC beginning 18 months after this transaction. If BEA exercises its option, BEA would continue to be treated as a bank holding company subject to the BHC Act because it operates branches in the United States. 12 U.S.C. § 3106(a).

³ Unless otherwise provided, asset and ranking data are as of June 30, 2012, and are based on the exchange rate as of that date, as appropriate. Japan Trustee Services Bank, Ltd. (“JTSB”) and The Master Trust Bank of Japan, Ltd. (“MTBJ”) own approximately 6.4 percent and 5.2 percent of the shares of SMFG, respectively, as of March 31, 2012. Both JTSB and MTBJ hold these shares as registered nominee accounts for various beneficial shareholders, none of which owns 5 percent or more of the shares of SMFG. No other shareholder owns 5 percent or more of the outstanding shares of SMFG.

⁴ These nonbanking subsidiaries include SMBC Capital Markets, Inc.; SMBC Leasing and Finance, Inc.; SMBC Nikko Securities America, Inc.; and JRI America, Inc., all of New York, New York.

meet the requirements for a qualifying foreign banking organization under Regulation K.⁵

BEA, with total consolidated assets of approximately \$82.6 billion, is the third largest bank in Hong Kong. BEA engages primarily in retail and commercial banking, wealth management, and insurance services in People's Republic of China, North America, the United Kingdom, and Southeast Asia. In the United States, BEA controls BEA-USA and operates an insured federal branch in New York City and uninsured federal branches in New York City and Los Angeles. BEA-USA, with consolidated assets of approximately \$720.6 million and deposits of approximately \$561.1 million, engages in retail and commercial banking in the United States. BEA USA operates 13 branches in New York and California.

Noncontrolling Investment

Applicants own approximately 4.7 percent of the voting shares of BEA. Applicants have stated that they do not propose to control or exercise a controlling influence over BEA as a result of the proposal.⁶

Applicants have agreed to abide by certain commitments substantially similar to those on which the Board has previously relied in determining that an investing 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"). For example, Applicants have committed not to exercise or attempt to exercise a controlling influence over the management or policies of BEA; not to seek or accept more than one representative on the board of directors of BEA; and not to have any other director, officer, employee, or agent interlocks with BEA or its subsidiaries. The Passivity Commitments also include certain restrictions on the business relationships between Applicants and BEA.

Based on these considerations and all the facts of record, the Board has concluded that Applicants would not, as a result of the structure of the proposed transaction, control or exercise a controlling influence over BEA or any of its subsidiaries through the acquisition of up to 9.9 percent of the voting common stock of BEA. The Board notes that the BHC Act requires Applicants to receive the Board's approval before they directly or indirectly acquire additional shares of BEA or attempt to exercise a controlling influence over BEA or any of its subsidiaries.⁷

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 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 clearly are 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

⁵ 12 CFR 211.23(a).

⁶ 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., Mitsubishi UFG Financial Group, Inc.*, 95 *Federal Reserve Bulletin* B34 (2009) (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); *Mansura Bancshares, Inc.*, 79 *Federal Reserve Bulletin* 37 (1993) (acquisition of 9.7 percent of the voting shares of a bank holding company).

⁷ 12 U.S.C. § 1842. *See, e.g., Emigrant Bancorp, Inc.*, 82 *Federal Reserve Bulletin* 555 (1996) ("Emigrant Bancorp Order").

⁸ 12 U.S.C. § 1842(c)(1). *See, e.g., Emigrant Bancorp Order.*

The Board previously has stated that one company need not acquire control of another company to lessen competition between them substantially.⁹ The Board has found that noncontrolling interests in directly competing depository institutions may raise competitive issues 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.¹⁰

Because the subsidiary banks of Applicants and BEA compete directly in California in the Los Angeles and San Francisco-Oakland-San Jose banking markets,¹¹ the Board has reviewed the competitive effects of the proposal in these 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 relevant institutions,¹² 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”).¹³

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in the Los Angeles and San Francisco banking markets. The transaction would not change the HHI in the Los Angeles banking markets and on consummation, the market would remain moderately concentrated, as measured by the HHI.¹⁴ The HHI in the San Francisco banking market would also remain unchanged.¹⁵ In each banking market, numerous competitors would remain in the market.

The DOJ also has reviewed the matter and has advised the Board that it does not believe that the ownership interest of Applicants in BEA is likely to have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking

⁹ See e.g., *Sun Trust Banks, Inc.*, 76 *Federal Reserve Bulletin* 542 (1990).

¹⁰ See e.g., *BOK Financial Corp.*, 81 *Federal Reserve Bulletin* 1052, 1053-54 (1995).

¹¹ The Los Angeles banking market is defined as the Los Angeles Ranally Metropolitan Area (“RMA”) and the cities of Acton in Los Angeles County and Rosamond in Kern County. The San Francisco banking market is defined as the San Francisco-Oakland-San Jose RMA and the cities of Byron in Contra Costa County, Hollister and San Juan Bautista in San Bonito County, Pescadero in San Mateo County, and Point Reyes Station in Marsh County. Applicants do not currently compete with BEA in any other relevant banking market. BEA operates an insured branch in New York, and BEA-USA operates in New York, SMBC’s New York branch is not insured by the Federal Deposit Insurance Corporation and generally cannot accept retail deposits. Moreover, neither banking organization controls a significant share of the New York banking market.

¹² Call report, deposit, and market share data are based on data reported by insured depository institutions in the summary of deposits data, as of June 30, 2011. The data are also 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, Inc.*, 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift 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 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 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 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.

¹⁴ The HHI would remain unchanged at 1018 in the Los Angeles banking market, which has 145 insured depository institution competitors. The combined deposits of the institutions involved in the proposal in the banking market represent less than 1 percent of market deposits.

¹⁵ The HHI would remain unchanged at 2048 in the San Francisco banking market, which has 92 insured depository institution competitors. The combined deposits of the institutions involved in the proposal in the banking market represent less than 1 percent of market deposits.

agencies have been afforded an opportunity to comment and have not objected to the application.

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 factors are consistent with approval of the proposal.

Financial, Managerial, and Other Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources (including consideration of the competence, experience, and integrity of officers, directors, and principal shareholders) and future prospects of the companies and depository institutions involved in the proposal, as well as the effectiveness of these companies in combatting money laundering activities.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.¹⁷

The review was conducted in light of all the facts of record, including confidential supervisory and examination information from the various U.S. banking supervisors of the institutions involved, publicly reported and other financial information, and information provided by Applicants and by public commenters. The Board also has consulted with the Japanese Financial Services Agency (“JFSA”), the agency with primary responsibility for the supervision and regulation of Japanese banking organizations, including Applicants.

In evaluating financial factors, the Board reviews the financial condition of the applicants and the target depository institutions. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. The Board also evaluates the effect of the transaction on the financial condition of the applicants, including their 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 capital levels of Applicants 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 seeking to acquire up to 9.9 percent of BEA.¹⁸ Applicants’ reported earnings performance and asset quality indicators, including nonperforming loans and reserves for loan losses, are consistent with approval of the proposal. Applicants’ U.S. bank subsidiary, Manufacturers Bank, and BEA-USA are each well capitalized and would remain so on consummation.

The proposed transaction is structured as a cash purchase of shares, and Applicants will use existing resources to fund the proposed purchase of shares. In light of the relative size of Applicants to the size of the investment in BEA, the transaction would have a minimal

¹⁶ The Board has analyzed the effectiveness of Applicants’ anti-money-laundering efforts in connection with the Board’s assessment of whether Applicants are subject to comprehensive supervision or regulation on a consolidated basis by appropriate authorities in their home country.

¹⁷ 12 U.S.C. § 1842(c)(3)(A).

¹⁸ The Board has considered the total, and the tier 1 risk-based, capital ratios and the ratios of tier 1 capital to total consolidated assets of SMFG and SMBC.

impact on the financial condition of Applicants. 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' and BEA's U.S. operations, including assessments of their management, risk-management systems, and operations. The Board also has considered its supervisory experiences and those of the other relevant bank supervisory agencies with the organizations, including consultations in connection with this proposal, and the organizations' records of compliance with applicable banking and anti-money-laundering laws. As noted, the Board has also consulted with the JFSA. In addition, the Board has considered the future prospects of Applicants, BEA, Manufacturers Bank, and BEA-USA in light of the financial and managerial resources of the organizations.

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, Applicants have committed that, to the extent not prohibited by applicable law, they will make available to the Board such information on their operations and the operations of their affiliates that the Board deems necessary to determine and enforce compliance with the BHC Act, the International Banking Act, and other applicable federal laws. Applicants also have committed to cooperate with the Board to obtain any waivers or exemptions that may be necessary to enable them or their affiliates to make such information available to the Board.

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, as well as access to information by the Board, are consistent with approval.

Supervision or Regulation on a Consolidated Basis

In evaluating this application and as required by section 3 of the BHC Act, the Board has considered whether Applicants are subject to comprehensive supervision or regulation on a consolidated basis by appropriate authorities in their home country.¹⁹

The Board previously has determined that SMBC is subject to comprehensive supervision on a consolidated basis by its home country supervisor.²⁰ SMBC continues to be supervised by the JFSA on substantially the same terms and conditions. Based on this finding

¹⁹ 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 is subject to consolidated home country supervision if the foreign bank is supervised or regulated in such a manner that its home country supervisor receives sufficient information on the worldwide operations of the foreign bank (including the relationships of the bank to any affiliate) to assess the foreign bank's overall financial condition and compliance with law and regulation. 12 CFR 211.24(c)(1)(ii). In assessing this standard under section 211.24 of Regulation K, 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.

²⁰ The *Wakashio Bank, Limited*, 89 *Federal Reserve Bulletin* 217 (2003). SMBC merged with and into The Wakashio Bank, Limited, which was subsequently renamed Sumitomo Mitsui Banking Corporation.

and all the facts of record, the Board has concluded that SMBC continues to be subject to comprehensive supervision on a consolidated basis by its home country supervisor.

In evaluating this proposal, the Board also has considered whether SMFG is subject to comprehensive supervision or regulation on a consolidated basis by appropriate authorities in its home country. As noted, the JFSA is the supervisor of Japanese banking organizations, including holding companies such as SMFG. As such, the JFSA conducts inspections of SMFG and its subsidiaries and requires SMFG to submit reports about its operations on a consolidated basis. The JFSA also reviews transactions between SMFG and its subsidiaries and has authority to require SMFG to take measures necessary to ensure the safety and soundness of the SMFG organization. The Board has previously determined that other Japanese holding companies of Japanese banks were subject to comprehensive, consolidated supervision by the JFSA.²¹ SMFG has represented, and the JFSA has confirmed, that SMFG is subject to the same supervisory regime as those other Japanese holding companies. Based on all the facts of record, the Board has determined that SMFG is subject to comprehensive supervision on a consolidated basis by its appropriate home country authorities for purposes of this application.

In evaluating the effectiveness of Applicants' policies and procedures to combat money-laundering activities in connection with these determinations, the Board considered Applicants' anti-money-laundering policies and procedures as well as the Board's supervisory experiences and those of other relevant banking supervisory organizations with Applicants' compliance record. On the basis of all facts of record, the Board has determined that Applicants' anti-money-laundering measures are consistent with approval.

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 Community Reinvestment Act ("CRA").²² 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.²³

The Board has considered all the facts of record, including evaluations of the CRA performance records of Manufacturers Bank, BEA-USA, and BEA's insured New York City branch; data reported by BEA-USA under the Home Mortgage Disclosure Act ("HMDA");²⁴ other information provided by Applicants; confidential supervisory information; and public comments received on the proposal. A commenter alleged, based on 2009 HMDA data, that BEA-USA had excluded African Americans and Hispanics in its conventional home purchase and refinance lending ("one-to-four family lending") and Asian Americans with income below 100 percent of the median income of the metropolitan statistical area in its refinance lending.

²¹ See, e.g., *Mitsubishi UFJ Financial Group, Inc.* (Order dated June 14, 2011), 97 *Federal Reserve Bulletin* 10 (2nd Quar. 2011); *Chuo Mitsui Trust Holdings, Inc.* (Order dated March 15, 2011), 97 *Federal Reserve Bulletin* 30 (1st Quar. 2011).

²² 12 U.S.C. § 2901 *et seq.*; 12 U.S.C. § 1842(c)(2).

²³ 12 U.S.C. § 2903.

²⁴ 12 U.S.C. §§ 2801-2810.

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 supervisors of the CRA performance records of the relevant insured depository institutions, including BEA-USA. 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

Manufacturers Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Deposit Insurance Corporation ("FDIC"), as of November 29, 2010.²⁶ BEA's insured federal branch in New York City received an "outstanding" rating at its most recent CRA performance evaluation by the FDIC, as of January 4, 2010.²⁷ BEA-USA received an "outstanding" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency ("OCC"), as of January 4, 2010.²⁸ The bank received an "outstanding" rating under each of the lending and community development tests.²⁹

BEA-USA has approximately \$561.1 million in total deposits and \$720.6 million in total assets. The bank is primarily a commercial lender and engages in limited residential lending.³⁰ Examiners noted that a substantial majority of BEA-USA's loans were originated in its assessment areas, that the distribution of its loans reflects excellent penetration among businesses of different sizes in the assessment areas, and that the geographic distribution of loans reflects excellent dispersion throughout the assessment areas. Examiners also reported that BEA-USA's community development performance demonstrates excellent responsiveness to the needs of the assessment areas through loans, investments, and services.³¹ As indicated above, Applicants would not control BEA or BEA-USA as a result of the proposal and, accordingly, the proposal should not affect BEA-USA's CRA program or performance.

B. HMDA and Compliance with Fair Lending and Other Consumer Protection Laws

The Board has considered the HMDA data for 2009, 2010, and 2011 reported by BEA-USA in its combined assessment areas, as well as the fair lending record of BEA-USA in light of public comments received on the proposal.³² A commenter alleged, based on HMDA data reported in 2009, that BEA-USA had engaged in disparate treatment of minority individuals in its one-to-four family home mortgage lending. Specifically, the com-

²⁵ See Interagency Questions and Answers Regarding Community Reinvestment, 75 *Federal Register* 11642 at 11665 (2010).

²⁶ Manufacturers Bank received a high satisfactory in each of the lending, investment, and service tests. The evaluation period was October 25, 2007, to November 29, 2010.

²⁷ The evaluation period was January 1, 2007, to September 30, 2009. SMBC's and BEA's uninsured branches are not subject to the CRA.

²⁸ The evaluation period was January 1, 2006, to January 4, 2010.

²⁹ BEA-USA was evaluated under the intermediate small bank performance criteria, which only include a lending test and a community development test.

³⁰ HMDA-reportable loans were not part of BEA-USA's CRA performance evaluation because examiners did not consider the bank's volume of those types of loans to be sufficient enough to review.

³¹ BEA-USA controls \$261 million in deposits in the New York banking market, which approximates its CRA assessment area in New York. In that assessment area, BEA-USA made 15 community development loans totaling \$18.6 million, including 5 loans for affordable housing, and 22 qualified investments totaling approximately \$2.6 million, which consisted of \$2.5 million in Fannie Mae investments and \$100,000 in charitable donations. BEA-USA's staff also provided community development services during the review period, including financial literacy and homeownership seminars.

³² BEA-USA's combined CRA assessment areas consist of Kings, Manhattan, and Queens Counties in the New York-New Jersey-Long Island, NY-NJ-PA Metropolitan Statistical Area; the San Francisco-San Mateo-Red-

menter has asserted that BEA-USA excludes African Americans and Hispanics in home purchase and refinance lending and discriminates against Asian Americans with income below 100 percent of the median income of the metropolitan statistical area in its refinance lending.

Although the HMDA data provide an insufficient basis by themselves on which to conclude whether or not BEA-USA is excluding or imposing higher costs on any racial or ethnic group on a prohibited basis, the Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending.³³ The Board 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 and taken into account other information, including examination reports that provide evaluations of compliance by BEA-USA with consumer protection laws. The Board also has consulted with the OCC, BEA-USA's primary federal supervisor.

As noted above, BEA-USA is predominantly a commercial lender and makes a limited number of one-to-four family mortgage loans. BEA-USA's one-to-four family mortgage lending largely results from walk-in traffic at BEA-USA's branches, most of which are in Asian American neighborhoods. Throughout its combined assessment areas, BEA-USA made a total of 32 one-to-four family mortgage loans in 2009, 26 in 2010, and 20 in 2011. During that same time period, BEA-USA received only one application for a one-to-four family mortgage loan from an African American and four applications from Hispanics. The HMDA data also indicate that the bank made a material percentage of its one-to-four family mortgage loans to LMI borrowers (those with incomes of less than 80 percent of the area median income) in BEA-USA's assessment areas. Between 2009 and 2011, 21 percent of BEA-USA's mortgage refinance loans, and 35 percent of BEA-USA's conventional home purchase loans, were made to LMI borrowers.³⁴

The record of this application, including confidential supervisory information, also indicates that BEA-USA has taken steps to ensure compliance with fair lending and other consumer protection laws and regulations. In BEA-USA's most recent CRA performance evaluation, examiners noted no evidence of discriminatory or other illegal credit practices.³⁵ In addition, BEA-USA's loan policies include information on prohibited discriminatory lending practices and its advertising and marketing policy contains specific guidance on practices employees should avoid that would tend to discourage loan applicants on a prohibited basis. Additionally, the bank's employees who are involved in lending are

wood City, California Metropolitan Division and the Alameda County portion of the Oakland-Fremont-Hayward, CA Metropolitan Division, which are part of the greater San Francisco-Oakland-Fremont, California Metropolitan Statistical Area; and the Los Angeles-Long Beach-Glendale Metropolitan Division.

³³ The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applications than other institutions attract and do not provide 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 cost credit) are not available from HMDA data.

³⁴ More than half of BEA-USA's branches are located in low-to-moderate income communities.

³⁵ The Bank of East Asia, USA, National Association Community Reinvestment Act Performance Evaluation, January 4, 2010, at 5. Moreover, the CRA performance evaluation noted that BEA-USA's assessment areas do not arbitrarily exclude LMI areas. *Id.* at 4.

required to participate in annual training that includes compliance with fair lending laws and other applicable laws and regulations.

C. Conclusion on Convenience and Needs and CRA Performance

The Board has considered all the facts of record, including evaluations of the CRA performance record of Manufacturers Bank (the bank controlled by Applicants), BEA-USA, and other relevant insured depository institutions, information provided by Applicants, comments received on the proposal, and confidential supervisory information. 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.

Financial Stability

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) amended section 3 of the BHC Act to require the Board also to consider “the extent to which a proposed acquisition, merger, or consolidation would result in greater or more concentrated risks to the stability of the United States banking or financial system.”³⁶

In this case, the proposed acquisition of a noncontrolling interest in BEA is not a significant expansion by SMFG and would have a de minimis impact on SMFG’s systemic footprint. The value of the additional shares that Applicants propose to purchase is approximately \$415 million.³⁷ In addition, there is no evidence of any significant increase in interconnectedness, complexity, cross-border activities, or other risk factor, as the proposal merely increases the ownership by Applicants from approximately 4.7 percent to 9.9 percent of the voting shares of BEA. Applicants would neither consider BEA a subsidiary nor consolidate its financial performance on their balance sheets.

Based on these and all the other facts of record, the Board has determined that the proposal would not materially increase risk to the stability of the U.S. financial or banking system.

Conclusion

Based on the foregoing and all the facts of record, the Board approves the proposal by Applicants to acquire up to 9.9 percent of the voting shares of BEA. 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 conditions its decision on Applicants providing to the Board adequate information on their operations and activities as well as those of their affiliates to determine and enforce compliance by Applicants or their affiliates with applicable federal statutes. Should any restrictions on access to information on the operations or activities of Applicants or any of their affiliates subsequently interfere with the Board’s ability to obtain information to determine and enforce compliance by Applicants or their affiliates with applicable federal statutes, the Board may require termination or divestiture of any of Applicants’ or their affiliates’ direct or indirect activities in the United States.

The Board’s approval is specifically conditioned on compliance by Applicants with the conditions imposed in this order and the commitments made to the Board in connection with

³⁶ Section 604(d) of the Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376, codified at 12 U.S.C. § 1842(c)(7).

³⁷ This value is based on BEA’s listed price on the Hong Kong Stock Exchange as of October 17, 2012, and the exchange rate as of that date.

the proposal.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, 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 October 31, 2012.

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

Robert deV. Frierson
Secretary of the Board

³⁸ The commenter requested that the Board hold a public 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 hearing on an application to acquire shares of 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(e) and 262.25(d). The Board has considered the commenter's request in light of all the facts of record. In the Board's view, the commenter had ample opportunity to submit views and, in fact, submitted written comments that the Board has considered 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 hearing. For these reasons, and based on all the facts of record, the Board has determined that a public hearing or meeting is not required or warranted in this case. Accordingly, the request for a public hearing on the proposal is denied. The commenter raised additional concerns that address matters 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).

Legal Developments: First Quarter, 2013

Orders Issued Under Bank Holding Company Act

Orders Issued Under Section 3 of the Bank Holding Company Act

FirstMerit Corporation
 Akron, Ohio

Order Approving the Acquisition of a Bank Holding Company
FRB Order No. 2013-3 (March 22, 2013)

FirstMerit Corporation (“FirstMerit”), Akron, Ohio, has requested the Board’s approval under section 3 of the Bank Holding Company Act (“BHC Act”)¹ to acquire Citizens Republic Bancorp, Inc. (“Citizens”) and thereby indirectly acquire its subsidiary bank, Citizens Bank (“Citizens Bank”), both of Flint, Michigan. Immediately following the proposed acquisition, Citizens Bank would be merged into FirstMerit’s subsidiary bank, FirstMerit Bank, N.A. (“FirstMerit Bank”), Akron.²

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (77 *Federal Register* 64338 (2012)). 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.

FirstMerit, with consolidated assets of approximately \$14.9 billion, is the 76th largest insured depository organization in the United States, controlling approximately \$11.8 billion in consolidated deposits. FirstMerit Bank operates in Ohio, Illinois, and Pennsylvania. FirstMerit Bank is the seventh largest depository institution in Ohio, controlling deposits of approximately \$8.7 billion, which represent 3.6 percent of the total deposits of insured depository institutions in the state.³ FirstMerit Bank is the 19th largest insured depository institution in Illinois, controlling deposits of approximately \$2.7 billion, and the 128th largest insured depository institution in Pennsylvania, controlling deposits of approximately \$200 million, which represent less than 1 percent of the total deposits of insured depository institutions in those states, respectively.

Citizens, with total consolidated assets of \$9.6 billion, controls Citizens Bank, which controls approximately \$7.2 billion in deposits. Citizens Bank operates in Michigan, Wisconsin, and Ohio. Citizens Bank is the 62nd largest insured depository institution in Ohio, con-

¹ 12 U.S.C. § 1842.

² The merger of Citizens Bank into FirstMerit Bank is subject to the approval of the Office of the Comptroller of the Currency (“OCC”) under the Bank Merger Act.

³ State deposit and asset data are as of June 30, 2012. All other asset data are as of December 31, 2012, unless otherwise noted. In this context, insured depository institutions include commercial banks, savings associations, and savings banks.

trolling deposits of approximately \$306.5 million, which represent less than 1 percent of the total deposits of insured depository institutions in that state.

On consummation of this proposal, FirstMerit would become the 55th largest depository organization in the United States, controlling consolidated deposits of approximately \$19.0 billion, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States. FirstMerit Bank would remain the seventh largest insured depository institution in Ohio, controlling deposits of approximately \$9.0 billion, which would represent 3.7 percent of the total deposits of insured depository institutions in the state.

Interstate and Deposit Cap Analysis

Section 3(d) of the BHC Act imposes certain requirements on interstate transactions. Section 3(d) generally provides that the Board may approve an application by a bank holding company that is well capitalized and well managed to acquire control of a bank in a state other than the home state of the bank holding company without regard to whether the transaction is prohibited under state law.⁴ However, this section further provides that the Board may not approve an application that would permit an out-of-state bank holding company to acquire a bank in a host state that has not been in existence for the lesser of the state statutory minimum period of time or five years.⁵ In addition, the Board may not approve an application by a bank holding company to acquire an insured depository institution if the home state of such insured depository institution is a state other than the home state of the bank holding company and the applicant controls or would control more than 10 percent of the total deposits of insured depository institutions in the United States.⁶

For purposes of the BHC Act, the home state of FirstMerit is Ohio,⁷ and Citizens is located in Michigan, Ohio, and Wisconsin.⁸ FirstMerit is well capitalized and well managed under applicable law. Michigan and Wisconsin have no minimum requirements for period of operation,⁹ and Citizens Bank has been in existence for more than five years.

Based on the latest available data reported by all insured depository institutions, the total amount of consolidated deposits of insured depository institutions in the United States is \$9.9 trillion. On consummation of the proposed transaction, FirstMerit would control less than 1 percent of the total amount of consolidated deposits in insured depository institutions in the United States. Accordingly, in light of all the facts of record, the Board is not required to deny the proposal under section 3(d) of the BHC Act.

⁴ The standard was changed from adequately capitalized and adequately managed to well capitalized and well managed by section 607(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), Pub. L. No. 111-203, 124 Stat. 1376, codified at 12 U.S.C. § 1842(d)(1)(A).

⁵ 12 U.S.C. § 1842(d)(1)(B).

⁶ 12 U.S.C. § 1842(d)(2)(A).

⁷ 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.

⁸ 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).

⁹ See MSA § 487.13702 and WSA § 221.0901(8) (both permit interstate acquisitions but do not impose a requirement for period of operation).

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 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.¹⁰

FirstMerit and Citizens compete directly in the Akron and Cleveland, Ohio, banking markets.¹¹ The Board has considered 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 insured depository institutions in the markets (“market deposits”) controlled by FirstMerit and Citizens,¹² 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 Competitive Review Guidelines (“DOJ Bank Merger 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 Bank Merger Guidelines in the Akron and Cleveland banking markets. On consummation of the proposal, the banking markets would remain moderately concentrated, as measured by the HHI, and numerous competitors would remain.¹⁴

¹⁰ 12 U.S.C. § 1842(c)(1).

¹¹ The Akron banking market is defined as Summit County (excluding Sagamore Hills, Northfield Center, Twinsburg, Richfield and Boston townships, the villages adjoining these townships, and the cities of Twinsburg, Macedonia, and Hudson); Franklin, Ravenna, Charlestown, Paris, Brimfield, Rootstown, Edinburg, Palmyra, Suffield, Randolph, Atwater, and Deerfield townships, and the city of Kent in Portage County; Guilford, Wadsworth, and Sharon townships, and the city of Wadsworth in Medina County; Lawrence and Lake townships in Stark County; and Milton and Chippewa townships, and the villages adjoining those townships, in Wayne County, all in Ohio (the “Akron banking market”). The Cleveland, Ohio banking market is defined as Cuyahoga, Lake, Lorain, and Geauga Counties; Sagamore Hills, Northfield Center, Twinsburg, Richfield, and Boston townships, the villages surrounding those townships, and the cities of Macedonia, Twinsburg, and Hudson in Summit County; Homer, Harrisville, Westfield, Spencer, Chatham, Lafayette, Montville, Litchfield, York, Medina, Granger, Liverpool, Brunswick Hills, and Hinckley townships, and the cities of Medina and Brunswick in Medina County; Mantua, Hiram, Nelson, Shalersville, Freedom, and Windham townships, and the cities of Aurora and Streetsboro in Portage County; and the city of Vermilion (not the whole township) in Erie County, all in Ohio (the “Cleveland banking market”).

¹² Deposit and market share data are as of June 30, 2012, 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 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 by more than 200 points. Although DOJ and the Federal Trade Commission issued revised Horizontal Merger Guidelines in 2010, *see* Press Release, Department of Justice (August 19, 2010), www.justice.gov/opa/pr/2010/August/10-at-938.html, the DOJ has confirmed that its Bank Merger Guidelines, which were issued in 1995, were not modified.

¹⁴ FirstMerit Bank operates the sixth largest depository institution in the Cleveland banking market, controlling deposits of approximately \$3.1 billion, which represent approximately 6.7 percent of market deposits. Citizens Bank operates the 17th largest depository institution in the market, controlling deposits of approximately \$293.4 million, which represent less than 1 percent of market deposits. On consummation, FirstMerit Bank would operate the sixth largest depository institution in the market, controlling weighted deposits of approximately \$3.4 billion, which represent approximately 7.3 percent of market deposits. The HHI would increase by

The DOJ has advised the Board that consummation of the proposal 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 of 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 the banking markets in which FirstMerit Bank and Citizens Bank compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

Other Section 3(c) Considerations

Section 3(c) of the BHC Act requires the Board to take into consideration a number of other factors in acting on bank acquisition applications. These factors include the financial and managerial resources (including consideration of the competence, experience, and integrity of the officers, directors, and principal shareholders) and future prospects of the company and banks concerned; the effectiveness of the company in combatting money laundering; the convenience and needs of the communities to be served; and the extent to which the proposal would result in greater or more concentrated risks to the stability of the United States banking or financial system.

The Board has considered all of these factors and, as described below, has determined that all considerations are consistent with approval of the application. The review was conducted 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, information provided by FirstMerit, and a public comment received on the proposal.

A. Financial, Managerial, and Other Supervisory Considerations

In evaluating financial factors in expansionary 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. The Board evaluates the financial condition of the combined organization, including its capital position, asset quality, liquidity, and earnings prospects, and the impact of the proposed funding of the transaction. The Board also considers the ability of the organization to absorb the costs of the proposal and the proposed integration of the operations of the institutions. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important.

The Board has considered the financial factors of the proposal. FirstMerit and FirstMerit Bank are well capitalized and would remain so on consummation of the proposed acquisition. The proposed transaction is a bank holding company merger, structured as a share exchange. Each share of Citizens' common stock would be cancelled and converted into

9 points to 1045. FirstMerit Bank operates the largest depository institution in the Akron banking market, controlling deposits of approximately \$3.0 billion, which represent approximately 29.6 percent of market deposits. Citizens Bank operates the 22nd largest depository institution in the market, controlling deposits of approximately \$13.1 million, which represent less than 1 percent of market deposits. On consummation, FirstMerit Bank would control deposits of approximately \$3 billion, which represent approximately 29.7 percent of market deposits. The HHI would increase by 8 points to 1497.

the right to receive FirstMerit common stock based on an exchange ratio.¹⁵ FirstMerit is in stable financial condition, and the asset quality and earnings of both FirstMerit Bank and Citizens Bank are consistent with approval. On a pro forma basis, the acquisition of Citizens is not expected to have a negative impact on FirstMerit's operations. Based on its review of the record, the Board finds that the organization 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 FirstMerit, FirstMerit Bank, Citizens, and Citizens Bank, 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. The Board also has considered FirstMerit's plans for implementing the proposal.

FirstMerit, FirstMerit Bank, Citizens, and Citizens Bank are each considered to be well managed. FirstMerit's existing risk management program and its directorate and senior management are considered to be satisfactory. The directors and senior executive officers of FirstMerit have substantial knowledge and experience in the banking and financial services sectors.¹⁶ Both the chairman and chief executive officer of FirstMerit would continue in their roles following consummation of the proposed transaction.

FirstMerit successfully integrated into its operations the banking operations of three insured depository institutions located in the Chicago, Illinois, market, including the assets and deposits of two failed depository institutions in 2010. FirstMerit is devoting significant financial and other resources to address all aspects of the post-acquisition integration process for this proposal. FirstMerit would implement its risk-management policies, procedures, and controls at the combined organization, and they are considered acceptable from a supervisory perspective. In addition, FirstMerit's management has the experience and resources to ensure that the combined organization operates in a safe and sound manner, and FirstMerit is proposing to integrate Citizens Bank's existing management and personnel in a manner that augments FirstMerit's management.¹⁷

FirstMerit's integration record, managerial and operational resources, and plans for operating the combined institutions after consummation provide a reasonable basis to conclude that managerial factors are consistent with approval. 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.

¹⁵ As part of the proposed transaction, FirstMerit would pay the United States Department of the Treasury in full for all of Citizens' Troubled Asset Relief Program ("TARP") preferred stock, including accumulated but unpaid dividends.

¹⁶ On consummation, FirstMerit's board of directors would include two additional directors from Citizens' current board of directors.

¹⁷ The commenter referred to press releases issued by two rating agencies raising concerns regarding possible integration difficulties and FirstMerit's entry into new markets. The commenter also referred to outstanding litigation associated with the proposed transaction. The record in this case supports the conclusion that FirstMerit has the necessary support structures, and human and financial resources, to integrate the organizations' operations. In addition, the referenced litigation has been settled.

B. 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 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,¹⁹ 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.²⁰

The Board has considered all the facts of record, including reports of examination of the CRA performance of FirstMerit Bank and Citizens Bank, data reported by FirstMerit Bank and Citizens Bank under the Home Mortgage Disclosure Act (“HMDA”),²¹ other information provided by FirstMerit, confidential supervisory information, and the public comment received objecting to the proposal. The commenter objected to the proposal on the basis of the mortgage lending records of FirstMerit Bank and Citizens Bank as reflected in HMDA data.

1. Records of Performance Under the CRA

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.²² The CRA requires that the appropriate federal financial supervisor for a depository institution prepare a written evaluation of the institution’s record of meeting the credit needs of its entire community, including LMI neighborhoods.²³ 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.

CRA Performance of FirstMerit Bank. FirstMerit Bank was assigned an “outstanding” rating at its most recent CRA performance evaluation by the OCC, as of November 17, 2008 (“FirstMerit Evaluation”). Examiners concluded that the distribution of loans among borrowers of different income levels was good overall, including lending in LMI areas.²⁴ OCC examiners noted that FirstMerit Bank’s community development lending performance reflected an excellent level of responsiveness to community needs. FirstMerit Bank received

¹⁸ 12 U.S.C. § 1842(c)(2); 12 U.S.C. § 2901 *et seq.*

¹⁹ 12 U.S.C. § 2901(b).

²⁰ 12 U.S.C. § 2903.

²¹ 12 U.S.C. § 2801 *et seq.*

²² See Interagency Questions and Answers Regarding Community Reinvestment, 75 *Federal Register* 11642 at 11665 (2010).

²³ 12 U.S.C. § 2906.

²⁴ The Akron, Canton, and Cleveland assessment areas were selected for full-scope reviews in Ohio. FirstMerit Bank’s Ohio ratings are based primarily on conclusions reached for the bank’s performance in these full-scope assessment areas. Performance in the Akron and Cleveland assessment areas is weighed more heavily than the Canton assessment area. A limited scope review was performed in the Toledo assessment area.

an “outstanding” rating on the Lending Test and “high satisfactory” ratings on both the Investment and Service Tests.²⁵

CRA Performance of Citizens Bank. Citizens Bank was assigned a “satisfactory” rating at its most recent CRA performance evaluation by the Federal Reserve Bank of Chicago, as of November 1, 2010 (“Citizens Evaluation”),²⁶ with ratings of “high satisfactory” for the Lending Test and “low satisfactory” for the Investment and Service Tests.²⁷ Examiners concluded that Citizens Bank exhibited excellent penetration among borrowers of different income levels and businesses of different sizes based on the bank’s record of lending to small businesses.

2. Fair Lending Record

The Board has considered the records of FirstMerit Bank and Citizens Bank in complying with fair lending and other consumer protection laws. This includes a review of their performance as detailed in the FirstMerit and Citizens Evaluations and an evaluation of FirstMerit Bank’s record of performance in providing community development lending and services since the FirstMerit Evaluation. This also includes an evaluation of FirstMerit Bank’s fair lending policies and procedures and consideration of other agencies’ views on FirstMerit Bank’s record of performance under fair lending laws. The Board also has taken into account the comment on the application.

The FirstMerit Evaluation. As described in the FirstMerit Evaluation, OCC examiners found that FirstMerit Bank provided significant levels of community development loans and qualified community development investments. In the FirstMerit Evaluation, examiners noted that delivery systems were accessible to geographies and individuals of different income levels. Examiners found that FirstMerit Bank had a good record of participating in community development initiatives.

Examiners stated that FirstMerit Bank had been highly responsive to community needs through its community development lending. The community development loans reflected a variety of community development purposes including affordable housing, funding for organizations providing community services targeted to LMI individuals and families, activities that revitalize or stabilize LMI geographies, and initiatives that provide financing to small businesses. With respect to community development services, FirstMerit Bank was found to have a good record of participating in community development initiatives, especially considering the limited opportunities for working with local organizations that provide community development services.

The OCC assigned FirstMerit Bank a rating of “outstanding” for the Lending Test, noting that the bank had an excellent community development lending record. Examiners found that FirstMerit Bank’s overall geographic distribution performance and borrower distribution performance were good. Examiners noted that FirstMerit Bank’s excellent community

²⁵ The evaluation period for the Lending Test in the FirstMerit Evaluation was January 1, 2004, through December 31, 2007, except for community development loans, which had an evaluation period from May 17, 2004, through November 17, 2008. The evaluation period for the Investment and Service Tests was from May 17, 2004, through November 17, 2008.

²⁶ The rating was an improvement from the “needs to improve” rating Citizens Bank received during the previous CRA review, in 2008. The review period for the 2010 evaluation of loans reported under the HMDA and the CRA was January 1, 2008, to December 31, 2009, and for the evaluation of community development activities was January 1, 2008, through October 31, 2010. Citizens Bank’s current CRA evaluation by the Federal Reserve Bank of Chicago commenced in the fourth quarter of 2012.

²⁷ For the 2010 evaluation, the review period for the evaluation of loans reported under the HMDA and the CRA was January 1, 2008, to December 31, 2009, and for the evaluation of community development activities was January 1, 2008, through October 31, 2010.

development lending record had a significant positive impact on its Lending Test performance. During the evaluation period, FirstMerit Bank generated 56 community development loans totaling \$43.5 million in the Akron Metropolitan Statistical Area (“MSA”), and 66 community development loans totaling \$38.2 million in the Cleveland MSA. In addition to the community development loans, examiners noted that in the Cleveland MSA, FirstMerit Bank originated 19 loans totaling \$4 million for home mortgage and small business purposes that also had community development characteristics, which demonstrate FirstMerit Bank’s commitment to community development lending. Examiners noted that in the Toledo MSA, the bank’s performance was weaker than the bank’s overall performance in the state due to weaker geographic distribution records and lower levels of community development lending.²⁸

Examiners assigned FirstMerit Bank a rating of “high satisfactory” for the Investment Test. Examiners highlighted FirstMerit Bank’s qualified investments in the Ohio Equity Fund Limited Partnership funds and other low-income housing tax credit facilities, FirstMerit Bank’s community development corporation (“CDC”), and grants to local organizations to support community development initiatives within the bank’s assessment areas. In particular, FirstMerit’s \$7.6 million equity investment in the FirstMerit CDC was given positive consideration by the examiners. Projects financed by the CDC are types that the bank cannot normally provide similar degrees of support because the CDC can use less stringent financing standards. Most of the investments addressed affordable housing and social service needs of LMI individuals. Examiners also noted that FirstMerit Bank had taken leadership roles in some projects and combined loan and investment activities to fund initiatives.

The Citizens Evaluation. As noted above, Citizens Bank received a “high satisfactory” rating for the Lending Test in the Citizens Evaluation. Federal Reserve examiners concluded that Citizens Bank exhibited excellent penetration among borrowers of different income levels and businesses of different sizes based on the bank’s record of lending to small businesses. Examiners found that Citizens Bank made a relatively high level of community development loans in the full review assessment areas in Michigan and Ohio. Examiners highlighted Citizens Bank’s use of innovative and flexible lending programs and practices to help meet the credit needs of LMI individuals and LMI areas.

The Reserve Bank assigned Citizens Bank a rating of “low satisfactory” for the Investment Test. Examiners found that Citizens Bank had an adequate level of qualified community development investments. Examiners noted that Citizens Bank was adequately responsive to the credit and community development needs in its assessment areas and occasionally used innovative or complex investments to support community development initiatives.

The Reserve Bank assigned Citizens Bank a rating of “low satisfactory” for the Service Test. Examiners found that service delivery systems were accessible to all portions of Citizens Bank’s assessment areas. Examiners found that Citizens Bank provided an adequate level of community development services in most geographies.

FirstMerit Bank’s efforts since the 2008 CRA Evaluation. According to FirstMerit, since the FirstMerit Evaluation, FirstMerit Bank has invested \$18 million in Low Income Housing Tax Credit Equity Funds syndicated by the Ohio Capital Corporation for Housing, providing direct equity to affordable housing projects throughout Ohio. FirstMerit Bank has pro-

²⁸ The Toledo assessment area was not included as a full-scope assessment area because of FirstMerit’s relatively low level of lending volume in the Toledo MSA. For example, from January 1, 2004, to December 31, 2007, FirstMerit reported only 373 total loans in the Toledo MSA as compared to 8,081 in the Akron MSA, 5,430 in the Canton MSA, and 11,454 in the Cleveland MSA.

vided small business loans of almost \$665 million in the Akron, Cleveland, and Toledo MSAs.²⁹ During this same time period, FirstMerit Bank has provided community development loans of over \$126 million in the Akron, Cleveland, and Toledo MSAs.³⁰ Examples of community development projects include \$7.1 million in Akron to create single family homes for LMI families and affordable housing for low-income seniors, participation in the Cleveland Housing Network to provide housing for more than 2,000 families in Cleveland, and \$4.6 million in a senior housing development in Toledo.

FirstMerit's Fair Lending Program. The Board also considered information about FirstMerit's compliance and risk management systems and the steps it has taken to ensure compliance with fair lending laws. FirstMerit has instituted policies and procedures to help ensure compliance with all fair lending and other consumer protection laws and regulations. FirstMerit's legal and compliance risk management program includes procedures to evaluate new laws and regulations to determine applicability to FirstMerit's mortgage operations, annual fair lending risk assessments to analyze potential vulnerabilities in loan processes and controls, fair lending training for all lending-related employees, specialized training for personnel with higher fair lending risk, ongoing statistical regression analysis of loan data, comparative loan file reviews, legal and compliance reviews for all fair lending complaints, and a second review committee, which reviews all home mortgage loan applications initially recommended for denial or for approval based on a policy exception. FirstMerit also has a corporate fair lending committee, which is charged with reviewing fair lending compliance and regulatory changes and recommending policy and procedural changes aimed at ensuring compliance with fair lending laws and regulations. FirstMerit's risk-management systems and policies and procedures for assuring compliance with fair lending laws will be implemented at the combined organization.

Consultation with the OCC and the CFPB. The Board has reviewed the FirstMerit and Citizens Evaluations and consulted with the OCC and the Consumer Financial Protection Bureau ("CFPB") with respect to FirstMerit Bank's record of fair lending performance since the FirstMerit Evaluation. The OCC reported, based on its review of supervisory information, that it did not find evidence that FirstMerit Bank engaged in discriminatory conduct during the period before which the CFPB assumed jurisdiction over federal consumer financial laws.³¹ The OCC has indicated that the bank's operations and compliance program are compliant with fair lending and other consumer protection laws. Based on its consultation with the CFPB, the Board is satisfied with FirstMerit's performance, policies, and procedures in the areas reviewed by that agency.

The OCC conducted a pre-merger examination of Citizens Bank in October 2012. The OCC identified specific measures FirstMerit Bank must take to enhance its fair lending compliance program in order to ensure continued fair lending compliance by the combined organization. As a condition of approval, FirstMerit must ensure that FirstMerit Bank is in full compliance with the OCC's requirements within 180 days of the date of this order.

3. HMDA Analysis and Public Comment on the Application

The commenter cited HMDA data and alleged that FirstMerit Bank made fewer conventional home purchase loans to African-American and Hispanic applicants than to white applicants and disproportionately denied applications by minority applicants for conven-

²⁹ The small business lending comprises \$234 million in the Akron MSA, \$388 million in the Cleveland MSA, and \$43 million in the Toledo MSA.

³⁰ The community development lending comprises \$19 million in the Akron MSA, \$101 million in the Cleveland MSA, and \$6 million in the Toledo MSA.

³¹ See 12 U.S.C. § 5481(14).

tional home purchase loans in the Akron and Cleveland MSAs. The commenter further alleged low levels of conventional home purchase lending by FirstMerit Bank to African-American applicants relative to those for white applicants in the Toledo MSA. In addition, the commenter cited HMDA data and alleged that Citizens Bank made fewer conventional home purchase loans to African Americans than to whites in the Akron and Cleveland MSAs.

The Board has reviewed HMDA data from 2010 and 2011 reported by FirstMerit Bank, FirstMerit Mortgage Corporation (“FirstMerit Mortgage”), and Citizens Bank, the most recent publicly available data.³² In response to the comment, the Board analyzed data related to all HMDA-reportable loans to develop a view of overall lending patterns, as well as the subset of that data related specifically to conventional home purchase loans, which was the subject of the public comment received on the proposal. Within those data sets, the Board focused its review on the races and ethnicities highlighted by the public comment, in this case, African Americans and Hispanics. The Board considered not only the MSAs addressed in the public comment (Akron, Cleveland, and Toledo), but also the MSAs in which FirstMerit Bank and Citizens Bank have their headquarters and all of the states in which FirstMerit Bank, FirstMerit Mortgage, and Citizens Bank originate HMDA-reportable loans.

With respect to FirstMerit Bank and Citizens Bank, the Board confirmed the levels of conventional home purchase loans and denial disparity ratios associated with conventional home purchase loans noted by the commenter. In addition, the Board’s analysis for all HMDA-reportable loans revealed small differences in the percentages of loan applications received and loans originated by FirstMerit Bank and FirstMerit Mortgage for applicants residing in majority-minority tracts³³ in the Cleveland MSA as compared to the percentages of loan applications received and loans originated by all HMDA reporters for applicants residing in majority-minority tracts in the Cleveland MSA. The Board did not find any significant disparities with respect to Citizens Bank. The Board communicated its findings with respect to FirstMerit to the OCC and the CFPB.

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. 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, HMDA data alone do not provide a sufficient basis on which to conclude whether FirstMerit Bank and FirstMerit Mortgage have excluded or denied credit to any group on a prohibited basis.³⁴

Because of the limitations of HMDA data, the Board also has considered other information, including examination reports that provide on-site evaluations of compliance by FirstMerit Bank and Citizens Bank with fair lending laws and regulations. The Board also has

³² FirstMerit Mortgage, a wholly owned mortgage banking subsidiary of FirstMerit Bank, services the loans it originates as well as those originated by FirstMerit Bank.

³³ In this case, majority-minority tracts are those where a majority of the population is African American and/or Hispanic.

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 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 (the reasons most frequently cited for a credit or higher credit cost) are not available from HMDA data.

consulted with the OCC and the CFPB about this proposal, including the record of FirstMerit Bank with fair lending laws and regulations since the FirstMerit Evaluation.

With respect to the specific HMDA data on conventional home mortgages cited by the commenter, FirstMerit provided information on the nondiscriminatory reasons for individual lending decisions (i.e., credit history, inadequate collateral, and debt-to-income ratio). With respect to the small differences in the percentages of loan applications received and loans originated by FirstMerit Bank and FirstMerit Mortgage identified in the Board's analysis for applicants residing in majority-minority tracts in the Cleveland MSA as compared to the aggregate, the Board has concluded that these differences alone would not be enough to preclude approval. FirstMerit Bank branches are accessible to majority-minority areas in the Cleveland MSA, with four branches in majority-minority tracts.³⁵ FirstMerit Bank has not attempted to adjust its assessment area to exclude majority-minority areas for CRA purposes, but rather has included the entire Cleveland MSA into its assessment area. FirstMerit also has provided the Board with detailed information on its training, marketing, and advertising, and centralized underwriting programs reflecting its commitment to the prevention of prescreening, discouragement, or exclusion of credit applications on a prohibited basis. Based on its review of information to date, the Board has not found evidence that FirstMerit has engaged in discrimination or other illegal credit practices.

Based on this information, as well as the views of the CFPB and the OCC on FirstMerit Bank's record of fair lending performance, and considering the fair lending policies and procedures and compliance record of FirstMerit Bank, the Board concludes that FirstMerit Bank's fair lending record is consistent with approval and that the HMDA disparities cited by the commenter and identified by the Board are not a barrier to approval.

4. Convenience and Needs of Communities to be Served by the Combined Organization

The Board has considered the extent to which the proposal would benefit the customers of FirstMerit Bank, Citizens Bank, or both. Such benefits can include merger-related cost savings, improvements in the quality of existing product offerings, and the availability of products that were not previously available to customers of either of the parties.

FirstMerit represents that the proposal would result in cost savings for the combined organization by reducing its funding costs and consolidating redundant functions, including Citizen's reliance on third-party vendors to supply services to its customers. The Board has considered that decreased funding costs could result from the fact that FirstMerit would redeem Citizens Bank's TARP shares with alternative funding, allowing it to lower its debt service; Citizens' stable base of short-term deposits would allow FirstMerit to reduce its reliance on more expensive wholesale funding sources; and the combined organization would pay lower FDIC insurance assessments.

FirstMerit also has stated that it would be able to use its existing infrastructure to perform a variety of services that Citizens currently contracts with third party vendors to provide. In addition to the projected cost savings, FirstMerit represents that, by providing certain services in-house, they would have the ability to provide more customization than is currently offered by Citizens Bank through third parties. For example, FirstMerit has represented that it would assume responsibilities from third-parties that issue credit cards, provide international trade letters of credit, and originate mortgages for Citizens' customers on Citizens' behalf.

³⁵ This information is based on census demographic data for the year 2012 that were updated in June 2012 using 2006-2010 ACS and Census 2010 SF1-based data.

The merger also would extend the branch and ATM footprints of FirstMerit Bank and Citizens Bank to cover portions of five states. The resulting network would be contiguous over a broader geographic area than is currently available to customers of either institution. Consumers that commute to work and businesses located across multiple geographic areas are likely to be the primary beneficiaries of the larger branch network.

Finally, FirstMerit represents that, as a result of the merger, Citizens' customers would have access to a variety of consumer and business services that are not currently offered by Citizens. Citizens' retail customers would have access to private banking, wealth management, and additional lending products. As a result of the merger, Citizens' small business customers would gain access to a variety of financial services such as mobile banking and merchant services, commercial purchasing cards, and import/export services. FirstMerit also represents that it would expand Citizens' commercial and industrial lending business and hire additional commercial lending officers at Citizens Bank branches, and that, as a result of the merger, Citizens' business customers would have access to larger loans.

5. Conclusion on Convenience and Needs Considerations

The Board has considered all the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by FirstMerit, confidential supervisory information, and the public comment on the proposal. Based on the Board's analysis of the HMDA data, evaluation of FirstMerit Bank's and Citizens Bank's mortgage lending operations and compliance programs, review of examination reports, and consultations with the OCC and the CFPB, the Board believes that the convenience and needs factor, including the CRA record of the insured depository institutions involved in this transaction, is consistent with approval of the application. The Board encourages FirstMerit Bank to continue to seek opportunities to assist in meeting the credit needs of the communities it serves.

C. Financial Stability

The Dodd-Frank Act amended section 3 of the BHC Act to require the Board to consider "the extent to which a proposed acquisition, merger, or consolidation would result in greater or more concentrated risk to the stability of the United States banking or financial system."³⁶

To assess the likely effect of a proposed transaction on the stability of the U.S. banking or financial system, the Board considers a variety of metrics that capture the systemic "footprint" of the resulting firm and the incremental effect of the transaction on the systemic footprint of the acquiring firm. These metrics include measures of the size of the resulting firm; the availability of substitute providers for any critical products and services offered by the resulting firm; the interconnectedness of the resulting firm with the banking or financial system; the extent to which the resulting firm contributes to the complexity of the financial system; and the extent of the cross-border activities of the resulting firm.³⁷ These categories are not exhaustive, and additional categories could inform the Board's decision. In addition to these quantitative measures, the Board considers qualitative factors, such as the opaqueness and complexity of an institution's internal organization, that are indicative of the relative degree of difficulty of resolving the resulting firm. A financial institution

³⁶ Section 604(d) of the Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376, codified at 12 U.S.C. § 1842(c)(7).

³⁷ Many of the metrics considered by the Board measure an institution's activities relative to the U.S. financial system.

that can be resolved in an orderly manner is less likely to inflict material damage to the broader economy.³⁸

The Board has considered information relevant to risks to the stability of the United States banking or financial system. After consummation, FirstMerit would have approximately \$24 billion in consolidated assets and, by any of a number of alternative measures of firm size, FirstMerit would be between the 50th and 75th largest U.S. insured depository organization. The Board generally presumes that a merger resulting in a firm with less than \$25 billion in total consolidated assets will not pose significant risks to the financial stability of the United States absent evidence that the transaction would result in a significant increase in interconnectedness, complexity, cross-border activities, or other risk factors. Such additional risk factors are not present in this transaction. The companies engage and would continue to engage in traditional commercial banking activities. The resulting organization would experience small increases in the metrics that the Board considers to measure an institution's complexity and interconnectedness, with the resulting firm generally ranking outside of the top 50 U.S. financial institutions in terms of those metrics. For example, FirstMerit's intrafinancial assets and liabilities would comprise a negligible share of the system-wide total, both before and after the transaction. The resulting organization would not engage in complex activities, nor would it provide critical services in such volume that disruption in such services would have a great impact on the macroeconomic condition of the United States by disrupting trade or resulting in increased resolution difficulties.

In light of all the facts and circumstances, this transaction would not appear to result in meaningfully greater or more concentrated risks to the stability of the U.S. banking or financial system. Based on these and all other facts of record, the Board has determined that considerations relating to financial stability 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.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 the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by FirstMerit with all the conditions imposed in this order and the commitments made to the Board in connection with the application, including receipt of all required regulatory approvals. 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.

³⁸ For further discussion of the financial stability standard, see *Capital One Financial Corporation*, FRB Order No. 2012-2 (February 14, 2012).

³⁹ The public commenter requested that the Board hold a public 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 rules, the Board also may, in its discretion, hold a public hearing if appropriate to allow interested persons an opportunity to provide relevant testimony when written comments would not adequately present their views. The Board has considered the commenter's request in light of all the facts of record. In the Board's view, commenters have had ample opportunity to submit comments on the proposal and, in fact, submitted written comments that the Board has considered in acting on the proposal. The commenter's request does not identify disputed issues of fact that are material to the Board's decision and that would be clarified by a public hearing. In addition, the request does not demonstrate why the written comments do not present the commenter's views adequately or why a 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 hearing is not required or warranted in this case. Accordingly, the request for a public hearing on the proposal is denied.

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

By order of the Board of Governors, effective March 22, 2013.

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

Margaret McCloskey Shanks
Deputy Secretary of the Board

Trustmark Corporation Jackson, Mississippi

Order Approving the Acquisition of a Bank Holding Company and the Merger of Bank Holding Companies
FRB Order No. 2013-1 (January 24, 2013)

Trustmark Corporation (“Trustmark”), Jackson, Mississippi, has requested the Board’s approval under section 3 of the Bank Holding Company Act (“BHC Act”)¹ to acquire BancTrust Financial Group, Inc. (“BancTrust”), and thereby indirectly acquire BancTrust’s subsidiary bank, BankTrust (“BankTrust”), both of Mobile, Alabama. In addition, Trustmark has requested the Board’s approval under section 3 of the BHC Act to merge with BancTrust.²

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (77 *Federal Register* 42312 (July 18, 2012)). 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.

Trustmark, with total consolidated assets of approximately \$9.9 billion, is currently a bank holding company that owns all of Trustmark Bank and The Somerville Bank & Trust Company, Somerville, Tennessee (“Somerville Bank”). Trustmark is the 102nd largest depository organization in the United States, controlling approximately \$8.0 billion in deposits. Trustmark Bank operates branches in Mississippi, Florida, Tennessee, and Texas. In Florida, Trustmark Bank is the 80th largest insured depository institution, controlling deposits of approximately \$444 million, which represent about 0.1 percent of the total amount of deposits of insured depository institutions in that state.³ Somerville Bank operates only in Tennessee.

BancTrust, with total consolidated assets of approximately \$2.0 billion, is the 358th largest depository organization in the United States, controlling \$1.8 billion in deposits. BancTrust controls BankTrust, which has operations in Alabama and Florida. In Florida, BankTrust is the 154th largest insured depository institution, controlling about \$178 million in depos-

¹ 12 U.S.C. § 1842.

² After the transaction, Applicant plans to merge BankTrust with and into Trustmark’s subsidiary depository institution, Trustmark National Bank (“Trustmark Bank”), Jackson, Mississippi. The Office of the Comptroller of the Currency (“OCC”) has approved the proposed merger pursuant to the Bank Merger Act and the National Bank Act. 12 U.S.C. § 1828(c) and 12 U.S.C. § 215a.

³ Data are as of June 30, 2012. In this context, insured depository institutions include commercial banks, savings associations, and savings banks.

its, which represent about 0.04 percent of the total amount of deposits of insured depository institutions in the state.

On consummation of this proposal, Trustmark would become the 93rd largest depository organization in the United States with consolidated assets of approximately \$11.9 billion, controlling \$9.8 billion in deposits. Trustmark Bank would become the 60th largest insured depository institution in Florida, controlling approximately \$622 million in deposits, which represent approximately 0.14 percent of the total amount of deposits of insured depository institutions in the state.

Interstate and Deposit Cap Analysis

Section 3 of the BHC Act imposes certain requirements on interstate transactions. Section 3(d) generally provides that the Board may approve an application by a bank holding company (“BHC”) that is well capitalized and well managed⁴ to acquire a bank located in a state other than the home state of the BHC without regard to whether the transaction is prohibited under state law. However, this section further provides that the Board may not approve an application that would permit an out-of-state BHC to acquire a bank in a host state that has not been in existence for the lesser of the state statutory minimum period of time or five years.⁵ In addition, the Board may not approve an application by a BHC to acquire an insured depository institution if the home state of such insured depository institution is a state other than the home state of the BHC, and the applicant controls or would control more than 10 percent of the total amount of deposits of insured depository institutions in the United States (“nationwide deposit cap”).⁶

For purposes of the BHC Act, the home state of Trustmark is Mississippi and BankTrust’s home state is Alabama.⁷ Trustmark is well capitalized and well managed under applicable law. Alabama has a five-year minimum age requirement,⁸ and BankTrust has been in existence for more than five years.

Based on the latest available data reported by all insured depository institutions, the total amount of deposits of insured depository institutions in the United States is \$9.9 trillion. On consummation of the proposed transaction, Trustmark would control less than 1 percent of the total amount of deposits in insured depository institutions in the United States. Accordingly, in light of all the facts of record, the Board is not required to deny the proposal under section 3(d) of the BHC Act.

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

⁴ The standard was changed from adequately capitalized and adequately managed to well capitalized and well managed by section 607(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), Pub. L. No. 111-203, 124 Stat. 1376, codified at 12 U.S.C. § 1842(d)(1)(A).

⁵ 12 U.S.C. § 1842(d)(1)(B).

⁶ 12 U.S.C. § 1842(d)(2)(A). For a detailed discussion of the nationwide deposit cap, see *Bank of America Corporation/LaSalle*, 93 *Federal Reserve Bulletin*, 109, 109-110 (2007); *Bank of America Corporation/Fleet*, 90 *Federal Reserve Bulletin* 217, 219-220 (2004).

⁷ A bank holding company’s home state is the state in which the total deposits of all subsidiary banks of the 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). 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).

⁸ Ala. Code § 15-13B-6(d) (*LexisNexis* 2010).

banking in any relevant 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.⁹ The Board has considered the competitive effects of the proposal in light of all the facts of record. Trustmark and BancTrust compete directly in two banking markets in Florida: The Fort Walton and Panama City banking markets.¹⁰

The Board has reviewed the competitive effects of the proposal in the Fort Walton and Panama City banking markets. In particular, the Board has considered the number of competitors that would remain in the banking markets, the relative shares of total deposits in the depository institutions in the markets (“market deposits”) controlled by Trustmark and BancTrust, the concentration level of market deposits and the increase in that level as measured by the Herfindahl-Hirschman Index (“HHI”) under the Department of Justice Merger Competitive Review Guidelines (“DOJ Bank Merger Guidelines”),¹¹ and other characteristics of the markets.

Consummation of the proposal would be consistent with Board precedent and within the DOJ Bank Merger Guidelines in both banking markets. On consummation of the proposal, one market would remain unconcentrated and the other market would remain moderately concentrated, as measured by the HHI. The change in HHI in both markets would be small and consistent with Board precedent and the thresholds in the DOJ Bank Merger Guidelines. In both banking markets, numerous competitors would remain.¹²

The DOJ also has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the proposal was not likely to 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.

⁹ 12 U.S.C. § 1842(c)(1).

¹⁰ The Fort Walton Area banking market is defined as: Okaloosa and Walton Counties; and the western half of Holmes County, including the town of Ponce de Leon, all in Florida. The Panama City Area banking market is defined as: Bay and Gulf Counties; and the southern half of Washington County, including the towns of Vernon and Wausau, all in Florida.

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 anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. Although DOJ and the Federal Trade Commission issued revised Horizontal Merger Guidelines in 2010, *see* Press Release, Department of Justice (August 19, 2010), www.justice.gov/opa/pr/2010/August/10-at-938.html, the DOJ has confirmed that its Bank Merger Guidelines, which were issued in 1995, were not modified.

¹² Based on data as of June 30, 2012, Trustmark Bank is the 14th largest insured depository institution in the Fort Walton Area banking market, controlling deposits of \$123 million, representing approximately 2.89 percent of market deposits. BancTrust is the 11th largest insured depository institution, controlling deposits of \$136 million, representing 3.20 percent of market deposits. On consummation, Trustmark Bank would become the 8th largest insured depository institution, controlling deposits of \$260 million, representing 6.09 percent of market deposits. As a result, the HHI would increase by 18 points to 812, and 22 competitors would remain in the market.

In the Panama City Area market, Trustmark Bank is the 2nd largest insured depository institution, controlling deposits of \$320 million, representing 12.19 percent of market deposits. BancTrust is the 12th largest insured depository institution, controlling deposits of \$41 million, representing 1.58 percent of market deposits. Upon consummation, Trustmark Bank would remain the 2nd largest insured depository institution, controlling deposits of \$362 million, representing 13.8 percent of market deposits. As a result, the HHI would increase by 39 points, to 1356, and 17 competitors would remain in the market.

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 the two banking markets in which Trustmark and BancTrust compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

Other Section 3(c) Considerations

Section 3(c) of the BHC Act requires the Board to take into consideration a number of other factors in acting on bank acquisition applications. These factors include: the financial and managerial resources (including consideration of the competence, experience, and integrity of officers, directors, and principal shareholders) and future prospects of the company and banks concerned; effectiveness of the company in combatting money laundering; the convenience and needs of the community to be served; and the extent to which the proposal would result in greater or more concentrated risks to the stability of the United States banking or financial system.

The Board has considered all these factors and, as described below, has determined that all considerations are consistent with approval of the application. The review was conducted 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, information provided by Trustmark, and public comments received on the proposal.

A. Financial, Managerial, and Other Supervisory Considerations

In evaluating financial factors in expansionary 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. The Board evaluates the financial condition of the combined organization, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding on the transaction. The Board also considers the ability of the organization to absorb the costs of the proposal and the proposed integration of the operations of the institutions. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important.

The Board has considered the financial factors of the proposal. Trustmark, Trustmark Bank, and Somerville Bank are well capitalized and would remain so on consummation of the proposed transaction, which is a bank holding company merger, structured as an exchange of shares. Trustmark would issue new shares of common stock to complete the transaction. Trustmark is in stable financial condition, and the asset quality and earnings of both Trustmark Bank and Somerville Bank are consistent with approval. On a pro forma basis, the acquisition of BancTrust would not adversely impact Trustmark's operations financially. Based on its review of the record, the Board finds that the organization 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 Trustmark, Trustmark Bank, and Somerville Bank, including assessments of their management, risk management systems, and operations. Trustmark, Trustmark Bank, and Somerville Bank are considered to be well managed, and their boards of directors and senior management are considered experienced and capable. Following the merger, BancTrust and BankTrust would be integrated into

Trustmark's operations and governed by Trustmark's risk management, corporate governance, and compliance policies and procedures. Trustmark's existing risk-management program and its directorate and senior management are considered to be satisfactory. The directors and senior management of Trustmark, Trustmark Bank, and Somerville Bank, and the risk-management program of Trustmark, would not change as a result of the proposal. 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 financial and managerial resources and future prospects of the organizations involved are consistent with approval, as are the other supervisory factors.

B. 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 Reinvestment Act ("CRA").¹³ 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,¹⁴ 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.¹⁵

The Board has considered all the facts of record, including reports of examination of the CRA performance of Trustmark Bank, Somerville Bank, and BankTrust, data reported by Trustmark Bank under the Home Mortgage Disclosure Act ("HMDA"),¹⁶ other information provided by Trustmark, confidential supervisory information, and one public comment received on the proposal. The commenter objected to the proposal on the basis of Trustmark Bank's mortgage lending record. The commenter highlighted disparities in denial rates to African American and Hispanic applicants for conventional home purchase or refinance loans, relative to those for white applicants in the Jackson, Mississippi, Metropolitan Statistical Area ("MSA"). In addition, the commenter noted disparities in the level of conventional home purchase loans made to African American applicants as compared to white applicants in the Gulfport-Biloxi MSA, the Memphis MSA, and the Houston MSA.

1. Records of Performance Under the CRA

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.¹⁷ The CRA requires that the appropriate federal financial supervisor for a depository institution prepare a written evaluation of the institution's record of meeting the credit needs of its entire community, including LMI neighborhoods.¹⁸ An institution's most recent CRA performance evaluation is a particularly impor-

¹³ 12 U.S.C. § 1842(c)(2); 12 U.S.C. § 2901 *et seq.*

¹⁴ 12 U.S.C. § 201(b).

¹⁵ 12 U.S.C. § 2903.

¹⁶ 12 U.S.C. § 2801 *et seq.*

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

¹⁸ 12 U.S.C. § 2906.

tant 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.

CRA Performance of Trustmark Bank. Trustmark Bank was assigned an “outstanding” rating at its most recent CRA performance evaluation by the OCC, as of April 12, 2010 (“Trustmark Evaluation”). In general, examiners concluded that Trustmark Bank had an excellent record of lending inside its assessment areas by number and dollar amount of loans and that its community development lending performance was excellent. In particular, examiners stated that Trustmark Bank used flexible and innovative loan products. The bank received a “high satisfactory” rating on the lending test and “outstanding” ratings on both the investment and service tests.¹⁹

CRA Performance of Somerville Bank. Somerville Bank was assigned a “satisfactory” rating at its most recent CRA performance evaluation by the Federal Deposit Insurance Corporation (“FDIC”), as of August 11, 2008 (“Somerville Evaluation”).²⁰ In general, examiners concluded that Somerville Bank exhibited a reasonable penetration of lending among individuals of different income levels and had an excellent record of small business lending.

CRA Performance of BankTrust. BankTrust received an overall “satisfactory” rating at its most recent CRA performance evaluation by the FDIC, as of April 19, 2010 (“BankTrust Evaluation”).²¹ The bank received “high satisfactory” ratings on the lending and service tests and a “needs to improve” rating on the investment test. Examiners reported that BankTrust’s lending performance reflected a good record of serving the credit needs of the most economically disadvantaged assessment areas, low-income individuals, and very small businesses consistent with safe and sound business practices.

2. HMDA Analysis and Fair Lending Record

The Board has considered the records of Trustmark Bank in complying with fair lending and other consumer protection laws. The commenter cited HMDA data and alleged that Trustmark Bank disproportionately denied applications by minority applicants for conventional home purchase or refinance loans in the Jackson, Mississippi, MSA. In addition, the commenter alleged disparities in the level of conventional home purchase loans made to African American applicants compared to white applicants in the Gulfport, Memphis, and Houston markets.

The Board has reviewed HMDA data from 2010 and 2011 reported by Trustmark Bank, focusing on 2011, the most recent publicly available data.²² The HMDA data indicate that the ratio of the denial rate for African American or Hispanic applicants to the denial rate

¹⁹ The evaluation period for the Lending Test in the Trustmark Evaluation was January 1, 2006, through December 31, 2009, except for community development loans, which had an evaluation period from July 12, 2006, through April 12, 2010. The evaluation period for the Investment and Service Tests was from July 12, 2006, through April 12, 2010.

²⁰ The period for home mortgage data evaluation in the Somerville Evaluation was January 1, 2006, through March 31, 2008 and the period of small business loan origination evaluation was July 23, 2007 through July 23, 2008.

²¹ The period for mortgage data evaluated in the BankTrust Evaluation was January 1, 2008, through December 31, 2009. The period for small business data evaluated was January 1, 2009, through December 31, 2009, with a sampling of loans from 2008. The period of community development loans evaluated was February 22, 2007, through April 19, 2010.

²² The Board reviewed HMDA data for Trustmark Bank in its assessment areas on a combined basis (“the combined assessment areas”) for both loan denial disparities and loan penetration and separately reviewed portions of the bank’s assessment areas located within the specific metropolitan areas cited by the commenter: Jackson, Mississippi, Gulfport-Biloxi, Mississippi, Memphis, Tennessee, and Houston, Texas, for the concerns raised by the commenter relevant to a specific MSA.

for white, non-Hispanic applicants was higher for the bank than for the aggregate of all HMDA reporters in the Jackson MSA and in the bank's combined assessment areas. In addition, Trustmark Bank's number of originations from African American applicants as a percentage of its total HMDA originations in 2011 was lower than the aggregate's percentage in the portion of the bank's assessment areas in the Gulfport-Biloxi MSA, the Memphis MSA, and the Houston MSA, although the bank's percentage of originations to African American applicants was higher than the aggregate's in the bank's combined assessment areas in 2011.

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. 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, HMDA data alone do not provide a sufficient basis on which to conclude whether Trustmark Bank has excluded or denied credit to any group on a prohibited basis.²³

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 by Trustmark Bank with fair lending laws and regulations. The Board also has consulted with the OCC about this proposal, including the record of Trustmark Bank with fair lending laws and regulations since the Trustmark Evaluation.

The Trustmark Evaluation. As described in the Trustmark Evaluation, above, Trustmark Bank provides significant levels of community development loans and qualified community development investments. In the Trustmark Evaluation, examiners noted that service delivery systems were readily accessible to all portions of the assessment areas, commensurate with the size and scope of the operations of the bank. Examiners found that Trustmark Bank provided a relatively high level of community development services that were responsive to a variety of community development needs.

Examiners stated that the bank had responded to other community credit needs, such as affordable housing for LMI geographies and borrowers, through extensive transactions associated with community development loans, investments, and services.²⁴ With respect to community development services, Trustmark Bank employs a full-time Community Outreach Coordinator who is responsible for providing financial education classes to LMI individuals, working with the bank's originators to increase lending to LMI individuals, and working with housing-related entities to educate consumers and promote homeownership.

The OCC assigned Trustmark Bank a rating of "High Satisfactory" for the Lending Test, noting that the bank's lending activity was excellent. Examiners found that Trustmark Bank's geographic distribution of home mortgage and small business loans was adequate and that the distribution of home mortgage loans by income level of the borrower and the distribution of loans by size of business were good. Examiners determined that Trustmark

²³ 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 (the reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

²⁴ Trustmark Bank's performance in Mississippi was given considerably more weight than its performance in other states that are part of its assessment area to reflect the fact that 82 percent of the bank's deposits were booked in branches in Mississippi.

Bank had an excellent record of lending within its assessment areas by number and dollar amount of loans. Examiners found that Trustmark Bank's community development lending performance was excellent and highlighted the bank's origination of more than \$97 million of community development loans in Mississippi. Examiners also stated that Trustmark Bank's use of flexible and innovative loan products had a positive impact on the bank's performance under the Lending Test.

Examiners assigned Trustmark Bank a rating of "Outstanding" for the Investment Test and noted the bank's excellent level of qualified community development investments. In particular, examiners highlighted qualified investments, grants, and donations totaling \$36.3 million in the bank's full-scope assessment areas in Mississippi. Most of those investments provided for: the construction, repair, and expansion of schools serving primarily LMI students; funding home ownership and rental housing for LMI households; and a project to revitalize and stabilize a low-income area.

Trustmark Bank's efforts since the 2010 CRA Evaluation. Trustmark states that Trustmark Bank reported almost 14,000 HMDA, small business and small farm loans totaling approximately \$2 billion for 2011. In addition, Trustmark indicated that the bank made 50 community development loans totaling \$65 million during 2010 and 35 community development loans totaling \$59 million in 2011. Trustmark also reported that Trustmark Bank made approximately \$54 million in qualified community development investments from July 10, 2010, through July of 2012, including investments in GNMA and FNMA mortgage-backed securities, low-income-housing tax credits, new market tax credit projects, and contributions to nonprofit organizations serving LMI individuals.

Trustmark Bank's Fair Lending Program. The Board also considered information about Trustmark Bank's compliance and risk management systems and the steps it has taken to ensure compliance with fair lending laws. Trustmark Bank has instituted policies and procedures to help ensure compliance with all fair lending and other consumer protection laws and regulations. Trustmark Bank's fair lending program includes a separate fair lending department led by a full-time person, a second review process, various policies and procedures,²⁵ training, and internal fair lending risk assessments. Trustmark Bank also has a second review committee, which reviews all home mortgage loan applications initially recommended for denial or for approval based on a policy exception. The bank completes quarterly reviews of compliance with Trustmark Bank's fair lending policies. Trustmark's risk-management systems and policies and procedures for assuring compliance with fair lending laws will be implemented at the combined organization.

Consultation with the OCC. As previously noted, the Board has reviewed the Trustmark Evaluation and consulted with the OCC with respect to Trustmark's record of fair lending performance since the Trustmark Evaluation. In its review, the OCC relied in large part on data gathered as part of its supervisory process to satisfy it that Trustmark did not engage in discriminatory conduct. The OCC did not find evidence that indicates the presence of prohibited discrimination or other illegal credit practices by Trustmark. In addition, the OCC has indicated that the bank's operations and compliance program are compliant with fair lending and other consumer protection laws.

²⁵ To assure underwriting consistency, the bank's centralized underwriting center consults a database of all applications that were declined or approved with a policy exception before permitting a new application with a policy exception to be declined or approved. Trustmark Bank's Retail Credit Administration and Fair Lending Department performs an ongoing Fair Lending Risk Assessment designed to identify areas of inherent risk associated with products, delivery channels, and disparity in decline ratios. This assessment is reviewed and changed as products, branches, and underwriting guidelines change, and as fair lending complaints and other pertinent issues arise.

3. Convenience and Needs of Communities Served by BankTrust

Trustmark represents that the proposal would benefit the convenience and needs of the communities currently served by BankTrust in several ways. Primarily, Trustmark asserts that the proposed transaction would strengthen BankTrust and enable it to be a stronger and more active participant in the markets it serves. Specifically, Trustmark indicated that the merged bank would have expanded lending capacity and a higher legal lending limit and that no broad or material categories of BankTrust products would be eliminated. In addition, consummation of the proposal would provide access to a larger ATM network to current customers of Trustmark Bank and BankTrust and would provide BankTrust customers access to Trustmark Bank's expertise as a Small Business Administration Preferred Lender.

4. Conclusion on Convenience and Needs Considerations

The Board has considered all the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by Trustmark, and confidential supervisory information. Based on the Board's analysis of the HMDA data, evaluation of Trustmark Bank's mortgage lending operations and compliance programs, review of examination reports, and consultations with the OCC, the Board believes that the convenience and needs factor, including the CRA record of the insured depository institutions involved in this transaction, is consistent with approval of the application. The Board encourages Trustmark Bank to continue to seek opportunities to assist in meeting the credit needs of the communities it serves.

C. Financial Stability

The Dodd-Frank Act amended section 3 of the BHC Act to require the Board to consider "the extent to which a proposed acquisition, merger, or consolidation would result in greater or more concentrated risk to the stability of the United States banking or financial system."²⁶

To assess the likely effect of a proposed transaction on the stability of the U.S. banking or financial system, the Board considers a variety of metrics that capture the systemic "footprint" of the resulting firm and the incremental effect of the transaction on the systemic footprint of the acquiring firm. These metrics include measures of the size of the resulting firm; the availability of substitute providers for any critical products and services offered by the resulting firm; the interconnectedness of the resulting firm with the banking or financial system; the extent to which the resulting firm contributes to the complexity of the financial system; and the extent of the cross-border activities of the resulting firm.²⁷ These categories are not exhaustive, and additional categories could inform the Board's decision. In addition to these quantitative measures, the Board considers qualitative factors, such as the opacity and complexity of an institution's internal organization, that are indicative of the relative degree of difficulty of resolving the resulting firm. A financial institution that can be resolved in an orderly manner is less likely to inflict material damage to the broader economy.²⁸

The Board has considered information relevant to risks to the stability of the U.S. banking

²⁶ Section 604(d) of the Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376, codified at 12 U.S.C. § 1842(c)(7).

²⁷ Many of the metrics considered by the Board measure an institution's activities relative to the U.S. financial system.

²⁸ For further discussion of the financial stability standard, see *Capital One Financial Corporation*, FRB Order No. 2012-2 (February 14, 2012).

or financial system. After consummation, Trustmark would have assets well below the threshold established by the Board for transactions that are presumed to raise financial stability concerns absent evidence that the transaction would result in a significant increase in interconnectedness, complexity, cross-border activities, or other risk factors. Such other risk factors are not present in this transaction. The companies engage and would continue to engage in traditional commercial banking activities. The resulting organization would experience small increases in the metrics that the Board considers to measure an institution's complexity and interconnectedness with the resulting firm generally ranking outside, and often well outside, of the top 100 U.S. financial institutions in terms of those metrics. The resulting organization would not engage in complex or international activities, nor would it provide critical services whose disruption would impact the macroeconomic condition of the United States by disrupting trade or resulting in increased resolution difficulties.

In light of all the facts and circumstances, this transaction would not appear to result in meaningfully greater or more concentrated risks to the stability of the U.S. banking or financial system. Based on these and all other facts of record, the Board has determined that considerations relating to financial stability are consistent with approval.

Conclusion on Section 3(c) Factors

Based on all the facts of record, including those described above, the Board has determined that all of the factors it must consider under section 3(c) of the BHC Act are consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has approved the proposed transaction.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 and other applicable statutes.³⁰ The Board's approval is specifically conditioned on compliance by Trustmark Corporation with all the commitments made to and relied on by the Board in connection with the application and on receipt of all other regulatory approvals. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing

²⁹ The commenter requested that the Board extend the comment period. The Board believes that the record in this case does not warrant postponing its consideration of the proposal. During the applications process, the Board accumulated a significant record, including reports of examination, supervisory information, public reports and information, and public comment. The Board believes this record is sufficient to allow it to assess the factors it is required to consider under the BHC Act. The BHC Act and the Board's processing rules establish time periods for consideration and action on acquisition proposals. Moreover, as discussed above, the CRA requires the Board to consider the existing record of performance of an organization and does not require an organization to enter into contracts or agreements with interested parties to implement its CRA programs. For the reasons discussed above, the Board believes that commenter has had ample opportunity to submit views, and in fact, the commenter has provided substantial 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 concludes that granting an extension of the comment period is not warranted.

³⁰ The 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 comment 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.

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, 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 January 24, 2013.

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

Margaret McCloskey Shanks
Deputy Secretary of the Board

Order Issued Under International Banking Act

NongHyup Bank
Seoul, Republic of Korea

Order Approving Establishment of a Branch and a Representative Office
FRB Order No. 2013-2 (January 28, 2013)

NongHyup Bank (“NH Bank”), Seoul, Republic of Korea, a foreign bank within the meaning of the International Banking Act (“IBA”), has applied under sections 7(d) and 10(a) of the IBA¹ to establish a state-licensed branch and a representative office (“U.S. offices”), both 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 or representative office in the United States.

Notice of the applications, affording interested persons an opportunity to comment, has been published in a newspaper of general circulation in New York, New York (*New York Post*, April 19, and July 30, 2012). The time for filing comments has expired, and all comments received have been considered.

NH Bank, with total consolidated assets of approximately \$175 billion, is a newly chartered banking entity resulting from an internal corporate restructuring of National Agricultural Cooperative Federation (“NACF”), also of Seoul.² NH Bank is wholly owned by NH Financial Group Inc. (“NHFG”) which, in turn, is wholly owned by NACF.³

NHFG and NH Bank were established as of March 2, 2012, pursuant to an amendment to the Korean National Agricultural Cooperative Federation Act, which separated NACF’s financial and non financial activities. On that date, by operation of Korean law, NACF’s credit and banking businesses were transferred to NH Bank. NH Bank assumed NACF’s banking business in its entirety and succeeded to all of NACF’s rights and obligations associated therewith. As of year-end 2011, NH Bank would have been the fourth largest

¹ 12 U.S.C. §§ 3105(d) and 3107(a).

² Asset data is as of September 30, 2012.

³ NACF is a special-purpose entity created by the Korean government that acts as an umbrella organization for Korean agricultural cooperatives. NACF is entirely owned by its member agricultural cooperatives. No shareholder, directly or indirectly, owns 5 percent or more of the voting shares of NACF.

banking institution in Korea based on asset size.⁴ NH Bank engages in commercial banking activities through its head office and approximately 1,172 branch offices in Korea, including general commercial, agricultural and credit card lending, trust activities, and deposit taking. In the United States, NACF operates a representative office in New York City and a nonbank company in Cerritos, California.⁵ Upon the establishment of the proposed branch, NACF, NHFG, and NH Bank would all be qualifying foreign banking organizations under Regulation K.⁶

The proposed representative office would assume the current business of NACF's existing representative office. When NH Bank establishes the proposed branch, the proposed representative office would be closed. The proposed representative office would act as liaison between NH Bank and its customers in the United States and would engage in other representational activities, including soliciting purchasers of loans and parties to contract with NH Bank for the servicing of NH Bank loans; and conducting research.⁷ The proposed representative office would also solicit loans in principal amounts of \$250,000 or more and, in connection with those loan proposals, would assemble credit information, make property inspections and appraisals of property, secure title information, and prepare loan applications and make recommendations. The proposed branch would provide remittance/money transmittal services for existing NH Bank customers in Korea; trade finance services, such as letters of credit and bankers acceptances, on behalf of NH Bank and its Korean branches for Korean companies and U.S. companies seeking to do business with Korea; and financing for Korean and other companies with subsidiaries or branches in the United States.

Under the IBA and Regulation K, in acting on an application by a foreign bank to establish a branch or a representative office, the Board must consider whether the foreign bank (1) engages directly in the business of banking outside the United States; (2) has furnished to the Board 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.⁸ The Board also considers additional standards set forth in the IBA and Regulation K.⁹

⁴ This ranking is based on the asset size of NACF's banking business prior to the restructuring and includes trust accounts.

⁵ See e.g., *National Agricultural Cooperative Federation*, 96 *Federal Reserve Bulletin* B27 (2010). Through a Korean nonbanking subsidiary, NACF has an indirect U.S. subsidiary that engages primarily in agricultural market research, marketing Korean agricultural products, and other nonbanking activities. NACF has similar establishments in Tokyo and Beijing. NACF would hold its indirect U.S. subsidiary pursuant to section 2(h)(2) of the Bank Holding Company Act. 12 U.S.C. § 1841(h)(2).

⁶ 12 CFR 211.23(a).

⁷ 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).

⁸ 12 U.S.C. §§ 3105(d)(2) and 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.

⁹ See 12 U.S.C. § 3105(d)(3)-(4); 12 CFR 211.24(c)(2). These standards include: 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 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

The IBA includes a limited exception to the general standard relating to comprehensive, consolidated supervision.¹⁰ 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 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.¹¹ This is the standard applied in this case. 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.¹² 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.¹³

As noted above, NH Bank engages directly in the business of banking outside the United States. NH Bank has provided the Board with the information necessary to assess the applications through submissions that address the relevant issues.

With respect to supervision by home country authorities, the following factors have been taken into consideration. NH Bank is subject to oversight by a number of Korean government agencies, including the Financial Supervisory Service (“FSS”), in a manner different from other Korean commercial banks.¹⁴ As NH Bank is a specialized bank that is part of an agricultural cooperative, several other governmental agencies, in addition to the FSS, participate in the supervision of NH Bank and in the oversight of its parent companies. These include the Ministry for Food, Agriculture, Forestry, and Fisheries (“Food and Agriculture Ministry”); the Ministry of Strategy and Finance; and the Board of Audit and Inspection. Under applicable Korean law, the Financial Services Commission, whose executive body is the FSS, must take into account the unique objectives of NH Bank and consult with the Food and Agriculture Ministry before imposing sanctions on or granting authorizations to the bank. NH Bank’s direct parent, NHFG, is supervised as a financial holding company by the FSS, while NH Bank’s ultimate parent, NACF, is supervised by the Food and Agriculture Ministry, which inspects each NACF unit over the course of a three-year schedule. Additionally, NACF is subject to periodic on-site examination of all its businesses by the Korean National Assembly’s Committee of Agriculture, Forestry and Ocean in connection with its oversight of the Korean agricultural industry. NH Bank is subject to lower liquidity requirements than commercial banks and, in connection with its formation, was granted temporary authority to extend credit to other business units in the NACF group.

efforts to combat money laundering; 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; and the bank’s record of operation. 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).

¹⁰ 12 U.S.C. § 3105(d)(6).

¹¹ 12 U.S.C. § 3105(d)(6)(A).

¹² 12 U.S.C. § 3105(d)(6)(B).

¹³ *Id.*

¹⁴ The FSS is the executive body of the Financial Services Commission (“FSC”), which is responsible for promulgating supervisory regulations, making policy decisions about supervision, and imposing sanctions on Korean financial institutions. The FSS is responsible for the supervision of Korean financial institutions, including overseas offices, pursuant to regulations promulgated by the FSC.

The structure of NH Bank is new and was designed to permit more effective supervision of the banking operations of the NACF organization. This restructuring has caused a realignment of the regulatory structure applicable to NH Bank as well. This regulatory structure involves a combination of agencies and a balancing of missions that is different than the regulatory structure previously reviewed by the Board for other Korean banks.¹⁵ The relevant Korean authorities are working together to fully implement a supervisory framework that will effectively supervise NH Bank on a worldwide consolidated basis.

Korea is a member of the Financial Action Task Force (“FATF”) and subscribes to its recommendations regarding measures to combat money laundering and international terrorism. In accordance with those recommendations, Korea 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 Korea, and financial services businesses are required to establish internal policies, procedures, and systems for the detection and prevention of money laundering throughout their worldwide operations. NH Bank has policies and procedures to comply with those laws and regulations, and these policies and procedures are monitored by governmental entities responsible for anti-money laundering compliance.

Based on all the facts of record, it has been determined that NH Bank’s home country supervisory authorities are actively working to establish arrangements for the consolidated supervision of NH Bank. Considerations relating to the steps taken by NH Bank and its home jurisdiction to combat money laundering are consistent with approval under this standard.

The additional standards set forth in section 7 of the IBA and Regulation K also have been taken into account.¹⁶ The FSS has no objection to the establishment of the proposed branch and representative office.

The financial and managerial factors in this case have been considered and are consistent with approval of the proposed offices. Korea’s risk-based capital standards are consistent with those established by the Basel Capital Accord. NH Bank’s capital is in excess of the minimum levels that would be required of a U.S. banking organization. Managerial and other financial resources of NH Bank are consistent with approval, and NH Bank appears to have the experience and capacity to support the proposed branch. In addition, NH Bank has established controls and procedures for the proposed U.S. offices to ensure compliance with U.S. law.

With respect to access to information about NH Bank’s operations, the restrictions on disclosure in relevant jurisdictions in which NH Bank operates have been reviewed and relevant government authorities have been communicated with regarding access to information. NH Bank and NACF have committed to make available to the Board such information on the operations of NH 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.¹⁷ To the extent that providing such information to the Board may be prohibited by law or otherwise, NH Bank and NACF 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

¹⁵ See *Shinhan Financial Group Co., Ltd.*, 90 *Federal Reserve Bulletin* 85 (2004); *Woori Finance Holdings Co., Ltd.*, 89 *Federal Reserve Bulletin* 436 (2003).

¹⁶ See 12 U.S.C. § 3105(d)(3)-(4); 12 CFR 211.24(c)(2).

¹⁷ NACF previously provided this commitment to the Board in connection with its application to establish a representative office in 2010. See *supra*, note 4.

addition, subject to certain conditions, the FSC and FSS may share information on NH 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 NH Bank and NACF have provided adequate assurances of access to any necessary information that the Board may request.

Section 173 of the Dodd-Frank Act amended the IBA to provide that the Board may consider, for a foreign bank that presents a risk to the stability of the United States financial system, 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.¹⁸ 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 NH Bank in its home country, the scope of NH 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 NH Bank in its home country. Based on these and other factors, financial stability considerations in this proposal are consistent with approval.

On the basis of all the facts of record, and subject to the commitments made by NH Bank and NACF, NH Bank's applications to establish the proposed U.S. offices are 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.¹⁹ Should any restrictions on access to information on the operations or activities of NH Bank and its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by NH Bank or its affiliates with applicable federal statutes, the Board may require termination of any of NH Bank's direct or indirect activities in the United States. Approval of the applications also is specifically conditioned on compliance by NH Bank and NACF with the conditions imposed in this order and the commitments made to the Board in connection with this application.²⁰ For purposes of this action, these commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with this decision and, as such, may be enforced in proceedings under applicable law.

By order, approved pursuant to authority delegated by the Board, effective January 28, 2013.

Margaret McCloskey Shanks
Deputy Secretary of the Board

¹⁸ 12 U.S.C. § 3105(d)(3)(E).

¹⁹ 12 CFR 265.7(d)(12).

²⁰ The Board's authority to approve the establishment of the proposed representative office and 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 or its agent, the New York State Department of Financial Services, to license the proposed offices of NH Bank in accordance with any terms or conditions that it may impose.



Federal Reserve
BULLETIN

Legal Developments: Second Quarter, 2013

No orders or decisions were released in the second quarter of 2013.

Legal Developments: Third Quarter, 2013

Orders Issued Under Bank Holding Company Act

Order Issued Under Section 3 of the Bank Holding Company Act

Hana Financial Group Inc.
 Seoul, Republic of Korea

Order Approving Acquisition of Shares of a Bank Holding Company
FRB Order No. 2013-4 (August 14, 2013)

Hana Financial Group Inc., Seoul, Republic of Korea (“HFG”), a foreign banking organization subject to the provisions of the Bank Holding Company Act, as amended (“BHC Act”),¹ has requested the Board’s approval under section 3 of the BHC Act to acquire up to 71.4 percent of the voting shares of BNB Financial Services Corporation (“BNB”), New York, New York, and indirectly acquire BNB Bank, National Association, Fort Lee, New Jersey, pursuant to section 3(a)(1) of the BHC Act.²

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (77 *Federal Register* 48984, August 15, 2012). 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.

HFG, with total assets of approximately \$260.4 billion, is the third largest banking organization in Korea.³ HFG, through its subsidiaries, Hana Bank and Korea Exchange Bank (“KEB”), both of Seoul, engages in a broad range of banking and financial services throughout the world, including retail and commercial banking, corporate and investment banking, asset management, insurance-related activities, leasing, foreign exchange, and trade finance.

Internationally, HFG operates through its branches and subsidiaries in five continents, including Asia, Australia, Europe, and North and South America. In the United States, Hana Bank operates an uninsured New York state-licensed agency. HFG also maintains nonbanking subsidiaries in the United States.⁴

¹ 12 U.S.C. § 1842.

² 12 CFR 225.11(c)(1).

³ Unless otherwise provided, asset and ranking data are as of March 31, 2013, and are based on the exchange rate as of that date, as appropriate.

⁴ KEB does not engage in commercial banking activities in the U.S., but owns several U.S. nonbank subsidiaries. The nonbanking subsidiaries are KEB NY Financial Corp. and KEB USA International Corp., both of New York, New York; and KEB LA Financial Corp., Los Angeles, California. KEB NY and KEB LA provide lending and trade financing services, while KEB USA engages in activities limited to providing administrative back-office functions to KEB.

HFG is a qualifying foreign banking organization and, upon consummation of the proposal, would continue to meet the requirements for a qualifying foreign banking organization under Regulation K.⁵

BNB, with total consolidated assets of \$320.1 million, owns BNB Bank and a non-bank subsidiary, BNB Statutory Trust I (“BNB Trust”), also of New York, New York.⁶ BNB Bank provides general commercial banking services to individuals and small- and medium-sized businesses through its three branches, two in New Jersey and one in New York. The bank also has two loan production offices in New Jersey.

Factors under the Bank Holding Company Act

The BHC Act sets forth the factors that the Board must consider when reviewing the formation of bank holding companies or the acquisition of banks. These factors are the competitive effects of the proposal in the relevant geographic markets; the convenience and needs of the communities to be served, including the records of performance of the insured depository institutions involved in the transaction under the Community Reinvestment Act (“CRA”);⁷ the effects of the acquisition on financial stability; the financial and managerial resources and future prospects of the companies and banks involved in the proposal; the availability of information to determine and enforce compliance with the BHC Act and other applicable federal banking laws; and, in the case of applications involving a foreign bank such as Hana Bank, whether the foreign bank is subject to comprehensive supervision and regulation on a consolidated basis by its home country supervisor.⁸

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 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 clearly are 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

HFG does not currently compete with BNB in any relevant banking or nonbanking market.¹⁰ 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 factors are consistent with approval of the proposal.

Financial, Managerial, and Other Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources (including the competence, experience, and integrity of officers, directors, and principal shareholders) and future prospects of the companies and depository institutions

⁵ 12 CFR 211.23(a).

⁶ BNB Trust was established in 2004 to issue trust preferred securities for BNB.

⁷ 12 U.S.C. § 2901 *et seq.*

⁸ 12 U.S.C. § 1842(c).

⁹ 12 U.S.C. § 1842(c)(1). *See e.g., Emigrant Bancorp, Inc., 82 Federal Reserve Bulletin 555 (1996).*

¹⁰ Hana Bank’s New York agency is not insured by the Federal Deposit Insurance Corporation and cannot accept retail deposits. BNB’s only nonbank subsidiary is a trust company that provides services solely to BNB Bank, while Hana’s nonbank subsidiaries engage in lending, trade finance and money transmittal services.

involved in the proposal as well as the effectiveness of these companies in combatting money laundering activities.¹¹ The Board's review was conducted in light of all the facts of record, including confidential supervisory and examination information from the various U.S. banking supervisors of the institutions involved, publicly reported and other financial information, and information provided by HFG and by public commenters. The Board also has consulted with the Korean Financial Supervision Service ("FSS"), the agency with primary responsibility for the supervision and regulation of Korean banking organizations, including HFG.

In evaluating financial factors, the Board reviews the financial condition of the applicant and the target depository institution. The Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. The Board also evaluates the effect of the transaction on the financial condition of the applicant, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The capital levels of HFG 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.¹² HFG's reported earnings performance and asset quality indicators, including nonperforming loans and reserves for loan losses, are consistent with approval of the proposal. The proposed transaction is structured as a cash purchase of shares. HFG would use existing resources to fund the purchase of the shares. In light of the size of HFG relative to the size of its investment in BNB, the transaction would have a minimal impact on the financial condition of HFG. Based on its review of the record, the Board finds that HFG 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 HFG's U.S. operations and of BNB, including assessments of their management, risk-management systems, and operations. The Board also has considered its supervisory experience and that of the other relevant bank supervisory agencies with the organizations, including consultations in connection with this proposal, and the organizations' records of compliance with applicable banking and anti-money-laundering laws. As noted, the Board has also consulted with the FSS. In addition, the Board has considered the future prospects of HFG in light of the financial and managerial resources of the organizations.

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.¹³ The Board has reviewed the restrictions on disclosure in the relevant jurisdictions in which HFG operates and has communicated with relevant government authorities concerning access to information. In addition, HFG has committed that, to the extent not prohibited by applicable law, it will make available to the Board such information on its operations and 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. HFG also has

¹¹ 12 U.S.C. § 1842(c)(2), (5), and (6). The Board has analyzed the effectiveness of HFG's anti-money-laundering efforts in connection with the Board's assessment of whether HFG is subject to comprehensive supervision or regulation on a consolidated basis by appropriate authorities in its home country.

¹² The Board considered the total and tier 1 risk-based capital ratios and the ratio of tier 1 capital to total consolidated assets of HFG, Hana Bank, and KEB.

¹³ 12 U.S.C. § 1842(c)(3)(A).

committed to cooperate with the Board to obtain any waivers or exemptions that may be necessary to enable it or its affiliates to make such information available to the Board. 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, as well as access to information by the Board are consistent with approval.

Supervision or Regulation on a Consolidated Basis

In evaluating this application and as required by section 3 of the BHC Act, the Board considered whether HFG is subject to comprehensive supervision or regulation on a consolidated basis by appropriate authorities in its home country.¹⁴

As noted, the FSS is the supervisor of Korean banking organizations, including holding companies such as HFG. The FSS conducts inspections of HFG and its subsidiaries annually or on an as needed basis, and requires HFG to submit reports about its operations on a consolidated basis. The FSS also reviews transactions between HFG and its subsidiaries and has authority to require HFG to take measures necessary to ensure the safety and soundness of the HFG organization. The Board has previously determined that the FSS exercises comprehensive consolidated supervision over Korean financial holding companies and banks.¹⁵ HFG represents, on its own behalf and with respect to Hana Bank and KEB, that they are subject to the same supervisory regime as applies to other Korean financial holding companies and banks. The Board also has consulted with the FSS about their supervision of Hana Bank, KEB, and HFG. Based on all the facts of record, the Board has concluded that HFG, Hana Bank and KEB are subject to comprehensive supervision on a consolidated basis by their appropriate home country authorities for purposes of this application.

In evaluating the effectiveness of HFG and its subsidiaries' policies and procedures to combat money laundering activities in connection with these determinations, the Board considered HFG's and its subsidiaries' anti-money-laundering policies and procedures as well as the Board's supervisory experiences and those of other relevant banking supervisory organizations with HFG's compliance record. On the basis of all facts of record, the Board has determined that HFG and its subsidiaries' anti-money-laundering measures are consistent with approval.

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

¹⁴ 12 U.S.C. § 1842(c)(3)(B). As provided in Regulation Y, the Board determines whether a foreign bank is subject to comprehensive supervision on a consolidated basis by the appropriate authorities in the bank's home country under the standards set forth in Regulation K. See 12 CFR 225.13(a)(4). Regulation K provides that a foreign bank is subject to consolidated home country supervision if the foreign bank is supervised or regulated in such a manner that its home-country supervisor receives sufficient information on the worldwide operations of the foreign bank (including the relationships of the bank to any affiliate) to assess the foreign bank's overall financial condition and compliance with law and regulation. 12 CFR 211.24(c)(1)(ii). In assessing this standard under section 211.24 of Regulation K, the Board must assess, among other factors, the extent to which the home country supervisor: (a) ensures that the bank has adequate procedures for monitoring and controlling its activities worldwide; (b) obtains information on the condition of the bank and its subsidiaries and offices outside the home country through regular reports of examination, audit reports, or otherwise; (c) obtains information on the dealings and relationships between the bank and its affiliates, both foreign and domestic; (d) 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 (e) 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.

¹⁵ See *Woori Finance Holdings Co., Ltd.*, 89 *Federal Reserve Bulletin* 436 (2003).

take into account the records of the relevant insured depository institutions under the CRA.¹⁶ 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.¹⁷

The Board has considered the convenience and needs factor and the CRA performance record of BNB in light of all the facts of record. HFG represented that it intends to leverage its resources and banking expertise to strengthen BNB Bank, and to update and expand the products and services that BNB Bank offers to its customers.

As part of its consideration of convenience and needs, the Board has examined the CRA performance record of BNB Bank. BNB Bank received a CRA rating of "satisfactory" from the Office of the Comptroller of the Currency at its most recent CRA performance evaluation dated March 12, 2012. HFG does not own any entities that are subject to CRA. 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 the relevant insured depository institutions are consistent with approval.

Financial Stability

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") amended section 3 of the BHC Act to require the Board also to consider "the extent to which a proposed acquisition, merger, or consolidation would result in greater or more concentrated risks to the stability of the United States banking or financial system."¹⁸

In this case, the proposed acquisition of BNB is not a significant expansion by HFG and would have a de minimis impact on HFG's systemic footprint. In addition, there is no evidence of any significant increase in interconnectedness, complexity, cross-border activities, or other risk factors. Based on these and all the other facts of record, the Board has determined that the proposal would not materially increase risk to the stability of the U.S. financial or banking system.

Conclusion

Based on the foregoing and all the facts of record, the Board approves the proposal by HFG to acquire up to 71.4 percent of the voting shares of BNB. 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 HFG with all the representations and commitments made in connection with the applications, commitments referred to in this order, and the receipt of all other regulatory approvals. These representations, 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 transaction 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,

¹⁶ 12 U.S.C. § 2901 *et seq.*; 12 U.S.C. § 1842(c)(2).

¹⁷ 12 U.S.C. § 2903.

¹⁸ Section 604(d) of the Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376, codified at 12 U.S.C. § 1842(c)(7).

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 August 14, 2013.

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

Margaret McCloskey Shanks
Deputy Secretary of the Board

Order Issued Under Section 4 of the Bank Holding Company Act

Live Oak Bancshares, Inc.
Wilmington, North Carolina

Order Approving Notice to Engage in Nonbanking Activities
FRB Order No. 2013-5 (August 14, 2013)

Live Oak Bancshares, Inc. (“Live Oak”), Wilmington, North Carolina, has requested the Board’s approval under sections 4(c)(8) and 4(j) of the Bank Holding Company Act (“BHC Act”)¹ and section 225.24 of the Board’s Regulation Y² to acquire Government Loan Solutions, Inc. (“GLS”), Cleveland, Ohio.³ GLS provides support services in connection with the settlement, accounting, and securitization processes for government-guaranteed loans, including loans originated under section 7(a) of the Small Business Administration Act (“SBA”) and U.S. Department of Agriculture (“USDA”) loan programs.

Notice of the proposal, affording interested persons an opportunity to comment, has been published in the *Federal Register* (77 *Federal Register* 73467 (2012)). The time for filing comments has expired, and the Board has considered the notice and all comments received in light of the factors set forth in section 4 of the BHC Act.

Live Oak, with consolidated assets of approximately \$342.9 million, controls deposits of approximately \$288.8 million, which represents less than 1 percent of the total amount of deposits of insured depository institutions in the United States.⁴ Live Oak controls one insured depository institution, Live Oak Banking Company (“Bank”), Wilmington, that operates one office in North Carolina.

As a result of the proposed acquisition, Live Oak would engage in the following nonbanking activities:

1. making, acquiring, brokering, or servicing loans or other extensions of credit for the account of GLS or the account of others, in accordance with 12 CFR 225.28(b)(1);
2. activities usual in connection with making, acquiring, brokering, or servicing loans or other extensions of credit, as determined by the Board, including performing apprais-

¹ 12 U.S.C. §§ 1843(c)(8) and 1843(j).

² 12 CFR 225.24.

³ Live Oak indirectly would acquire a controlling interest in SB Indexes, LLC (“SB Indexes”) and Secondary Market Access, LLC (“SMA”), both of Cleveland, Ohio. GLS owns 33 percent of SB Indexes. GLS and two management officials of GLS own a combined total of 51 percent of SMA. SB Indexes and SMA are not currently conducting any operations.

⁴ Asset and nationwide deposit data are as of December 31, 2012.

als of real estate and tangible and intangible personal property, including securities, in accordance with 12 CFR 225.28(b)(2);

3. acting as investment or financial advisor to any person, including furnishing general economic information and advice, general economic statistical forecasting services, and industry studies, in accordance with 12 CFR 225.28(b)(6);
4. providing management consulting advice on any matter to unaffiliated depository institutions, including commercial banks, in accordance with 12 CFR 225.28(b)(9); and
5. providing data processing, data storage and data transmission services, facilities, databases, advice, and access to such services, facilities, or databases by any technological means, in accordance with 12 CFR 225.28(b)(14).

The Board has determined by regulation that these proposed activities are activities closely related to banking for purposes of section 4(c)(8) of the BHC Act. Live Oak has committed to conduct the proposed activities in accordance with the limitations set forth in Regulation Y and the Board's orders.

In reviewing the proposal, the Board is required by section 4(j)(2)(A) of the BHC Act to determine that the proposed acquisition "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, unsound banking practices, or risk to the stability of the United States banking or financial system."⁵ As part of its evaluation of these factors, the Board considers the financial and managerial resources of the companies involved and the effect of the proposal on competition in the relevant markets.⁶

In assessing the financial and managerial resources of the companies involved, the Board has considered, among other things, information provided by Live Oak, public comments on the proposal, confidential reports of examination, other confidential supervisory information, and publicly reported financial and other information.

In evaluating the financial factors of this proposal, the Board has considered a number of factors, including capital adequacy and earnings performance. Live Oak and Bank are well-capitalized and would remain so after consummation of the proposed transaction. The transaction would be structured as a share exchange, with the outstanding shares of GLS's common stock being exchanged for shares of Live Oak. Asset quality and earnings prospects are consistent with approval.

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 Live Oak and Bank, including assessments of their management expertise, internal controls, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of other relevant financial supervisory agencies with the organization and its records of compliance with applicable banking laws and with anti-money-laundering laws.

The Board also considered public comments that expressed general concern about Live Oak's capacity to supervise the proposed activities. Live Oak has represented to the Board

⁵ 12 U.S.C. § 1843(j)(2)(A).

⁶ 12 CFR 225.26.

that the necessary controls and reporting requirements would be implemented in order to manage effectively GLS as a nonbank subsidiary of Live Oak. These controls and reporting requirements include policies and procedures for the management of financial risk and treasury operations, formal operating and strategic planning processes, and review by Live Oak's internal and external auditors, which report directly to the audit committee of Live Oak's board of directors. Live Oak and Bank are considered to be well managed, and the policies and procedures to be implemented at GLS are considered satisfactory.

Based on all the facts of record, including a review of the comments received, the Board has concluded that considerations relating to the financial and managerial resources of the organizations involved in the proposal are consistent with approval under section 4 of the BHC Act.

In addition, the Board has considered the competitive effects of the proposal in light of all the facts of record. Live Oak and GLS do not provide the same nonbanking services and, therefore, do not compete in the same market for any nonbanking services. As a result, the proposed acquisition would not have any effect on competition. Based on all the facts of record, the Board concludes that the proposed acquisition would have no significantly adverse competitive effects in any relevant market.

Section 4(j)(2)(A) of the BHC Act also requires the Board to consider whether the proposal is likely to pose a significant risk to the stability of the United States banking or financial system. Given the size of the entities involved in this transaction, the types of activities proposed, and the availability of substitute providers of the proposed financial services, this transaction would not result in a significant increase in the risk to or interconnectedness of the financial system. Based on these and all the other facts of record, the Board has determined that considerations relating to financial stability are consistent with approval.

The Board expects that the proposed acquisition would result in benefits to the public that outweigh any possible adverse effects from the transaction. GLS provides automation and valuation services for financial participants in SBA and USDA loan programs. The acquisition of GLS by Live Oak will enhance the ability of GLS to provide its services to lenders who make SBA and USDA loans, thereby potentially expanding the availability of those services. The Board concludes 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, unsound banking practices, or a significant risk to the stability of the United States banking or financial system that would outweigh the public benefits of the proposal discussed above.⁷

⁷ Three commenters opposed the proposal on Community Reinvestment Act ("CRA") (12 U.S.C. § 2901 *et seq.*) grounds. A depository institution's CRA performance record is not a statutory factor in evaluating a notice to acquire a nondepository institution under section 4 of the BHC Act. Nevertheless, the Board considered the substance of the comments in evaluating the balance of public benefits likely to result from the transaction. The Board consulted with the Federal Deposit Insurance Corporation ("FDIC"), Bank's primary federal regulator, and reviewed Bank's most recent CRA performance evaluation ("2010 Evaluation"). The FDIC has determined that the CRA performance of Bank is "Satisfactory," "given the strong performance in the loans and investments and grants criteria." 2010 Evaluation, p.2. Moreover, the 2010 Evaluation did not identify any violations of antidiscrimination laws or regulations or uncover evidence of discriminatory or other illegal credit practices. Bank has indicated it has complied in all respects with its approved CRA Strategic Plan since the 2010 Evaluation. The commenters also asserted that Bank should not have received credit under the lending test for a particular loan in Bank's 2010 Evaluation. The FDIC evaluated the loan and determined that it met the CRA-qualifying criteria for community development loans. The commenters also questioned whether Live Oak would expand its CRA commitments "to serve in its expanded markets" in view of this proposal. Acquisition by a bank holding company of a nondepository institution under section 4 of the BHC Act does not result in an expansion of an institution's CRA assessment area. *See* 12 CFR 228.41.

Accordingly, based on all the facts of record, the Board has determined that the balance of the public benefits that it must consider under section 4(j)(2) of the BHC Act is consistent with approval of the proposal.

Based on the foregoing the Board has determined that the notice 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 Live Oak with the conditions imposed in this order and the commitments made to the Board in connection with the notice. The Board's approval also is subject to all the conditions set forth in Regulation Y, including those in sections 225.7 and 225.25(c),⁸ and to the Board's authority to require such modification or termination of the activities of Live Oak and any of its subsidiaries as the Board finds necessary to ensure compliance with, or to prevent evasion of, the provisions of the BHC Act and the Board's regulations and orders issued thereunder. For purposes of this action, these 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.

This transaction shall not be consummated 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 August 14, 2013.

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

Margaret McCloskey Shanks
Deputy Secretary of the Board

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

One PacificCoast Foundation
Oakland, California

One PacificCoast Bancorp, Inc.
Oakland, California

Order Approving the Formation of Bank Holding Companies and Notice to Engage in Nonbanking Activities
FRB Order No. 2013-7 (September 25, 2013)

One PacificCoast Foundation (the "Foundation"), a savings and loan holding company within the meaning of the Home Owners' Loan Act, and its subsidiary, One PacificCoast Bancorp, Inc. ("OnePac Bancorp"), both of Oakland, California (collectively, "Applicants"), have requested the Board's approval under section 3 of the Bank Holding Company Act ("BHC Act")¹ to become bank holding companies by acquiring 90.1 percent of

⁸ 12 CFR 225.7 and 225.25(c).

¹ 12 U.S.C. § 1842.

the common stock² of Albina Community Bank (“Albina Bank”), Portland, Oregon.³ Applicants have also 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 retain control of One PacificCoast Bank, FSB (“One PacificCoast Bank”), also of Oakland,⁴ a federal savings association currently controlled by Applicants, and thereby engage in operating a savings association under section 225.28(b)(ii). The Foundation has requested the Board’s approval under sections 4(c)(8) and 4(j) of the BHC Act to engage in community development activities and activities related to extending credit.⁵

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (78 *Federal Register* 11884, 15015, 24201 (2013)). 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 the BHC Act.

The Foundation, OnePac Bancorp, and One PacificCoast Bank were created and funded by Thomas Steyer and Kathryn Taylor.⁶ The Foundation commenced operations in 2007, and in that same year, Mr. Steyer and Ms. Taylor donated all of the nonvoting stock of OnePac Bancorp to the Foundation.⁷ Mr. Steyer and Ms. Taylor control all of the voting rights of OnePac Bancorp.

The Foundation, a non-stock, Delaware corporation and a nonprofit, taxexempt corporation under section 501(c)(3) of the Internal Revenue Code, was established for the purpose of combating economic distress and encouraging community development in communities that One PacificCoast Bank serves by promoting financial literacy, affordable housing, and the provision of loans and investments, including consumer loans and micro and small business loans. The Foundation also supports efforts to bring depository services to disadvantaged communities. One PacificCoast Bank is a direct subsidiary of OnePac Bancorp, which is a shell savings and loan holding company subsidiary of the Foundation.

OnePac Bancorp has total consolidated assets of approximately \$290.5 million and controls approximately \$227.5 million in deposits.⁸ OnePac Bancorp operates in California,

² OnePac Bancorp would directly acquire newly issued shares of Albina Bank, representing 90.1 percent of the latter’s common stock. Under the proposal, Albina Bank’s current parent, Albina Community Bancorp (“Albina Bancorp”), Portland, would retain 9.9 percent of the common stock of Albina Bank.

³ Albina Bank has been operating under a consent order issued by the Federal Deposit Insurance Corporation (“FDIC”) and the Oregon Division of Finance and Corporate Securities since March 2, 2010. On consummation, Applicants would operate AlbinaBank separately from One PacificCoast Bank.

⁴ 12 U.S.C. §§ 1843(c)(8) and 1843(j); 12 CFR 225.24. The Board previously has determined by regulation that the operation of a savings association is closely related to banking for the purposes of section 4(c)(8) of the BHC Act. 12 CFR 225.28(b)(4)(ii).

⁵ 12 U.S.C. §§ 1843(c)(8) and 1843(j); 12 CFR 225.28(b)(2) and 225.28(b)(12). OnePacificCoast Bank is designated as a Community Development Financial Institution (CDFI). A CDFI is a financial institution that provides credit and financial services to underserved markets and populations and is certified by the Community Development Financial Institutions Fund at the U.S. Department of Treasury. One PacificCoast Bank’s mission is to bring banking to low-income communities in an economically and environmentally sustainable manner.

⁶ Mr. Steyer and Ms. Taylor founded OneCalifornia Bank and OneCalifornia Foundation in Oakland in 2007. OnePac Bancorp was formerly named OneCalifornia Bancorp, Inc. One PacificCoast Bank, which OnePac Bancorp acquired in 2010, was formed by merging OneCalifornia Bank and ShoreBank Pacific, Ilwaco, Washington.

⁷ The nonvoting common stock carries with it all of the dividend and distribution rights and all of the economic interest in Bancorp. Profits of One PacificCoast Bank can only be distributed to the Foundation, which is mandated to reinvest those proceeds into the communities it serves and into businesses and programs designed to protect the environment.

⁸ Unless otherwise noted, national data on deposits and assets are as of June 30, 2013, while state data are as of June 30, 2012. In this context, insured depository institutions include commercial banks, savings associations, and savings banks.

Oregon, and Washington.⁹ In Oregon, the only state of common operation with Albina Bank, OnePac Bancorp is the 54th largest depository institution, controlling deposits of approximately \$23.2 million, which represent less than 1 percent of the total deposits of insured depository institutions in the state.¹⁰

Albina Bancorp, which operates solely in Portland, has total consolidated assets of \$123.2 million and is the 36th largest insured depository institution in Oregon, controlling deposits of approximately \$114.1 million, which represent less than 1 percent of the total deposits of insured depository institutions in the state.

On consummation of this proposal, OnePac Bancorp would control deposits of approximately \$341.6 million, which would represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States. In Oregon, OnePac Bancorp would become the 32nd largest insured depository institution, controlling deposits of approximately \$147.1 million, which would represent less than 1 percent of the total amount of deposits of insured depository institutions in the state.

Because this transaction involves both the formation of a bank holding company through the acquisition by Applicants of a bank and the retention of a thrift by that bank holding company, the Board has reviewed the transaction under both section 3 and section 4 of the BHC Act. Section 3 governs the formation of a bank holding company and the acquisition of a bank; section 4 establishes the standards governing the acquisition and retention of a thrift.

Interstate and Deposit cap Analysis

Sections 3(d) and 4(i)(8) of the BHC Act impose certain requirements on interstate transactions. Section 3(d) generally provides that the Board may approve an application by a bank holding company that is well capitalized and well managed to acquire control of a bank in a state other than the home state of the bank holding company without regard to whether the transaction is prohibited under state law.¹¹ However, this section further provides that the Board may not approve an application that would permit an out-of-state bank holding company to acquire a bank in a host state that has not been in existence for the lesser of the state statutory minimum period of time or five years.¹² In addition, sections 3(d) and 4(i)(8) provide that the Board may not approve an application by a bank holding company to acquire an insured depository institution if the home state of such insured depository institution is a state other than the home state of the bank holding company and the applicant controls or would control more than 10 percent of the total deposits of insured depository institutions in the United States.¹³

OnePac Bancorp would become a bank holding company upon the acquisition of control of Albina Bank. For purposes of the BHC Act, the home state of OnePac Bancorp would

⁹ One PacificCoast Bank operates branches in Oakland; Portland; and Seattle and Ilwaco, Washington. One PacificCoast Bank also operates a loan production office in Sacramento, California.

¹⁰ In California and Washington, states in which Albina Bank does not operate, OnePacBancorp is also not among the largest 50 insured depository institutions.

¹¹ The standard was changed from adequately capitalized and adequately managed to wellcapitalized and well managed by section 607(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No.111-203, 124 Stat. 1376, codified at 12 U.S.C. § 1842(d)(1)(A).

¹² 12 U.S.C. § 1842(d)(1)(B).

¹³ 12 U.S.C. §§ 1842(d)(2)(A) and 1843(i)(8).

be Oregon on consummation of the proposal,¹⁴ and One PacificCoast Bank is located in California. On consummation, OnePac Bancorp would own one insured depository institution in each of Oregon and California. Assuming this were an interstate transaction for purposes of the BHC Act, the Board would not be required to deny the proposal under section 3(d) or 4(i)(8) of the BHC Act.

OnePac Bancorp is well capitalized and well managed under applicable law. The minimum age requirement under Oregon law is three years,¹⁵ and Albina Bank has been in existence for more than three years.

Based on the latest available data reported by all insured depository institutions, the total amount of consolidated deposits of insured depository institutions in the United States is \$9.9 trillion. On consummation of the proposed transaction, OnePac Bancorp would control less than 1 percent of the total amount of consolidated deposits in insured depository institutions in the United States. Accordingly, in light of all the facts of record, the Board is not required to deny the proposal under sections 3(d) or 4(i)(8) of the BHC Act.

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 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.¹⁶ In addition, under section 4 of the BHC Act, the Board must consider the competitive effects of a proposal to retain a savings association under the public benefits factor of section 4(j) of the BHC Act.¹⁷

OnePac Bancorp and Albina Bank compete directly in the Portland banking market.¹⁸ The Board has considered the competitive effects of the proposal in this banking market in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking market, the relative shares of total deposits in insured depository institutions in the market (“market deposits”) that are controlled by OnePac Bancorp and Albina Bank,¹⁹ 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 Competitive Review Guidelines (“DOJ Bank Merger

¹⁴ 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. §1842(d). The home state of a federal savings association is the state where the home office is located. 12 U.S.C. § 1841(o)(4).

¹⁵ See Oregon Revised Statutes § 715.017.

¹⁶ 12 U.S.C. § 1842(c)(1).

¹⁷ 12 U.S.C. § 1843(j)(2)(A).

¹⁸ The Portland (OR-WA) banking market includes portions of Clark County, Washington, as well as six counties in Oregon (Clackamas, Columbia, Marion, Multnomah, Washington, and Yamhill).

¹⁹ Deposit and market share data are as of June 30, 2012, 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 deposits in the market share calculation on a 50 percent weighted basis. See, e.g., *First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991). In this case, OnePacBancorp’s deposits are weighted at 50 percent pre-merger and 100 percent postmerger to reflect the resulting ownership by a commercial banking organization.

Guidelines”),²⁰ and other characteristics of the markets.

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Bank Merger Guidelines in the Portland banking market. The proposal would result in a slight decrease in market concentration, as measured by the HHI, and numerous competitors would remain.²¹

The DOJ has advised the Board that consummation of the proposal 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 of 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 the banking market in which OnePac Bancorp and Albina Bank compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

Other Section 3(c) Considerations

Section 3(c) of the BHC Act requires the Board to take into consideration a number of other factors in acting on bank acquisition applications. These factors include the financial and managerial resources (including consideration of the competence, experience, and integrity of the officers, directors, and principal shareholders) and future prospects of the company and banks concerned; the effectiveness of the company in combatting money laundering; the convenience and needs of the community to be served; and the extent to which the proposal would result in greater or more concentrated risks to the stability of the United States banking or financial system.

The Board has considered all of these factors and, as described below, has determined that all considerations are consistent with approval of the application. The review was conducted 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, information provided by Applicants, and public comments received on the proposal.

A. Financial, Managerial, and Other Supervisory Considerations

In evaluating financial factors in expansionary proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only

²⁰ 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 by more than 200 points. Although DOJ and the Federal Trade Commission issued revised Horizontal Merger Guidelines in 2010 (*see* Press Release, Department of Justice (August 19, 2010), www.justice.gov/opa/pr/2010/August/10-at-938.html), the DOJ has confirmed that its Bank Merger Guidelines, which were issued in 1995, were not modified.

²¹ OnePac Bancorp operates the 34th largest depository institution in the Portland banking market, controlling deposits of approximately \$23.2 million, which represent less than 1 percent of market deposits. Albina Bank operates the 22nd largest depository institution in the market, controlling deposits of approximately \$123.9 million, which represent less than 1 percent of market deposits. On consummation, OnePac Bancorp would control weighted deposits of approximately \$135.5 million and unweighted deposits of approximately \$147.1 million, both of which represent less than 1 percent of market deposits. The HHI of 2065 would decrease by 1 point to 2064.

and a 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. The Board evaluates the financial condition of the combined organization, including its capital position, asset quality, liquidity, and earnings prospects, and the impact of the proposed funding of the transaction. The Board also considers the ability of the organization to absorb the costs of the proposal and the proposed integration of the operations of the institutions. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. This transaction would be structured as a share purchase by OnePac Bancorp of newly issued shares of Albina Bank, representing 90.1 percent of the common shares of Albina Bank. As noted previously, under the proposal, Albina Bank's current parent, Albina Bancorp, would retain common shares of Albina Bank that would represent 9.9 percent of Albina Bank's common stock.²²

The Board has considered the financial factors of the proposal, including public comments received on the proposal. The commenters expressed concern that OnePac Bancorp does not possess the financial or managerial resources necessary to restore Albina Bank to sound condition in light of the fact that OnePac Bancorp (i) does not appear to have a plan to restore Albina Bank to profitability and (ii) has not generated a profit since acquiring ShoreBank Pacific in late 2010. The commenters argue that Mr. Steyer and Ms. Taylor, rather than the Foundation and OnePac Bancorp, appear to be the source of strength for One PacificCoast Bank and would be the source of strength for Albina Bank. In addition, the commenters questioned the ability of Applicants to effectively oversee and manage One PacificCoast Bank and Albina Bank as two separate banks and asserted that the two institutions could be operated at lower cost if combined.

OnePac Bancorp and One PacificCoast Bank are well capitalized and would remain so on consummation of the proposed acquisition. The Foundation, which controls most of the total equity of OnePac Bancorp, would provide the capital necessary to complete the proposed transaction through a cash grant made to it by Mr. Steyer and Ms. Taylor. The Foundation is controlled by a board of eight directors, which includes Mr. Steyer and Ms. Taylor. The board of directors has determined to focus the Foundation's support on OnePac Bancorp and the bank(s) that it owns, and substantially all of the Foundation's activities and expenditures are in direct support of One PacificCoast Bank.²³

As a nonstock corporation, Foundation cannot directly raise funds through stock issuance. However, OnePac Bancorp, an intermediate stock holding company, would be the direct owner of Albina Bank and One PacificCoast Bank and would have the ability to access funding markets, including by issuing new shares of common stock for the purpose of

²² The commenters, two of which are indirect investors in the trust preferred securities ("TruPS") issued by affiliates of Albina Bancorp, and one of which provided credit protection to indirect holders of the TruPS, objected to the structure of the proposal for several reasons, including that (i) the structure of the transaction violates Albina Bancorp's legal obligations to its creditors pursuant to indentures under which the TruPS were issued, exposing Albina Bancorp, its management, Albina Bank, and possibly OnePac Bancorp, to litigation; and (ii) the proposed transaction may raise other legal bases of liability, including deepening insolvency and breach of fiduciary duty by directors of Albina Bancorp and Albina Bank and tortious interference with contractual relations by OnePac Bancorp, further exposing OnePac Bancorp, Albina Bank, and potentially Albina Bancorp, to litigation. The commenters also speculated that approval of the proposed transaction could impair the ability of bank holding companies to raise capital in the future. Applicants disagree with the conclusion presented by the commenters. Courts have concluded that the Board's limited jurisdiction to review applications under the BHC Act does not authorize it to consider matters unrelated to specific statutory factors, and in particular, matters related to minority shareholder valuations. See *Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973). These matters are governed by state corporate and contract law and may be adjudicated by a court with jurisdiction to provide the commenters with relief, if appropriate. *Id.* at 753.

²³ Applicants have represented that the Foundation can contribute capital directly to Albina Bank, or indirectly through OnePac Bancorp, consistent with its status as an IRS tax-exempt entity.

funding the capital needs of Albina Bank and One PacificCoast Bank. Furthermore, Applicants have represented that whenever capital has been needed to support One PacificCoast Bank, the Foundation has been able to raise capital through donations made directly by Mr. Steyer and Ms. Taylor or indirectly through organizations funded by Mr. Steyer and Ms. Taylor. For example, Mr. Steyer and Ms. Taylor have contributed approximately \$50 million to the Foundation, \$46 million of which has been injected into One PacificCoast Bank. In addition, the Foundation has unencumbered cash on hand that is available to support the capital needs of the bank. In light of OnePac Bancorp's ability to raise capital and the record of the financial support provided by Mr. Steyer and Ms. Taylor to Applicants and One PacificCoast Bank, Applicants appear to have adequate resources to absorb the costs of the proposal and to manage the operations of both One PacificCoast Bank and Albina Bank. In addition, asset quality and earnings prospects are consistent with approval. On a pro forma basis, the acquisition of Albina Bank is not expected to have a negative impact on OnePac Bancorp's operations. Based on its review of the record, the Board finds that the organization has sufficient financial resources to effect the proposal.

The Board also has considered the managerial resources of the organizations involved and of the pro forma organization. The Board has reviewed the examination records of OnePac Bancorp, One PacificCoast Bank, and Albina Bank, 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 these organizations' records of compliance with applicable banking and anti-money-laundering laws. The Board also has considered One Pacific's plans for implementing the proposal, as well as the public comment received on the proposal. The commenters expressed concern regarding the ability of Applicants' management team to restore Albina Bank to profitability.²⁴

OnePac Bancorp and One PacificCoast Bank are each considered to be well managed, and their senior management would continue in their roles following consummation of the proposed transaction. The directors and senior executive officers of OnePac Bancorp have substantial knowledge and experience in the banking and financial services sectors.

As noted, Albina Bank has been operating under a Consent Order since March 2, 2010, that requires Albina Bank, among other things, to increase its Tier 1 capital by such amount to ensure that its leverage ratio equals or exceeds 10 percent; maintain its total risk-based capital ratio at 12 percent or above; retain qualified management; reduce classified assets and CRE concentrations; maintain a fully funded allowance for loan and lease losses ("ALLL") and update its ALLL policy consistent with the Interagency Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions from July 2, 2001; improve its lending and credit administration policies; and adopt a three-year strategic plan.

OnePac Bancorp will devote significant financial and other resources to address all aspects of the Consent Order on consummation. OnePac Bancorp's investment in Albina Bank would bring Albina Bank into compliance with the capital requirements set forth in the Consent Order, and the recapitalization would enable Albina Bank to continue with the measures underway to improve asset quality, as required by the Consent Order. OnePac Bancorp is proposing to appoint two directors to Albina Bank's board of directors, which

²⁴ The commenters also raised concerns as to whether the boards of directors of OnePac Bancorp and One PacificCoast Bank, respectively, could replace Ms. Taylor, the president and chief executive officer of OnePac Bancorp and OnePacificCoast Bank, given the significant financial contributions she has made to augment the capital of those institutions. Ms. Taylor's service on the boards is similar to that of a majority shareholder of a bank holding company and does not raise heightened concerns in this case.

is expected to augment Albina Bank's management. In addition, OnePac Bancorp would advise Albina Bank with respect to its risk-management policies, procedures, and controls. The Board also has consulted with the FDIC, the primary federal supervisor of Albina Bank. The FDIC does not object to the proposed transaction.

The Board also has considered the future prospects of Applicants, One PacificCoast Bank, and Albina Bank, in light of the financial and managerial resources involved and the proposed business plan, including Applicants' proposal to operate One PacificCoast Bank and Albina Bank separately. In this regard, the Board has considered Applicants' successful integration of the banking operations of OneCalifornia Bank and ShoreBank Pacific in August 2010.²⁵ Applicants' integration record, financial and managerial resources, and plans for operating One PacificCoast Bank and Albina Bank after consummation provide a reasonable basis to conclude that future prospects are consistent with approval. 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.

B. 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 Reinvestment Act ("CRA").²⁶ 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.²⁷

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,²⁸ 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.²⁹

The Board has considered the convenience and needs factor and the CRA performance record of One PacificCoast Bank and Albina Bank in light of all the facts of record. As part of its consideration of convenience and needs, the Board has examined the CRA performance records of One PacificCoast Bank and Albina Bank. One PacificCoast Bank received a CRA rating of "satisfactory" from the Office of Thrift Supervision at its most recent CRA performance evaluation dated December 31, 2009. As noted above, One PacificCoast Bank has been a participant in the CDFI program, which provides funds for increasing community development activities in economically distressed communities. Albina Bank received a CRA rating of "satisfactory" from the FDIC at its most recent CRA performance evaluation dated June 1, 2011. Applicants have represented that the acquisition of Albina Bank by Applicants would allow Albina Bank to expand its existing CRA activities, such as providing financial counseling and assistance, administering Indi-

²⁵ ShoreBank Pacific was a subsidiary of ShoreBank Corporation, a bank holding company, whose other subsidiary depository institution, ShoreBank, was closed by the Illinois Department of Financial & Professional Regulation in August 2010.

²⁶ 12 U.S.C. § 1842(c)(2); 12 U.S.C. § 2901 *et seq.*

²⁷ *See, e.g., North Fork Bancorporation, Inc.*, 86 *Federal Reserve Bulletin* 767 (2000).

²⁸ 12 U.S.C. § 2901(b).

²⁹ 12 U.S.C. § 2903.

vidual Development Accounts, collaborating with local nonprofit organizations, and extending credit to improve and stabilize neighborhoods. 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 the relevant insured depository institutions are consistent with approval.

C. Financial Stability

The Board has considered information relevant to the risk to the stability of the United States banking or financial system. The Board generally presumes that a merger that involves an acquisition of less than \$2 billion in assets, or results in a firm with less than \$25 billion in total consolidated assets, will not pose significant risks to the financial stability of the United States absent evidence that the transaction would result in a significant increase in interconnectedness, complexity, cross-border activities, or other risk factors. Such additional risk factors are not present in this case. The Board, therefore, concludes that financial stability considerations in this proposal are consistent with approval.

Public Benefits

As noted above, the Board has also reviewed the proposal in accordance with the standards in sections 4(c)(8) and 4(j) of the BHC Act. The Board previously has determined by regulation that the operation of a savings association by a bank holding company is so closely related to banking as to be a proper incident thereto, for purposes of section 4(c)(8) of the BHC Act.³⁰ The Foundation would engage in community development activities³¹ and activities related to extending credit, as well as operation of a savings association.³² Specifically, the Foundation seeks to continue to provide funding and other support³³ to One PacificCoast Bank to support various community development programs, including One PacificCoast Bank's loans to LMI individuals that serve as alternatives to payday and auto title loans, and micro loans to small businesses and nonprofit organizations in economically disadvantaged areas.³⁴ In addition, the Foundation seeks to continue to provide disadvantaged communities served by One PacificCoast Bank with access to financial education workshops and online business-building materials. The Foundation sponsors exchanges among business leaders designed to identify segments of disadvantaged communities served by One PacificCoast Bank where One PacificCoast Bank can provide products and financing. This program also serves as an educational tool for the Foundation's board of directors and key staff about potential markets into which OnePac Bancorp could expand. Finally, the Foundation conducts research to identify gaps in the financing of underbanked communities where One PacificCoast Bank may further its mission through, among other activities, conducting focus group studies and retaining consultants to assist in designing programs that are relevant for a bank that has been certified as a CDFI (such as One PacificCoast Bank).

³⁰ 12 U.S.C. §§ 1843(c)(8) and 1843(j); 225.28(b)(4)(ii).

³¹ Section 225.28(b)(12) of the Board's Regulation Y authorizes bank holding companies to engage in community development activities.

³² Section 225.28(b)(2) of the Board's Regulation Y authorizes bank holding companies to engage in any activity usual in connection with making, acquiring, brokering, or servicing loans or other extensions of credit. 12 CFR 225.28(b)(2).

³³ For example, the Foundation has provided the development resources necessary for One PacificCoast Bank to launch the programs described herein and provides collateral for the loans that One PacificCoast Bank makes to LMI individuals and businesses operating in underserved areas under certain programs.

³⁴ The Foundation provides collateral to One PacificCoast Bank to make loans to LMI individuals and businesses operating in underserved communities, which would be permissible both as a community development activity under section 225.28(b)(12) of Regulation Y and as an activity usual in connection with making, acquiring, brokering, or servicing loans or other extensions of credit under section 225.28(b)(2).

The Board previously has recognized the benefit of allowing bank holding companies to participate in community development activities based on their unique role in the community.³⁵ Under Regulation Y, the Federal Reserve Board has broadly construed the nature and scope of permissible community development activities.³⁶ Section 225.28(b)(12) of Regulation Y authorizes bank holding companies to (i) make equity and debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and development of low-income areas by providing housing, services, or jobs for residents; and (ii) provide advisory and related services for programs designed primarily to promote community welfare.³⁷ The Board previously has determined that activities similar to those in which the Foundation seeks to continue to engage are permissible community development activities or activities related to extending credit. Section 225.28(b)(12) also authorizes bank holding companies to invest in and provide financing to a CDFI, such as One PacificCoast Bank, that is organized and operated pursuant to section 103(5) of the Community Development Banking and Financial Institutions Act of 1994.³⁸

In reviewing the proposal, the Board is required by section 4(j)(2)(A) of the BHC Act to determine that the proposal “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, unsound banking practices, or risk to the stability of the United States banking or financial system.”³⁹

The Board expects that the proposed transaction would result in benefits to the public that outweigh any possible adverse effects from the transaction. The record indicates that consummation of the proposal would create a stronger and more diversified financial services organization and would provide the current and future customers of OnePac Bancorp and Albina Bank with expanded financial products and services. As noted previously, One PacificCoast Bank has been a participant in the CDFI program, which provides funds for increasing community development activities in economically distressed communities. The proposed acquisition of Albina Bank by Applicants would allow OnePac Bancorp to expand its community development activities to the markets served by Albina Bank to include financial counseling, education, and assistance activities, administering Individual Development Accounts, collaborating with local nonprofit organizations, and extending credit to individuals and small businesses in underserved communities to help improve and stabilize neighborhoods.

For the reasons discussed above, and based on the entire record, the Board has determined that Applicants’ continued operation of the savings association, and the Foundation’s proposal to continue engaging in community development activities and activities related to extending credit within the framework of Regulation Y and Board precedent, are not likely

³⁵ See 12 CFR 225.127 for the Board’s interpretation of permissible investments designed primarily to promote community welfare (“bank holding companies possess a unique combination of financial and managerial resources making them particularly suited for a meaningful and substantial role in remedying our social ills”).

³⁶ The Board noted that while the interpretation set forth in section 225.127 “primarily focuses on low- and moderate-income housing, it is not intended to limit projects under [section 225.28(b)(12)] to that area. Other investments primarily designed to promote community welfare are considered permissible but have not been defined, in order to provide bank holding companies flexibility in approaching community problems.” 12 CFR 225.127.

³⁷ 12 CFR 225.28(b)(12).

³⁸ 12 U.S.C. § 4702(5). See also 12 CFR 225.127(f). Therefore, the financial support that the Foundation proposes to provide to One PacificCoast Bank, a registered CDFI, to support various community development programs is permissible under section 225.28(b)(12).

³⁹ 12 U.S.C. § 1843(j)(2)(A).

to result in significantly adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, unsound banking practices, or a significant risk to the stability of the United States banking or financial system that would outweigh the public benefits of the proposal discussed above.

Section 4(j)(2)(A) of the BHC Act also requires the Board to consider whether the proposal is likely to pose a significant risk to the stability of the United States banking or financial system. As described above, given the size of the entities involved in this transaction, the types of activities proposed, and the availability of substitute providers of the proposed financial services, this transaction would not result in a significant increase in the risk to or interconnectedness of the financial system. Based on these and all the other facts of record, the Board has determined that considerations relating to financial stability are consistent with approval.

Accordingly, the Board has determined that the balance of the public benefits under the standards of section 4(j)(2) of the BHC Act is consistent with approval of the proposal.

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. The Board's approval is specifically conditioned on compliance by Applicants with all the conditions imposed in this order and the commitments made to the Board in connection with the proposal, including receipt of all required regulatory approvals. The Board's approval also is subject to all the conditions set forth in Regulation Y, including those in sections 225.7 and 225.25(c),⁴⁰ 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 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, or later than three months thereafter, 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 September 25, 2013.

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

Margaret McCloskey Shanks
Deputy Secretary of the Board

⁴⁰ 12 CFR 225.7 and 225.25(c).

Order Issued Under Federal Reserve Act

Adams Bank & Trust
Ogallala, Nebraska

*Order Approving Establishment of a Branch
FRB Order No. 2013-6 (September 4, 2013)*

Adams Bank & Trust (“Adams Bank”), a state member bank subsidiary of ADBANC, Inc., both of Ogallala, Nebraska, has requested the Board’s approval under section 9 of the Federal Reserve Act (“Act”)¹ to establish a branch at 370 North Franklin Avenue in Colby, Kansas.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in accordance with the Board’s Rules of Procedure.² The time for filing comments has expired, and the Board has considered the notice and all comments received in light of the factors specified in the Act.

Adams Bank is the 20th largest depository institution in Nebraska, controlling approximately \$331 million in deposits, which represents 0.6 percent of the total amount of deposits of insured depository institutions in the state.³ Adams Bank’s main office is in Ogallala, with nine additional branches throughout western Nebraska. Adams Bank operates six branches in Colorado, and the proposed branch would be the first in Kansas.

Section 9(3) of the Act allows a state member bank to establish and operate branches, including a branch to be operated in a state other than the home state of the state member bank, on the same terms and conditions as a national bank.⁴ As such, the Board may approve an application by a state member bank to establish a *de novo* interstate branch at any location at which a bank chartered by the host State could establish a branch.⁵ Kansas, the prospective host State, would allow a Kansas-chartered bank to establish a branch in Colby.⁶

When acting on a branch application, the Board is required by section 9(4) of the Act to consider the financial condition of the applying bank, the general character of its management, and whether its corporate powers are consistent with the purposes of the Act.⁷ Under the Board’s regulation implementing section 9(4),⁸ the factors that the Board must consider in acting on branch applications include: (1) the financial history and condition of the applying bank and the general character of its management; (2) the adequacy of the bank’s capital and its future earnings prospects; (3) the convenience and needs of the com-

¹ 12 U.S.C. § 321 *et seq.*

² 12 CFR 262.3(b).

³ Data are as of June 30, 2012, the most recent available, and are updated to reflect mergers through that date. In this context, insured depository institutions include commercial banks, savings associations, and savings banks.

⁴ 12 U.S.C. § 321. *See also* 12 U.S.C. § 36(g).

⁵ 12 U.S.C. § 36(g)(1)(A), as amended by section 613(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The requirements of section 102 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 for the establishment of a *de novo* interstate branch have also been met. Those provisions require that Adams Bank comply with State filing requirements and submit a copy of the branch application to the host State bank supervisor, and that the Board take into account Adams Bank’s compliance with community reinvestment laws and evaluate its capital and management. *See* 12 U.S.C. § 36(g)(2); 12 U.S.C. § 1831u(b)(1), (3), (4).

⁶ Kan. Stat. Ann. § 9-1111(b)(1).

⁷ 12 U.S.C. § 322.

⁸ 12 CFR 208.6(b).

munity to be served by the branch; (4) in the case of branches with deposit-taking capability, the bank's performance under the Community Reinvestment Act ("CRA");⁹ and (5) whether the bank's investment in bank premises in establishing the branch satisfies certain limitations.

The Board has considered the application in light of these factors and public comments received from prospective competing banks in Colby and from residents of the surrounding areas. The commenters assert that their community's demographic and economic characteristics would not profitably support another branch and that the area's financial services needs are adequately met by the financial institutions currently operating there.

In considering the financial history and condition, earnings prospects, and capital adequacy of Adams Bank, the Board has reviewed reports of examination, other supervisory information, publicly reported and other financial information, information provided by Adams Bank, and the comments received. Adams Bank is well-capitalized and would remain so on consummation of the proposal. The Board also has reviewed Adams Bank's business plan and financial projections for the branch, including the projections for deposits, income, and costs. After carefully considering all the facts of record, the Board has concluded that the financial history and condition, capital adequacy, and future earnings prospects of Adams Bank are consistent with approval of the proposal. The Board also has reviewed Adams Bank's proposed investment for a branch in Colby and concluded that its investment is consistent with regulatory limitations on investment in bank premises.¹⁰

In considering Adams Bank's managerial resources, the Board has reviewed the bank's examination record, including assessments of its management, risk-management systems, and operations. The Board also has considered its supervisory experiences with Adams Bank and the bank's record of compliance with applicable banking law, including anti-money laundering laws. Adams Bank is considered to be well-managed. Based on this review and all the facts of record, the Board has concluded that the character of Adams Bank's management is consistent with approval of the proposal.

The Board also has considered the convenience and needs of the community to be served, taking into account the comments received and the bank's performance under the CRA. Adams Bank received a "Satisfactory" rating by the Federal Reserve Bank of Kansas City at its most recent CRA performance evaluation, as of June 20, 2011.¹¹ The Board generally considers the entry of a new competitor in a community to be a positive factor when assessing the effect of a proposal on the convenience and needs of the community because new entry provides additional alternatives for consumers and businesses. Adams Bank represents that its business relationships already extend into northwest Kansas and that the proposed branch would allow it to better serve the residents of Colby and the surrounding communities.¹² For these reasons and based on a review of the entire record, the Board has concluded that the convenience and needs considerations and Adams Bank's record of performance under the CRA are consistent with approval of the proposal.

⁹ 12 U.S.C. § 2901 *et seq.*

¹⁰ 12 CFR 208.21(a).

¹¹ 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. *See Interagency Questions and Answers Regarding Community Reinvestment*, 75 *Federal Register* 11642 (2010).

¹² For example, a branch in the region will allow Adams Bank: to offer long-term, fixed rate loans on agricultural real estate and homestead property exceeding 15 acres; to offer Farmer Mac loans, Health Savings Accounts and Health Access Accounts; and to provide a self-branded mobile banking application in the area.

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved. The Board's approval is specifically conditioned on Adams Bank's compliance with all commitments made to the Board in connection with the proposal. The commitments and conditions relied on by the Board are deemed to be conditions imposed in writing in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

Approval of this application is also subject to the establishment of the proposed branch within one year of the date of this order, unless such period is extended by the Board or the Federal Reserve Bank of Kansas City, acting under authority delegated by the Board.

By order of the Board of Governors, effective September 4, 2013.

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

Margaret McCloskey Shanks
Deputy Secretary of the Board

Federal Reserve BULLETIN

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