

August 1996

FAIR LENDING

Federal Oversight and Enforcement Improved but Some Challenges Remain





United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-272004

August 13, 1996

The Honorable Henry B. Gonzalez
Ranking Minority Member
Committee on Banking and
Financial Services
House of Representatives

The Honorable Joseph P. Kennedy II
House of Representatives

This report responds to requests concerning federal oversight and enforcement of the nation's fair lending laws, principally the Equal Credit Opportunity Act and the Fair Housing Act. The report reviews federal efforts to strengthen enforcement of the fair lending laws, discusses the challenges federal regulators face in their efforts to detect discrimination and ensure compliance, and recommends actions to meet some of those challenges.

We are sending copies of this report to the U.S. Attorney General, the Secretary of Housing and Urban Development, the Chairman of the Board of Governors of the Federal Reserve System, The Chairwoman of the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Acting Director of the Office of Thrift Supervision, and the Chairman of the National Credit Union Administration. We are also sending copies to Members of the Senate Banking Committee, other interested Committees and Subcommittees, and other interested parties.

This report was prepared under the direction of Mark J. Gillen, Assistant Director. Other major contributors are listed in appendix XIII. If you have any questions, please call me on (202) 512-8678.

A handwritten signature in cursive script that reads 'James L. Bothwell'.

James L. Bothwell
Director, Financial Institutions
and Markets Issues

Executive Summary

Purpose

Concerns about discrimination in the credit markets, particularly in the market for home mortgages, have existed for some time but have recently moved to the fore among civil rights issues. This resurgence has been due in large part to repeated reports in the media and elsewhere that members of various racial and ethnic groups are more likely to be denied credit for a home mortgage than are white applicants with comparable income. Although no single one of these reports has offered conclusive evidence that discrimination is pervasive, their collective weight has raised concern.

Partly because of these reports, Members of Congress and others began to question the effectiveness of federal oversight and enforcement in the fair lending area and the zeal with which the nation's principal fair lending laws—the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA)—have been enforced. The former Chairmen of the House Committee on Banking, Finance and Urban Affairs and the Subcommittee on Consumer Credit and Insurance asked GAO to (1) review federal efforts to oversee and enforce the fair lending laws and (2) discuss the challenges federal regulators face in their efforts to detect discrimination and ensure compliance. To accomplish this work, GAO reviewed agency fair lending policies and examination procedures, interviewed federal agency officials and staff, consulted with legal and academic experts, industry groups, and fair housing advocates, and attended conferences, seminars, and workshops on fair lending issues.

Background

ECOA and FHA, enacted in 1974 and 1968, respectively, comprise the federal civil rights statutes applicable to extensions of credit by banks and other lending institutions. Together, these statutes—referred to in this report as the “fair lending laws”—prohibit discrimination in all forms of credit transactions, including consumer and business loans as well as mortgage loans. To support the enforcement of the fair lending laws, the Home Mortgage Disclosure Act (HMDA), as amended, provides for disclosure to the regulatory agencies and the public, information about mortgage loan applicants and borrowers at certain lending institutions. Such information is intended to be useful for identifying possible discriminatory lending patterns.¹

¹The Community Reinvestment Act (CRA) is often included in discussions of the fair lending laws. However, CRA is distinct from the antidiscrimination laws and is thus discussed in this report only as it relates to fair lending. CRA is, however, the subject of a separate GAO report, *Community Reinvestment Act: Challenges Remain To Successfully Implement CRA* (GAO/GGD-96-23, Nov. 28, 1995).

General rulemaking authority for implementing the fair lending laws is split between the Federal Reserve Board (FRB), which has such authority for ECOA and HMDA, and the Department of Housing and Urban Development (HUD), which has similar authority under FHA. For depository institutions, compliance with ECOA, FHA, and HMDA is primarily assessed through regularly scheduled consumer compliance examinations conducted by the primary federal banking regulators.² In contrast, other nonbank lending institutions, such as independent mortgage companies, are generally not subject to regularly scheduled compliance examinations but may be periodically investigated for noncompliance by HUD, the Department of Justice (DOJ), the Federal Trade Commission (FTC), or other responsible federal agencies.

Enforcement responsibilities under the three acts follow a similar pattern. The federal banking regulatory agencies are responsible for administrative enforcement of ECOA and HMDA with respect to financial institutions within their jurisdictions.³ HUD, on the other hand, has administrative enforcement authority with respect to FHA violations for all institutions and HMDA compliance responsibilities for independent mortgage companies.⁴ Both ECOA and FHA provide for civil suits by the DOJ and by private parties. Current law also dictates that whenever the banking regulatory agencies or HUD have reason to believe that an institution has engaged in a “pattern or practice” of illegal discrimination, the agencies must refer these cases to DOJ for possible civil action. Such cases include repeated, regular, or institutionalized discriminatory practices. Other types of cases also may be referred.

In 1992, DOJ filed its first major lawsuit alleging discriminatory lending against a financial institution, Decatur Federal Savings and Loan of Atlanta. Since then, DOJ has filed nine additional lawsuits against financial institutions for “pattern and practice” violations of the fair lending laws. Although most DOJ-initiated fair lending lawsuits against financial institutions to date have been settled by consent decrees before trial,

²The primary banking regulatory agencies are FRB, the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA).

³ECOA specifically charges certain other agencies with responsibility for enforcing the act with respect to persons and matters under their jurisdictions. The Federal Trade Commission (FTC) has enforcement responsibility in all other areas. 15 U.S.C. § 1691(c).

⁴The federal banking regulators may also take enforcement actions for FHA violations to the extent provided in their general enforcement authorities, which are contained in section 8 of the Federal Deposit Insurance Act, 12 U.S.C. 1818.

significant remedies, including affirmative initiatives and substantial monetary payments, have been prescribed in the settlement agreements.

Results in Brief

Following years of little activity, the banking regulators, DOJ, HUD, and other responsible federal agencies have begun to devote additional effort toward improving compliance with the nation's fair lending laws. Since 1992, these agencies have moved to step up enforcement of the fair lending laws and to heighten the level of awareness and sensitivity of the lending community to its responsibilities under these laws. The banking regulatory agencies have also moved to strengthen their ability to detect discrimination through improved examination procedures. In addition, these and other federal agencies have recommended a number of compliance programs and activities that, if implemented, could help lenders ensure that their loan applicants are treated fairly.

Yet, despite the overall improvement in federal fair lending oversight and enforcement efforts, challenges still remain in some areas. On the basis of its review of fair lending compliance policies and examination procedures of the federal banking regulatory agencies, GAO identified several areas related to the regulators' existing examination procedures where it believes the agencies have not taken full advantage of opportunities to strengthen their ability to detect lending discrimination in all of its forms and improve the consistency of oversight and enforcement. For example, fair lending examination procedures of the federal banking regulatory agencies currently lack adequate means to detect discrimination that could occur prior to submission of a formal loan application. Additionally, compliance examiners at the FDIC, OCC, FRB, and OTS have indicated that detecting discrimination during fair lending examinations was made more difficult by poor quality HMDA data, examiner inexperience, and to some extent by insufficient time allowances. In addition, GAO also learned that uncertainty persists among some federal agency officials and examiners about what constitutes a referable "pattern or practice" violation under ECOA and FHA.

GAO also found that a number of other legal issues related to interpretation and application of the fair lending laws remain unresolved, creating uncertainty among both lenders and regulators. This uncertainty has, in turn, somewhat impeded current attempts by the federal banking regulatory agencies, DOJ, and HUD to provide clearer and more concise guidance regarding fair lending policies—leaving banks and other lending

institutions confused about what, precisely, is needed to ensure that they are in compliance.

Unresolved legal issues also pose potential barriers to achieving wider adoption of some of the programs and activities recommended by federal agencies to ensure compliance. Perhaps principal among these issues are questions surrounding the establishment of proof under the disparate impact theory of lending discrimination,⁵ and the use by regulators and third parties of data acquired or generated by lenders through self-testing programs.

Compounding the problems created by uncertainty is that solutions to many of the legal questions may be difficult to achieve by regulation and thus may require resolution through civil or administrative judicial proceedings or legislation. Consequently, it could take some time before the contours of the fair lending laws become more distinct. In the meantime, controversies surrounding the interpretation and application of the fair lending laws are likely to remain, as is the reluctance of some lending institutions to implement additional compliance programs.

Principal Findings

Fair Lending Oversight and Enforcement Have Improved

Prior to DOJ's filing of its first lending discrimination lawsuit under ECOA and FHA in 1992, federal enforcement of the nations's fair lending laws was limited. Before that time, only a few complaints involving lending discrimination had been filed under either ECOA or FHA by federal agencies. However, actions taken since then by Congress, the administration, federal banking regulatory agencies, DOJ, HUD, and others have increased federal oversight and, as a consequence, have contributed to a regulatory environment that is more likely to engender greater compliance by the lending industry.

More vigilant enforcement of the fair lending laws was made possible, in part, by Congress, which over the years has passed a progression of amendments to the fair lending statutes and related laws aimed at strengthening their public and private enforcement mechanisms. Among

⁵According to this theory, a lender commits discrimination if the lender applies a seemingly innocuous policy or practice equally to all credit applicants but with the result that the policy or practice has a disproportionate adverse impact on applicants from a protected group. Furthermore, it must be the case that the policy or practice is not justified by a business necessity.

the more notable of these were amendments to HMDA, which provided for the creation of a database on mortgage lending activity for use by both regulators and the public, and the 1988 amendments to FHA, which created an administrative enforcement system at HUD that did not previously exist. These legislative initiatives, combined with the attention focused on the issue by the media and concerned community groups, spurred DOJ to initiate, in 1989, its first investigation of lending discrimination under ECOA. DOJ's investigation culminated in the 1992 complaint against Decatur Federal, which was significant in that it signaled the beginning of a more aggressive federal enforcement program and set forth DOJ's view of evidentiary requirements sufficient for claiming a "pattern or practice" of unlawful lending discrimination under ECOA. The investigation also marked the beginning of a trend toward increased reliance on statistical analysis to establish evidence of discriminatory lending patterns.

The movement by regulatory agencies toward more energetic enforcement of the fair lending laws received additional momentum in 1993 when the incoming administration declared that the development of an effective and aggressive fair lending enforcement program would be a top priority and promptly formed an interagency task force charged with clarifying federal regulatory policies in the fair lending area. Marking the first time that the federal agencies primarily responsible for fair lending enforcement had spoken with one voice on the topic of lending discrimination, the task force released a landmark policy statement in March 1994 outlining how the regulatory agencies are to define and enforce ECOA and FHA.

Another significant effort by federal agencies, which has contributed to an overall improvement of the regulatory environment, has been the encouragement of preventative measures by the lending industry. In May 1993, the bank and thrift regulators released a list of recommended programs and activities for financial institutions to consider when planning their fair lending compliance programs. Among these recommendations were such things as second-review programs for applications that may otherwise be denied, participation on multilender mortgage review boards, affirmative marketing programs, enhanced employee training on fair lending issues, and self-testing programs. In 1994, HUD initiated its more formal "best practices" program in which independent mortgage companies were urged to sign individually negotiated, nonbinding agreements with HUD that encourage initiatives similar to those recommended for the banking industry. The regulators' intent in encouraging lenders to consider these types of programs was to help financial institutions design compliance programs that would ensure

that unlawful discrimination does not affect the fair and even-handed distribution of credit in society.

Finally, over the last several years, the federal banking regulatory agencies have undertaken a major overhaul of their policies and procedures for ensuring compliance with the fair lending laws. The new procedures broadened the regulators' search for discriminatory lending practices by, among other things, emphasizing "comparative-file analysis"—a methodology that seeks to detect unequal or disparate treatment among similarly qualified applicants.

Challenges Remain in Oversight and Enforcement

Despite the progress federal regulators have made toward improving oversight and enforcement of the fair lending laws, there remain several issues that present significant and continuing challenges to the efforts of federal regulators to detect discrimination and ensure consistent oversight and enforcement.

First, current fair lending examination procedures are not uniform across banking regulatory agencies—creating a situation in which application and enforcement of the laws could vary by regulator. Since a failed effort at developing uniform examination procedures in 1992, the federal banking regulatory agencies have each pursued independent efforts to improve their own procedures. This has resulted in a situation in which some depository institutions may be subject to compliance examinations involving the use of newer detection methodologies like regression analysis or testing, while others may not. In light of the legal and economic consequences of even being accused of discriminatory lending practices, as illustrated in recent DOJ settlement agreements, the lack of uniform examination procedures raises an important equity issue regarding the evenhanded application of the law to all depository institutions.

Second, procedures to detect discrimination prior to submission of a formal application are inadequate. At this point in the mortgage application process, there are no documents or records for bank examiners to review. Although current examination procedures call for examiners to routinely interview those bank personnel who serve as initial contact points for potential applicants, it is extremely difficult, if not impossible, for an examiner to determine (on the basis of information gathered through interviews) whether any applicant was illegally discouraged from making a formal application or was steered to a less advantageous product or institution.

Third, concerns about the accuracy of HMDA data—which is intended to assist regulatory agencies and the public in identifying possible discriminatory lending patterns—have been long standing and have recently received credence from special examination efforts by FRB and FDIC. Yet, not until fiscal year 1994 did a federal agency use its full range of enforcement authorities in an effort to ensure compliance with HMDA data reporting requirements. Typically, enforcement of HMDA reporting requirements by the responsible federal agencies has been limited to requiring institutions to correct and resubmit the required data. In fiscal year 1994, HUD and FDIC began imposing civil money penalties for inaccurate or untimely submission of HMDA data. However, the other federal regulatory agencies with HMDA oversight responsibilities have not yet taken similar action, although OTS has adopted specific guidelines for assessing civil money penalties (CMP) for future HMDA violations. Hence, even though HMDA data are widely used by both federal regulatory agencies and the public in overseeing compliance with the fair lending laws, the quality of the data remains suspect.

Fourth, responses to GAO surveys of bank compliance officers and agency examiners at FRB, OCC, FDIC, and OTS, and other sources, have indicated that additional examiner training in the latest fair lending examination and detection techniques would be beneficial. Also, in some instances, examiners felt they were not allowed sufficient time to develop evidence of substantive violations.

Finally, several officials and examiners at the federal agencies responsible for fair lending oversight have expressed some uncertainty regarding the meaning of statutory phrases like “reason to believe” and “pattern or practice,” which are pivotal to the referral of suspected cases of discrimination to DOJ.

While issues such as those just mentioned can be directly confronted and addressed by the responsible agencies, others, because of their nature, are more problematic and defy immediate resolution. For example, lending discrimination has often proven to be subtle, leaving the victim or victims unaware that they have been discriminated against. Also, in some cases, discriminatory lending patterns may become apparent only with the use of complex statistical analyses. This subtlety makes detection difficult even with newer, more advanced techniques. Additionally, because the contours of the fair lending laws are still evolving, there remain a number of unresolved legal issues associated with the interpretation and application of the fair lending laws. These unresolved issues contribute to

uncertainty within the lending industry and pose potential barriers to achieving wider adoption of some of the programs and activities recommended by federal agencies to ensure compliance with the fair lending laws. Perhaps principal among these issues are questions surrounding the establishment of proof under the disparate impact theory of lending discrimination, and the use by regulators and third parties of data acquired or generated by lenders through self-testing programs.⁶

As interpreted by the courts and the federal regulatory agencies, there currently exists under the fair lending laws a disparate impact (effects) test for discrimination. Under this test a lender commits lending discrimination if the lender maintains a neutral policy or practice that has a disproportionate, adverse effect on members of a protected group and which cannot be justified by “business necessity,” or for which a less discriminatory alternative is shown to exist.⁷ The application of disparate impact analysis to some common practices inherent to the financial services industry, however, could prove to be problematic. For example, some legal experts have questioned whether and how the disparate impact test would affect the use of differential and tiered pricing systems based on perceived credit risk. Also, others have indicated that the disparate impact test could pose compliance problems for banks that employ computerized underwriting systems. Some bankers are uncertain whether such standardized systems using uniform criteria would pass a disparate impact test, given the relative socioeconomic status of some protected groups.

In addition to the questions raised about the application of the disparate impact test, the banking industry has also expressed concern regarding the recommended use of self-testing programs. The data obtained through self-testing generally are not protected from disclosure to federal agencies or private litigants. Hence, institutions that undertake such programs in good faith run the risk of exposing fair lending violations that could result in administrative or civil sanctions.

Resolution of some of the legal questions related to the disparate impact test and other issues may only be possible through civil or administrative judicial proceedings, or by legislative action. Hence, it could be some time

⁶Self-testing programs are voluntarily initiated internal auditing procedures that may employ the use of “mystery shoppers” to check on an institution’s compliance with the fair lending laws.

⁷Even if a lender’s policy or practice were justified by business necessity, the policy or practice nonetheless may be discriminatory if it is shown that a less discriminatory alternative would achieve the same purposes or results and the challenged institution refused to adopt it. See 42 U.S.C. § 2000e-2(k)1(A) (ii).

before settlement of these issues is forthcoming. Meanwhile, application and enforcement of the law will probably continue to generate controversy—with some voluntary compliance activities possibly discouraged as a consequence.

Despite these and other potential difficulties with some of the recommended fair lending compliance activities, it has been reported that many financial institutions have, nevertheless, moved to adopt a number of the agencies' suggestions into their compliance programs. Although GAO has no basis for evaluating these voluntary efforts, it believes voluntary compliance is key to achieving the ultimate goal of the fair lending laws—preventing unlawful discrimination before it occurs.

Matter for Congressional Consideration

Congress may wish to consider measures that would remove or diminish the disincentives associated with self-testing by alleviating the legal risks of self-testing when conducted by lenders who in good faith are seeking to prevent discriminatory lending activity and who move to correct such discriminatory practices when they are identified.

Recommendations

Despite significant improvement in federal fair lending oversight and enforcement, GAO believes that further efforts can still be made in some areas, which would strengthen the ability of federal banking regulators to detect lending discrimination in all of its forms and help ensure greater consistency in oversight and enforcement. To this end, GAO recommends that the heads of FRB, FDIC, OCC, OTS, and NCUA:

- work together to develop and adopt uniform fair lending examination procedures and provide all compliance examination staff with the necessary training to implement those procedures;
- adopt as a component of their fair lending examination and training programs, guidelines and procedures for the use of testing methodologies for detection of discrimination at the preapplication stage of the lending process; and
- use their full range of enforcement authority, including the use of civil money penalties, to ensure that the HMDA data is submitted in a timely and accurate manner.

GAO also recommends that the U.S. Attorney General provide updated guidance to the banking regulatory agencies and HUD on the characteristics of referable “pattern or practice” cases under ECOA and FHA.

Agency Comments

GAO requested and received comments on a draft of this report from FRB, OCC, FDIC, OTS, NCUA, HUD, and DOJ. These written comments appear along with GAO's responses in appendixes VI - XII. NCUA did not comment on the conclusions and recommendations. Overall, the agencies were in general agreement with the report findings, conclusions, and recommendations. Agency remarks regarding individual recommendations are summarized below.

All agencies expressed general agreement with GAO's recommendation that the banking regulatory agencies adopt uniform fair lending examination procedures and provide appropriate training with respect to such procedures. OCC, however, maintained that some differences in examination procedures were appropriate, given the supervisory needs of the agencies and the varying sizes and risk profiles of the financial institutions they regulate. FRB commented that they have been working on the development of uniform procedures and anticipated submitting a draft for consideration by other agencies in the very near future. FRB noted, however, that their draft procedures did not include a testing component or recommend the routine use of regression analysis.

Among the regulatory agencies, only HUD and OCC fully supported GAO's recommendation that the agencies adopt guidelines and procedures for the use of testing methodologies for detection of discrimination at the preapplication stage of the lending process. In general, the banking regulatory agencies had concerns about the routine use of testing because of its associated costs and time requirements. Despite these concerns, OCC and FRB have already authorized its limited use in individual cases when compelling evidence exists that an institution may be discriminating. OTS commented that it would consider the future use of testing only after careful study, while FDIC preferred to promote voluntary self-testing by the financial institutions themselves. Although DOJ did not comment on the recommendation, the Department has historically supported the use of testers in agency fair lending enforcement efforts.

FRB, FDIC, OCC, OTS, and HUD agreed with GAO's recommendation that the regulatory agencies use their full range of enforcement authorities to ensure timely and accurate HMDA data. Although FRB and OCC expressed a willingness to consider civil money penalties in certain cases, current policy and preference of these agencies regarding violations of HMDA has been to require institutions they supervise to resubmit HMDA data if it contains errors that compromise its integrity.

DOJ accepted our recommendation to provide updated guidance to the bank regulatory agencies and HUD on the characteristics of referable “pattern or practice” cases. FRB, OTS, and HUD said they would welcome DOJ’s insights regarding these cases. FRB pointed out, however, that the ultimate responsibility to make determinations of the meaning of statutory phrases in the absence of court opinions rested with the agency.

Finally, FDIC, OCC, and HUD expressed support for our suggestion that Congress consider legislative initiatives that remove or diminish the disincentives associated with self-testing by protecting institutions from having to release results of self-testing reviews when they are followed by actions to correct any discriminatory behavior that may have been discovered. In their comments HUD stressed how important it was that any protection be granted only in those cases in which lenders promptly corrected the problems found through self-testing.

While there are some differences in the agencies’ response to our recommendations, these differences generally reflect the agencies’ desire to retain the discretion necessary to consider the specific facts and circumstances of individual cases. GAO agrees that agency discretion is necessary once due consideration has been given to the full range of regulatory alternatives and analytical techniques available to ensure effective fair lending oversight of financial institutions.

Contents

Executive Summary		2
Chapter 1		18
Introduction	Background	19
	Objectives, Scope, and Methodology	20
Chapter 2		22
Assessing Discrimination in the Credit Markets	Defining Discrimination	22
Chapter 3		28
Federal Oversight and Enforcement Have Improved	Fair Lending Named a Top Priority	28
	Fair Lending Initiatives by Banking Regulatory Agencies	32
	Fair Lending Oversight and Enforcement	35
	Conclusions	56
Chapter 4		57
Challenges Remain in Oversight and Enforcement	Further Improvements Possible in Fair Lending Examination Policies and Procedures	57
	Despite Improvements, Detection of Discrimination Will Remain Difficult	66
	Unresolved Legal Issues Pose Barriers to Voluntary Compliance Efforts	67
	Conclusions	71
	Matter for Congressional Consideration	72
	Recommendations	72
	Agency Comments and Our Evaluation	72
Appendixes		
	Appendix I: The Fair Lending Laws	76
	Appendix II: Lending Discrimination: A Review of What Is Known	81
	Appendix III: Description of FRB's Statistical Model and Its Use During Fair Lending Compliance Examinations	93
	Appendix IV: Limitations Associated With the Use of Statistical Models to Detect Discrimination	94
	Appendix V: The Case Against Decatur Federal Savings and Loan	97
	Appendix VI: Comments From the Federal Reserve Board	98

Appendix VII: Comments From the Federal Deposit Insurance Corporation	103
Appendix VIII: Comments From the Office of the Comptroller of the Currency	109
Appendix IX: Comments From the Office of Thrift Supervision	112
Appendix X: Comments From the National Credit Union Administration	115
Appendix XI: Comments From the Department of Housing and Urban Development	117
Appendix XII: Comments From the Department of Justice	122
Appendix XIII: Major Contributors to This Report	125
Bibliography	126

Tables

Table 2.1: Three Types of Lending Discrimination	24
Table 3.1: Number of Referrals by Bank Regulatory Agencies and HUD to DOJ for Violations of the Fair Lending Laws, by Agency, 1990-1995	40
Table 3.2: Number of Referrals by Banking Regulatory Agencies and HUD to DOJ for Violations of the Fair Lending Laws, by Agency, 1990-1995	40
Table 3.3: Description of Complaints Made by DOJ Against Financial Institutions for Alleged Violations of the Fair Lending Laws, 1992-1995	43
Table 3.4: Number and Percentage of Fair Lending Complaints Closed by HUD During FYs 1990-1995, by Closure Type	49
Table I.1: Major Amendments to FHA, ECOA, and HMDA Through December 31, 1994	79
Table II.1: Percentage of Home Purchase Loan Applications Denied, by Racial or Ethnic Identity of Applicant, 1990-1994	84

Figures

Figure 3.1: Chronology of Key Fair Lending Enforcement Initiatives, 1988-1995	30
Figure 3.2: Number of Referrals by Banking Regulatory Agency to DOJ for Violations of the Fair Lending Laws, 1990-1995	39
Figure 3.3: Checklist of Specific Provisions Agreed to in Consent Decrees in Order to Settle Claims of Lending Discrimination	45
Figure 4.1: Federal Reserve Board Survey of HMDA Reporters	63

Abbreviations

CCPA	Consumer Credit Protection Act
CMP	Civil Money Penalty
CRA	Community Reinvestment Act
DOJ	Department of Justice
ECOA	Equal Credit Opportunity Act
FCA	Farm Credit Administration
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act
FFIEC	Federal Financial Institutions Examination Council
FHA	Fair Housing Act
FHAA	Fair Housing Amendments Act
FHAP	Fair Housing Assistance Program
FHEO	Office of Fair Housing and Equal Opportunity
FHFB	Federal Housing Finance Board
FHIP	Fair Housing Initiatives Program
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act
FRB	Federal Reserve Board
FTC	Federal Trade Commission
GSE	Government-Sponsored Enterprise
HMDA	Home Mortgage Disclosure Act
HUD	Department of Housing and Urban Development
MBA	Mortgage Bankers Association
MOU	Memorandum of Understanding
MSAs	Metropolitan Statistical Areas
NCUA	National Credit Union Administration
NFHA	National Fair Housing Alliance
OCC	Office of the Comptroller of the Currency
OFHEO	Office of Federal Housing Enterprise Oversight
OTS	Office of Thrift Supervision
SEC	Securities and Exchange Commission

Introduction

Concerns about discrimination in the credit markets, particularly in the market for home mortgages, have existed for some time and have recently moved to the fore among civil rights issues. This resurgence of interest is due in large part to repeated reports in the media and elsewhere suggesting that the problem of lending discrimination is of such magnitude that it demands immediate and increased public attention. Most prevalent among these reports are ad hoc statistical analyses of data collected under the Home Mortgage Disclosure Act (HMDA), which reveal that applicants who are members of various racial and ethnic groups are more likely to be denied credit for a home mortgage than are white applicants with comparable incomes. In addition, a few widely-cited econometric studies of mortgage lending decisions have also reported results that indicate that lenders discriminate against minority applicants.

While none of these studies or analyses has offered conclusive evidence that lending discrimination is pervasive or represents an industrywide problem, their collective weight has raised concerns. In light of these continuing reports, Congress and others have questioned the effectiveness of supervision and oversight in the fair lending area and the zeal with which the nation's antidiscrimination laws governing the credit markets have been enforced. As a consequence, responsible federal agencies have rededicated themselves to upholding the fair lending laws, and have revamped outdated supervisory and compliance policies as well as examination procedures in the fair lending area. Even so, the fair lending laws still pose many difficult policy and legal questions and offer a number of operational challenges to federal oversight enforcement efforts.

This report responds to a request from the former Chairmen of the House Committee on Banking, Finance and Urban Affairs, and its Subcommittee on Consumer Credit and Insurance, asking us to review federal efforts to oversee and enforce the nation's "fair lending laws"—principally the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA)—and to discuss the challenges federal regulators face in their efforts to detect discrimination and ensure compliance. In conjunction with the Chairmen's request to review enforcement of the fair lending laws, we were also asked to evaluate compliance with the Community Reinvestment Act (CRA) and report on the strengths and weaknesses of current reform efforts. Our response to the request regarding CRA is contained in a separate report.¹

¹See *Community Reinvestment Act: Challenges Remain to Successfully Implement CRA*, (GAO/GGD-96-23, Nov. 28, 1995).

Background

The Fair Lending Laws

During the late 1960's and 1970's, Congress enacted a number of laws for the purpose of ensuring fair and equitable access to credit for both individuals and communities. These laws included the Fair Housing Act (1968), the Equal Credit Opportunity Act (1974), the Home Mortgage Disclosure Act (1975), and the Community Reinvestment Act (1977). Two of these laws, ECOA and FHA, comprise the federal antidiscrimination statutes applicable to lending practices and have become commonly referred to as the "fair lending laws." Additionally, HMDA, as amended in 1988, is intended to support enforcement of ECOA, FHA, and CRA by requiring certain lending institutions to provide federal regulators and the public with information on mortgage loan applicants and borrowers. Such information can be useful in identifying possible discriminatory lending patterns. Unlike ECOA and FHA, HMDA does not prohibit any specific activity of lenders, but only establishes a reporting obligation for particular institutions. For more detail on the scope, applicability, and evolution of these laws and their related implementing regulations, see appendix I.

Oversight Responsibility

General rulemaking authority for implementing the fair lending laws is divided between the Federal Reserve Board (FRB), which has such authority for ECOA and HMDA, and the Department of Housing and Urban Development (HUD), which has similar authority for FHA. Oversight and enforcement responsibilities, however, are divided among at least 12 separate federal agencies, including but not limited to the 5 federal banking regulatory agencies², the Department of Justice (DOJ), HUD, the Federal Trade Commission (FTC), the Federal Housing Finance Board (FHFB), the Office of Federal Housing Enterprise Oversight (OFHEO), the Securities and Exchange Commission (SEC), and the Farm Credit Administration (FCA).³ These agencies use varying approaches to discharge their oversight and enforcement responsibilities.

For depository institutions, compliance with ECOA, FHA, and HMDA is primarily assessed through regularly scheduled consumer compliance

²The primary banking regulatory agencies are FRB, the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA).

³Other agencies that enforce ECOA include the Department of Transportation, the Interstate Commerce Commission, the Small Business Administration, and the Packers and Stockyards Administration of the Department of Agriculture.

examinations conducted by the federal bank regulators. These agencies are also responsible for administrative enforcement of both ECOA and HMDA, whereas HUD has such authority for FHA (and for HMDA in the case of independent mortgage companies). In addition, federal regulatory agencies are required to refer to DOJ any matter in which an agency has reason to believe that a pattern or practice of lending discrimination has occurred. Moreover, the agencies are also required to notify HUD of apparent FHA violations.⁴ In contrast, mortgage companies and other nondepository lending institutions are generally not subject to regularly scheduled compliance examinations, but may be periodically investigated for noncompliance by their primary regulator or HUD, DOJ, or FTC.

The Role of Private Litigation

In addition to federal supervision, private litigation also serves as a prominent enforcement method under the fair lending laws. Under both ECOA and FHA, however, private civil suits must be brought within prescribed periods—generally within 2 years of the date of the occurrence or termination of the alleged violation. Individual claimants under ECOA can recover actual damages and punitive damages up to \$10,000. In class action suits, punitive damages are limited to the lesser of \$500,000 or 1 percent of the institution's net worth. Under FHA, plaintiffs can also recover both kinds of damages, but the amount of punitive damages is not limited.

To assist private enforcement of FHA, amendments to FHA in 1988 created within HUD an administrative system within which a complainant could pursue a fair lending complaint at little or no cost. Within HUD's system, a case can be heard in a formal administrative proceeding before an administrative law judge, or the complainant or respondent can elect to move the case to federal district court.

Objectives, Scope, and Methodology

The objectives of this study were to (1) review recent federal efforts to oversee and enforce the fair lending laws and (2) discuss the challenges federal regulators face in their efforts to detect discrimination and ensure compliance. To achieve this, we began by reviewing the legislative and case history of the laws to discern their original intent and to see how the interpretation of that intent has evolved over time. We also undertook an extensive review of the literature on lending discrimination. We then

⁴Specifically, the agency must notify HUD when the agency has reason to believe that an ECOA violation also violated FHA and the matter was not referred to DOJ as a pattern or practice case. See 15 U.S.C. § 1691e(k). Executive branch agencies are also required to notify HUD of FHA violations and complaints under Executive Order 12892. See Federal Register, Vol. 59, No. 13, Thursday, Jan. 20, 1994.

interviewed officials from the five federal banking regulatory agencies, HUD, and DOJ. These interviews served to help us more fully understand the existing regulatory system, including the practices and procedures used to detect discrimination, and the policies in place to deal with violations, especially violations of a serious or substantive nature. Information and documentation regarding various aspects of the agencies' fair lending oversight and enforcement activities were collected from all of the federal banking regulators, HUD, FTC, and DOJ. Also, the impressions and experiences of 40 bank compliance officers and agency examiners, who were participants in compliance examinations during 1993, were obtained through surveys and interviews. These surveys and interviews were conducted as part of our work related to our review of CRA. In that review, the case study approach was used to review in detail compliance examinations at 40 banks and thrifts. The institutions included in the review were judgmentally chosen to represent a cross section of geographic areas, federal banking regulatory agencies, and depository institutions. Of the institutions studied, 6 were examined by FRB, 13 by FDIC, 9 by OCC, and 12 by OTS.

In addition to contacts with federal agency officials, we also judgmentally selected and interviewed individuals from the banking industry, industry trade groups, and consumer groups, as well as a number of private consultants, academic and legal experts, and officials at firms active in the secondary mortgage market. We also attended workshops and conferences on fair lending sponsored by a variety of industry and community groups, professional law associations, and the federal banking regulatory agencies. Finally, we reviewed letters submitted by bankers and other concerned parties responding to public policy statements and proposed rule changes related to the fair lending laws.

We did the work underlying this report between January 1994 and December 1995 in accordance with generally accepted government auditing standards. We requested comments on a draft of this report from FRB, FDIC, OCC, OTS, NCUA, HUD, and DOJ. Their written comments, along with our evaluation, are summarized at the end of chapter 4 and are presented in appendixes VI through XII.

Assessing Discrimination in the Credit Markets

The fair lending laws prohibit discrimination with regard to any aspect of a consumer, commercial, or real estate credit transaction based on a number of protected personal characteristics, including but not limited to race, color, religion, gender, and national origin. However, interpretation and applicability of the fair lending laws is unclear in a number of areas and federal regulatory agencies have had to translate and apply the laws to a wide variety of lending practices, including some that are not specifically mentioned in the statutes. Lenders, federal regulators, and consumers have not always agreed on these interpretations. As a result, there has been, and continues to be, some controversy and confusion regarding the scope and applicability of the laws and what it means in practice to discriminate against a credit applicant. Moreover, this uncertainty has been compounded by numerous difficulties encountered in measuring and assessing the nature of lending discrimination.

Defining Discrimination

In fair lending cases, courts and the federal agencies have adopted the analytical framework applicable to employment discrimination cases under Title VII of the Civil Rights Act of 1964.¹ Under this framework, two methods of analysis are used to evaluate discrimination claims. The first method, known as disparate treatment analysis, determines whether a borrower has been treated less favorably than his or her peers due to race, sex, or other characteristic that places the individual within a group protected by ECOA or FHA. The second method, known as disparate impact analysis, determines (a) whether a seemingly innocuous lending policy or practice has a disproportionately adverse effect on a protected group and, if so, whether the policy or practice can be justified by business necessity; and (b) whether a less adverse alternative to such a policy or practice exists.²

Both of these tests have generally recognized that discriminatory behavior can enter the credit search and lending processes in a number of forms and at various stages. For example, the courts have held that discrimination can be blatant or it can consist of extremely subtle behavior that may leave the victim or victims unaware that they have been treated unfairly. Furthermore, the courts have ruled that in disparate impact cases, discrimination can occur even without actual, subjective animus against an individual or a protected group. In other words, when a

¹See 42 U.S.C. § 2000e - 2000e-17.

²For a discussion of the disparate treatment and disparate impact models as they apply to employment law, see Richey (1994). For relevant case law and a description of the legal requirements necessary for establishing proof of discrimination under ECOA, see Lieberman (1994).

protected group is adversely affected, discrimination may be found even in the absence of any discriminatory intent.

Three Types of Lending Discrimination

In practice, all potential violations of the fair lending laws have been categorized by federal regulators into three distinct types of discriminatory behavior: (1) blatant or overt, (2) disparate treatment, and (3) disparate impact (see table 2.1). To help lenders and examiners better understand the various forms that lending discrimination can take, the Interagency Task Force on Fair Lending released a policy statement in March 1994 that provides examples of the three types of discriminatory behavior and illustrates through hypothetical case examples the types of lending-related activities that might be considered to constitute illegal discrimination.³

³The task force consists of representatives from HUD, DOJ, FRB, OCC, FDIC, OTS, NCUA, FHFB, FTC, and OFHEO. The statement was subsequently published as "Policy Statement on Discrimination in Lending," Federal Register, Vol. 59, No. 73, Friday, Apr. 15, 1994, pp. 18266-18274.

Chapter 2
Assessing Discrimination in the Credit
Markets

Table 2.1: Three Types of Lending Discrimination

Blatant or overt	Three types of discriminatory behavior	
	Disparate treatment	Disparate/adverse impact
Definitions		
Occurs when a lender openly discriminates against an individual or group based on a protected factor under ECOA or FHA (race, marital status, sex, age, etc.).	Occurs when two or more applicants, who are similar in most respects except for some protected characteristic like race, age, sex, etc., receive different treatment based on that characteristic. Disparate treatment can range from blatant discrimination to more subtle disparities in treatment and does not require that such treatment be motivated by prejudice or a conscious intent.	Occurs when a seemingly innocuous policy or practice is applied equally to all credit applicants but with the result that the policy or practice has a disproportionate adverse impact on applicants from a protected group. It must be the case that the policy or practice is not justified by a business necessity and that a less discriminatory alternative does not exist.
Ease of Identification		
Blatant/overt discrimination is usually easily identified.	Disparate treatment may more likely occur in the treatment of applicants who are neither clearly well-qualified nor clearly unqualified. Hence, it is generally more difficult to detect and necessarily involves detailed comparative-file analysis or some other means of detection capable of identifying differences in treatment among similar applicants.	Of the three types, detection of disparate impact is the most difficult and encompasses several steps. First, the existence of disparate impact must be established. Frequently this is done by quantitative or statistical analysis. Once a disparate impact has been identified, it must then be determined if the policy or practice is justified by business necessity. If so, it must then be shown that a less discriminatory alternative to the policy or practice existed and that the lender refused to adopt the alternative policy.
Examples		
It may include, e.g., lender's outright refusal to assist applicant or refusal to accept application on a prohibited basis.	A nonminority applicant applied for a loan. The lender found adverse information in the applicant's credit report. The lender discussed the report with the applicant and determined that the information was incorrect. The nonminority applicant was granted the loan. A minority applicant applied for a similar loan with the same lender. Upon discovering adverse information in the minority applicant's credit report, the lender denied the loan application on the basis of the adverse information without giving the minority applicant an opportunity to discuss the report.	A lender's policy is not to extend loans for single family residences for less than \$60,000. This minimum loan amount policy is shown to disproportionately exclude potential minority applicants from consideration because their income levels or the value of the houses in the areas where they live would qualify them only for smaller loan amounts. The lender would be required to justify the business necessity for the policy.

Source: Adopted from the Interagency Policy Statement on Discrimination in Lending, Federal Register, Vol. 59, No. 73, Friday, Apr. 15, 1994, pp. 18266-18274.

Under ECOA and FHA, the statement explained, lenders may not, because of a prohibited factor,

- fail to provide information or services or provide different information or services regarding any aspect of the lending process, including credit availability, application procedures, or lending standards;
- discourage or selectively encourage applicants with respect to inquiries about or applications for credit;
- refuse to extend credit or use different standards in determining whether to extend credit;
- vary the terms of credit offered, including the amount, interest rate, duration, or type of loan;
- use different standards to evaluate collateral;
- treat a borrower differently in servicing a loan or invoking default remedies;
- use different standards for pooling or packaging a loan in the secondary market;
- express, orally or in writing, a preference for or against protected applicants;
- discriminate because of a person associated with a credit application (for example, a co-applicant, spouse, business partner, or live-in aide); or
- discriminate because of the present or prospective occupants of the area where property to be financed is located.

The policy statement is particularly notable in part because it represents the first time that the federal regulatory agencies comprising the Task Force have spoken with one voice on the subject of fair lending. As such, the respective agencies believe it represents a significant step in arriving at a uniform and effective fair lending policy. However, individual lenders and banking trade associations, while applauding the agencies' efforts, have expressed serious concerns about certain aspects of the policy and its implementation. Among other things, lenders have expressed concern that the new fair lending policy will not be implemented in a manner consistent with safety and soundness; i.e., they are concerned that safety and soundness examiners will question the adequacy of relaxed underwriting standards for loans made to applicants in protected groups who may not otherwise be deemed creditworthy. Lenders have also voiced concern that enforcement will not be administered equitably across industry segments, since depository institutions are examined regularly for fair lending compliance and other lenders, like mortgage companies, are not. Lenders have further argued that, in some instances, the statement

goes beyond the strictures of settled law, particularly with respect to disparate impact theory.

In addition, the agencies' interpretation of the fair lending laws could, lenders contend, result in unintended consequences in a number of areas. For example, bankers point out that the policy has the potential to eliminate so-called "character lending" by forcing the adoption of credit scoring systems in an effort to demonstrate that all applicants are treated alike. They suggest that this could actually restrict, rather than expand, credit to marginal applicants as banks amend underwriting criteria and practices to remove elements of judgment in the lending process. Hence, while the federal regulatory agencies and the lending industry are both on record as being committed to combating lending discrimination, the two do not necessarily agree on the legal definitions and techniques to be used in implementing fair lending policy.

Extent of Problem Remains Unknown

Much has been written on the topic of discrimination in housing and housing-related practices over the last 20 years, and reviews of the literature by a number of reputable researchers aptly assess and critique the myriad of individual studies related to those subjects.⁴ Upon review, the literature on discrimination in housing seems generally well developed, and there appears to be widespread recognition that discrimination in the housing market exists and has been and continues to be a serious problem. Evidence of racial and ethnic steering and discriminatory real estate marketing and advertising practices, for example, is particularly well documented.

In contrast, the literature on the subject of lending discrimination is not nearly as extensive and a consensus has not yet been reached regarding the nature and pervasiveness of discrimination in the mortgage markets and elsewhere in the credit industry. Indeed, one scholar well known in the discrimination literature may have said it best when he observed that "given its social importance and media attention, it is staggering that researchers in fact have little definitive knowledge about the existence and severity of discrimination in mortgage markets."⁵

The absence of consensus on the nature and pervasiveness of lending discrimination may be explained, at least in part, by the complexity of the lending process itself. The home-buying process, for example, is a

⁴See for example, Galster (1992), Goering (1990), Lake (1986), Benston (1979), and Yinger et al (1979).

⁵Galster (1992).

multifaceted and perplexing process that involves many different participants. The process and the roles of the various agents, brokers, underwriters, insurers, lenders, and even the buyers themselves are not well understood. Additionally, the multifariousness of the process has presented a number of methodological obstacles to researchers that have not yet been resolved. Thus, our perspective is limited by the imprecise and often contradictory nature of the work to date. A description of the various press accounts, HMDA data analyses, statistical studies, and other sources of information is provided in appendix II.

For example, statistical studies examining the lending discrimination issue have not yielded consistent results. Although several studies of loan application denial rates have reported finding evidence of disparate treatment among mortgage lenders, recent studies of redlining (the refusal of lenders to make loans in certain geographic areas regardless of the creditworthiness of the individual loan applicant) and mortgage default rates have generally not found such evidence. Additionally, a number of reputable researchers have argued that the findings from contemporary statistical studies are severely limited by the data sources, the accuracy of model specifications, and the current state of knowledge regarding the mortgage search and underwriting processes.

Insights regarding the pervasiveness of discrimination from other sources have also proven to be contradictory. Information derived from the examination of depository financial institutions (together with information from consumer complaints), for example, has not indicated a major problem. In contrast, testing programs recently conducted around the country by private fair housing groups have exposed numerous instances of differential treatment during the mortgage application process. If confirmed by further tests, the findings from these programs would suggest a fair lending problem of greater dimensions. Hence, despite all that has been said and done, there remains much to be learned about the forms, occurrence, and magnitude of discrimination in the credit markets, particularly in markets other than the mortgage credit market.

Federal Oversight and Enforcement Have Improved

Prior to DOJ's initiation of its first major fair lending investigation in 1989 against Decatur Federal Savings and Loan, federal efforts to detect, deter, and punish instances of lending discrimination were quite limited—confined for the most part to the examination programs of the federal banking regulatory agencies.¹ Before that time, few, if any, federal lawsuits involving lending discrimination had been filed under ECOA. Federal enforcement efforts under FHA were similar. However, actions taken since 1988 by Congress, the Executive Branch, federal banking regulatory agencies, DOJ, HUD, and others have contributed to a more aggressive regulatory environment designed to engender greater compliance by the lending industry.

Fair Lending Named a Top Priority

In the late 1980s, Congress, the administration, and the banking regulatory agencies began taking actions to more effectively oversee and enforce the fair lending laws. Congress passed several amendments to the laws aimed at strengthening the statutes' enforcement provisions and to provide regulators with additional information on loan applicants and mortgage lending patterns. At about the same time, DOJ began its first investigation into alleged discriminatory lending practices, and the federal banking regulators began to revise their fair lending policies and examination procedures.

The movement toward more aggressive enforcement of the fair lending laws received additional momentum in 1993 when the new administration declared that the development of an effective and aggressive fair lending enforcement program would be a top priority. In 1993, the administration formed an interagency task force charged with clarifying regulatory policies in the fair lending area. The Interagency Task Force on Fair Lending subsequently released a major policy statement on fair lending enforcement policies in March 1994 and has continued to meet regularly.² Numerous other federal initiatives were also underway by this time. Figure 3.1 provides a chronology of events and key fair lending initiatives undertaken at the federal level over the last several years.

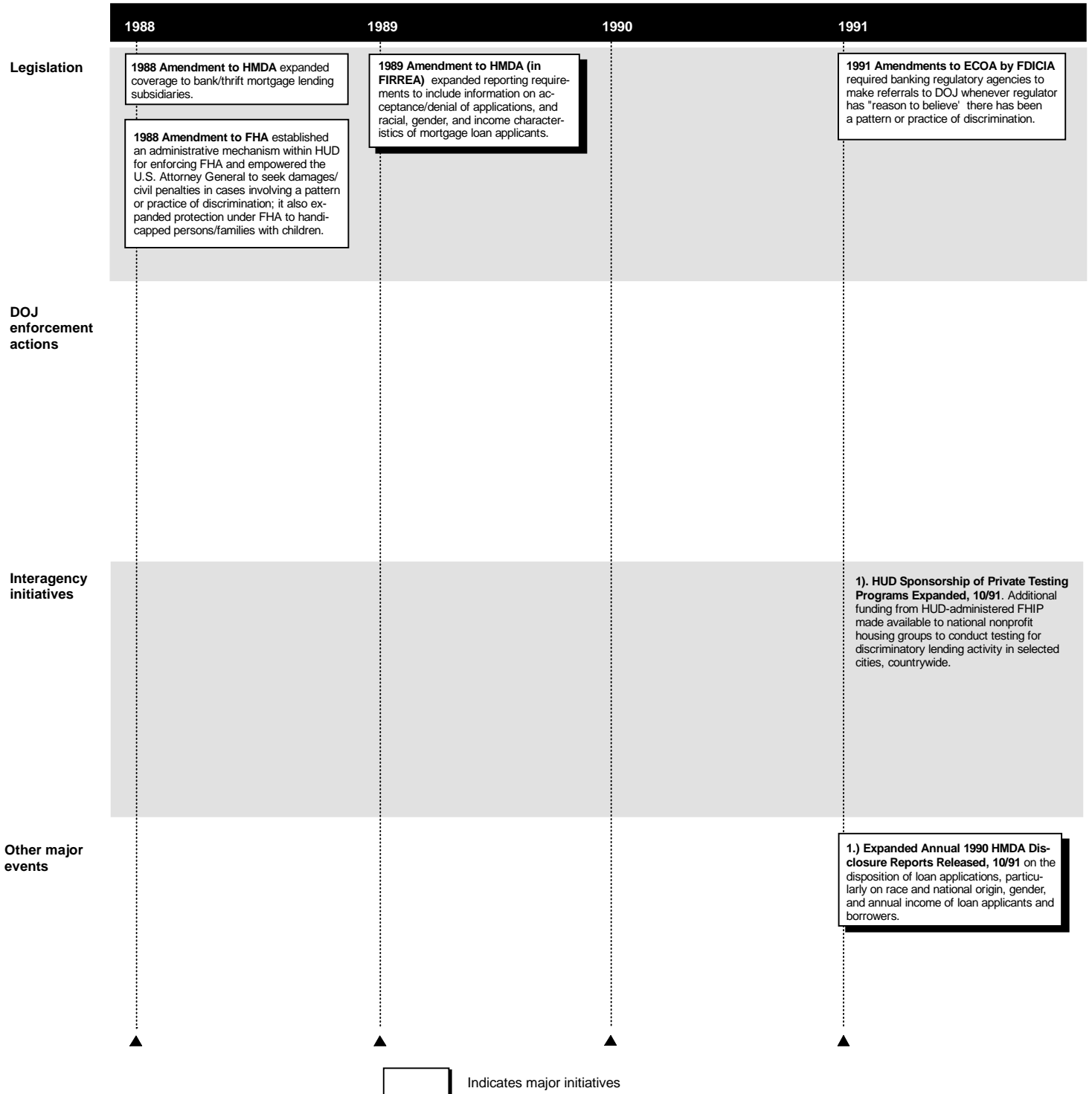
¹Prior to 1980, only FRB had in place an organization and cadre of examiners trained and dedicated to perform examinations to assess banks' compliance with consumer protection laws, including the fair lending laws.

²See Interagency Policy Statement on Discrimination in Lending, Federal Register, Vol. 59, No. 73, Friday, Apr. 15, 1994.

**Chapter 3
Federal Oversight and Enforcement Have
Improved**

**Chapter 3
Federal Oversight and Enforcement Have
Improved**

Figure 3.1: Chronology of Key Fair Lending Enforcement Initiatives, 1988-1995



**Chapter 3
Federal Oversight and Enforcement Have
Improved**

1992	1993	1994	1995
<p>1992 Amendments to HMDA by The Housing and Community Development Act of 1992 required greater public disclosure of loan application information by HMDA.</p> <p>The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 expanded HUD's general regulatory authority over the two major housing GSEs.</p>			
<p>Complaint and Consent Decree, 9/92. <i>United States of America v. Decatur Federal Savings and Loan Association.</i></p>	<p>FRB Denial of Shawmut Application, 11/93. Shawmut National Corporation's application to acquire New Dartmouth Bank denied on fair lending grounds.</p> <p>Complaint and Consent Decree, 2/93. <i>United States of America v. Shawmut Mortgage Company.</i></p>	<p>Complaint and Consent Decree, 12/93. <i>United States of America v. First National Bank of Vicksburg.</i></p> <p>Complaint and Consent Decree, 1/94. <i>United States of America v. Blackpipe State Bank.</i></p> <p>Complaint and Consent Decree, 8/94. <i>United States of America v. Chevy Chase Federal Savings Bank and B.F. Saul Mortgage Company.</i></p>	<p>Complaint and Consent Decree, 6/95. <i>United States of America v. Northern Trust Company.</i></p> <p>Complaint and Consent Decree, 10/95. <i>United States of America v. Security State Bank of Pecos.</i></p> <p>Complaint and Consent Decree, 10/95. <i>United States of America v. Huntington Mortgage Company.</i></p>
<p>1.) MOU between HUD and FFIEC Member Agencies, 5/92. MOU outlines procedures for coordination/cooperation in investigation of complaints that allege an FHA violation.</p>	<p>1.) New Fair Lending Examination Procedures Introduced, 4/93. OCC and FDIC formally adopt revised fair lending exam procedures to be used when searching for racial/ethnic discrimination in residential lending activities of commercial banks. Procedures emphasize "comparative file" methodologies designed to improve detection of more subtle discriminatory behavior e.g., disparate treatment.</p> <p>2.) Interagency Task Force on Fair Lending Formed 5/93 by ten of the federal agencies responsible for implementing and enforcing the nation's fair lending laws to share information/expertise in fair lending area and to develop a uniform policy for ECOA and FHA enforcement.</p>	<p>1.) President's Executive Order 12892, Leadership and Coordination of Fair Housing in Federal Programs, 1/94 charges HUD with responsibility for promulgating regulations describing nature/scope of coverage and conduct prohibited under FHA, incl. mortgage lending and property insurance discrimination.</p> <p>2.) FRB Incorporates Computerized Statistical Model into its Fair Lending Examination Procedures, 5/94 FRB formally authorizes the use of regression analysis as a routing part of its fair lending examination procedures.</p> <p>3.) HUD and Mortgage Bankers Association Sign "Best Practices" Agreement, 9/94 Assoc. entered into a voluntary agreement with HUD to promote, within mortgage lending industry, fair and equal housing opportunities for all.</p>	<p>1.) HUD Issues GSE Final Fair Lending Regulations, 12/95 implementing Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (GSE Act). Under GSE Act, regulations apply affirmative fair housing goals/fair lending requirements to Fannie Mae and Freddie Mac; and also contain fair lending provisions that enhance ability of HUD/other federal enforcing agencies to access data on secondary mortgage market.</p>
<p>1.) Boston Federal Reserve Bank Study on Mortgage Lending in Boston Metro Area, 10/92 concluded that black or Hispanic applicants in the Boston area were roughly 60 percent more likely to be denied a mortgage loan than were similarly situated white applicants.</p>	<p>1.) Interagency Letter on Lending Discrimination Issued to Financial Institutions, 5/93. FRB, OCC, FDIC, and OTS issued joint statement reaffirming their commitment to the enforcement of fair lending laws and suggested activities that financial institutions could undertake to improve fair lending compliance.</p> <p>2.) Interagency Policy Statement on Fair Lending Initiatives 6/93. Federal banking regulatory agencies announced they would pursue initiatives to strengthen fair lending detection and enforcement efforts and improve the level of education they provide to the industry/their examiners.</p>	<p>1.) Interagency Policy Statement on Discrimination in Lending, 3/94. Interagency Task Force on Fair Lending (10 federal government agencies responsible for implementing and enforcing nations' fair lending laws) released statement to provide (1) guidance about factors the agencies consider in determining if lending discrimination exists and (2) a foundation for future interpretations and rulemakings by the agencies.</p>	<p>1.) DOJ Guidance to Banking Industry on Fair Lending Issues, 2/95 responding to questions on lending discrimination posed by banking industry, DOJ outlined to major industry trade groups the general principles underlying DOJ's fair lending enforcement programs/position on particular fair lending issues.</p>

Fair Lending Initiatives by Banking Regulatory Agencies

The administration also spurred the executive branch regulatory agencies and others to reconsider their fair lending policies and procedures. On June 10, 1993, four of the five federal banking regulatory agencies (FRB, OCC, FDIC, and OTS) responded by announcing initiatives that they would undertake to improve the effectiveness of their examination and enforcement efforts. Specifically, the agencies pledged to

- develop new training programs for examiners in fair lending detection techniques,
- develop and sponsor regional fair lending seminars for senior industry executives to foster increased sensitivity and awareness among lenders for discrimination issues,
- explore the use of statistically-based discrimination detection models as tools in the examination process,
- implement an internal process for making referrals to DOJ for violations of ECOA, and
- refine their consumer complaint systems to improve the agencies' ability to detect and correct credit discrimination.

By year-end 1994, the agencies had made progress in several of these areas. For example, since the announcement, each of the federal banking regulatory agencies had developed and initiated new or enhanced fair lending training programs for their examiners and had substantially increased the number of examiners who received training in fair lending detection techniques in a given year. For example, in 1994, FRB implemented a new 2-week school for its examiners devoted solely to fair lending issues. Seventy-one FRB examiners attended the 2-week program in its first year. NCUA, meanwhile, retained a private consulting firm to instruct its examiners on compliance with the fair lending laws. The training was completed in February 1996.

The agencies have also followed through on their pledge to sponsor fair lending seminars for top-level industry executives. The first of three regional seminars was held in Washington, D.C., on July 18, 1994. Other seminars were held later in the year in Chicago and San Francisco. In total, the seminars drew more than 900 executives from bank and thrift institutions around the country. In responses to questionnaires circulated by the Federal Financial Institutions Examination Council (FFIEC)³, numerous participants indicated that the seminars provided a useful forum for them to exchange information and open channels of communication

³Members of the council include FRB, FDIC, OCC, OTS, and NCUA.

between top bank management and federal regulators and enforcement authorities.

The banking regulatory agencies have also made a commitment to reforming their examination procedures to reflect a new emphasis on the more subtle forms of discrimination like disparate treatment. These reforms have included, among other things, the development and use of sophisticated statistical methods for detecting discriminatory lending patterns. For example, FRB has already adopted statistical techniques as a means to more efficiently identify loan files for comparative analysis—eliminating the need for manual sampling at many institutions. Several of the agencies have also supported the examination function by adding fair lending specialists to their staffs, not only to support the examination function but to provide technical assistance to financial institutions on fair lending matters as well.

Finally, the agencies have also made some progress in refining their consumer complaint systems. At the time of the agencies' June 1993 announcement that each agency would undertake an evaluation of the effectiveness of its consumer complaint system in detecting credit discrimination, several of the agencies had already begun the process. The FRB initiative in the area, for example, had begun in November 1992, and new complaint procedures were adopted in June 1995. By the end of fiscal year 1995, OTS had joined FRB in completing revisions to its consumer complaint procedures. In its response, FDIC advised us that it planned to complete revisions to its procedures by June 1996.

Agencies Recommend Voluntary Fair Lending Compliance Activities

Another major effort by the responsible federal agencies to ensure compliance with the fair lending laws has been the encouragement of preventative measures in the lending industry. In May 1993, the federal banking regulators released the following list of recommended activities or practices for financial institutions to consider when planning their fair lending compliance programs:⁴

- Use of an internal second review system for consumer, mortgage, and small business loan applications that would otherwise be denied.
- Enhanced employee training that engenders greater sensitivity by financial institution management and employees to racial and cultural differences in our society.

⁴Joint News Release from Federal Banking Regulatory Agencies, May 27, 1993.

- Training of loan application processors to assure that any assistance provided to applicants in how to best qualify for credit is provided consistently to all applicants.
- Efforts to ensure that all persons inquiring about credit are provided equivalent information and encouragement.
- Use of flexible underwriting and appraisal standards that preserve safety and soundness criteria while responding to special factors in low- and moderate-income and minority communities.
- Efforts to encourage equal employment opportunity at all levels throughout the institution, including lending, credit review, and other key positions related to credit applications and decisions.
- Affirmative marketing and call programs designed to assure minority consumers, realtors, and business owners that credit is available on an equal basis. Marketing may involve sustained advertising programs covering publications and electronic media that are targeted to minority audiences.
- Ongoing outreach programs that provide the institution with useful information about the minority community, its resources, credit needs, and business opportunities.
- Participation on multilender Mortgage Review Boards that provide second reviews of applications rejected by participating lenders.
- Participation in public or private subsidy or guarantee programs that would provide financing on an affordable basis in targeted neighborhoods and communities.
- Use of commissions or other monetary or nonmonetary incentives for loan officers to seek and make safe and sound consumer and small business loans in minority communities.

Variations of the list of recommended activities have also been published by other agencies, lending institutions, compliance consultants, and a number of financial industry trade groups. These recommendations reflect the input of a variety of sources, including mortgage lenders, bankers' associations, credit counseling agencies, fair housing organizations, and social research groups. Among the recommended activities are such things as enhanced employee training programs, participation in multilender review boards, self-assessment activities, and affirmative marketing programs. HUD formalized its push for "best practices" by asking mortgage lenders to sign voluntary Fair Lending Best Practices Agreements that incorporate many of the suggested activities from the above list. Despite some delays due to resource and staffing constraints and extended one-on-one negotiations with interested mortgage lenders, HUD reported

that as of November 30, 1995, 70 lenders had either signed agreements or had agreed in principle on agreements and were expected to sign soon.

Many banking institutions have already incorporated at least some of the recommended activities into their lending operations. For example, in a recent survey of bank chief executives conducted by KPMG Peat Marwick, of the 660 chief executive officers who responded, 85 percent reported that they had reviewed fair lending policies and procedures at their institutions; 43 percent reported having done a quantitative analysis of application and loan files; and 23 percent acknowledged having tested their banks using mystery shoppers.

All recommendations, however, have not been enthusiastically endorsed by the entire financial services industry. Some bankers see certain aspects of the Interagency Policy Statement on Discrimination in Lending, as well as some of the recommended activities, as problematic. In public letters to the regulatory agencies and in the press, individual bankers and industry trade groups have cited the high costs associated with some activities, and the legal liabilities associated with others, as potential barriers to acceptance. Other bankers expressed concern that special-purpose lending and credit assistance programs developed by banks to increase lending to certain groups may run afoul of the fair lending laws by excluding nontargeted groups and individuals in a discriminatory manner. While ECOA makes exceptions for such programs, FHA does not directly address the issue. Although failure to adopt any of the recommended practices is to have no express bearing on an institution's compliance rating, DOJ has suggested that by undertaking such activities a lender could possibly avoid severe sanctions if the government were to discover discriminatory activity at the institution at a later date.

Fair Lending Oversight and Enforcement

Federal efforts to ensure compliance with the fair lending laws have not always been so energetic. In the period immediately following the passage of FHA, federal enforcement efforts were almost exclusively limited to matters related to housing discrimination rather than lending discrimination. For example, HUD and DOJ had initiated programs to identify discriminatory behavior by landlords and other agents in the housing search process. Similarly, no significant enforcement actions were taken under ECOA for more than a decade after its enactment. In the late 1980s, however, Congress, DOJ, and other responsible federal agencies began to respond to the growing number of media reports suggesting that lending discrimination was widespread.

In 1988 and 1989, respectively, Congress amended FHA and HMDA to both expand the scope and breadth of the laws and to strengthen FHA's enforcement provisions. Soon thereafter, DOJ began laying the groundwork for an intensive fair lending enforcement campaign. Other federal agencies with oversight responsibilities in the fair lending area also began, at about this time, to respond to the increasing calls for stepped up fair lending enforcement efforts. Similarly, the banking regulatory agencies recognized shortcomings in their existing fair lending compliance policies and examination procedures and began extensive revisions.

Oversight by the Federal Banking Regulatory Agencies

For depository institutions, compliance with the fair lending laws is primarily assessed through regularly scheduled consumer compliance examinations conducted by the federal banking regulatory agencies. Fundamentally, the objectives of fair lending examinations are to determine (1) whether a lender's written policies and standards for creditworthiness are nondiscriminatory and (2) whether those standards are applied uniformly and without discrimination. While the purpose of the examination process is to reveal any unlawful practices that affect large numbers of people, as well as more isolated cases of discrimination, the subtle nature of nonovert forms of discrimination might defy detection by conventional means. This was especially true prior to 1993 when fair lending compliance examination procedures were, for the most part, designed to identify cases of blatant discrimination—i.e., cases in which clearly qualified minority loan applicants were unjustifiably denied credit. For example, under the pre-1993 examination procedures, examiners were directed to select a small judgmental sample of rejected minority applications and review them for consistency with a lender's written underwriting standards. With this focus, examiners rarely detected instances of discriminatory lending activity.

Improvements Made to Fair Lending Examination Procedures

By the early 1990s, the federal banking regulatory agencies had recognized the inability of their examination process to detect the more subtle forms of discriminatory behavior and moved to revamp their examination procedures. Since announcing in June 1993 their intention to work on improving fair lending examination procedures, in general, and detection capabilities, in particular, the agencies have made considerable progress. By 1994, FRB, OCC, FDIC, OTS, and NCUA had each adopted revised or interim procedures that abandoned the past process of only comparing rejected applications with underwriting standards and emphasized a "comparative-file" approach. The comparative-file approach seeks primarily to detect disparate treatment by comparing the outcomes of the

Regulators Increase Use of
Comparative-File Analysis

lending process for similarly qualified, but racially or ethnically different, applicants.⁵

The interim procedures for fair lending oversight vary by regulatory agency but essentially share the same focus—a hands-on search for evidence of differential treatment of applicants based on prohibited factors like race or gender. In theory, a comparative-file review for disparate treatment seeks to answer two questions: (1) are the outcomes of the lending process equivalent for racially or ethnically different applicants with equivalent qualifications and (2) did the lender give equivalent levels of assistance during the application and underwriting processes to applicants from different racial or ethnic groups?

When conducting a comparative-file analysis, an examiner can employ a variety of techniques for selecting files to compare. For example, files may be selected by choosing a particular period (time-period approach), or be chosen based on reasons for denial (questionable-transaction approach), or by matching comparable files (matched-pair analysis), or through scientific sampling, or some other method. Regardless of the method chosen, the comparative-file approach attempts to find individual cases in which disparate treatment may have occurred or when an institution's credit standards were not applied consistently.

The effectiveness of the comparative-file technique was recently illustrated in DOJ's fair lending investigation of the Northern Trust Company and several of its affiliates. By examining numerous applications from potential borrowers who were deemed by DOJ to be only marginally creditworthy, the department was able to find what it considered to be substantial evidence of differential or disparate treatment of minority loan applicants. The differences in treatment described included disparities in the level of assistance and advice, dissimilarities in the way financial information was analyzed, and variations in how and when "offsetting" qualifications were considered as compensation for credit deficiencies.⁶

Despite its obvious benefits, however, comparative-file analysis is time-consuming and is often limited in its application because of the

⁵FDIC, OCC, and NCUA adopted interim fair lending examination procedures emphasizing the comparative-file approach in mid-1993. FRB formally updated its fair lending examination procedures in May 1994, but said it had been using the comparative-file technique since it adopted a compliance examination program in 1979.

⁶DOJ indicated that it is not necessary to obtain truly "comparable" files when using the comparative-file technique to document a type of disparate treatment they referred to as "processing discrimination." Processing discrimination could include, for example, instances in which minority loan applicants were not given the same level of assistance and advice as were white applicants.

difficulties that can be encountered in finding a sufficient number of comparable files to review. Because of these difficulties, the agencies have continued to seek ways to improve their practical ability to detect discrimination.

New Statistical Models Being Tested as Examination Tools

In 1994, FRB began to use, on a regular basis, a computerized statistical model in bank examinations. OCC and other agencies are also experimenting with statistical models. Essentially, FRB's model automates the comparative-file analysis of the fair lending examination (see app. III).

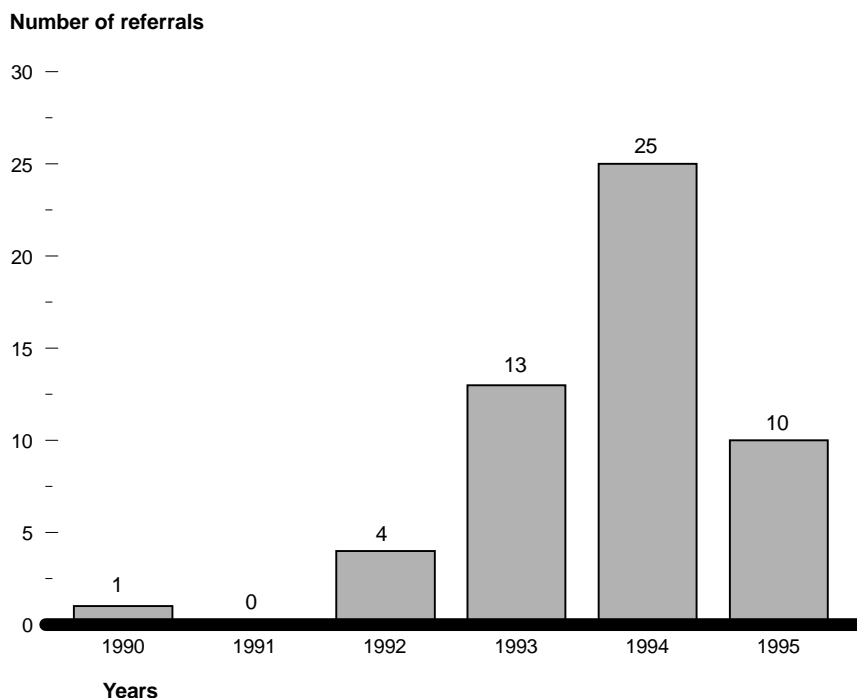
The use of statistically-based methods to detect discrimination can offer a more systematic means of examination than that of older methods. In combination with HMDA data, census data, and geographic information, computerized statistical analysis can allow examiners to more quickly identify institutions that may require a more intensive review of their mortgage lending decisions. Use of statistical models also essentially automates the approach of on-site fair lending examinations and allows examiners to quickly sort through vast quantities of data, focus on data for specific lending markets, select a sample of files, and draw comparisons.

However, the use of statistics and statistical models as examination tools is not a panacea. Economists and statisticians have repeatedly pointed out that statistical approaches have limitations and can be misleading. For example, the application and effectiveness of such models as examination tools can be limited by an institution's size and volume of lending activity. Moreover, statistical models of the loan underwriting process are difficult to construct and data errors or omitted variables can cause such models to give unreliable results. These and other limitations associated with the use of statistics in overseeing and enforcing the fair lending laws are further discussed in appendix IV.

Referrals to DOJ Have Increased

Adoption of the new statistical-based examination techniques, combined with certain statutory reforms, has led to an increase in the number of cases being reviewed by DOJ. ECOA, as amended by the Federal Deposit Insurance Corporation Improvement Act (FDICIA) in 1991, requires the federal banking regulatory agencies to refer pattern and practice violations of ECOA to DOJ, and to notify HUD when it appears that ECOA violations not referred to DOJ would also violate FHA. To implement this requirement, each of the banking regulatory agencies has put in place an internal process under which apparent fair lending violations are to be referred to the responsible department. As a result, agency referrals to DOJ have risen noticeably since 1990 (see figure 3.2).

Figure 3.2: Number of Referrals by
Banking Regulatory Agency to DOJ for
Violations of the Fair Lending Laws,
1990-1995



Source: U.S. Department of Justice.

Upon receiving a referral, DOJ is to assess the nature of the case to determine if the violation warrants a full investigation. If not, the case is to be returned to the appropriate agency to be handled administratively. In practice, this process can be informal, with DOJ and the banking regulatory agencies engaged in two-way discussions regarding the merits of individual cases so as to ascertain how best to pursue enforcement. Table 3.1 provides a breakdown of the number of referrals by banking regulatory agencies to DOJ by year. Table 3.2 briefly describes the nature of the referrals and any subsequent action taken by DOJ.

Although the number of referrals to DOJ has increased since passage of the 1992 amendments to ECOA, there remains a degree of uncertainty on the part of some agency officials and examiners as to the characteristics of

possible “pattern or practice” cases of lending discrimination. Such uncertainty arises, in part, from two terms within the statutory language, “reason to believe” and “pattern or practice.” Because the meaning of these terms is often defined on a case-by-case basis, the standard for referrals to DOJ is unclear. Such uncertainty could possibly result in inconsistent application of the referral mandate and ultimately to inconsistent enforcement of the fair lending laws across agencies and financial institutions. This issue is discussed in greater detail in chapter 4.

Table 3.1: Number of Referrals by Bank Regulatory Agencies and HUD to DOJ for Violations of the Fair Lending Laws, by Agency, 1990-1995

Year	Bank regulatory agencies					HUD	Total
	FRB	FDIC	OCC	OTS	NCUA		
1990	0	0	1	0	0	0	1
1991	0	0	0	0	0	0	0
1992	1	3	0	0	0	0	4
1993	0	7	4	1	0	1	13
1994	1	12	7	5	0	0	25
1995	5	0	5	0	0	0	10
Total	7	22	17	6	0	1	53

Source: U.S. Department of Justice.

Table 3.2: Number of Referrals by Banking Regulatory Agencies and HUD to DOJ for Violations of the Fair Lending Laws, by Agency, 1990-1995

Agency	Year	No.	Action taken	Details of referral
FRB	1992	1	Legal action	DOJ/FTC lawsuit filed against Shawmut Mortgage Company charging racial discrimination; settled by consent agreement.
	1994	1	Legal action	DOJ complaint filed against Security State Bank alleging discrimination in loan pricing based on national origin; settled by consent agreement.
	1995	4	Returned to agency	Alleged discrimination based on marital status ^a and spousal signature violations; to be handled administratively.
	1995	1	Legal action	DOJ complaint filed against Fleet Financial Group for alleged discrimination in the pricing of home mortgage loans based on race and national origin.
OCC	1990	1	Returned to agency	None.
	1993	3	Returned to agency	Alleged discrimination based on age, sex, and marital status; violations to be handled administratively.

(continued)

**Chapter 3
Federal Oversight and Enforcement Have
Improved**

Agency	Year	No.	Action taken	Details of referral
	1993	1	Legal action	DOJ lawsuit filed against First National Bank of Vicksburg charging racial discrimination; settled by consent agreement.
	1994	1	Returned to agency	Alleged racial discrimination; administrative remedy achieved through HUD.
	1994	1	Legal action	DOJ lawsuit filed against Huntington Mortgage Company alleging price discrimination based on race; settled by consent agreement.
	1994	5	Returned to agency	Marital status violation; ^a to be handled administratively.
	1995	2	Returned to agency	Marital status violation; to be handled administratively.
	1995	2	Returned to agency	Alleged age discrimination in use of credit scoring models; to be handled administratively.
	1995	1	Legal action	DOJ complaint filed against First National Bank of Gordon for alleged price discrimination against Native Americans.
FDIC	1992	3	Returned to agency	CRA violations by small lenders; to be handled administratively.
	1993	7	Returned to agency	Insufficient information.
	1994	1	DOJ intends to close and return	Alleged racial discrimination case; referred to and being handled by HUD.
	1994	1	Returned to agency	Alleged violation of FHA based on appraisal rules; isolated incident with administrative remedy achieved.
	1994	10	Returned to agency	Marital status violation; to be handled administratively.
OTS	1993	1	Returned to agency	Alleged racial discrimination in marketing; no cause found.
	1994	1	Under investigation by DOJ	Alleged discrimination based on race, national origin, sex, and age.
	1994	2	Returned to agency	Alleged discrimination based on national origin; failure to serve entire community; to be handled administratively.
	1994	1	Returned to agency	Alleged discrimination based on age; to be handled administratively.
	1994	1	To be returned	Alleged racial discrimination in marketing; insufficient documentation; to be handled administratively.
HUD	1993	1	Returned to agency	Racial discrimination case; nonserious violation to be handled administratively.

(Table notes on next page)

^aFailure to combine income/assets and credit histories of joint applicants who are not married, while routinely doing so for married joint applicants.

Source: U.S. Department of Justice.

Enforcement by the Department of Justice

DOJ has independent authority under both ECOA and FHA to conduct investigations and bring a civil suit against financial institutions when it appears that a pattern or practice of lending discrimination has occurred.⁷ However, like other federal agencies, DOJ did not use its authority to aggressively enforce these laws prior to 1988. According to a senior DOJ official, DOJ's lack of involvement prior to that time was primarily due to a lack of sufficient information and because evidentiary standards for lending discrimination had not yet been developed. The implementation of expanded HMDA reporting requirements in 1990, however, provided DOJ with sufficient information to begin investigations of mortgage lending patterns at financial institutions. In 1992, DOJ filed its first major complaint alleging discriminatory lending practices against Decatur Federal Savings and Loan (N.D. GA. 1992). That action resulted in a consent decree in which Decatur Federal, while denying the allegations of discrimination, agreed to set aside \$1 million to compensate the alleged victims and to adopt a detailed business plan designed to make home mortgage loans more available to African-Americans (see app. V). Since then, DOJ has filed nine additional lawsuits against lending institutions alleging illegal discriminatory lending practices under ECOA and FHA. They are (1) U.S. vs. Shawmut Mortgage Company (D. Conn. 1993); (2) U.S. vs. First National Bank of Vicksburg (S.D. Miss. 1994); (3) U.S. vs. Blackpipe State Bank (D. S.D. 1994); (4) U.S. vs. Chevy Chase Savings and Loan (D. D.C. 1994); (5) U.S. vs. Northern Trust Company (N.D. Ill. 1995); (6) U.S. vs. Security State Bank of Pecos (W.D. Tex. 1995); (7) U.S. vs. Huntington Mortgage Company (N.D. Ohio 1995); (8) U.S. vs. First National Bank of Gordon (D. S.D. 1996); and (9) U.S. vs. Fleet Mortgage Corporation (E.D. N.Y. 1996). None of these cases has gone to court. Rather, in every case but one, DOJ obtained a consent agreement with the accused institution. Only the tiny First National Bank of Gordon, Nebraska, refused to agree to a settlement at the time the complaint was filed. Disposition of that case was still pending at the time of our review (see table 3.3 and figure 3.3 for details on all these cases).

⁷In addition, FHA authorizes an independent DOJ action when it appears that any group of persons has been denied rights to fair housing as provided in the act, including equal access to housing-related credit, and the denial "raises an issue of general public importance." 42 U.S.C. § 3614(a).

**Chapter 3
Federal Oversight and Enforcement Have
Improved**

Table 3.3: Description of Complaints Made by DOJ Against Financial Institutions for Alleged Violations of the Fair Lending Laws, 1992-1995

Financial institution	Date	Description of DOJ complaint
Decatur Federal Savings and Loan	9/17/92	Complaint alleged that Decatur Federal engaged in policies and practices that discriminated against potential and actual loan applicants on the basis of race by, among other things, conducting its home mortgage loan marketing in a manner that excluded potential black borrowers and that it discriminated against those blacks who did apply for home mortgage loans.
Shawmut Mortgage Co. of Boston	12/13/93	Complaint alleged that the mortgage company engaged in policies and practices that discriminated on the basis of race and national origin in its home mortgage lending business by, among other things, requiring a higher level of documentation of black and Hispanic applicants' information, failing to make the same effort to assist minority applicants obtain qualifying information as it did for other applicant groups, and by applying more stringent underwriting standards to black and Hispanic applicants.
National Bank of Vicksburg	1/21/94	Complaint alleged that the bank engaged in a pattern or practice of racial discrimination by charging blacks higher interest rates than those charged whites on unsecured home improvement loans.
Blackpipe State Bank	1/21/94	Complaint alleged that the bank discriminated on the basis of race, color, and/or national origin by, among other things, refusing to make secured loans to Native Americans when the collateral was located on a reservation and by applying different underwriting standards to Native Americans than those applied to whites.
Chevy Chase Federal Savings Bank and B.F. Saul Mortgage Co.	8/22/94	Complaint alleged that the bank and its affiliated mortgage company discriminated on the basis of race by adhering to policies and practices that denied an equal opportunity to residents of African-American neighborhoods to obtain mortgage financing and other types of credit transactions—practices commonly referred to as redlining.

(continued)

**Chapter 3
Federal Oversight and Enforcement Have
Improved**

Financial institution	Date	Description of DOJ complaint
Northern Trust Company and named affiliates	6/1/95	Complaint alleged that in processing home mortgage loan applications, the banks engaged in lending practices that constituted unlawful discrimination on the basis of race and national origin; i.e., that African-American and Hispanic loan applicants were treated differently (and less favorably) than white applicants.
Security State Bank of Pecos	10/18/95	Complaint alleged that the bank discriminated on the basis of national origin by charging Hispanic borrowers higher annual percentage rates for general consumer, nonmortgage related installment and single payment loans than for similarly situated non-Hispanic borrowers.
Huntington Mortgage Company	10/18/95	Complaint alleged that the mortgage company engaged in a pattern of racial discrimination in the pricing of home mortgage loans by charging African-Americans higher up-front fees or "overages" for home mortgage loans than similarly situated white borrowers.
First National Bank of Gordon	04/15/96	Complaint alleged that the bank discriminated on the basis of race, color, and/or national origin by charging Native American borrowers higher interest rates for consumer loans than similarly situated white borrowers.
Fleet Mortgage Corporation	05/07/96	Complaint alleged that the mortgage company engaged in discriminatory treatment of African American and Hispanic borrowers at two of its branch offices by charging them higher prices in the form of greater "overages" on home mortgage loans than it charged white borrowers.

Source: Compiled by GAO from DOJ case records.

**Chapter 3
Federal Oversight and Enforcement Have
Improved**

Figure 3.3: Checklist of Specific Provisions Agreed to in Consent Decrees in Order to Settle Claims of Lending Discrimination

Case name	Injunctive provision												Monetary damages (\$1,000s)	Civil penalty (\$1,000s)	
	Redefine service community	Change mortgage lending procedures	Branch location prescriptions	Require second review committee	Require specialized lending programs	Recruitment prescriptions	Training requirements	Prescribe compensation structure	Require self-testing	Advertising/marketing prescriptions	Recordkeeping/reporting requirements	Implement loan price monitoring system			
Decatur Federal Savings and Loan	●	●	●	●	●	●	●	●	●	●	●	●	●	\$1,000	\$ 0
Shawmut Mortgage Company of Boston			●	●	●		●	●	●	●	●			960	0
National Bank of Vicksburg		●		●	●		●		●		●			750	50
Blackpipe State Bank	●	●		●	●	●	●			●	●			125	0
Chevy Chase Federal Savings Bank and B.F. Saul Mortgage Co.	●	●	●	●	●	●	●		●	●	●			11,000	0
Northern Trust Company and Affiliates				●	●		●				●			700	0
Security State Bank										●	●			500	10
Huntington Mortgage Company							●				●	●		420	0
Fleet Mortgage Company							●				●	●		4,000	0

Source: Compiled by GAO from DOJ case records.

In initiating these legal actions, DOJ has adhered to a broadened philosophy regarding what constitutes discrimination—scrutinizing not only an institution’s lending policies and loan files for evidence of discrimination but also its geographic branching patterns and marketing efforts as well. For example, in the Decatur and Chevy Chase cases particularly, DOJ alleged that given the racial characteristics of the thrifts’ lending areas, the institutions’ credit standards and practices and branching and marketing strategies discriminated against protected minority groups. Initiatives to address these problems were an integral part of the consent decrees agreed to by these institutions.

In addition to the ten lawsuits brought against financial institutions to date, DOJ officials have acknowledged that several other investigations are

underway both within and outside of the banking industry. For example, DOJ has already entered into an agreement with HUD to investigate independent mortgage companies and is also investigating, in cooperation with FTC, the finance units of the “Big Three” U.S. automobile companies⁸ for possible lending bias in automobile loans. DOJ officials believe that joint investigations such as these can be particularly effective given the mix of knowledge, experience, and resources that could be brought to bear in these efforts. However, Decatur-like investigations, i.e., those involving in-depth statistical analyses of loan files, are time consuming and expensive. According to DOJ, a full and thorough investigation typically takes 6 to 9 months to complete and can cost as much as \$500,000.⁹ Because of the increased workload stemming from lending discrimination investigations and from FHA “election” cases; i.e., those cases in which the complainant elects to have their FHA-related complaint heard in federal court rather than by HUD’s administrative law judge, Attorney General Reno has added 34 new positions to DOJ’s Housing Section since 1992 (the authorized staffing level for fiscal year 1994 was 76 full-time positions). Additionally, she has also asked that U.S. District Attorneys make some of their staff members available for these investigations. However, although DOJ has increased its enforcement efforts, officials suggest that limited resources and the high cost of Decatur-like investigations will necessarily limit the number of cases that can be pursued.

DOJ investigations and legal actions appear to have had a significant impact both on lenders’ compliance efforts and on the enforcement efforts of other federal agencies. By illustrating their willingness to single out individual financial institutions for prosecution and by extracting consent agreements with substantial monetary penalties, DOJ has reawakened the lending industry to its responsibilities under the fair lending laws. Although we cannot confirm the extent to which the financial industry has reacted by increasing its efforts to ensure compliance with the fair lending laws, indications are that the industry has been generally responsive. For example, it has been reported in the press that the industry has been voluntarily implementing many of the preventative practices, like second review programs, affirmative marketing programs, and self-testing, as prescribed in the settlement agreements with Decatur Federal and others, and as recommended by federal banking regulators.

In addition to apparently spurring increased industry compliance activity, DOJ’s enforcement efforts may also have had an impact on the enforcement

⁸General Motors, Ford, and Chrysler.

⁹DOJ’s first fair lending investigation, that of Decatur Federal Savings and Loan, took nearly 3 years and cost more than \$1 million.

efforts of other federal agencies—prompting stepped-up enforcement by all of the federal banking regulatory agencies, HUD, and FTC. Moreover, the findings from DOJ investigations have aided the banking regulators in their efforts to improve their own fair lending policies and procedures, and in developing and implementing more sophisticated examination techniques.

Oversight and Enforcement by HUD

The Secretary of Housing and Urban Development (HUD) is authorized to administer FHA. However, under the original act, HUD's enforcement authority was limited to complaint investigation, referral, and attempts at voluntary conciliation. It was not until 1988, with the passage of the Fair Housing Amendments Act, that a full administrative enforcement system was put in place to administer and enforce the law.¹⁰ Also, through the establishment of the Fair Housing Initiatives Program (FHIP) in 1987, Congress made additional funding available to HUD for the purpose of conducting investigations—through grants with private organizations—of possible FHA violations and to take such enforcement actions as necessary to remedy violations detected by those organizations.¹¹

Several units within HUD share fair lending oversight and enforcement responsibilities. HUD's Office of Fair Housing and Equal Opportunity (FHEO) has overall responsibility for enforcing FHA and other civil rights laws and makes referrals to DOJ when appropriate. The Federal Housing Administration is responsible for ensuring that HUD-approved mortgagees (lenders) comply with all fair housing and fair lending laws and promulgates rules implementing fair lending requirements. In this capacity, the Federal Housing Administration has outlined requirements covering such fair lending-related topics as minimum loan amounts, tiered pricing, overages, and second review programs.¹² HUD-approved lenders that violate the fair lending laws are subject to administrative sanctions and civil money penalties by HUD's Mortgagee Review Board. In 1992, HUD was also given authority to oversee the two major housing government-sponsored enterprises—Fannie Mae and Freddie Mac (the

¹⁰The Fair Housing Amendments Act of 1988 created an administrative enforcement system subject to judicial review and allowed the use of court enforcement by private litigants and DOJ (Pub. Law No. 100-430).

¹¹See Housing and Community Development Act of 1992, Pub. Law No. 102-550, Title IX, § 905(b) (1992).

¹²See for example, HUD Mortgagee Letter 94-22 (May 4, 1994) and 94-43 (Sept. 29, 1994), Office of the Assistant Secretary for Housing-Federal Housing Commissioner.

GSES) to, among other things, ensure that they were not discriminating in their mortgage purchases based on factors protected under FHA.¹³

Responsibilities of FHEO

As just mentioned, FHEO has been delegated primary responsibility for enforcing FHA's provisions. FHEO's enforcement program has several components: (1) complaint investigations, (2) Fair Housing Initiatives Program grants, and (3) voluntary "best practices" agreements.

Complaint Investigations

The largest component of FHEO's fair lending enforcement program is its complaint investigation program. As described by HUD, it consists of two parts: consumer complaints, and Secretary-initiated complaints.¹⁴ Consumer complaints can be narrow or broad in scope depending on the number and type of allegations. In contrast, Secretary-initiated complaints are normally broader in scope, require more resources, and take longer to investigate than do consumer complaints. All Secretary-initiated complaints are processed by HUD staff in FHEO. Consumer complaints are primarily processed by HUD, but about one-third of them are processed by state and local government agencies under the Fair Housing Assistance Program (FHAP). The FHA requires that HUD allow state and local government agencies, which have been determined to have fair housing enforcement programs substantially equivalent to those under FHA, to process complaints filed in those agencies' jurisdictions.¹⁵ Under FHAP, HUD is to provide financial support and technical assistance to these agencies for complaint processing.

In the past 7 years since the Fair Housing Amendments Act of 1988 was implemented (in 1989), HUD and the FHAP agencies have processed 2,356 fair lending complaints. Of this number, HUD processed 1,598 (68 percent), and the FHAP agencies processed 758 (32 percent). In fiscal year 1995, HUD closed 456 complaints alleging discrimination in housing finance (6.5 percent of all FHA-related complaints closed by HUD that year).

¹³See 12 U.S.C. 4501-4641, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, enacted as Title XIII of the Housing and Community Development Act of 1992 (Pub. Law 102-550).

¹⁴Section 810 of FHA sets forth the requirements for HUD investigations of potential discriminatory housing practices, which include discriminatory mortgage lending and related activities. The section requires that HUD investigate all consumer complaints and authorizes the agency to self-initiate investigations and file complaints (Secretary-initiated complaints). 42 U.S.C. § 3610.

¹⁵See 42 U.S.C. § 3610(f) (1988).

HUD's Secretary-initiated complaint program began focusing on mortgage lending issues in fiscal year 1993. FHEO and HUD's Federal Housing Administration reviewed 16 FHA-approved lenders to determine whether a formal investigation was warranted. The review resulted in two Secretary-initiated investigations. In all, HUD has initiated four investigations of mortgage lenders, all of which were nearing completion at the time of our review.

Although HUD is required to process all consumer complaints, FHA requires that HUD attempt to conciliate complaints and try to avoid a time-consuming and costly investigation or enforcement action. Conciliation is voluntary and both the respondent and complainant must agree for it to occur. Through this process, a large percentage (38 percent) of the fair lending complaints that HUD processes are conciliated (See table 3.4).

Table 3.4: Number and Percentage of Fair Lending Complaints Closed by HUD During FYs 1990-1995, by Closure Type

Closure type	Number of complaints	Percentage
Administrative ^a	720	30.6%
Conciliated	896	38.0
No violation	717	30.4
Violation	14	0.6
Referred to DOJ	9	0.4
Total	2,356	100.0%

^aHUD may close complaints administratively with or without an investigation. This can occur, for example, when the complainant refuses to cooperate with HUD during an investigation, or when HUD is unable to contact the complainant after the complaint is filed.

Source: HUD, Office of Fair Housing and Equal Opportunity.

Conciliation agreements may provide compensatory and equitable relief for the complainant(s) and relief in the public interest. They may also enjoin the respondents from further discriminatory behavior. According to HUD, in fiscal year 1995, it conciliated 105 mortgage lending complaints that resulted in some form of monetary compensation to the complainant. As a result of these conciliations, complainants received \$1.3 million in monetary compensation—an average of over \$12,000 per complainant. However, this is only a fraction of the amount that lenders agreed to expend in the public interest. For example, HUD stated that it had recently negotiated a settlement of \$175,000 for a Hispanic female employee who was discharged by a lender for making loans to minority persons and for questioning why one of her clients, a Hispanic male, was denied a loan. As

part of the settlement, the lender agreed to advertise the availability of loans in minority media, contribute \$2,500 to a nonprofit housing organization for the purpose of promoting fair housing, and to make \$250,000 available to a lending program for low- to moderate-income borrowers.

Another case described by HUD involved a black developer who was denied a commitment to finance homes to be constructed in a minority area. The lender agreed to settle the case by paying the complainant \$68,000 and establishing a \$500,000 fund to counsel credit applicants under a program established pursuant to the Community Reinvestment Act (CRA). The lender also agreed to provide mortgages for qualified applicants presented by the complainant for up to 250 newly constructed homes at an average of \$70,000. According to HUD, this represents a commitment of over \$17 million in predominantly minority areas.

Under FHA, the Secretary is to investigate complaints of discriminatory lending practices. However, according to HUD, investigations of complaints are generally only conducted if the complainant and/or respondent refuse to participate in the conciliation process or when conciliation is attempted but fails. As a result, HUD actually investigates only about one-third of all fair lending complaints. Of the 740 fair lending complaints that were not administratively closed or successfully conciliated by HUD during fiscal years 1990-1995, and which required an investigation, only 23 (or 3 percent) were found to substantiate a violation of FHA. If a conciliation agreement is not reached and HUD believes that discrimination has occurred, the Secretary must file a charge on behalf of the aggrieved person. Once the charge is filed, the aggrieved person on whose behalf the charge was filed may elect to have the matter administratively adjudicated within HUD or have HUD commence a civil action on behalf of that person.¹⁶

If during the investigation of a consumer complaint, or when considering matters for Secretary-initiated complaints, HUD has reason to believe that a pattern or practice of discriminatory behavior is evident, the Department must transmit the pertinent information to DOJ. In addition to its referral obligations, HUD officials have told us that they have agreed to cooperate with DOJ in investigations of independent mortgage companies. In the past, these investigations have taken place either sequentially or concurrently, but not jointly.

¹⁶See 42 U.S.C. § 3612.

As mentioned earlier, the federal banking regulatory agencies must notify HUD of cases not referred to DOJ when the agencies believe that an institution's apparent violation of ECOA also would violate FHA. Moreover, under an agreement with member agencies of the FFIEC and by executive order, FHA-related complaints of lending discrimination received by the agencies must be referred to HUD for investigation. (Likewise, if the complaint is received by HUD and it involves a federally regulated financial institution, HUD is to inform the appropriate regulatory agency of the complaint and any pending investigation.) During the past 3 fiscal years, HUD has received 560 complaint referrals from the regulators, and, during the same period, HUD notified the banking regulators of 139 complaints it received against lending institutions regulated by them.

The Fair Housing Initiatives Program (FHIP)

The Fair Housing Initiatives Program, which was established by the Housing and Community Development Act of 1987,¹⁷ provides grants to private organizations and State and local government agencies to provide education and outreach and to conduct enforcement-related activities. As currently administered, FHIP provides funding for activities in four program areas: (1) administrative enforcement, (2) education and outreach, (3) private enforcement, and (4) fair housing organizations.¹⁸ FHIP funds are awarded on a competitive basis. In fiscal year 1993, HUD awarded \$9.6 million in grants under FHIP, with almost \$5 million of that targeted to projects related to insurance redlining and mortgage lending discrimination. In fiscal year 1994, congressional appropriations for FHIP were increased to \$20.5 million, with approximately \$12 million targeted for enforcement projects in those same two areas. Through fiscal year 1994, FHIP competitions have awarded more than \$21.5 million in funds to support fair housing enforcement efforts. Included among those awards was a fiscal year 1992 grant for \$1 million to support a large-scale national testing program to assess mortgage lending discrimination. Information obtained from FHIP-funded projects can be used by either public or private nonprofit organizations, or HUD, as the basis for a formal complaint against individuals or lending institutions.

¹⁷Pub. L. No. 100-242, Title V, § 561, 101 Stat. 1942 (1987). The law was passed in 1987 but became effective Feb. 5, 1988. FHIP was subsequently amended in 1990 and 1992 (codified, as amended, at 42 U.S.C.A. § 3616a (West Supp. 1993)).

¹⁸Section 905 of the Housing and Community Development Act of 1992 allows for money appropriated under FHIP to be used to conduct investigations, through contracts with private nonprofit organizations of violations of rights granted under FHA. See 42 U.S.C. § 3616 note.

Following passage of the Housing and Community Development Act of 1992, HUD lifted a requirement that FHIP-funded testing activities be restricted to bona fide complaints and expanded FHIP to permit contract recipients to carry out testing programs whenever there is a reasonable basis for doing so. According to HUD, a reasonable basis may be obtained from complaints, allegations, statistical disparities, or other types of substantive information. Testing programs involve the use of “testers” posing as renters, purchasers, or borrowers in order to ascertain if a similarly situated member of a protected group has been subject to discrimination. Beginning with the fiscal year 1990 and 1991 FHIP competitions, funding started to become available for testing programs focusing on mortgage lending discrimination. Those first testing projects were largely experimental but have served as the prototype for other FHIP-funded testing programs now under way in a variety of locations. Several FHIP-funded projects involving testing of mortgage lenders and insurance companies were completed in 1995 and, as a result, complaints have been filed with HUD against three of the largest home insurance companies and five of the largest independent mortgage companies in the country. Additional large-scale investigations are still under way.

HUD “Best Practices” Agreements

Section 809 of FHA charges the Secretary of HUD to endeavor to work out programs of voluntary compliance and enforcement with the housing industry and other interested parties. In 1994, as part of these efforts, HUD and the Mortgage Bankers Association (MBA) signed a best practices agreement designed to encourage individual mortgage banking firms to use fair lending “best practices”; i.e., practices or activities that firms could undertake to deter discriminatory activity and further lending to underserved groups and communities. Under this agreement, MBA agreed to urge its members, which are not regulated like banks, to sign individually negotiated, nonbinding agreements with HUD to increase credit and homeownership opportunities for historically underserved borrowers. Generally, these agreements encourage initiatives similar to those recommended for the banking industry, and include initiatives like second review programs, self-testing, and minority targeted advertising and recruitment. In addition, HUD has also included tailor-made lending targets within the agreements for lending to underserved communities. According to HUD, as of November 30, 1995, 70 mortgage lenders had either signed, or agreed in principle to sign, best practices agreements. In January 1996, HUD also reported that it had signed its first voluntary fair lending agreements with commercial banking institutions.

HUD's Oversight of the
Secondary Mortgage Market

It should be noted that while HUD, MBA, and consumer groups have generally hailed the agreements, the banking industry has publicly decried the use of formalized “best practices” agreements—citing them as credit allocation and an attempt by the unregulated mortgage banking industry to ensure that laws like CRA are not amended to apply to mortgage bankers.

Partly in response to public concerns regarding the potential for discrimination (disparate impact) by primary lenders who follow the underwriting standards created by secondary mortgage market institutions, Congress passed the Federal Housing Enterprises Financial and Safety and Soundness Act (the GSE Act) in October 1992.¹⁹ In the GSE Act, Congress reaffirmed the Secretary of HUD's role as the programmatic regulator for Fannie Mae and Freddie Mac—the two largest housing GSEs.²⁰ Among the provisions of the GSE Act were requirements for the Secretary of HUD to

- set levels of congressionally-mandated housing goals that require the GSEs to purchase mortgages for very low- and moderate-income families and families living in areas underserved by the mortgage markets;
- establish fair lending requirements for the GSEs;
- monitor the GSEs' performance in meeting housing goals; and
- create a public-use database, making available information on the GSEs' activities.

More specifically, the GSE Act required HUD to issue regulations to prohibit the housing GSEs from discriminating in their mortgage purchases and to carry out a number of other fair lending obligations. Under the GSE Act, the Secretary of HUD must

- prohibit discrimination by the GSEs in their mortgage purchases because of race, color, religion, sex, handicap, familial status, age, or national origin, including any consideration of the age or location of a dwelling or age of the neighborhood or census tract where the dwelling is located in a manner that has a discriminatory effect;
- require that the GSEs submit information to the Secretary to assist enforcement of FHA and ECOA;

¹⁹12 U.S.C. § 4501-4641.

²⁰The GSEs were created by Congress and, in return for their publicly provided benefits—such as exemption from state and local taxes—the GSEs are required to extend the benefits of the secondary market to a broad range of Americans, including low-income, working class families, first-time homebuyers, and residents of communities that may be underserved by mortgage credit.

- advise the GSEs of violations of FHA, ECOA, and state and local fair lending laws by lenders;
- periodically review the underwriting and appraisal guidelines of the GSEs to ensure compliance with FHA and the Federal Housing Enterprises Financial Safety and Soundness Act;
- review the annual assessment by the GSEs, in their statutorily required Annual Housing Activities Report, of their underwriting standards, business practices, repurchase requirements, pricing fees and procedures that affect the purchase of mortgages of low- and moderate-income families, or that may yield disparate results based on the race, status, age, or national origin of the borrower;
- direct the GSEs to take action, following adjudication, against lenders for violations of FHA and ECOA; and
- refer potential violations of the fair lending provisions of the Federal Housing Enterprises Financial Safety and Soundness Act to the Director of the Office of Federal Housing Enterprise Oversight (OFHEO) for enforcement action.

HUD published a proposed rule implementing the Secretary's regulatory authorities on February 16, 1995, with a 75-day comment period. After reviewing comments on the proposed rule, including extensive comments from the GSEs, HUD met with each of the GSEs, industry trade groups, public interest groups, the Treasury Department, the U.S. Department of Agriculture, the federal banking regulatory agencies, and various state and local officials to discuss issues related to the rule. HUD issued its final rule implementing the GSE Act on December 1, 1995.²¹

Oversight and Enforcement by FTC

The Federal Trade Commission has the authority to investigate certain lenders suspected of lending discrimination. The FTC's authority is provided in ECOA and extends to lenders subject to ECOA whose activities are not regulated by the federal agencies specified in the act.²² FTC, through DOJ or on its own, may file suit in federal district court against lenders suspected of violating the law. In so doing, FTC can seek injunctions to prohibit future illegal conduct, civil money penalties of up to \$10,000 for each violation, and redress for consumers unfairly denied loans. In addition, FTC can impose recordkeeping and reporting requirements on defendants to assist FTC in monitoring compliance.

²¹See 24 CFR Part 81, Federal Register, Vol. 60, No. 231, Friday, Dec. 1, 1995.

²²As described in Appendix A to FRB's Regulation B (12 C.F.R. Part 202), which implements ECOA, FTC's authority under the act typically extends to retailers, finance companies, and other creditors not subject to oversight by the agencies specified in ECOA. See 15 U.S.C. § 1691c(c).

Since fiscal year 1991, FTC has obtained consent decrees against eight small-loan and mortgage finance companies for alleged violations of ECOA and Regulation B, which implements the act. In December 1993, FTC and DOJ jointly entered into a settlement agreement with Shawmut Mortgage Company. In signing the agreement, Shawmut agreed to pay almost \$1 million into a redress fund to compensate minority applicants who allegedly were unfairly denied mortgage loans during the period from 1990 through late 1992. The agreement with Shawmut is of particular note in that it organized a framework for recordkeeping and reporting that could be followed in future cases to identify and compensate applicants that have been the victims of lending discrimination.²³

Agency Educational and Outreach Programs Expanded

In addition to their oversight and enforcement initiatives, the federal banking regulatory agencies, HUD, DOJ, and FTC have also increased their education and outreach efforts to assist institutions in creating effective antidiscrimination programs. By 1993, FRB, FDIC, OCC, and OTS had created or substantially expanded their community affairs programs, especially in the areas of fair lending and community reinvestment. Included among these educational and outreach efforts are training workshops, seminars, major conferences, and the development of new publications and educational materials to assist lenders, community organizations, and others to better understand and respond to fair lending concerns. The Boston Federal Reserve Bank, for example, developed and distributed more than 90,000 copies of Closing the Gap: A Guide to Equal Opportunity Lending, a publication highlighting various techniques that banks can use to help combat possible discrimination in lending and to ensure equitable treatment for loan applicants. It is the most widely circulated publication ever developed by FRB. FDIC also achieved great success with its publication on self-testing, Side-by-Side: A Guide to Fair Lending. By late 1995, FDIC reported that more than 35,000 copies of the guide had been distributed.

In addition, the federal banking regulatory agencies, HUD, DOJ, and FTC have supported or participated in a number of public/ private working groups that provide forums for the development of a public consensus on actions to ensure equal access to mortgage and other types of credit. One example of this is the Cleveland Residential Housing and Mortgage Credit Project, in which nearly 100 housing, real estate, and lending organizations

²³As indicated in table 3.3, FRB referred the Shawmut case to DOJ on the basis of its examination of the bank holding company. However, pursuant to ECOA, FTC has jurisdiction over mortgage companies that are subsidiaries of a bank holding company. Because of these overlapping authorities, both FTC and DOJ filed the complaint against the institution.

throughout the Cleveland area formed a group to identify potential discriminatory lending practices in the home-buying process and to recommend ways of eliminating them.²⁴ The project, begun in 1993, identified 18 points in the mortgage lending process where discrimination could occur. Smaller task forces were then formed to study what the larger forum thought were the four most critical points. These areas were explored in depth, problems were identified, and possible solutions were recommended to the forum. The project is still active and the different industries involved in the project are currently implementing some of the task force's recommendations.

Conclusions

In recent years, the federal banking regulatory agencies, DOJ, HUD, and most other responsible federal agencies have devoted considerable effort toward improving compliance with the nation's fair lending laws. Beginning in the late 1980s, these agencies have stepped-up enforcement of the fair lending laws and have tried to heighten the level of awareness and sensitivity of the lending community. The federal banking regulatory agencies have also moved to strengthen their ability to detect discrimination through improved examination procedures and techniques. A number of these agencies have also put forward a list of recommended compliance activities and programs for use by lenders who seek to ensure that all loan applicants are treated fairly. Most of these agencies have also intensified their efforts over the last several years to develop and deliver educational and informational programs designed to help lenders ensure equal access to credit. All of these efforts are ongoing.

We believe the totality of the actions taken by the responsible federal agencies over the last several years has served to increase the level of awareness and sensitivity to the issue of fair lending throughout most of the lending industry. If maintained, we believe these efforts are also likely to lead to increased lender compliance and improved enforcement of the fair lending laws in the future.

²⁴The Project was initiated and co-sponsored by the Federal Reserve Bank of Cleveland. Other co-sponsors include the Cuyahoga County Department of Development, the Greater Cleveland Roundtable, and the Ohio Civil Rights Commission.

Challenges Remain in Oversight and Enforcement

Even though responsible federal agencies have made substantial progress in the area of fair lending oversight and enforcement, there remain a number of issues that present significant and continuing challenges to the efforts of federal regulators to combat lending discrimination. For instance, during the course of our review, we identified several areas related to the banking regulatory agencies' existing fair lending examination policies and procedures where we believe the agencies have not taken full advantage of opportunities to (1) strengthen their ability to detect discrimination in all of its forms and (2) improve the consistency of oversight and enforcement. For example, because fair lending examination procedures are not uniform across agencies, the likelihood of finding evidence of discrimination may vary by regulator due to differences in examination techniques. Additionally, the ability of the agencies to detect discrimination during the early stages of the lending process is constrained because they have not incorporated pre-application testing as an examination tool. Finally, most agencies have not used the full range of their enforcement authority to ensure that HMDA reporting requirements are adhered to in a timely and accurate manner.

Although issues such as those mentioned above can be directly confronted and addressed by the agencies, others, by their nature, are more problematic and defy immediate resolution. For example, the subtle and sometimes statistical nature of some types of lending discrimination makes detection difficult even with newer, more advanced techniques. Additionally, some key legal issues associated with the interpretation and application of the fair lending laws remain unresolved. Nevertheless, it remains important to understand that these issues exist, and that they pose substantial challenges to oversight and enforcement of the fair lending laws.

Further Improvements Possible in Fair Lending Examination Policies and Procedures

In June 1993, the banking regulatory agencies indicated that they had begun several efforts to promote compliance with the fair lending laws. These efforts included revisions to their fair lending examination procedures aimed at strengthening their ability to detect discrimination. We began our review of the agencies' fair lending examination procedures by conducting in-depth interviews with bank management, compliance officers, and federal bank examiners who were involved in recently completed compliance examinations at 40 financial institutions around the country. On the basis of this work, and on the insights and knowledge we gained from other aspects of our review of the lending discrimination issue, we identified several areas where we believe the agencies have not

taken full advantage of opportunities to strengthen their fair lending examination procedures. Although our case studies of 40 compliance examinations were specific to examination practices in effect during 1993, the issues are still relevant to the revised and interim examination procedures now in use.

On the basis of our review, we found that past and current fair lending examination policies and procedures of the federal banking regulators: (1) lack uniformity across agencies—a situation that could result in inconsistent application and enforcement of the laws; (2) have inadequate methods for detecting discrimination prior to a prospective borrower’s submission of a formal application; and (3) have not resulted in vigorous enforcement of HMDA data reporting requirements by all agencies. Also, responses to our surveys of bank compliance officers and agency examiners indicated that additional examiner training in the latest fair lending examination and detection techniques would be beneficial and that, in some instances, examiners felt they were not allowed sufficient time to develop evidence of substantive violations. Finally, some officials and examiners at several of the federal agencies responsible for fair lending oversight have expressed some uncertainty about the identification of “pattern or practice” cases.

Fair Lending Examination Procedures Not Uniform Across Agencies

In June 1993 the federal banking regulatory agencies announced their intention to work on improving fair lending examination procedures and to improve their detection capabilities. Initially, FRB, OCC, OTS, FDIC, and NCUA had sought to develop uniform fair lending examination procedures through the FFIEC—the interagency body charged with bringing uniformity to all examination procedures and processes. As part of this effort the FFIEC awarded, in late 1992, a \$75,000 contract to Arthur Andersen & Co. to review the agencies’ fair lending examination procedures and training programs and to recommend improvements. However, agency officials told us that the contract yielded little of value. Partly as a result, the drive toward development of uniform examination procedures stalled. Each of the banking regulatory agencies then began independent efforts to improve their own fair lending examination procedures. These efforts included experimentation with such things as alternative ways of analyzing HMDA data, new sampling paradigms for comparative-file analysis, and the use of regression models for detecting discriminatory lending patterns.

By the end of 1994, each of the federal banking regulatory agencies had made significant revisions to, or had replaced, older examination procedures with procedures that, while similar in some respects, lacked uniformity in a number of areas. For example, while FRB's revised procedures have formalized a statistically-based approach to aid in the detection of discriminatory lending patterns at large institutions, most other bank regulatory agencies have not adopted similar procedures. Also, in 1994, OCC initiated a pilot testing program involving the use of mystery shoppers to search for disparate treatment of similarly situated loan applicants and has subsequently adopted testing as an optional component of its examination procedures.

If continued, we believe the agencies' independent efforts to revise their examination procedures could result in a situation in which the same degree of oversight is not necessarily applied to all lenders; e.g., some depository institutions may be subject to compliance examinations involving the use of advanced detection methodologies such as regression analysis or testing, while others may not. Consequently, it may be that the likelihood of finding evidence of lending discrimination, and/or being referred to DOJ, will vary by regulator due to differences in examination techniques.¹ In light of the economic and legal consequences that could arise from allegations of discriminatory lending practices, as illustrated in recent DOJ settlement agreements, the lack of uniform examination procedures raises an important issue regarding the evenhanded application of the law. Furthermore, adoption of uniform examination procedures would also help to avoid confusion within the banking industry—a situation that could possibly inhibit voluntary compliance efforts.

**Procedures to Detect
Discrimination Prior to
Submission of a Formal
Application Are Inadequate**

Both examiners and their respective agencies agree that the ability of examiners to detect illegal credit discrimination in the preapplication stage is limited. At this point in the mortgage application process there is no paper trail for the bank examiner to review. Although examination procedures call for examiners to routinely interview those bank personnel who serve as initial contact points for potential applicants, it is extremely difficult, if not impossible, for an examiner to determine whether any

¹Differences across agencies in examiner experience and training, and in examination time and resource constraints, could also affect the likelihood of detecting violations of the fair lending laws.

It should also be noted that uneven oversight and enforcement are probably more pronounced across different segments of the financial industry. For example, while depository institutions are regularly examined for compliance with the fair lending laws, most finance companies and other nondepository lending institutions are seldom so closely scrutinized.

applicant was illegally discouraged from making a formal application or steered to a less advantageous product or institution—unless a complaint had been filed. Furthermore, it is not possible for examiners to know how many prospective applicants have even approached an institution to inquire about credit. Inadequate procedures for detecting discrimination at the preapplication stage represent a serious omission, especially since pre-application testing programs conducted by private groups have uncovered evidence of disparate treatment among prospective loan applicants.²

One technique that has the potential to be a useful means of detecting and preventing illegal activities, especially in the preapplication stage, is testing. Generally, the testing methodology involves having matched pairs of “testers” pose as prospective loan applicants. After discussing loan possibilities on an individual basis, the testers document their treatment and the completeness of the information given to them by the institution’s personnel. Although they do not actually complete an application, the testers do experience the important preapplication phase of the loan process.³

Although the use of testers as an examination tool has been formally discussed by FFIEC and individual banking regulatory agencies, the regular use of a testing procedure has never been widely supported except by HUD and DOJ. For example, in a 1991 feasibility study on the application of the testing methodology to the detection of lending discrimination, FRB expressed reservations regarding the use of testers because of ethical concerns involving entrapment or self-incrimination.⁴ FRB also expressed concern about the ability to measure treatment accurately, objectively, and in quantifiable terms, and about the high costs associated with a reliable testing program. It should be noted, however, that FRB’s concerns about costs were primarily associated with using testing methodologies to obtain statistically valid results regarding the extent and nature of possible mortgage discrimination in a given marketplace (for example, a selected metropolitan area). A testing project with this objective would necessarily involve hundreds of tests and entail significant labor and overhead

²See discussion of findings from preapplication testing programs in app. II.

³The testing methodology could also be used to investigate individual complaints. In this case, a single tester could assume financial, demographic, or other characteristics similar to a complainant’s and attempt to obtain information about the same loan product. Observing the treatment received by the tester can help investigators ascertain if a complaint has cause.

⁴See *A Feasibility Study on the Application of the Testing Methodology to the Detection of Discrimination in Mortgage Lending*, prepared for the Federal Reserve’s Consumer Advisory Council by Staff of the Board of Governors of the Federal Reserve System, Washington, D.C., (1991), 80 p.

expenses. In contrast, the FRB acknowledged that an alternative approach that they considered—referred to as an “enforcement design,” whose objective was only to determine if systemic differences in treatment based on race were present at individually selected institutions—could yield useful information for enforcement purposes from a relatively small number of tests per institution, but only if differential treatment of testers was unambiguous and very commonplace.⁵ Indeed, this approach has been employed by a number of private fair housing groups for detecting disparate treatment by mortgage lenders (See app. II).

The renewed emphasis on lending discrimination and the impotence of current examination procedures in the preapplication stage prompted OCC to undertake a pilot testing program based on the “enforcement design” in 1994 and early 1995. Of the eight institutions tested for illegal preapplication discrimination under OCC’s pilot program, no evidence of discrimination was found in six of them. In the remaining two institutions, questionable treatment was reported by the testing contractor, but after reviewing the raw data, OCC concluded that discrimination did not occur. Even though the pilot testing program proved to be labor-intensive and failed to uncover evidence of illegal lending discrimination, OCC concluded that testing can be a valuable tool in its overall fair lending program. Consequently, in April 1996, OCC formerly adopted a policy to use matched-pair testing as an examination technique on a case-by-case basis when information received from examiners, consumers, or the media indicated that an institution might be engaged in illegal discrimination, particularly when such information indicated a problem at the institution’s preapplication stage. FDIC also recently considered a testing program but postponed any action on the proposal indefinitely—opting instead to wait and see if efforts to encourage voluntary testing programs bear fruit.

Agencies Have Not Used
Full Enforcement
Authority to Ensure
Compliance With HMDA
Data Reporting
Requirements

Amendments to HMDA in 1989, requiring the collection and reporting of data on race, gender, and income characteristics of mortgage applicants, were intended to provide data to assist in identifying discriminatory lending practices. Although the banking agencies and HUD are supposed to ensure that the lenders they supervise provide complete and accurate HMDA information, concerns have arisen regarding the accuracy of

⁵The FRB study, however, goes on to question whether the issues of cost and effectiveness it raised regarding marketplace testing can be overcome under the “enforcement design” if the discrimination is subtle. In such circumstances, they argue, discrimination may be more difficult to identify and, therefore, more likely to require a larger number of tests in order to obtain a reliable outcome that could be used to take action against a bank. This could possibly undermine the agency’s ability to conduct the tests without being identified, and negate the cost advantage obtained by conducting fewer tests.

reported data. These concerns were echoed repeatedly in our interviews with bank examiners and FRB staff involved in the processing of HMDA data. Findings from recently completed internal agency audits at FRB and FDIC have also lent some credence to these longstanding concerns about HMDA data accuracy. For example, based on the results of its 1994 review, FRB required one out of every five banks it examined to resubmit their reported HMDA data for the year 1992 (See figure 4.1).

We believe that large and frequent errors in HMDA data, especially in critical variables like applicant income, could impair fair lending examination and enforcement efforts of the federal agencies. For example, despite its limitations, HMDA data is still widely used by regulators and the public to target institutions for further scrutiny and to perform mechanical analyses of institutional lending patterns. If based on inaccurate data, these analyses could be misleading and result in a misappropriation of time and resources by regulatory agencies, the public, and lending institutions. Until recently, enforcement of HMDA reporting requirements by the federal regulatory agencies has been limited to verbal warnings or requiring institutions to correct and resubmit the required data. Not until fiscal year 1994 did a federal regulatory agency levy a civil money penalty against a financial institution for untimely and/or inaccurate HMDA reporting.⁶

⁶All federal banking regulatory agencies have similar enforcement authorities. See section 8(i) of the Federal Deposit Insurance Corporation Act, 12 U.S.C. § 2804, as amended; see also 12 C.F.R. part 203 (FRB Regulation C). Also, HUD's Mortgage Review Board is authorized to levy fines under 24 C.F.R. 25.9(j) when a Federal Housing Administration-approved lender is in "[v]iolation of the requirements set forth in any statute, regulation, handbook, mortgagee letter, or other written rule or instruction[.]"

Figure 4.1: Federal Reserve Board Survey of HMDA Reporters

Background	The Findings
<p>In early 1994, the Federal Reserve District Banks compiled information from 1993 compliance examinations on the quality of reported 1992 HMDA data by state member banks. In 1993, nearly all state member banks who were HMDA reporters were the subject of regularly scheduled FRB compliance examinations (a total of roughly 224 were examined—representing about 6 percent of all HMDA records for 1992).</p>	<p>Results from the survey confirmed long-standing concerns about the accuracy of reported HMDA data. Based on examiner scrutiny of bank HMDA loan application registers, FRB required one out of every five banks examined to resubmit their reported HMDA data for 1992. Although FRB has no set policy that designates a minimum acceptable error rate for HMDA reporting, as a “rule of thumb” FRB required resubmissions from all banks having an error rate of 10 percent or greater. A 10-percent error rate means that 10 percent of all records had at least one error. A single record represents one loan file.</p> <p>The most common errors observed in these examinations involved the date of application, date of action taken, and reported income. Although the date errors were not felt to be degrading, the inaccurate reporting of applicant income was thought to be problematic. The income field had a 5-percent error rate (not counting those records containing rounding errors—these amounted to an additional 1-2 percent). Over half of the income-related errors resulted from reported income from unverified application information rather than a verified income figure. The other half consisted mostly of clerical errors (typing errors).</p> <p>After resubmissions, FRB believed that the 1992 HMDA numbers for state member banks were pretty good—having less than a 2-percent error rate in each field. However, state member banks represented only a small fraction of the 9,000 plus HMDA reporters in 1992.</p>

Source: FRB.

In December 1993, HUD imposed a civil money penalty of \$500 on an independent mortgage company it supervised for violating HMDA reporting requirements. Since then, it has assessed penalties of up to \$2,000 on an additional 16 lenders for violating HMDA.⁷ In June 1994, FDIC announced that it had fined six institutions for late submissions of 1992 and 1993 HMDA data. By the end of fiscal year 1995, FDIC had levied civil money penalties totaling \$79,000 against 31 institutions. The penalties ranged from \$1,000 to \$5,000.

The willingness on the part of HUD and FDIC to impose monetary penalties on HMDA violators is an important step toward ensuring more accurate

⁷The data submitted by HUD indicated that other lenders may also have been assessed civil money penalties for HMDA violations, but because these lenders had multiple violations, which included HMDA violations, it was not possible to determine the specific purpose of the civil penalty.

HMDA data reporting. However, adherence to a consistent enforcement policy across all federal agencies for late and inaccurate HMDA data submissions is still needed to help ensure the integrity of the entire HMDA dataset. Otherwise, enforcement of HMDA will not be perceived to be a priority of the regulators—thereby making HMDA data quality less likely to become a priority of financial institution management. In its response, OTS indicated that it had recently adopted a new policy and issued specific guidelines regarding the use of civil money penalties (CMP) against HMDA reporters who submit late or inaccurate reports. According to OTS, after this policy was announced, institutions that had been significantly tardy in their 1993 and 1994 reporting filed timely reports covering 1995.

Examiner Training and Examination Time Allowances Cited by Examiners as Being Insufficient

Agency examiners have cited as hindrances to their examination efforts a lack of sufficient training in HMDA data analysis and in discrimination detection techniques, and an insufficient time allowance in which to uncover discriminatory conduct. The lack of examiner training in some fair lending procedures was mentioned by a number of consumer compliance examiners in our case studies of institutions examined by FRB, OCC, FDIC, and OTS in 1993. Of the 39 examiners responding to our survey questions about training, 17 reported not having received HMDA-related training as part of their own agencies' general compliance training program and 7 reported that as of December 30, 1993, they had no HMDA-related training whatsoever.

Inexperience in HMDA data analysis and fair lending detection techniques was also cited by the examination staff at FDIC. During a year-long, agency-initiated review of FDIC-supervised institutions with large disparities in minority/white mortgage application denial rates, which was completed in 1995, examination staffs cited the lack of formal training, unclear guidance, and the need for improved resource tools as causing difficulties in conducting fair lending examinations.

Another problem cited by some examiners in our case studies was an insufficient time allowance during examinations to develop evidence of substantive violations. During interviews and in survey responses, a number of examiners told us that they had insufficient time during consumer compliance examinations to conduct useful HMDA analyses or comparative-file analyses. The HMDA data, they said, are simply too voluminous and too complex to analyze in the time allotted. Examiners often criticized the FFIEC-standardized HMDA output for being too narrow in scope—it only includes mortgage lending—or too institution-specific to

give a full picture of lending patterns in a community. It would be more helpful, they suggested, if HMDA analyses were done by well-trained specialists prior to each examination so that examiners could focus more quickly on suspicious patterns. Also, some examiners felt that a graphical representation of HMDA and census data combined could be more quickly and easily interpreted than the summary tables currently being provided.

If not addressed, the time constraints and lack of training cited by examiners may prove to be major obstacles to using the new comparative-file techniques designed to detect disparate treatment. The comparative-file approach, as currently practiced, is relatively more labor intensive and time consuming than the older procedures. Not only do the newer comparative-file procedures require examiners to review many more loan files than was previously dictated, but they also may require them to search for “matched-pairs” to compare for equal treatment.

While our survey results and interviews highlighted the needs of some examiners for training in fair lending issues and examination techniques, we acknowledge the fact that the federal banking regulatory agencies and HUD have already instituted advanced HMDA training programs and have upgraded their automated systems to improve their ability to analyze HMDA data and to integrate it with other databases. It will take some time, however, before all agency examination staff receive such training and become familiarized with the new software programs for analyzing HMDA data. Furthermore, adoption of uniform fair lending examination procedures, as recommended later in this report, would necessitate an additional training effort focusing on those examination techniques and procedures not previously common to all the banking regulatory agencies.

Some Uncertainty Remains Regarding the Referral Requirement

Since 1992, ECOA has required the regulatory agencies to refer certain violations of ECOA to DOJ. Specifically, section 706(g) of ECOA states that an agency charged with enforcing the act “shall refer the matter to the Attorney General whenever the agency has reason to believe that one or more creditors has engaged in a pattern or practice of discouraging or denying applications for credit in violation of [the Act]”.⁸ A similar provision in FHA also charges HUD with the referral mandate.⁹ However, officials at HUD and several of the banking regulatory agencies have expressed some uncertainty about how to identify a “pattern or practice” in a particular case.

⁸15 U.S.C. 1691e(g).

⁹See 42 USC 3610(e)(2).

Such uncertainty arises, in part, from two terms within the statutory language—“reason to believe” and “pattern or practice.” Since the law does not precisely define the meanings of these terms, they must be discerned on a case-by-case basis. Hence, the standard for referrals to DOJ is sometimes unclear. For instance, if a “pattern or practice” decision is not necessarily a mathematical process (the Interagency Policy Statement on Discrimination in Lending says it is not), then whatever decisionmaking process should be used merits clarification. Although both DOJ and the Fair Lending Task Force have discussed some of these issues informally and in the Interagency Policy Statement on Discrimination in Lending, agency officials and examiners indicated during discussions with us that further clarification would be helpful.

Additional guidance on the characteristics of a referable case should be possible. Since the agencies have frequently sought such guidance from DOJ on a case-by-case basis over the last several years, it should now be possible for DOJ to share its accumulated experience regarding “pattern or practice” inquiries.

Despite Improvements, Detection of Discrimination Will Remain Difficult

At the core of many of the difficulties encountered in attempts to improve enforcement of the fair lending laws is the fact that detection of lending discrimination has been, and continues to be, a difficult and time-consuming task. One that, in the end, often requires examiners to use their professional judgment in determining whether violations have occurred. For example, research studies have suggested that the problem of disparate treatment is highly concentrated among marginal loan applications—those that have one or more deficiencies. This observation has been independently supported by both agency and DOJ investigations. Yet, to uncover disparate treatment at the margin is extremely difficult and time consuming, even with improved examination techniques. Automated statistics-based detection methods may aid examiners in their search for possible discriminatory lending patterns or practices, but they are as yet not deemed accurate or reliable enough by economists and agency officials to replace examiner judgment—nor is that the intention of the agencies. Even though several of the agencies have adopted revised fair lending examination procedures that emphasize comparative-file analysis, it seems unlikely that all instances of discriminatory treatment could be discovered. It is, therefore, critical that the agencies continue to research and develop better detection methodologies in order to increase the likelihood of detecting illegal practices. Moreover, we encourage the agencies’ efforts to broaden their knowledge and understanding of the

credit search and lending processes in general. Such knowledge is prerequisite to both improved detection and prevention of discriminatory lending practices.

Unresolved Legal Issues Pose Barriers to Voluntary Compliance Efforts

To date, all but one of the cases brought by DOJ under ECOA and FHA have been settled by consent agreements wherein the defendants have not admitted any wrongdoing. While these agreements serve a public purpose by speedily bringing cases to closure, remedying the alleged wrongs, and highlighting the government's commitment to enforce the fair lending laws, they leave some complex legal issues unanswered. For example: what liabilities are associated with self-assessment programs? How will the disparate effects test be applied across widely divergent geographic markets with different demand and supply pressures? Is credit scoring and accompanying differential pricing illegal? As long as these issues remain unresolved, they could contribute to the reluctance of some financial institutions to initiate self-testing and other voluntary compliance programs suggested by the bank regulatory agencies to improve compliance with the fair lending laws. Some of the more pressing areas in need of clarification are discussed below.

Concerns About Liability for Results of Self-Assessment Programs

Among the banking regulatory agencies' list of suggested activities for banks and other lending institutions to employ to ensure compliance with the fair lending laws is a continuing program of self-assessment. As described by FDIC, self-assessment is a way of measuring, in a controlled manner, differences in treatment of customers and potential customers. It can consist of a variety of programs, including preapplication testing and comparative-file analysis. The goal of these programs is to help find potential problems so that corrective actions can be taken and to help ensure that an institution's lending practices and decisions are not discriminatory. In addition, an institution can also gain insight into how its lending personnel and practices are perceived by prospective loan applicants, a valuable insight not readily available through other audit methods.

However, some self-assessment activities, like self-testing, pose a dilemma for lending institutions in that under current law the results of self-testing programs may not be privileged or protected from disclosure to federal regulatory agencies or private litigants. Hence, despite the obvious preventative benefits to be gained from having lenders adopt continuous self-testing programs, many institutions are reluctant to undertake such

programs out of fear that the findings could be used as evidence against them, especially by third-party litigants.

A few states have recognized this dilemma faced by financial institutions and have moved to eliminate, or at least partially mitigate the fears institutions have regarding self-incrimination. For example, Maryland has passed legislation that partially protects from discovery by third parties information obtained through the use of self-testing programs. Additionally, the Attorney General of Massachusetts has entered into an agreement with the Massachusetts Banker's Association to seek the enactment of legislation to ensure that institutions engaging in self-testing and comparative-file review evaluation by senior level management, as it relates to residential financing, will not be (a) forced to disclose to private litigants in civil actions the results of the use of such methods and (b) subject to legal action by nonregulatory government agencies based on the results of such self-testing and comparative-file reviews. The legislation was under consideration by the Massachusetts State legislature at the time of our review. Such legal protection is intended to engender voluntary self-testing programs and place greater emphasis on prevention rather than ex-post government enforcement through regulation and legal action.

Concerns About Third-Party Liability

Some legal experts have suggested that a lending institution's relationship with appraisers, loan brokers, and other financial institutions could pose potential compliance problems if the third-party were found to be in violation of FHA or ECOA. For example, if loan brokers were found to be charging, in an unlawfully discriminatory manner, "overage" or rates above that rate at which the underwriting bank was willing to lend, then the funding institution could possibly be held liable as well. This argument is based on the premise that the funding institution would be in a position to know the magnitude and distribution of the price differentials charged by its affiliate brokers. In light of this potential liability, institutions may be reluctant to monitor third-party lending practices.

Potential Problems Associated With the Disparate Impact Test

As interpreted by the federal regulators and others, there exists under the fair lending laws a disparate impact test for discrimination.¹⁰ Under this test, unlawful discrimination is presumed to occur if a lender maintains a neutral lending policy or practice that has a disproportionate adverse effect on members of a protected group and for which there is no business necessity and no less discriminatory alternative. Yet, because no case involving the disparate impact test within the context of lending discrimination has been decided by a court, considerable controversy exists as to how the test should or will be applied in certain lending scenarios. Although DOJ and the federal banking regulatory agencies have tried to provide some guidance as to what constitutes a discriminatory impact, the applicability of the disparate impact test to certain lending practices remains hotly debated. Additionally, legal scholars, bankers, and others have pointed out some common practices in the financial services industry which may prove to be problematical under the disparate impact test as defined in the agencies' fair lending policy statement. Because of the lack of case law, many significant legal questions also remain regarding the nature of the evidence required to prove a disparate impact claim under ECOA and FHA. Some of the areas that may prove to be problematic are described below.

Standard of Proof: Business Necessity. Some controversy has arisen regarding the threshold showing a lender must make in order to prove that a practice having a disparate impact is not discriminatory. Under the Civil Rights Act of 1991, a defendant in an employment discrimination case can rebut a presumption that a disparate impact was discriminatory by demonstrating that the challenged practice is "job related ... and consistent with business necessity."¹¹ The federal agencies charged with administering ECOA and FHA have adopted this standard with adjustments to practices relevant to fair lending. However, disagreement exists as to what constitutes a "business necessity." Some legal experts have argued that the test can be satisfied when the lender shows that the challenged practice serves a "legitimate business purpose." Others have contended that the necessity of the practice in question must be more closely scrutinized. Resolution of this issue could prove to be significant given the

¹⁰The disparate impact test has been borrowed from employment law as established from cases brought under Title VII of the Equal Employment Opportunity Act.

The Senate report accompanying the 1976 amendments to ECOA expresses the view that disparate impact applies to ECOA. Senate Report No. 94-589, 94th Congress, 2nd Session, at 4. See also the related House Report, H.R. Rep. No. 94-210, 94th Congress, 2nd Session at 5. See also *Betsey v. Turtle Creek*, 736 F.2d 983 (4th Cir. 1984) and *Mountain Side Mobile Estates v. HUD*, 1995 U.S. App. Lexis 13043 (10th Cir. 1995).

¹¹See 42 U.S.C. § 2000e-2(k)(1)(A)(i).

far-reaching effects such a change could have on the development of fair lending law and policy and the burden of proof that financial institutions and the industry would have to meet in order to avoid liability.

Differential and Tiered Pricing Systems. Half of the fair lending lawsuits filed against financial institutions to date by DOJ have alleged disparate treatment in the pricing of mortgage and consumer loans. Legal experts have indicated that some common loan pricing strategies also have the potential to cause compliance problems for many lending institutions under the disparate impact test. For example, experts questioned whether differential and tiered pricing strategies based on cost and risk factors could be said to constitute a necessary business practice under the disparate impact test.

With differential pricing, the interest rate charged on a loan (its price) typically will vary based on the credit risk of the borrower or some other factor or factors that affect the lender's perception of the borrower's ability to repay the loan. Under the disparate impact test, however, the lender's use of such a pricing scheme (and uniform pricing schemes as well) could prove to be problematic, especially if a protected group were to be disproportionately adversely affected. If that were to occur, the experts contended, a lender could conceivably be required to prove the business necessity of each price differential and to show that no less discriminatory pricing alternative was available—a potentially costly proposition.

Similar problems were envisioned by legal experts for tiered pricing systems. Under a tiered pricing system, interest rates for loans or mortgages vary by size, with higher rates charged on loans of lesser amounts. For example, for mortgages under a certain amount, say \$25,000, the policy might be to increase the interest rate charged by 0.5 percentage points for each \$5,000 increment below the floor amount. Fair housing advocates have argued, however, that this pricing scheme has a disparate impact on minority or female applicants because they tend to borrow smaller amounts. Lenders counter, however, that higher rates on smaller denomination loans are justified because of the business need to cover origination and servicing expenses.

Questions have also arisen regarding profit margins under tiered pricing systems. For example, some in the banking industry query whether profit margins would need to be similar for each tier for an institution to be in compliance. How much of a problem the disparate effects test proves to

be for banks will depend on how broadly the courts, DOJ, and the regulators apply disparate impact theory.

Computerized Underwriting Programs. Some bankers argue that rigorous interpretation and enforcement of the fair lending laws will result in more and more institutions adopting computerized underwriting systems to alleviate any chance of unequal or disparate treatment. Although it is generally agreed that overall loan processing costs are expected to decline as a result of automated underwriting, lenders are uncertain whether such standardized systems using uniform criteria will pass a disparate impact test, given the relative socioeconomic status of protected groups. While some experts believe that the use of computerized underwriting programs would be within the bounds of the law, they point out that defending the selection and weighting of underwriting factors could raise costs and further limit the availability of credit to marginal applicants.

As can be seen, there remain a number of practical issues unique to the business of lending that raise significant legal questions under the disparate effects test for discrimination. The issues are substantive and regulatory interpretations are likely to be controversial. Due to the complexities of these questions, it appears unlikely that more concrete judicial or administrative guidance on these issues will be forthcoming in the near future.

Conclusions

Since 1988, the federal regulatory agencies have made significant strides in strengthening their oversight and enforcement of the fair lending laws. However, during the course of our review, we identified several areas related to the banking regulatory agencies' existing fair lending examination policies and procedures where we believe that the agencies have failed to take full advantage of opportunities to ensure thorough and consistent supervision. Additionally, unresolved legal issues involving, among other things, interpretations of statutory language and practical applications of the laws appear to present barriers to an immediate formulation of a more effective policy and greater acceptance of voluntary compliance efforts by financial institutions.

Finally, it should be remembered that the detection of discrimination in its more subtle forms can be a difficult and time-consuming task. Even with improved detection methodologies and clearer legal interpretations, detection of lending discrimination in all its forms will continue to pose a significant challenge to regulators.

Matter for Congressional Consideration

Congress may wish to consider measures that would remove or diminish the disincentives associated with self-testing by alleviating the legal risks of self-testing when conducted by lenders who in good faith are seeking to prevent discriminatory lending activity and who move to correct such discriminatory practices when they are identified.

Recommendations

Despite significant improvement in federal fair lending oversight and enforcement, we believe that further efforts can still be made in some areas, which would strengthen the ability of federal banking regulators to detect lending discrimination in all of its forms and help ensure greater consistency in oversight and enforcement. To this end, we recommend that the heads of FRB, FDIC, OCC, OTS, and NCUA:

- work together to develop and adopt uniform fair lending examination procedures and provide all compliance examination staff with the necessary training to implement those procedures;
- adopt, as a component of their fair lending examination and training programs, guidelines and procedures for the use of testing methodologies for detection of discrimination at the preapplication stage of the lending process; and
- use their full range of enforcement authority, including the use of civil money penalties, to ensure that the HMDA data is submitted in a timely and accurate manner.

We also recommend that the U.S. Attorney General provide updated guidance to the banking regulatory agencies and HUD on the characteristics of referable “pattern or practice” cases under ECOA and FHA.

Agency Comments and Our Evaluation

GAO requested and received comments on a draft of this report from FRB, OCC, FDIC, OTS, NCUA, HUD, and DOJ. These written comments appear along with GAO’s responses in appendices VI-XII. NCUA did not comment on the conclusions and recommendations. Overall, the agencies were in general agreement with the report findings, conclusions, and recommendations. Agency remarks regarding individual recommendations and our evaluations are summarized below.

All agencies expressed general agreement with GAO’s recommendation that the banking regulatory agencies adopt uniform fair lending examination procedures and provide appropriate training with respect to such procedures. FRB commented that they have been working on the

development of uniform procedures and anticipated submitting a draft for consideration by other agencies in the very near future. OCC, however, maintained that some differences in examination procedures were appropriate, given the supervisory needs of the agencies and the varying sizes and risk profiles of the financial institutions they regulate. We agree that the initiatives by OCC and the other banking regulatory agencies to establish their own fair lending procedures in the absence of an interagency agreement on uniform procedures seems prudent given the pressing need for improvements in the interim. We reiterate, however, that the adoption of uniform fair lending examination procedures would increase the likelihood that each of the banking agencies would use the most advanced and proven techniques to detect discrimination while applying the same degree of oversight to all depository institutions.

Among the regulatory agencies, only HUD and OCC fully supported GAO's recommendation that the agencies adopt guidelines and procedures for the use of testing methodologies for detection of discrimination at the preapplication stage of the lending process. In general, the banking regulatory agencies had concerns about the routine use of testing because of its associated costs and time requirements. Despite these concerns, OCC and FRB have already authorized its limited use in individual cases when compelling evidence exists that an institution may be discriminating. OTS commented that it would consider the future use of testing only after careful study, while FDIC preferred to promote voluntary self-testing by the financial institutions themselves. As we discuss in chapter 4, we believe that the ability of examiners to detect illegal discrimination at the preapplication stage of the lending process is limited. Thus, we believe that our recommendation to adopt testing as a tool for examinations is well grounded. However, our recommendation does not necessarily suggest that testing be used routinely, only that the technique be employable when a situation may warrant its use—such as when compelling evidence from other sources suggests that discriminatory behavior may be occurring prior to submission of a formal written loan application.

FRB, FDIC, OCC, OTS, and HUD agreed with GAO's recommendation that the regulatory agencies use their full range of enforcement authorities to ensure timely and accurate HMDA data. Although FRB and OCC expressed a willingness to consider civil money penalties in certain cases, current policy and preference of these agencies regarding violations of HMDA has been to require institutions they supervise to resubmit HMDA data if it contains errors that compromise its integrity. Although we agree that the

cost associated with correcting and resubmitting HMDA data can be significant, we believe that the use of CMPS represents a more formal and public deterrent to future inaccurate HMDA data submissions for both the violating institution and others in the lending industry.

DOJ accepted our recommendation to provide updated guidance to the bank regulatory agencies and HUD on the characteristics of referable “pattern or practice” cases. FRB, OTS, and HUD said they would welcome DOJ’s insights regarding these cases. FRB pointed out, however, that the ultimate responsibility to make determinations of the meaning of statutory phrases in the absence of court opinions rested with the agency. We are in agreement with FRB that the absence of clear statutory language regarding the characteristics of referable pattern and practice cases under ECOA and FHA necessitates independent interpretations by the various agencies responsible for fair lending enforcement. It is for precisely this reason we recommend that DOJ provide additional guidance to the agencies regarding the referral mandate. It is hoped that such guidance would be of assistance to the agencies in making their own determinations by providing a “case history” of prior referral decisions made in agreement with DOJ.

Finally, FDIC, OCC, and HUD expressed support for our suggestion that Congress consider legislative initiatives that remove or diminish the disincentives associated with self-testing by protecting institutions from having to release results of self-testing reviews when they are followed by actions to correct any discriminatory behavior that may have been discovered. In their comments HUD stressed how important it was that any protection be granted only in those cases in which lenders promptly corrected the problems found through self-testing. We agree in principle that the implementation of corrective measures should be a prerequisite for gaining protection for self-testing activities and have used language to that effect in the Matter for Congressional Consideration.

Although there are some differences in the agencies’ response to our recommendations, these differences generally reflect the agencies’ desire to retain the discretion necessary to consider the specific facts and circumstances of individual cases. GAO agrees that agency discretion is necessary once due consideration has been given to the full range of regulatory alternatives and analytical techniques available to ensure effective fair lending oversight of financial institutions.

The Fair Lending Laws

The Fair Housing Act (FHA)

FHA, the first of the fair lending laws, was passed by Congress in 1968 as Title VIII of the Civil Rights Act of 1968 and amended in 1974 and 1988.¹ FHA prohibits discrimination in residential real estate-related transactions against any person because of race, color, religion, handicap, gender, familial status, or national origin. Under FHA it is unlawful for anyone who engages in the business of making or purchasing residential real estate loans, or in the selling, brokering, or appraising of residential real property, to discriminate on the basis of any of the aforementioned factors. Prohibited activities include, for example, denying a loan or discriminating in fixing the amount, interest rate, duration, application procedures, or other terms and conditions on a prohibited basis. Any financial institution that extends housing loans is subject to FHA.

Congress amended FHA in 1988 to, among other things, extend the provisions of the act to certain secondary mortgage market transactions and other purchase and sales transactions involving residential loans and residential-related securities, and to add “handicap” and “familial status” (having one or more children under the age of 18) to the group of protected categories under FHA. The 1988 amendments also provided an administrative enforcement system for HUD that did not previously exist, and removed barriers to the use of court enforcement by private litigants and DOJ.²

FHA is implemented by HUD Regulation (24 C.F.R. Parts 100-121). Under the act, HUD has administrative enforcement responsibilities. The act also provides for enforcement through civil actions initiated by the aggrieved party or, in certain cases, HUD or DOJ. By law, the U.S. Attorney General has authority to file suit in Federal District Court whenever it has reason to believe that a pattern or practice of violations exists, or when it appears that rights granted under the act have been denied to any group, and the matter raises an issue of general public importance. Additionally, the banking regulatory agencies must notify HUD of apparent FHA violations in cases that are not referred by them to DOJ.

The Equal Credit Opportunity Act (ECOA)

ECOA, originally enacted in 1974 and amended in 1976 and 1991, is broader than FHA in that it prohibits discrimination with regard to any aspect of a consumer, commercial, or real estate credit transaction based on race,

¹Table I.1 provides a brief description of major amendments to the various fair lending laws from the time of their passage through December 31, 1994.

²For a detailed discussion of the 1988 amendments to FHA, see Kushner (1992) and U.S. Commission on Civil Rights (1994).

color, religion, gender, national origin, marital status, age, receipt of public assistance, or the exercise, in good faith, of rights granted by the Consumer Credit Protection Act.³ The law applies to all persons who are creditors, including but not limited to, banks, thrifts, credit unions, federal land banks, investment companies, and finance companies.

ECOA is implemented by Federal Reserve Board (FRB) Regulation B (12 C.F.R. Part 202), which requires, among other things, that creditors notify credit applicants of the action taken on their applications and the reasons for any adverse credit decisions. Regulation B also requires that creditors collect certain monitoring information about the applicants. However, such data are currently only permitted to be collected on mortgages.

The federal agencies that regulate financial institutions have authority to enforce Regulation B administratively. However, the 1991 amendments to ECOA require the banking regulatory agencies to refer certain cases to the U.S. Attorney General when an agency has a “reason to believe that one or more creditors has engaged in a pattern or practice of discouraging or denying applications for credit” on a prohibited basis. Specifically, section 223 of FDICIA amended ECOA to prescribe the following courses of action by the banking regulatory agencies for specific types of apparent violations of ECOA or FHA:

- Pattern or practice of ECOA violations, with or without related FHA violations: mandatory referral to DOJ;
- Isolated ECOA violation with or without related FHA violation: optional referral to DOJ for civil action when compliance is not obtained administratively;
- FHA violation that is also a violation of ECOA, but not related to violations referred to DOJ: mandatory notice to HUD;
- Other violations: to be handled administratively.

Home Mortgage Disclosure Act (HMDA)

HMDA was enacted by Congress in 1975 to provide public officials and U.S. citizens with information to enable them to determine whether financial institutions were serving the housing needs of their communities. HMDA is a disclosure law. It does not prohibit any specific activity of lenders, rather,

³Note that while the protected categories under FHA and ECOA are, for the most part, the same, there are important differences. For example, the categories “handicap” and “familial status” are protected under FHA but not under ECOA. Conversely, factors protected under ECOA but not under FHA include “marital status,” “age,” “receipt of public assistance,” and “the exercise of certain consumer protection rights.”

it merely establishes a recordkeeping and reporting obligation for certain institutions.

FRB Regulation C (12 C.F.R. Part 203), which implements HMDA, requires most mortgage lenders located in metropolitan statistical areas (MSA) to report annually to their respective federal supervisory agency, and disclose to the public information about their home mortgage and home improvement lending activity. The reports and disclosures cover loan originations, applications that don't result in originations, e.g., applications that are denied or withdrawn), and purchases of loans. FRB processes the data and prepares disclosure statements on behalf of HUD and member agencies of the Federal Financial Institutions Examination Council (FFIEC). Members of the council include FRB, FDIC, OCC, OTS, and NCUA. The FFIEC also prepares aggregate reports that contain data for all lenders in a given MSA. The reports are to be publicly available at a central depository within each MSA. Additionally, each institution subject to HMDA must also make its individual mortgage loan application registers available to the public.

As originally enacted, HMDA required only the collection of information regarding the number and total dollar amount of loans originated or purchased by a covered institution during the fiscal year, itemized by the geographic location of the property within a MSA. In 1989, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) amended HMDA to require, among other things, the collection and reporting of additional data about the racial, gender, and income characteristics of mortgage applicants and borrowers.⁴ These amendments were intended to provide data to assist in identifying discriminatory lending practices and enforcing the fair lending statutes. Amendments to HMDA in 1988 and 1991 extended HMDA reporting requirements to most mortgage banking subsidiaries of bank and thrift holding companies and independent mortgage companies not affiliated with depository institutions. Finally, the Housing and Community Development Act of 1992 further amended HMDA by requiring financial institutions to make available to the public, upon request, their loan application registers, which contain data on loans and applications covered by HMDA.

⁴The effect of the changes in the 1988 amendments was not actually realized until late 1991, when the HMDA data was reported for calendar year 1990.

Appendix I
The Fair Lending Laws

Table I.1: Major Amendments to FHA, ECOA, and HMDA Through December 31, 1994

Statute	Year	Comment
Fair Housing Act	1968	Passed as Title VIII of the Civil Rights Act of 1968.
	1974	Amended to include sex as a prohibited factor.
	1988	FHAA of 1988 extended the provisions of FHA to secondary mortgage market activity and other purchase and sales transactions involving residential loans and residential-related securities, and added two protected categories, handicap and familial status. The amendments also enhanced the enforcement responsibilities and authority for HUD and the U.S. Attorney General.
Equal Credit Opportunity Act	1974	Passed as Title V of the Depository Institution Amendments Act of 1974 as new Title VII to the Consumer Credit Protection Act (CCPA).
	1976	The Equal Credit Opportunity Act Amendments of 1976 added prohibitions for discrimination on the basis of race, color, religion, national origin, age, participation in public assistance programs, and exercise of consumer protection rights under the CCPA.
	1991	Amended by FDICIA to require the federal banking regulatory agencies to refer cases to the U.S. Attorney General when they have "reason to believe that one or more creditors has engaged in a pattern or practice of discouraging or denying applications for credit" on a discriminatory basis.
Home Mortgage Disclosure Act	1975	Passed.
	1988	Amended to extend the term "depository institution" to include any mortgage banking subsidiary of a bank holding company or savings and loan holding company, or savings and loan service corporation, that originates or purchases mortgage loans.
	1989	Amended by FIRREA to, among other things, require collection and reporting of data on the disposition of applications, and race, gender, and income characteristics of mortgage applicants.

(continued)

Appendix I
The Fair Lending Laws

Statute	Year	Comment
	1991	Amended by FDICIA to expand HMDA reporting requirements to most independent mortgage companies not affiliated with depository institutions.
	1992	Amended by the Housing and Community Development Act of 1992 to require, among other things, financial institutions to make available to the public, upon request, their loan application registers.

Source: Compiled by GAO from FHA, ECOA, and HMDA legislative histories.

Lending Discrimination: A Review of What Is Known

Some insight into the nature and occurrence of lending discrimination can be obtained by reviewing evidence from a variety of sources, including reports in the press, analyses of HMDA data, statistical studies, regulatory examinations, and private testing programs. Although the evidence is often contradictory and inconclusive, such a review can at least serve to put the current controversy surrounding the issue of lending discrimination in perspective.

Press Accounts

Public interest in the issue of lending discrimination was heightened in the mid-1980s by a growing number of reports on the topic in the press. Of particular note was the Pulitzer Prize winning series entitled, “The Color of Money,” published in May 1988 by the Atlanta Journal-Constitution. In this influential article, the newspaper reported that race was a decisive factor in determining the lending patterns of metropolitan Atlanta’s largest financial institutions. This conclusion was based on the observation that among stable neighborhoods with similar income levels, African-Americans were less likely than whites to receive conventional mortgage credit from financial institutions in the Atlanta area. For example, using 1981-1986 HMDA data matched with 1980 census data, the article showed that white neighborhoods in the Atlanta area always received the highest number of bank loans per 1,000 single-family homes, whereas black neighborhoods always received the fewest. Because, at the time, HMDA did not require collection of race and income data for individual mortgage applications, the newspaper’s analysis stopped short of a conclusion that deliberate racial discrimination was behind the difference.

Since the “Color of Money” series, similar articles have also appeared in The Detroit Free Press, The San Francisco Chronicle, The Washington Post, The Wall Street Journal, and elsewhere. Nearly all of these articles have relied on analyses of HMDA data to support their claims of racial bias in lending patterns. While none of these reports provides conclusive evidence of discrimination, their recurring avowal that racial bias pervades the lending practices of financial institutions has led some to question the effectiveness of bank oversight and oversight in the fair lending area.

Expanded HMDA Data

Congress responded to the concerns raised by the “Color of Money” and similar articles by amending HMDA in 1988, 1989, and 1991. These amendments extended HMDA coverage to additional mortgage lenders and

required covered institutions to report additional information about loan applicants, in particular their race, gender, and income level. Also, institutions were required to report whether each application was approved or denied. This additional information is intended to assist regulatory agencies in identifying possible discriminatory lending patterns and enforcing related fair lending laws. Analyses of HMDA data became instrumental in focusing public attention on mortgage credit availability, especially in low- and moderate-income neighborhoods, and on the possible existence of discrimination in mortgage lending decisions.

The expanded HMDA data, first released in 1991 for the year 1990, and annually thereafter, has consistently shown that while the majority of applications for home purchase loans are approved (about 75 percent in 1994), some minority applicants experienced a substantially higher denial rate than did white applicants (see Table II.1).¹ For 1994, the latest year for which data were available, HMDA data showed that for conventional home purchase loans, approximately 33 percent of black applicants, 25 percent of Hispanic applicants, 16 percent of white applicants, and 12 percent of Asian applicants were denied credit. As can be seen from the table, the difference in denial rates between blacks and whites has been both large and persistent. However, it is widely recognized that because of limitations with the HMDA data, conclusions regarding the nature or pervasiveness of discrimination cannot be drawn on the basis of HMDA data alone.

Principal among the limitations associated with HMDA data is that it suffers from a missing variables problem. For example, HMDA data does not include such basic indicators of an applicants' creditworthiness as net worth, housing expense-to-income ratios, the down-payment amount and the amount of other funds needed to close the loan, payment history on other mortgage and consumer loans, and employment stability of the prospective borrower. Also not included are details about the property to be purchased, its appraised value, credit terms of the loan, and local demand conditions. As a result, HMDA numbers, in and of themselves, do not provide a sufficient basis for determining whether the mortgage lending industry or any individual lender is discriminating unlawfully. Although aware of these limitations, HMDA data are still widely used by both federal regulators and private groups for the purpose of targeting and investigating financial institutions for possible fair lending violations.

¹For an in-depth analysis and discussion of HMDA statistics, see Canner and Smith (1991, 1992); Canner, Passmore, and Smith (1994); and Canner and Passmore (1995).

Appendix II
Lending Discrimination: A Review of What
Is Known

Appendix II
Lending Discrimination: A Review of What
Is Known

Table II.1: Percentage of Home Purchase Loan Applications Denied, by Racial or Ethnic Identity of Applicant, 1990-1994

Racial or ethnic identity of applicant	1990		1991	
	Government-backed	Conventional	Government-backed	Conventional
Native American ^a	22.5%	22.4%	22.1%	27.3%
Asian/Pacific Islander	12.8	12.9	12.5	15.0
Black	26.3	33.9	26.4	37.6
Hispanic	18.4	21.4	18.9	26.6
White	12.1	14.4	16.3	17.3
Other	18.4	19.0	16.3	19.9
Joint (all)	14.1%	14.9%	15.9%	17.5%

Appendix II
Lending Discrimination: A Review of What
Is Known

1992		1993		1994	
Government-backed	Conventional	Government-backed	Conventional	Government-backed	Conventional
17.5%	26.6%	17.5%	27.8%	15.3%	31.6%
13.5	15.3	11.7	14.6	10.5	12.0
23.8	35.9	22.2	34.0	18.8	33.4
18.5	27.3	14.6	25.1	12.7	24.6
12.8	15.9	11.8	15.3	10.4	16.4
16.0	21.0	17.8	23.1	15.0	23.8
14.8%	17.6%	14.7%	17.3%	11.7%	17.2%

Note: Government-backed mortgage loans are those guaranteed by the Federal Housing Administration, the Department of Veterans Affairs, or the Farmers Home Administration. These loans are generally targeted at lower-income borrowers and tend to have less stringent underwriting standards (e.g., lower downpayment requirements) than conventional mortgage loans (i.e., mortgages backed by private mortgage insurance).

^aAmerican Indian/Alaskan Native.

Source: Board of Governors of the Federal Reserve System.

Statistical Studies

A growing number of statistical studies have recently begun to address the issue of lending discrimination in the mortgage and credit markets. In general, these studies can be broadly categorized into three groups: (1) redlining studies—which focus on geographic lending patterns, (2) studies of denial rates—in which the emphasis is on modeling the outcome of the lending decision process, and (3) studies of default risk—which attempt to measure loan performance.

Redlining Studies

Among the various types of lending discrimination, redlining—the refusal of lenders to make mortgage loans in certain areas, regardless of the creditworthiness of the individual loan applicant—has probably received the most attention in the literature. Generally, early studies of redlining often claimed to verify the existence of this practice. However, in reviews of the literature, Benston (1979) and Galster (1992) concluded that most early studies were flawed, primarily because they failed to adequately control for differences in the demand for credit across neighborhoods and for variations in risk associated with different geographic areas. More recently, a review of the literature by Schill and Wachter (1993) also cited inconsistent findings with respect to the existence of redlining and

demonstrated how, in regression models that test for redlining, the inclusion of proxies for neighborhood risk can reverse results where redlining was previously found to exist.

Several more recent studies also cast doubt on the existence of redlining by lending institutions. First, a study by Benston and Horsky (1992) failed to find evidence of redlining. Their finding was based on interviews with several hundred home sellers and buyers (including potential buyers and sellers who were not successful) in allegedly redlined neighborhoods in three midwestern cities. In two separate studies, Schill and Wachter (1993, 1994) tested for sources of geographic disparities in lending decisions in several major metropolitan areas, using accept/reject methodologies while controlling for neighborhood risk. In both studies, these authors found no support for the allegation that financial institutions discriminate against borrowers on the basis of the racial and ethnic compositions of their neighborhoods. And more recently, Holmes and Horvitz (1994), using data and techniques that, they argued, addressed the aforementioned methodological problems associated with earlier redlining research, were able to show that racial disparities in the flow of mortgage credit can be explained by differences in risk and demand.

Studies of Denial Rates

In contrast to recent redlining studies, several studies that have attempted to model the lending decision process have found statistically measurable disparities in loan denial rates along racial and ethnic lines. Most notable among these are the work of Siskin and Cupingood (1993) and Munnell, et. al. (1992). In both of those studies, the researchers used a logit regression model to estimate the probability that a mortgage application with specific characteristics would be denied.²

As part of DOJ's fair lending investigation of Decatur Federal Savings and Loan of Atlanta, Siskin and Cupingood (1993) analyzed the institution's mortgage lending patterns during the period 1988 through 1989 for possible racial discrimination. On the basis of in-depth interviews with the thrift's loan officers and underwriters, the researchers constructed a statistical model that assigned weights to all the relevant factors in the loan decisionmaking process based on their ability to predict the observed outcome of the event, i.e., the acceptance or rejection of a loan. The model was then augmented with a race variable whose statistical significance indicated that black applicants had a lower likelihood of obtaining

²Logit regressions are particularly suited to modeling discrete outcomes, i.e., in which the dependent variable can take on one of only two values.

conventional fixed and adjustable-rate mortgage loans than did similarly situated white applicants.

Similar results were also found in the widely-cited Boston Federal Reserve Bank study by Munnell, et. al. (1992) [the Boston Fed Study]. In that study, the researchers supplemented 1990 HMDA data for 131 banks and thrifts in the Boston metropolitan area with additional demographic and economic information about the applicants, which the lenders said was relevant to their credit decisions. This additional data was voluntarily provided by the lenders from their original loan files. Then, using the logit regression approach, the researchers found that, for a minority individual with the average economic characteristics of a white applicant, the probability of denial increased 55 percent, from 11 percent to 17 percent. Unable to explain this disparity in denial probabilities, the economists concluded that black and Hispanic mortgage applicants in the Boston area were more likely to be denied credit because of their race or ethnic background.

At the time of their release, the DOJ-sponsored study and the Boston Fed study represented a turning point in the debate regarding the existence of discrimination in the mortgage credit markets. Their econometric (statistically-based) approach to investigating the issue of lending discrimination overcame some of the reservations many had regarding interpretations of HMDA data, and added additional weight to the argument that race played a significant role in credit decisions. Indeed, the findings from these studies were viewed by many as providing proof of widespread, pervasive lending discrimination.

Since its release, however, the Boston Fed study has been the center of much controversy. Although its results were later duplicated by other researchers using the same data base,³ critics have argued that the research suffers from problems with data accuracy and model specification and that its results were driven, for the most part, by a subsample of the data.⁴ Many researchers, for example, contend that studies like the Boston Fed study do not accurately capture the standards of creditworthiness as legitimately applied by lenders, nor do they adequately account for factors related to housing and mortgage credit demand. Indeed, Horne (1994b) demonstrated that the estimates of the race effect are quite sensitive to the selection of variables and that relatively minor modifications to the Boston Fed's statistical model are sufficient to eliminate the race effect altogether. In a rebuttal to these

³See for example, Carr and Megbolugbe (1993); Glennon and Stengel (1994); and Hunter (1995).

⁴See Day and Liebowitz (1993), Zandi (1993), Horne (1994, 1995).

criticisms, Browne and Tootell (1995) maintained that an applicant's race still affected the probability of getting a mortgage in the Boston metropolitan area in 1990, even when the concerns of some of the Boston Fed study's strongest critics were incorporated into the original model.⁵

Subsequent research has also questioned the appropriateness of the single-equation regression approach to testing for discrimination used in both the aforementioned studies. Some economists have argued that the models suffer from debilitating flaws related to selection or simultaneous-equations bias,⁶ i.e., that the outcome of the lending process reflects the decisions not only by the lender but by both lenders and applicants.⁷ This situation, they argue, would necessitate not a single-equation but a complete system of equations to explain the varied and numerous decisions required to be made by both parties. Under such circumstances, parameter estimates from a single-equation model would be unreliable and possibly misleading. Other research has also shown that current model specifications have a tendency to give "false positives," i.e., the models can incorrectly indicate a discriminatory bias when in fact none exists or when a thorough review of the loan files provides justification for seemingly improbable outcomes.⁸ As a result, most federal banking regulators have not yet fully embraced the use of these types of statistical models in their examination processes.

Default Studies

According to the economic theory of discrimination, if lenders discriminate against minority groups, they would do so by imposing stricter standards on loans to them than they would to whites with truly comparable credit backgrounds.⁹ In other words, lenders would be willing to finance only the most profitable minority applications. Theoretically then, mortgage loans approved for minority applicants should be more profitable than loans to whites, not less profitable or even equally

⁵See also Munnell, et. al. (1996).

⁶Simultaneous equation bias can occur when feedback effects exist between independent (explanatory) variables and the dependent variable to be estimated. For example, if mortgage applicants choose a downpayment amount (explanatory variable) based on the knowledge that it will influence the probability of having their loan approved (dependent variable), then the assumption of independence that underlies regression analysis is violated and unbiased estimates of the effects of the explanatory variables are no longer possible.

⁷See, for example, Rachlis and Yezer (1993) and Yezer, Phillips, and Trost (1994).

⁸See Stengel and Glennon (1995) and Bauer and Cromwell (1994).

⁹See Becker (1971).

profitable, and should exhibit lower default rates, holding other factors constant.¹⁰

Two recent studies are notable from among those that have attempted to uncover discrimination based on the implications of discrimination theory. Van Order, Westin, and Zorn (1993) examined the performance, as of year-end 1991, of loans purchased by the Federal Home Loan Mortgage Corporation (Freddie Mac) in 1983 that were originated between 1975 and 1983. Also, Berkovec, Canner, Gabriel, and Hannan (1994) analyzed default risk and loan losses associated with mortgages insured by the Federal Housing Administration. In general, both of these studies found that default rates in minority concentrated census tracts are the same as or higher than in other neighborhoods, not lower as predicted by economic theory. The study by Berkovec, et. al., also concluded as one of its main findings that black borrowers defaulted more often than did other similarly situated borrowers.¹¹ While not conclusive, these findings are not consistent with the hypothesis that lenders engage in prejudicial discrimination against minority applicants.

Research Efforts Have Generated Inconclusive Results

In summary, it appears that recent empirical efforts to detect and measure discriminatory lending activity using statistically-based methodologies have met with mixed results. To date, researchers have reported contradictory findings regarding the existence of lending discrimination and are still debating the merits of various statistical techniques and models used to study the issues. For example, some studies of loan application denial rates have reported finding evidence of discriminatory lending activity, but other studies have disputed those claims and highlighted shortcomings in the methodologies and data used in those studies. Elsewhere, recent statistical studies of redlining and mortgage default rates have generally not supported a finding of prejudicial discriminatory bias on behalf of mortgage lenders, but the research cannot be considered conclusive at this time due to ongoing methodological and data limitations.

¹⁰A conceptual challenge to this thesis is enumerated in Galster (1993).

¹¹Berkovec, et. al., are careful to note, however, that because a number of potentially important explanatory variables were not accounted for in the analysis, their statistical results could possibly suffer from bias if the omitted variables were related to race or ethnicity. Also, in testing for discrimination, the authors focused on only one type of lending bias—the application of different standards of creditworthiness to different groups. However, other types of discrimination, if present, could also lead to similar loan default performance. For example, if prejudicial discrimination led lenders to foreclose more quickly on black borrowers than on other borrowers, this could result in higher default rates for black borrowers—the very result observed in the Berkovec study.

Other Sources of Information

In addition to news articles, HMDA data, and statistical studies of mortgage lending patterns and practices, information regarding the pervasiveness of lending discrimination can also be gleaned by reviewing the results of fair lending examinations of depository financial institutions, from agency consumer-complaint files, and from private-sector testing programs. Unfortunately, the information obtained from a review of these sources is as ambiguous as is that obtained elsewhere.

The findings of routine compliance examinations, for instance, have historically found little evidence of racial discrimination in lending. In 1994, for example, the federal bank regulators examined nearly 5,000 banks and thrifts for compliance with ECOA, yet reportedly found less than two dozen violations of Regulation B involving discrimination on the basis of race and/or sex. Of that number, the agencies considered eight to be serious enough to merit a referral to DOJ for further investigation. There were, however, 20 referrals to DOJ in 1994 for suspected discriminatory practices involving protected factors others than race or sex.

Like the fair lending examination results, FRB investigations of consumer complaints also suggest that lending discrimination may not be widespread. In 1994, FRB reported receiving 98 complaints against state-member banks alleging discrimination during loan-related transactions (roughly 9 percent of the total received). After investigation, FRB determined that in only four cases had a state member bank possibly violated a law or regulation. In each of these cases the bank took corrective measures voluntarily or as indicated by FRB.¹² The resolution of an additional 16 cases, however, was still pending at year-end 1994.

Although these numbers do not appear to be indicative of an endemic problem, it should be noted that past and current examination procedures, with their focus on reviews of mortgage applications actually filed, are unlikely to detect discrimination at the preapplication stage of the loan process (prior to the creation of written records). For example, fair lending examinations conducted by the banking regulators failed to uncover evidence of discriminatory behavior in the Decatur, Chevy Chase, and Northern Trust cases. Furthermore, some have suggested that the low number of fair lending-related consumer complaints received by FRB and other agencies could be the result of prospective applicants either being unaware that they may have been treated unfairly or choosing not to (or not knowing how to) file a formal complaint with federal regulators.

¹²In addition to these four cases, a complaint filed in another case had resulted in litigation. However, the litigation was not the result of FRB investigative findings. Rather, in this particular case, litigation was initiated by the complainant prior to or during FRB's investigation.

In contrast, testing programs conducted by fair housing groups, like the National Fair Housing Alliance (NFHA), with financial support from HUD-administered programs, have exposed instances of differential treatment based on race during the mortgage application process. Moreover, findings from these programs appear to be suggestive of a lending discrimination problem with greater dimensions than that revealed by conventional fair lending examinations, consumer complaints, and some other indicators. For example, in 1991 the Chicago Fair Housing Alliance conducted experimental tests at ten financial institutions in Chicago: two banks, three thrifts, and five independent mortgage companies. Even though the testing program was experimental and conducted primarily to test the methodology, some evidence of differential treatment was reported by the testing teams at seven of the ten institutions. Similar findings were reported by the Philadelphia Commission on Human Relations, which investigated mortgage lenders in and around Philadelphia, Pennsylvania, in 1992. Of 96 completed matched-pair tests, involving 68 institutions, the testing teams generated 11 complaints involving racial steering, discriminatory policies, and disparate treatment. All complaints were filed with HUD and negotiated settlements were reported to have been obtained in at least five of the eleven cases.

Also, in the largest testing program undertaken to date, NFHA reported that in March 1995 it had completed a FHIP-funded fair lending testing program in which 81 lenders in 8 large metropolitan areas across the country were tested. During this program, a total of 760 individual tests were performed. The tests were of two types: (1) neighborhood-based tests that attempted to detect discriminatory behavior related to geography or housing location and (2) applicant-based tests that were “person sensitive” so as to detect disparate treatment of similarly qualified applicants. According to NFHA, on average, 45 percent of the tests they conducted revealed disparate treatment of minorities or some other type of discriminatory lending activity. Among the prohibited activities cited by NFHA testers were instances of minorities being charged higher appraisal fees for houses in the same neighborhood, cases in which minorities were told that they didn’t qualify for refinancing even though white testers with similar qualifications did, and instances where minority testers were not given “good faith estimates” of loan costs, or were not given the option of locking-in interest rates, when their white counterparts were furnished these preferences.

On the basis of these test results, in June and July of 1995, fair lending complaints were filed by NFHA with HUD against five large financial institutions, including two of the largest independent mortgage companies in the nation. All were undergoing HUD's complaint process at the time of our review and were to be further investigated by HUD if no conciliation agreement is reached between the respective parties. Other testing programs similar to that conducted by NFHA were also being conducted elsewhere around the country and results were expected in the near future.

Summary

Findings from the expanded HMDA data, statistical studies, and other sources justifiably raise concerns regarding the presence of discriminatory activity in the lending industry. Results from private-sector testing programs, for example, can be reasonably seen to provide evidence of the existence of discrimination in lending by some institutions in some parts of the country. Although there is little to indicate that discrimination in the credit markets is pervasive or widespread, the available evidence is often contradictory and inconclusive.

For example, statistical studies examining the lending discrimination issue have not yielded consistent results. While several studies of loan application denial rates have reported finding evidence of disparate treatment among mortgage lenders, recent studies of redlining and default rates have not. Additionally, a number of reputable researchers have argued that the findings from contemporary statistical studies are severely limited by the data sources, the accuracy of model specifications, and the current state of knowledge regarding the mortgage search and underwriting processes.

As a result, despite all that has been said and done, there remains much to be learned about the forms, occurrence, and magnitude of discrimination in the credit markets, particularly in markets outside the housing and mortgage credit markets. Obtaining such knowledge is critical to development of efficient and effective methods to detect discrimination and for proper allocation of limited public resources toward enforcement of the fair lending laws.

Description of FRB's Statistical Model and Its Use During Fair Lending Compliance Examinations¹

As described by FRB, its statistical model employs a two-step process. First, HMDA data is to be used to identify institutions that may require a more intensive review of their mortgage lending decisions. This is to be done by conducting a statistical analysis to determine whether applicants that are similar with respect to income and loan amount, applying for the same loan product within the same geographic area, are treated differently on the basis of race. When the results of this analysis show measurable differences among racial groups that cannot be explained by other HMDA variables, the program automatically selects a sample of applications to be reviewed more extensively.

For loans in the selected sample, examiners are to gather additional data from the loan application files, including data on the creditworthiness of the applicant and the related property. These data are to then be analyzed in a more sophisticated regression model to determine if the differences observed in denial rates across race, ethnicity, or gender persist even after controlling for these other influences. If so, the program is to pair a given applicant with one or several other applicants (of different races or ethnic groups, for instance) who have similar financial characteristics but who experienced different outcomes on their loan requests. If these matched-pair comparisons reveal any evidence of discriminatory activity, further examination of the files is in order and an explanation can be requested from bank management regarding any inconsistencies. If satisfactory answers cannot be found, enforcement actions, like cease and desist orders, may be taken, or a referral to DOJ or HUD may be made if deemed appropriate.

¹ As described in Canner, Smith, and Passmore (1994), and elsewhere. For an evaluation of FRB's statistical model and its use in fair lending examinations, see the report by FRB's Office of Inspector General entitled, Report on the Audit of the Board's Consumer Compliance Examination Process, Apr. 1996.

Limitations Associated With the Use of Statistical Models to Detect Discrimination

In the last several years, the federal regulatory agencies charged with oversight and enforcement responsibilities under the fair lending laws have increasingly relied on statistical analysis to detect discriminatory lending behavior. Initially, simple statistical measures based on HMDA data were used to screen or identify individual financial institutions that appeared to have unusual lending patterns. Often, these institutions became the focal point of more in-depth regulatory review. More recently, however, statistics have begun to play a more critical role in consideration of lending discrimination cases. For example, DOJ now relies to a great extent on sophisticated statistical analyses to provide evidence of discrimination, especially the more difficult to detect forms, like disparate treatment. In addition, FRB now employs on a regular basis a statistical model as an examination tool for larger institutions.

The use of such statistics and statistical models, however, is not a panacea. Economists and statisticians have repeatedly pointed out that statistical approaches have limitations and can, if relied on too heavily, lead to erroneous conclusions or have unintended consequences. For example, data errors, which will never be totally eliminated, can lead analysts to draw incorrect conclusions. Also, many loan decisions can be influenced by factors that are difficult to capture in a statistical model. In general, statistical findings will be unreliable if relevant information about loan applicants is omitted from a model or input in an inappropriate form, especially if the missing information is correlated with race or other important explanatory variables. Other limitations and shortcomings associated with the increasing use of statistics in the enforcement of the fair lending laws are discussed below:

Other Limitations and Shortcomings

(1) Smaller institutions offer an insufficient loan pool from which to sample. As described by FRB staff, FRB's newly employed statistical model generally requires a database of at least 125 applications—a minimum of 25 from minority applicants and 100 from white applicants. Under normal circumstances, however, examiners try to obtain about 100 applications from each group. This is a significant increase over the number of files reviewed under the judgmental sample procedures. This large database requirement effectively limits the use of the statistical program to the larger institutions. For example, of the roughly 1,000 commercial banks supervised by the Federal Reserve, only about 100 have a sufficient volume of loan applications to be evaluated under the new statistical technique. Institutions with insufficient loan files will still need to be examined using current manual sampling procedures. Furthermore, the

statistical model currently employed by FRB relies, in part, on HMDA data. This will further limit its application by excluding its use in examinations of non-HMDA reporting institutions. It will also make it susceptible to problems associated with poor data quality.

(2) Prescreening or other forms of discrimination that may occur prior to the formal submission of an application cannot be detected with a statistical model. Comparative-file analysis in general, whether done manually or using the new statistical modeling techniques, looks only at the end result of the application process. Thus, it cannot be used to detect discrimination prior to the submission of a formal application. It does not, therefore, address one of the fundamental weaknesses of existent examination procedures.

(3) It is not clear at this time whether the use of the new statistical models will result in a reduction in the length of time currently required for comparative-file analysis. Some examiners interviewed during our case studies indicated that they were given insufficient time to conduct comprehensive file comparisons. Yet, the new statistical models will require examiners to construct an expanded data set in order to competently test for disparate treatment. And, as mentioned previously, there is no substitute for hands-on examination of any suspicious files highlighted by the model's matching program. As a result, it may be that the use of the models will actually exacerbate, rather than alleviate, the time crunch some examiners reported during their fair lending examinations. Based on preliminary feedback from FRB examiners on the use of the computer model, this appears to be a legitimate concern.

For example, the modeling process requires FRB examiners not only to pull a larger sample of loan files for review but to collect information on an additional 12 to 15 non-HMDA variables. This has been estimated to take from 30 to 45 minutes per loan file. For a sample of 200 files, the number normally recommended by FRB supervisory staff, use of the statistical modeling procedure could increase examination time by as much as 100 to 150 hours. In light of this, FRB has brought professional economists into the process of conducting statistical analysis to mitigate the additional time requirement.

(4) The expanded use of sophisticated statistical techniques to conduct comparative-file reviews will necessitate a major training effort on behalf of the regulatory agencies. Examiners will need to be thoroughly familiarized with the use of the modeling techniques and in the

interpretation of the results. This will likely delay the widespread use of the statistical models in the near term and require a significant commitment of resources on behalf of the agencies for years to come.

(5) Reliance on Statistics as an Enforcement Tool Could Result in Unintended Consequences. Statistics have played a major role in consideration of the mortgage discrimination issue to date. And, their role as an enforcement tool appears to be increasing dramatically. In addition to FRB's use of a statistical model as an examination tool, DOJ now relies to a great extent on a complex statistical model to develop evidence of the disparate treatment form of lending discrimination. However, economists and others have cautioned that too heavy a reliance on statistics in fair lending enforcement could also lead, in some cases, to unintended consequences. For example, enforcement actions based on statistically-derived evidence could ultimately lead to a complete replacement of a bank officer's subjective and reasoned judgment regarding loan approvals with a computerized underwriting system. Such a system would, without doubt or bias, eliminate from consideration for credit all marginal applicants who do not meet the minimum criterion of the computerized system. Yet, this result is counterproductive to efforts designed to increase the flexibility of underwriting standards so that minorities and other disadvantaged groups can have greater access to credit. Marginal applicants could be similarly affected if a lender's costs associated with ensuring that a computerized underwriting system did not result in disparate impact, or some other violation of the fair lending laws, outweighed the savings achieved from automating the application process. For profit-minded institutions, higher marginal costs of making loans would, according to economic theory, necessarily eliminate those applicants at the margin of creditworthiness—the very ones that many of the flexible underwriting programs are attempting to help.

The Case Against Decatur Federal Savings and Loan

DOJ's first major effort to enforce the fair lending laws was prompted in part by the "Color of Money" article that appeared in the *Atlanta Journal-Constitution* in 1988. On the basis of that story, DOJ began an investigation into mortgage lending discrimination in the Atlanta area. Its investigation eventually focused on a single institution, the Decatur Federal Savings and Loan, one of the largest mortgage originators in the Atlanta area. Based on its findings, DOJ ultimately filed a lawsuit in September 1992, alleging that Decatur Federal engaged in unlawful racial discrimination in its mortgage lending program. The case was quickly settled through a consent agreement that, among other things, assessed \$1 million in damages for the victims of the alleged discrimination.

As part of the settlement, Decatur also agreed to make significant changes to its operating procedures so as to avoid future discriminatory activities. Among other things, the institution agreed to (1) redraw its CRA boundary to include previously excluded black neighborhoods, (2) open a branch or a regional loan office in the black residential area, (3) revamp its advertising program to target black residential areas and seek out real estate agents and builders serving those areas as potential aids in producing mortgages, (4) alter its account executive commission pay structure to provide increased incentives to market mortgage loans in black residential areas, (5) recruit more black applicants for job openings, and (6) adopt a program of testing to help ensure that potential applicants would be treated without regard to race when they visited the institution.

DOJ's investigation of Decatur Federal was also significant in that it relied heavily on a statistical analysis of the institution's mortgage loan files, and in so doing, signaled DOJ's view of the evidentiary standards sufficient to establish a "pattern or practice" of unlawful discrimination. This analysis included an examination of thousands of loan files over a multiyear period and the creation of a data base of more than 70 variables relevant to the institution's underwriting process. Ultimately, DOJ's statistical analysis revealed that the race of an applicant was a significant factor in determining whether or not Decatur would grant a loan, even after controlling for other economic factors thought to underlie the institution's mortgage lending decisions.

Comments From the Federal Reserve Board

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551-0001

LAWRENCE B. LINDSEY
MEMBER OF THE BOARD

May 20, 1996

Mr. James L. Bothwell, Director
Financial Institutions and Market Issues
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Bothwell:

We appreciate the opportunity to comment on the May 1996 draft of the GAO's report entitled "Fair Lending: Federal Oversight and Enforcement Improved But Some Challenges Remain." The Federal Reserve is committed to forceful enforcement of the nation's fair lending laws, and has devoted substantial resources to this effort. Generally, the draft's recommendations are useful and constructive, and the report reflects the considerable strides taken in recent years. The report will help assure that the agencies have as effective a program as possible and we believe the insights provided are helpful.

There is one aspect, however, that may be misleading as to the Federal Reserve, given the focus of the report on all the supervisory agencies. The draft speaks favorably about the desirability of using comparative file analysis in conducting fair lending examinations, rather than simply conducting an examination by comparing the outcomes of selected loan applications to the institution's own lending standards. It also acknowledges recent initiatives to automate the process of comparative file review in a statistical model at the Federal Reserve. However, the draft should be clear regarding the Federal Reserve's historical policy in this respect. The Federal Reserve has been using the comparative file technique since the time it adopted a compliance examination program in 1979, albeit in a less automated fashion than we are now able to do using the HMDA data. In other words, contrary to the implication of the report, we have always used the comparative file approach in our examinations. We believe that the language of the draft should be clarified to more accurately portray this fact.

See comment 1.

Appendix VI
Comments From the Federal Reserve Board

Mr. James L. Bothwell
May 20, 1996
Page 2

See comment 2.

Our responses to the other recommendations in the draft report follow. We support the recommendation for uniform fair lending examination procedures and appropriate examiner training with respect to any such procedures. We have been working on the development of uniform procedures and anticipate submitting a draft for consideration by the other agencies in the very near future. We have not, however, sought to propose in our draft procedures the uniform adoption of any form of regression analysis, in part because this procedure has proven highly labor intensive and costly, and the agencies have varying levels of resources. Moreover, the regression analysis system has largely been experimental; it is undergoing a number of changes, and there continues to be extensive debate among econometricians and others about how best to proceed with its use. We have, however, discussed our system with the other agencies and would make it available to them should they want it. For the reasons discussed in the following paragraph, our present effort to draft new uniform procedures also does not include a testing component.

See comment 3.

Regarding the recommendation to adopt a testing methodology for detecting discrimination at the preapplication stage of the lending process, the Board has reviewed the issue of using testers routinely as part of its fair lending examination program (as well as broader market uses of testing) a number of times and has found that the problems and expense related to such use outweigh the potential successes. The Board has authorized its limited use in individual cases in which a Reserve Bank discovers compelling evidence of discrimination and recommends to the Board that testing is the appropriate method of pursuing enforcement. No such cases have arisen to date, however. We understand other agencies, notably the Office of the Comptroller of the Currency, have recently completed pilot testing programs. We are prepared to review and discuss the results of these programs to determine whether they have uncovered useful new information about the methodology that might be of value in our enforcement efforts.

See comment 4.

We generally agree with the recommendation to use our full range of enforcement powers to address cases of inaccurate HMDA submissions. The draft raises the concern about the limited assessment of civil money penalties against State member banks that submit erroneous data, as opposed to relying primarily upon requiring resubmission of erroneous data. It is the Federal Reserve's policy to impose penalties for any violation of laws by a State member bank, including violations of HMDA, when appropriate. Where we have discretion with regard to HMDA data, however, we have been more

Appendix VI
Comments From the Federal Reserve Board

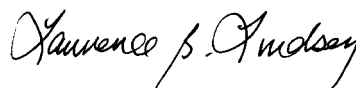
Mr. James L. Bothwell
May 20, 1996
Page 3

active in requiring resubmission by State member banks whose data contains errors which compromise its integrity. The cost of doing so, itself, is a "penalty" that is likely to deter future inaccurate submissions. The quality of the data submitted to the Federal Reserve for processing over the past few years has steadily improved.

The draft's final recommendation is that the U.S. Department of Justice (DOJ) provide guidance on the characteristics of referable "pattern or practice" cases under the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act. Though we are certainly interested in DOJ's views on the meaning of phrases in the ECOA referral provisions such as "reason to believe" and "pattern or practice," in the absence of court opinions on these matters we also recognize our own responsibilities to make determinations of the meaning of the statutory phrases in the context of particular circumstances.

Overall, the draft reflects the considerable thought, time, and effort put forth by your staff. The recommendations are useful and I appreciate your sharing them with us.

Sincerely,



See comment 5.

The following are GAO's comments on the Federal Reserve Board's letter dated May 20, 1996.

GAO Comments

1. Change made to footnote 5 on page 37 to reflect FRB's use of the comparative-file technique since 1979.

Although it is true that FRB has used the comparative-file technique since it adopted a compliance examination program in 1979, examination procedures at that time directed FRB examiners to judgmentally sample only a small number of loan applications. We believe such a sampling procedure may have limited the technique's effectiveness during past examinations. Revisions to FRB's fair lending examination procedures, however, and to those of the other federal banking regulatory agencies as well, have both greatly increased the number of loan applications sampled and adopted more systematic means of selecting those files. These changes, combined with an overall greater emphasis on the use of comparative-file analysis, have significantly enhanced the ability of the banking regulatory agencies to detect possible discriminatory lending behavior.

2. We agree that the use of regression analysis is still experimental and that continued testing by FRB is warranted. However, should regression analysis or some other technique prove to be an effective and efficient means for detecting possible discriminatory lending behavior, then we maintain that all agencies have the responsibility to adopt such a technique as part of their examination procedures and properly train their examination staffs. Adoption of uniform examination procedures, as recommended by GAO, will ensure that each of the banking regulatory agencies is using the most advanced and proven techniques to detect discrimination while still applying the same degree of oversight to all depository institutions.

3. As we discuss in chapter 4, we believe that the ability of the examiners to detect illegal discrimination in the preapplication stage of the lending process is limited. During our review, none of the agency examiners, officials, or other experts we spoke with disagreed with this conclusion. Thus, we believe that our recommendation to adopt a testing methodology for detecting discrimination at this stage of the lending process is well grounded. Our recommendation does not necessarily suggest that testing be used as a routine part of an agency's fair lending examination program, only that the technique be employable when a situation may warrant its

use—such as when compelling evidence from other sources suggests that discriminatory behavior may be occurring prior to submission of a formal written loan application.

We acknowledge that current FRB policy authorizes limited testing in individual cases, although FRB officials confirmed that they have not yet employed the technique. We are also encouraged that FRB intends to review the results of the OCC's pilot testing program and consider its potential for enhancing its own detection capabilities.

4. We agree that the cost associated with correcting and resubmitting HMDA data can be significant. However, we believe that the use of civil money penalties represents a more formal and public deterrent to future inaccurate HMDA data submissions for both the violating institution and others in the lending industry. Use of CMPS may be especially effective when used in combination with the resubmission requirement.

5. We are in agreement with FRB that the absence of clear statutory language regarding the characteristics of referable pattern and practice cases under ECOA and FHA necessitates independent interpretations by the various agencies responsible for fair lending enforcement. It is for precisely this reason we recommend that DOJ provide additional guidance to the agencies regarding the referral mandate. It is hoped that such guidance would be of assistance to the agencies in making their own determinations by providing a "case history" of prior referral decisions made in agreement with DOJ. Currently, DOJ is the only agency privy to this collective insight.

Comments From the Federal Deposit Insurance Corporation

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

FDIC

*Federal Deposit Insurance Corporation
Washington, DC 20429*

*Office of the Director
Division of Compliance and Consumer Affairs*

May 22, 1996

Mr. James L. Bothwell
Director, Financial Institutions
and Market Issues
General Government Division
United States General Accounting Office
Washington, D.C.

Dear Mr. Bothwell:

This letter provides our comments on the General Accounting Office's (GAO) draft of the proposed report entitled, Fair Lending, Federal Oversight and Enforcement Improved But Some Challenges Remain. We appreciate the opportunity to provide comments prior to your finalizing the report.

In general, the tone and content of the report is balanced. We appreciate the GAO's recognition of the significant accomplishments made by the FDIC in the fair lending area, as well as the challenges we face. A few major issues noted in the draft report, however, warrant specific comment:

FAIR LENDING INITIATIVES BY BANKING REGULATORY AGENCIES

Consumer Complaints and Inquiries: The GAO report indicates that only the OTS had joined the FRB in completing revisions to the complaint process by the end of fiscal year end 1995. The FDIC has made substantial progress in this area that is worthy of note. The Division of Compliance and Consumer Affairs (DCA) is responsible for processing and monitoring the receipt, resolution and disposition of consumer complaints and inquiries. Written complaints and inquiries are monitored through a computerized tracking system, the Consumer Compliance Inquiry System (CCIS). In 1995, DCA also began tracking telephone calls through a computerized system nationwide. Both systems track detailed information about complaints or inquiries received in writing or by telephone, including the nature of the complaint or inquiry. In addition, CCIS is able to track information about contact with the financial institution, the action taken in resolving the issues, on-site investigations, and the final disposition of the complaint.

Management reports are generated from the CCIS system that are used in identifying patterns of noncompliance, determination of the adequacy of operational and policy procedures and tracking information on deceptive acts. Other reports that are generated from both systems assist DCA management in the administration of the complaint handling functions.

See comment 1.

**Appendix VII
Comments From the Federal Deposit
Insurance Corporation**

In October, 1995 DCA instituted new category codes for written and telephone inquiries or complaints. The new codes were coordinated with the Federal Reserve to establish a more uniform complaint coding system, which allows data sharing among the agencies. DCA's Consumer Complaint Investigation procedures have been completely revised and will be distributed in final form by June 1, 1996.

AGENCY EDUCATIONAL AND OUTREACH PROGRAMS EXTENDED

Publications: The FDIC has continued its efforts to help financial institutions improve fair lending performance. The FDIC publication, "Side-by-Side, a Guide to Fair Lending," which is referenced in the GAO report, takes a practical, step-by-step approach to developing a self-testing program that can detect discrimination at the pre-application stage when an applicant inquires about a loan. In addition, it describes how to conduct a comparative analysis of loan files to compare the treatment of mortgage loan applicants after an application has been filed. It also offers suggestions on how to correct discriminatory practices and improve fair lending performance.

The guide, which was mailed to all FDIC-supervised institutions, has been favorably received. Several hundred lenders requested additional copies, not just for compliance officers, but for loan officers and directors as well. In addition, industry, community, and government agency conference planners repeatedly request copies of the guide to distribute to participants at fair lending and community reinvestment conferences. As a result, over 35,000 copies of the guide have been distributed. The guide was updated earlier this year and a new edition is being printed for distribution next month.

DCA also recently completed a booklet, "Mortgage Loan Prequalifications: Applications or Not?", which is a guide for institutions to use in complying with Regulations B (ECOA) and C (HMDA). The guide was developed in response to questions from lenders, examiners, community organizations and the general public about how the fair lending laws and regulations affect financial institutions' efforts to assist customers in obtaining mortgage credit. The guide, which is being printed, will be distributed to all FDIC supervised institutions next month.

Community Outreach: The FDIC has an outreach program specifically targeted towards promoting compliance with the fair lending laws by FDIC-supervised institutions; assisting consumers, community organizations, government officials and other interested parties in understanding and participating in the fair lending process; and supporting the examination process relative to fair lending. To accomplish this, the FDIC encourages and facilitates an exchange of information and sharing of knowledge between banks and the communities in which they operate. Some examples of outreach efforts in 1995 include:

- A focus group at Mississippi Valley State University, Itta Bena, MS to identify and discuss issues relevant to rural lending
- Seminars entitled "Fair Lending - Good Business" for bankers at various sites in Kansas

See comment 2.

**Appendix VII
Comments From the Federal Deposit
Insurance Corporation**

- Training for bankers on the Fair Housing Act and HMDA in conjunction with the Texas Bankers Association and the University of Texas-Austin
- Seminars in San Diego, CA on lending to Native Americans with community groups and tribal representatives
- A focus group in Spartanburg, SC to identify and discuss issues of common concern such as the loan application process, lending practices, networking and discrimination

FAIR LENDING OVERSIGHT AND ENFORCEMENT

Referrals to the Department of Justice (DOJ): The number of referrals to the DOJ made by the FDIC in 1994 noted on tables 3.4 and 3.5 of the GAO report do not reconcile. The correct number of referrals is 11 for 1994, as stated in table 3.5. Further, the FDIC made four referrals to the DOJ in 1995 for substantive violations of the fair lending laws. All four of these were for disparate treatment based on race. Therefore, the total for the FDIC should be 25, not 22.

On January 19, 1996, the FDIC also implemented a "Formal Consultation Policy" for our compliance staff. (Attachment 1) This policy requires, among other things, consultation among field examiners, regional office and Washington office staff where substantive fair lending violations are found during examinations that may require referral to the DOJ or the Department of Housing and Urban Development. This policy is designed to provide additional guidance to examiners during the examination process to assure that potential violations are fully supported. It also focuses resources on the most likely areas of potential problems since, as noted in the GAO report, detecting violations and developing evidence of substantive violations is a time consuming process. Since implementation of the policy, this consultation process has been invoked on three occasions. Referrals to the DOJ are pending on each of these cases.

AGENCY USE OF ENFORCEMENT POWERS TO ENSURE ACCURATE HMDA DATA

HMDA Civil Money Penalties: In addition to the civil money penalties (CMPs) noted in the GAO report, which were assessed by the FDIC for late and inaccurate reports for data submitted for 1992 and 1993, the FDIC assessed CMPs against two non-member banks in 1996 for violations of HMDA relating to inaccurate data that were found during examinations. These CMPs were for \$2,500 and \$5,000. CMPs of \$12,500 were also assessed against one other FDIC-supervised institution in 1995 for violations found during the examination. In this case, the violations related to HMDA and other compliance laws and regulations.

EXAMINER TRAINING AND EXAMINATION TIME

Training Efforts: In August 1995, the FDIC's Division of Compliance and Consumer Affairs (DCA) formed a National Training Committee (NTC) to provide a new training focus for the division. The committee's goals are to consider the training needs of employees; to

Now tables 3.1
and 3.2
See comment 3.

**Appendix VII
Comments From the Federal Deposit
Insurance Corporation**

provide both job-essential and common needs training; to review available technologies to meet training needs; and to include a process to solicit feedback and ensure effectiveness. This committee reports directly to DCA's Director through a National Training Coordinator, a position created this year to bring even closer attention to our training needs.

An example of recent training efforts is community development lending training. The objective of this course is to ensure that community development lending and sound underwriting standards are equally valued, supported, and encouraged by all FDIC examiners. All examiners are participating in the program. Each training session is a mixed audience of compliance and safety and soundness examiners.

Another training effort is an exchange program between DCA and the Division of Supervision (DOS). Selected DCA and DOS examiners are attending specialized safety and soundness and compliance training, respectively, and are detailed to their sister division for one year. The program began in the fourth quarter 1995 and will continue in successive quarters throughout 1996 and 1997. The detail for DCA examiners provides them a clearer understanding of the financial condition and business decisions faced by a commercial bank. DOS examiners receive customized educational courses on the Community Reinvestment Act and other fair lending laws and the technical examination tasks associated with consumer lending activities.

DCA is also conducting training on Data Integration and Mapping Software purchased by the FDIC in May 1995. At the present time, trainers are being trained in Washington. The trainers will then train every DCA examiner and community affairs staff person on how to use this new software. Examiners will use the maps and information tables generated by the software to do more thorough and efficient fair lending and CRA evaluations.

HMDA Data Examination Tools: During 1995, compliance examiners were provided with software containing the following data:

- Reports with aggregate data for all HMDA-covered lenders within each Metropolitan Statistical Area.
- Individual disclosure statements for each HMDA-covered FDIC supervised institution, which show each institution's lending patterns by geography, race, gender, and income.
- Loan-application records exactly as reported by the individual institutions.

Providing the data to examiners electronically helps to facilitate better manipulation of the data and therefore more thorough and accurate analyses. Additionally, new interagency HMDA examination procedures were approved by the Consumer Compliance Task Force of the Federal Financial Institutions Examination Council (FFIEC) this month. Finally, with respect to the specific recommendations made in the GAO report:

**Appendix VII
Comments From the Federal Deposit
Insurance Corporation**

- (1) Work with the other financial institutions regulatory agencies to develop and adopt uniform fair lending examination procedures and provide all compliance examination staff with the necessary training to implement those procedures.

See comment 4.

The FDIC is fully committed to consistency in the examination process and to adequately training our staff. We are working with the other agencies to accomplish this to the maximum extent possible. I am the FDIC's representative on the FFIEC's Consumer Compliance Task Force, which meets monthly. There is already a strong pattern of interagency coordination in this area because of extensive coordination by the four agencies on the new regulations and examination guidelines under the Community Reinvestment Act (CRA).

- (2) Incorporate testing methodologies for detection of discrimination at the preapplication stage into our examination and training programs.

See comment 5.

The FDIC believes that the most effective means of preventing and detecting discrimination is through effective self-evaluation by the institutions themselves. We actively encourage self-assessments, including pre-application self-testing, and provide guidance to financial institutions in implementing such programs, such as the publications "Side by Side" and "Mortgage Loan Prequalifications: Applications or Not?". In order to encourage lending institutions to engage in self-testing, we have also supported legislative initiatives that would protect institutions from having to release results of self-testing reviews. We believe our efforts are bearing fruit, but legislation is essential to getting one hundred percent cooperation because of the concerns among financial institutions about potential civil liability. If necessary however, to assure full compliance, the FDIC will consider conducting its own pre-application testing.

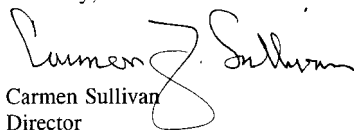
- (3) Use our full range of enforcement authority, including use of civil money penalties, to ensure that the HMDA data is submitted in a timely and accurate manner.

See comment 6.

We concur that accurate HMDA data are critical to effective fair lending enforcement. As noted in the GAO report, the FDIC is the only financial institution regulatory agency to have imposed CMPs for HMDA violations. Further, on March 11, 1996, the FDIC implemented a formal policy regarding assessment of CMPs, which specifically addresses HMDA related violations. (Attachment 2)

Again, thank you for the opportunity to comment. If you have any questions, please feel free to contact me.

Sincerely,



Carmen Sullivan
Director

Attachments

The following are GAO's comments on the Federal Deposit Insurance Corporation's letter dated May 22, 1996.

GAO Comments

1. Additional language has been added to our discussion of consumer complaint processes on page 33.
2. We acknowledge and commend the myriad on-going efforts of FDIC and the other banking agencies to improve their educational and outreach programs related to fair lending. Our discussion on pages 55 and 56 makes reference to FDIC's publication, Side-by-Side, but is not intended to be a complete accounting of all agency publications or other educational initiatives.
3. DOJ has verified the number of referrals it received from FDIC in 1994 and 1995. The numbers reported by GAO in tables 3.1 and 3.2 are those provided by DOJ.
4. We discuss the interagency initiatives in pursuit of consistency in fair lending examination procedures on page 58. We are encouraged by FDIC's commitment to continue to pursue interagency cooperation and coordination.
5. We agree with FDIC that one of the most effective means of preventing and detecting discrimination is to encourage self-evaluation by financial institutions. We also agree that some degree of protection from the legal liabilities associated with self-testing may be necessary to encourage greater voluntary efforts and have suggested that Congress consider the issue.
6. We discuss FDIC's commitment to ensuring accurate and timely HMDA data submissions and their use of CMPS to deter noncompliance with the law on page 63. Our chapter 4 discussion also goes on to describe why it is important for the regulatory agencies to use their full range of regulatory authority to ensure timely and accurate HMDA data submissions.

Comments From the Office of the Comptroller of the Currency

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

June 26, 1996

Mr. James L. Bothwell
Director, Financial Institutions and Markets Issues
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Bothwell:

We have reviewed your draft audit report titled Fair Lending: Federal Oversight and Enforcement Improved But Some Challenges Remain. The report was prepared in response to Congressional requests concerning federal oversight and enforcement of the nation's fair lending laws, principally the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA). The audit found that fair lending oversight and enforcement have improved but challenges remain. We are addressing three of GAO's recommendations to the federal financial institution regulatory agencies.

Examination Procedures

The agencies coordinate with each other to try to ensure that there is consistent enforcement of the fair lending laws through the examination process. Nevertheless, different examination procedures may be appropriate, given the supervisory needs of the agencies and the varying sizes and risk profiles of the financial institutions that they regulate. For example, to reduce regulatory burden, the OCC developed and issued procedures for compliance examinations in community banks that provide a streamlined approach. Examinations can be conducted in less time and examiners are more comfortable that comprehensive coverage of compliance issues is effected in examinations of small banks. In situations where examiners do not believe they have sufficient time in which to address potential fair lending problems, they are afforded additional flexibility on a case-by-case basis. We believe that the OCC's procedures represent sound examination and analytical techniques that permit us to ascertain compliance by national banks with a high degree of confidence, but we are committed to an ongoing process of periodically reviewing our procedures and revising them as appropriate to improve their accuracy and efficiency in light of advances in analytical techniques.

The OCC now has a stand-alone fair lending school that was tested last month. It provides training consistent with current fair lending guidelines. Should the agencies develop and adopt uniform examination procedures, we will modify our training programs to incorporate those procedures.

See comment 1.

**Appendix VIII
Comments From the Office of the
Comptroller of the Currency**

Testing

The GAO recommends that the agencies adopt guidelines and procedures for the use of testing to detect discrimination in the preapplication stage of the lending process. The OCC has already taken action in this area. In April, the OCC adopted a policy to use preapplication testing. The OCC will use matched-pair testing on a case-by-case basis when information from examiners, consumers, or other sources indicates that a bank may be engaged in illegal discrimination, particularly at the preapplication stage. Our new fair lending school includes a training module on preapplication testing.

We also support the recommendation that Congress provide incentives to financial institutions that self-test for lending discrimination by making the results of self-testing privileged. The OCC issued a bulletin in September 1995 that encourages self-tests and self-evaluations by national banks. The bulletin defines self-assessments to include self-tests, in which the bank arranges for testers to pose as loan applicants to determine if unlawful discrimination is occurring at the preapplication stage of the lending process, and self-evaluation, which includes all other self-analysis methods a bank might use to determine if it is complying with fair lending laws. The bulletin states that the OCC generally will not require disclosure of self-test and self-evaluation information. Nor will the OCC take enforcement action against a national bank that discovers discrimination through these methods and takes appropriate corrective action.

Enforcement

To address concerns for the accuracy of data filed by banks in accordance with the Home Mortgage Disclosure Act (HMDA), the GAO recommends that the agencies use their full range of enforcement authority, including civil money penalties, to ensure that the HMDA data is submitted in a timely and accurate manner. The OCC's course of action, to date, has been to have the bank resubmit data in the proper format, because we believe this to be the desired outcome. However, banks have now had approximately five years to implement the reporting requirements properly, and we agree that other remedies may be warranted. We are willing to work with the other agencies to try to reach consensus on civil money penalty assessments in this area.

Thank you for the opportunity to review and comment on the draft report. We provided clarifying comments and editorial suggestions to your evaluators informally.

Sincerely,



Judith A. Walter
Senior Deputy Comptroller for Administration

See comment 2.

See comment 3.

The following are GAO's comments on the Office of the Comptroller of the Currency's letter dated June 26, 1996.

GAO Comments

1. OCC's initiative to establish its own fair lending examination procedures in the absence of an interagency agreement on uniform procedures seems prudent considering the pressing need for improvements in the interim and the difficulties the agencies have encountered in past attempts to develop uniform fair lending examination procedures (see discussion on page 58). OCC's expressed willingness to modify their training programs to accommodate uniform interagency procedures in the future is also to be commended.

2. We believe that the use of civil money penalties represents a more formal and public deterrent to future inaccurate HMDA data submissions for both the violating institution and others in the lending industry. Use of CMPS may be especially effective when used in combination with the resubmission requirement.

3. OCC's informal suggestions and technical comments on the draft report were incorporated into the final report as appropriate.

Comments From the Office of Thrift Supervision

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6000

May 17, 1996

James L. Bothwell
Director, Financial Institutions
and Market Issues
General Accounting Office
Washington, D.C. 20548

Dear Mr. Bothwell:

Thank you for this opportunity to comment on the General Accounting Office's (GAO) draft report entitled, Fair Lending Oversight and Enforcement Improved But A Few Challenges Remain (GAO Code 233463). GAO staff has made a conscientious effort during its review to invite and consider agency input to its study and analysis. The draft presents a balanced recitation of the relevant issues in this complex field.

See comment 1.

As the GAO draft report concludes, the federal banking regulatory agencies have made significant strides in strengthening their oversight and enforcement of the fair lending laws. While some improvements to examination policies and procedures can be pursued, unresolved fair lending legal issues, outside the control of the agencies, present barriers to an immediate formulation of a more effective policy and greater acceptance of voluntary compliance efforts by financial institutions. Moreover, even with improved methodologies and clearer legal interpretations, detection of lending discrimination in all its forms will continue to pose significant challenges to regulators.

Despite the obstacles to identifying illegal discrimination and enforcing fair lending laws, the Office of Thrift Supervision (OTS) recognizes the need to take additional steps to advance the goals of fair lending policy. Accordingly, we concur in the GAO's recommendation to work with the other banking agencies to develop and adopt uniform fair lending examination procedures and provide training to compliance examination staff on those procedures.

See comment 2.

We also concur in the GAO's recommendation to apply the agency's enforcement power, including civil money penalties, to ensure that HMDA data is submitted in a timely and accurate manner. Indeed, OTS adopted such an enforcement policy in 1995 to address those concerns and has observed positive results in institutional data reporting for 1996.

**Appendix IX
Comments From the Office of Thrift
Supervision**

Page 2

OTS agrees that the agencies should strive to improve their abilities to detect pre-application discrimination. Testing provides a possible methodology for identifying such discrimination. Although it has not proven to be attractive as a routine examination procedure, testing can make an appropriate contribution to agency enforcement programs. Accordingly, we believe that agency fair lending training and enforcement programs should consider the adoption of guidelines and procedures for the use of testing methodologies for detecting discrimination at the pre-application stage of the lending process only after careful study and the continued review of actual testing experiences.

See comment 3.

Finally, we will welcome efforts of the U.S. Attorney General to provide updated guidance on the characteristics of referable "pattern or practice" cases under ECOA and FHA.

In conclusion, we appreciate the GAO's careful work in coming to grips with this important, but difficult, area. We believe that the GAO's draft report will yield renewed efforts by the banking regulatory agencies to continue to improve their fair lending oversight and enforcement.

See comment 4.

We append a synopsis of suggestions that you may wish to consider in finalizing your report. Please contact me at 202-906-5629 if you have any questions about our response.

Sincerely,



Timothy R. Burniston
Director, Compliance Policy

Enclosures

The following are GAO's comments on the Office of Thrift Supervision letter dated May 17, 1996.

GAO Comments

We address OTS' substantive comments below.

1. We discuss in chapter 4 the points OTS raises about how unresolved legal issues associated with the interpretation and application of the fair lending laws pose substantial challenges to oversight and enforcement efforts of the federal agencies and discourage some financial institutions from undertaking some voluntary compliance programs like self-testing. We are encouraged by OTS' intention to work with other agencies as we recommended.

2. We added language to our discussion on page 64 regarding OTS' adoption in 1995 of a policy on the use of CMPS for HMDA violations, and are encouraged by the positive results observed in thrift reporting for 1996.

3. We concur with OTS that the use of testing methodologies for detecting discrimination at the pre-application stage of the lending process is still experimental and that further careful study remains to be done. However, pilot programs like those conducted at OCC and HUD have already shown testing to be a viable examination tool in certain situations when properly employed. We, therefore, encourage all agencies to collaborate in further developing the technique and to incorporate it into their respective examination programs to be used when deemed appropriate.

4. OTS' appended suggestions and technical comments on the draft report were incorporated into the final report as appropriate.

In their appended comments, OTS suggested that we more clearly pinpoint the salient equity issue regarding what we referred to as "the evenhanded application of the law," as variation in interindustry oversight rather than what OTS says is the "relatively minimal variation among banking agencies." We agree that the differences in oversight of banking institutions and others in the financial services industry are much greater than that between segments of the banking industry. In fact, we highlight this fact on page 4 of the executive summary. In contrast, our discussion of the equity issue that appears on pages 9 and 59 is in the context of our review of the fair lending examination procedures of the banking regulatory agencies, not on interindustry differences in oversight.

Comments From the National Credit Union Administration

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



National Credit Union Administration

June 3, 1996

Mr. James L. Bothwell
Director Financial Institutions and Market Issues
U.S. General Accounting Office
441 G Street NW, Room 2440
Washington D.C. 20548

Dear Mr. Bothwell:

Thank you for the opportunity to review your draft Congressional report on fair lending.

Overall, I believe it presents an accurate picture of our enforcement activities at the National Credit Union Administration. I would like to suggest one modification with regard to our fair lending program discussed on pages 56 and 57. The current draft indicates that our select examiners were trained on a broad spectrum of consumer compliance regulations that included ECOA. In fact, the training focused exclusively on the fair lending laws; the Equal Credit Opportunity Act, the Fair Housing Act, and the Home Mortgage Disclosure Act.

Thank you for the opportunity to comment.

Sincerely,

A handwritten signature in cursive script that reads "Norm D'Amours".

Norman E. D'Amours
Chairman of the Board

EI/JJW:jjw

1775 Duke Street - Alexandria, VA 22314-3428 - 703-518-6300

Now on p. 32.

See comment 1.

Appendix X
Comments From the National Credit Union
Administration

The following are GAO's comments on the National Credit Union Administration letter dated June 3, 1996.

GAO Comment

1. Change made on page 32.

Comments From the Department of Housing and Urban Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



U. S. Department of Housing and Urban Development
Washington, D.C. 20410-2000

OFFICE OF THE ASSISTANT SECRETARY
FOR FAIR HOUSING AND EQUAL OPPORTUNITY

MAY 22 1996

Mr. James L. Bothwell
Director, Financial Institutions
and Market Issues
United States General Accounting Office
441 G Street, NW, Room 2440
Washington, DC 20548

Dear Mr. Bothwell:

Thank you for the opportunity to comment on the draft General Accounting Office report, Fair Lending: Federal Oversight and Enforcement Improved But Challenges Remain ("the Report"). The Department generally concurs with the findings and offers the following comments.

Persistent, pervasive lending discrimination denies homeownership opportunities for individuals and denies capital needs for businesses. In addition to being unlawful and wrong, such discrimination contributes to the decline and deterioration of communities. A comprehensive review of the effectiveness of Federal oversight and enforcement in the fair lending arena has long been needed. This Report is a major contribution to this effort. As the lead Federal enforcement agency for the Fair Housing Act, the Department regularly addresses the challenges referenced in the report.

Admittedly, the complexities of mortgage lending discrimination make it sometimes difficult to prove; however, the Report recognizes the role such discrimination continues to play in the marketplace. The Report makes several welcome recommendations, including the need for increased testing (both self-testing by lenders and testing by financial regulators in the preapplication stage of a mortgage loan), and the value of toughened Home Mortgage Disclosure Act (HMDA) compliance actions by agencies and departments with HMDA oversight responsibility -- areas in which the Department has a strong record.

As the Report states, it is difficult to document conclusively the widespread prevalence of pervasive mortgage lending discrimination because its forms are complex and subtle, often unrecognized by its victim, and many times requiring detailed, expensive and time-consuming statistical analysis. Nevertheless, while discrimination is difficult to document

**Appendix XI
Comments From the Department of Housing
and Urban Development**

2

abstractly, individual complaints of lending discrimination continue to increase, HUD supported testing reveals its presence, and its existence is underscored by a growing number of analyses:

- A Study by the Federal Reserve Bank of Boston, "Mortgage Lending in Boston: Interpreting HMDA Data," showed that even after controlling for financial, employment and neighborhood characteristics, black and Hispanic mortgage applicants in that city were far more likely to be turned down for mortgage loans than whites.
- An analysis of the Boston Fed Study by the Office of the Comptroller of the Currency found the race of an applicant continued to have a large and highly significant effect on the lending process ("An Evaluation of the Federal Reserve Bank of Boston's Study of Racial Discrimination in Mortgage Lending").
- A recent study of the Chicago Federal Reserve Bank ("The Cultural Affinity Hypothesis and Mortgage Lending Decisions") documents the role "cultural affinity" -- white loan officers' greater receptivity to loan requests from white applicants -- plays in mortgage lending.
- While the 1994 HMDA numbers reflect a very positive increase in the number of loans made to minorities, they also show that black mortgage applicants continue to be rejected at twice the rate of whites.

The responsibility of Federal Departments and Agencies to combat lending discrimination is made more challenging by rapidly changing technology which is drastically altering the mortgage lending arena. For example, new initiatives in automated underwriting and credit scoring, which have the very important positive potential to lower consumer costs and expand credit availability, nevertheless present the possibility for undesirable results as well. They must be examined in a comprehensive and balanced manner to ensure that the progress they promise does not bring with it unlawful discrimination in their design or implementation. The Report's recommendation that regulators and agencies work together to develop uniform fair lending examination procedures is especially timely. The exemplary work already done by the Interagency Task Force on Fair Lending, which has resulted in increased cooperation among the Federal financial regulators and enforcement agencies, should continue to be high priority -- with a special emphasis on fair lending issues that arise in a technologically evolving mortgage marketplace.

In addition, the evolving activities and standards of the secondary market will have an increasingly profound impact on primary mortgage lenders, a matter which deserves further

See comment 1.

**Appendix XI
Comments From the Department of Housing
and Urban Development**

3

attention from the perspective of fair lending, particularly in light of responsibility given HUD and the Office of Federal Housing Enterprise Oversight by Congress when the Federal Housing Enterprises Financial Safety and Soundness Act was enacted. That legislation recognized the influence government sponsored entities can have on the practices and policies of primary lenders and established an oversight and remedial mechanism to better assure fair lending outcomes. HUD's role in this area provides another means to address fair lending concerns and the Department is moving swiftly to implement its new responsibility.

See comment 2.

Although the Report has no specific recommendations for HUD, the Department strongly supports the recommendations made. The Department wants to emphasize that these recommendations are consistent with issues where the Department has long taken the lead -- testing and voluntary compliance.

HUD strongly supports the recommendation that regulators adopt testing as a component of their fair lending examination and training programs, guidelines and procedures as a tool to detect bias in the preapplication stage. HUD has funded a \$1 million grant to support a large-scale national testing program to measure mortgage lending discrimination. By March 1995, 81 lenders in 8 large metropolitan areas were tested. According to the grantee, the National Fair Housing Alliance (NFHA), 45 percent of the tests revealed disparate treatment of minorities or another type of discriminatory lending activity. NFHA filed fair lending complaints against 5 large financial institutions (including the nation's two largest independent mortgage companies) in June and July 1995.

Similarly, a 1992 Philadelphia Commission on Human Relations matched-paired testing effort involving 68 lenders in and around the Philadelphia area generated 11 complaints of racial steering, discriminatory policies and disparate treatment. All complaints were filed with HUD, and negotiated settlements were reached in several cases.

Increasingly, the Federal financial regulators have undertaken their own testing programs. HUD supports such testing programs, like those of the Comptroller of the Currency, and has drawn upon its expertise to provide technical assistance to the regulators. Of course, HUD also utilizes testers as part of its investigation of appropriate complaints and as a component of its research program to determine the nature and extent of discrimination.

While testing is critical to effective fair lending enforcement, scarce federal resources necessarily limit that role. It is therefore important to encourage self-testing by mortgage lenders, which the Report appropriately recommends. However, HUD stresses the importance that lenders follow self-

See comment 3.

**Appendix XI
Comments From the Department of Housing
and Urban Development**

4

testing by correction of the problems found, a matter not given enough emphasis in the Report. Otherwise, protection for self-testing could be used to shield evidence of uncorrected unlawful action, depriving deserving complainants of appropriate remedies.

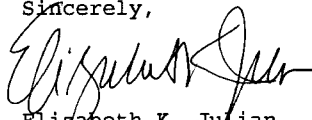
Protection for self-testing followed by self-correction leverages the limited resources available for enforcement and encourages voluntary compliance with the law. HUD and the Department of Justice have worked with lenders to craft legislation which addresses the legitimate concerns lenders have about exposing their self-testing results in enforcement actions. In addition, the Department is developing a policy statement on its use of lender self-testing data in HUD investigations and legal proceedings.

Finally, in the area of voluntary efforts to promote fair lending, the Department appreciates the recognition in the Report of HUD's "Best Practices" initiatives on mortgage lending. Such voluntary initiatives are critical to the educational efforts within the mortgage lending industry on such topics as overages or tiered pricing. The Department has signed or agreed in principle to sign close to 70 "Best Practices Agreements." Among the signatories are a few depository institutions; HUD hopes the Interagency Task Force on Fair Lending will encourage more federally insured depository institutions to sign such agreements.

Mortgage lending discrimination -- as evidenced by numerous consent decrees between lenders and the Department of Justice, the results of HUD-funded testing, serious academic studies, and complaints processed by HUD -- is an unwelcome part of the mortgage marketplace which requires vigorous Federal enforcement and oversight.

Again, thank you for the opportunity to comment on this Report and on the Department's efforts to promote and enforce fair lending. More detailed comments are included in the enclosed Appendix.

Sincerely,



Elizabeth K. Julian
Assistant Secretary

Enclosure

See comment 4.

The following are GAO's comments on the Department of Housing and Urban Development's letter dated May 22, 1996.

GAO Comments

1. Much of the material referred to by HUD is included in appendix II, which is itself a fairly extensive and objective review of the literature related to lending discrimination and what can be concluded regarding its nature and occurrence in the financial services industry.
2. We discuss in chapter 3 HUD's oversight and enforcement responsibilities under the fair lending laws and initiatives the Department has undertaken to fulfill those responsibilities, including those related to the GSEs.
3. We agree in principle that the implementation of corrective measures should be a prerequisite for gaining protection for self-testing activities and have adopted language to that effect in the Matter for Congressional Consideration on pages 10 and 72, which addresses the protection for self-testing issue.
4. HUD's appended comments on the draft report were incorporated into the final report as appropriate.

Comments From the Department of Justice

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



U.S. Department of Justice

Civil Rights Division

Office of the Assistant Attorney General

Washington, D.C. 20530

Mr. James L. Bothwell, Director
Financial Institutions and Markets Issue Area
General Government Division
U.S. General Accounting Office
Room 3858
441 G Street, N.W.
Washington, D.C. 20548

MAY 30 1996

Dear Mr. Bothwell:

I appreciate this opportunity to comment on your agency's draft report on the federal government's fair lending enforcement effort. Members of my staff have told me that they have engaged in a continuing dialog with your staff during the preparation of the report and that your staff members have been fully responsive to our ongoing comments. Consequently, I will limit my formal comments to an overview and a short discussion of our position on the application of the "disparate impact" theory in lending discrimination cases.

Your report is comprehensive, balanced, and fair. It identifies the strengths and weaknesses of all facets of the government's enforcement programs. It shows that encouraging progress has been made in recent years, and it should serve as a blueprint for further progress.

We accept your recommendation that this Department provide updated guidance to the bank regulatory agencies on what makes a referable "pattern or practice" case. We have established a procedure through which agency representatives can call our Housing and Civil Enforcement staff to describe the facts of any lending matter to obtain guidance as to whether the matter should be referred and, if so, whether it is one we believe should be considered for return to the agency for administrative action.

With respect to the disparate impact issue -- the question of a lender's legal responsibility for neutral practices that have an unintended, disproportionate and serious negative impact on persons protected by the fair lending laws, I believe it is worth my repeating what I said to representatives of the lending industry in a letter to them in February 1995:

See comment 1.

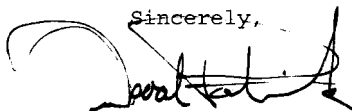
Appendix XII
Comments From the Department of Justice

When and if we encounter apparent disparate impact that is of serious consequence to those protected by the fair lending laws, we will look first to see whether the standards are facially neutral and whether they are in fact applied neutrally in all cases. If so, we will proceed to a disparate impact analysis, which includes whether there is a business necessity for the apparently neutral standard or practice. Unlike our approach in disparate treatment cases, in instances of disparate impact our emphasis will typically be on reform of the unlawful practice, rather than on penalties.

I believe it is important that lenders understand that the first thing we will look for in our fair lending investigations (and the first thing lenders should be alert to in their own self-examinations on this issue) is disparate treatment. Allegations of disparate treatment have been the basis for each of the 10 lending cases we have brought in the past four years, and I expect that this emphasis will continue.

Again, I commend you for a job well done.

Sincerely,



Deval L. Patrick
Assistant Attorney General
Civil Rights Division

cc: Vickie L. Sloan, Director
Audit Liaison Office
Justice Management Division

Norman J. Rabin, Director
Administration of Justice Issue Area
General Government Division

The following are GAO's comments on the Department of Justice's letter dated May 30, 1996.

GAO Comments

1. Our discussion on disparate impact theory in chapter 4 discusses how some common practices in the financial services industry may prove to be problematical under the disparate impact test. While DOJ's description of its approach to assessing fair lending performance explains that it first looks for disparate treatment, DOJ also describes how it will proceed when a disparate impact is encountered. This explanation may be helpful for lenders to better understand DOJ's approach to enforcement, but it does not dispel the uncertainty in the industry regarding how some common lending practices will fare under the disparate impact test.

Major Contributors to This Report

General Government
Division, Washington,
D.C.

Mark Gillen, Assistant Director, Financial Institutions and
Markets Issues
Kenneth D. Jones, Senior Economist and Project Manager

Office of General
Counsel, Washington,
D.C.

Paul G. Thompson, Senior Attorney

Bibliography

Bauer, Paul W., and Brian A. Cromwell. "A Monte Carlo Examination of Bias Tests in Mortgage Lending." Economic Review, Federal Reserve Bank of Cleveland, Vol. 30, No. 3, (1994) pp. 27-40.

Becker, Gary S. The Economics of Discrimination. Chicago: The University of Chicago Press, 1971.

Benston, George J. "Mortgage Redlining Research: A Review and Critical Analysis," Journal of Bank Research, Vol. 11, (1981) pp. 8-23.

Benston, George S., and D. Horsky. "The Relationship Between the Demand and Supply of Home Financing and Neighborhood Characteristics: An Empirical Study of Mortgage Redlining," Journal of Financial Services Research, Vol. 5, (1992) pp. 235-260.

Berkovec, James, Glenn Canner, Stuart Gabriel, and Timothy Hannan. "Race, Redlining, and Residential Mortgage Loan Performance," Journal of Real Estate Finance and Economics, Vol. 9, (1994), pp. 263-294.

Browne, Lynn E. and Geoffrey M.B. Tootell. "Mortgage Lending in Boston—A Response to the Critics," New England Economic Review, Federal Reserve Bank of Boston, Sept./Oct. 1995, pp. 53-78.

Canner, Glenn B., and Dolores Smith. "Home Mortgage Disclosure Act: Expanded Data on Residential Lending." Federal Reserve Bulletin, Vol. 77, Nov. 1991, pp. 859-881.

Canner, Glenn B., and Dolores Smith. "Expanded HMDA Data on Residential Lending: One Year Later." Federal Reserve Bulletin, Vol. 78, Nov. 1992, pp. 801-824.

Canner, Glenn B., Dolores Smith, and Wayne Passmore. "Residential Lending to Low-Income and Minority Families: Evidence from the 1992 HMDA Data." Federal Reserve Bulletin, Vol. 80, Feb. 1994, pp. 79-108.

Canner, Glenn B. and Wayne Passmore. "Home Purchase Lending in Low-Income Neighborhoods and to Low-Income Borrowers." Federal Reserve Bulletin, Vol. 81, Feb. 1995, pp. 71-103.

Carr, James H., and Isaac F. Megbolugbe. "The Federal Reserve Bank of Boston Study on Mortgage Lending Revisited." Journal of Housing Research, Vol. 4, Issue 2, 1993.

Day, Ted and S.J. Liebowitz. "Analyzing Mortgage Discrimination in the Twilight Zone: Making Sense of the Boston Fed Study." Working Paper, School of Management, University of Texas at Dallas, Oct. 5, 1993.

Federal Reserve Board of Governors, Office of Inspector General. Report on the Audit of the Board's Consumer Compliance Examination Process, Apr. 1996, 51 p.

Galster, George C. "Research on Discrimination in Housing and Mortgage Markets: Assessment and Future Directions." Housing Policy Debate, Vol. 3, Issue 2, (1992) pp. 639-83.

Galster, George C. "The Facts of Lending Discrimination Cannot be Argued Away by Examining Default Rates," Housing Policy Debate, Vol. 4, Issue 1, (1993) pp. 141-146.

Glennon, Dennis and Mitchell Stengel. "An Evaluation of the Federal Reserve Bank of Boston's Study of Racial Discrimination in Mortgage Lending." Comptroller of the Currency, Economic and Policy Analysis Working Paper 94-2, (Apr. 1994).

Holmes, Andrew and Paul Horvitz. "Mortgage Redlining: Race, Risk, and Demand." The Journal of Finance, Vol. 49, No. 1 (Mar. 1994) pp. 81-99.

Horne, David K. "Evaluating the Role of Race in Mortgage Lending." FDIC Banking Review, Vol. 7, No. 1, Spring/Summer 1994, pp. 1-15.

Horne, David K. "Mortgage Lending, Race, and Model Specification." Unpublished manuscript, 1995.

Hunter, William C., and Mary Beth Walker. "The Cultural Affinity Hypothesis and Mortgage Lending Decisions," Working Paper Series, Federal Reserve Bank of Chicago (WP-95-8), July 1995.

Kushner, James B. "Federal Enforcement and Judicial Review of the Fair Housing Amendments Act of 1988," in Housing Policy Debate: Discrimination in the Housing and Mortgage Markets, Proceedings from the Fannie Mae Annual Housing Conference, Washington, D.C., May 19, 1992, Vol. 3, Issue 2, pp. 537-99.

Lake, R. "Postscript: Unresolved Themes in the Evolution of Fair Housing," In Housing Desegregation and Federal Policy," ed. J. Goering, Chapel Hill, NC: University of North Carolina Press, 1986, pp. 313-26.

Lieberman, Carolyn B. "Equal Credit Opportunity and Fair Lending," in Fair Lending Compliance: The New Standards and Guidelines for Financial Institutions, Proceedings from a Conference held in Washington, D.C., Feb. 3-4, 1994. Prentice Hall Law & Business, Englewood Cliffs, NJ, pp. 269-275.

Miles, Barbara L. "Discrimination in Mortgage Lending: What Do We Know?," Congressional Research Service, CRS Report for Congress, No. 94-708E, Sept. 1, 1994.

Munnell, Alicia H., Lynn E. Browne, James McEneaney, and Geoffrey M. B. Tootell. "Mortgage Lending in Boston: Interpreting HMDA Data." Federal Reserve Bank of Boston, Working Paper No. 92-7, Oct. 1992.

Munnell, Alicia H., Geoffrey M. B. Tootell, Lynn E. Browne, and James McEneaney. "Mortgage Lending in Boston: Interpreting HMDA Data." American Economic Review, Vol. 86, No. 1, Mar. 1996, pp. 25-53.

Phillips-Patrick, Fred J., and David Senft. "Thrift Mortgage Lending in the Washington, D.C. Area." Office of Thrift Supervision, unpublished manuscript, Nov. 1993.

Rachlis, Mitchell B., and Anthony M. Yezer. "Serious Flaws in Statistical Tests for Discrimination in Mortgage Markets." Journal of Housing Research, Vol. 4, Issue 2, 1993.

Richey, Charles R., Manual on Employment Discrimination Law and Civil Rights in the Federal Courts, Clark Boardman Callaghan, New York, NY (1994).

Schill, Michael H., and Susan M. Wachter. "A Tale of Two Cities: Racial and Ethnic Geographic Disparities in Home Mortgage Lending in Boston and Philadelphia." Journal of Housing Research, Vol. 4, No. 2, 1993.

Schill, Michael H., and Susan M. Wachter. "Borrower and Neighborhood Racial Characteristics and Financial Institution Mortgage Application Screening," The Journal of Real Estate Finance and Economics, Vol. 9, No. 3, Nov. 1994.

Siskin, Bernard R., and Leonard A. Cupingood. "Use of Statistical Models to Provide Evidence of Discrimination in the Treatment of Mortgage Loan Applicants: A Study of One Lending Institution." U.S. Department of Housing and Urban Development, Home Mortgage Lending and Discrimination: Research and Enforcement Conference, May 18-19, 1993.

Stengel, Mitchell and Dennis Glennon. "Evaluating Statistical Models of Mortgage-Lending Discrimination: A Bank-Specific Analysis," Paper presented at the Allied Social Sciences Association Annual Conference, Washington, D.C., Jan. 6, 1995.

U.S. Commission on Civil Rights, The Fair Housing Act Amendments of 1988: The Enforcement Report, Washington, D.C., Sept. 1994.

U.S. Congress. Senate. Committee on Banking, Housing, and Urban Affairs. Subcommittee on Consumer and Regulatory Affairs. Discrimination in Home Mortgage Lending. Hearing, 101st Congress, 1st session. Oct. 24, 1989. Washington, D.C., G.P.O. 1990. 305 p.

U.S. Congress. House. Committee on Banking, Finance and Urban Affairs. Subcommittee on Housing and Community Development and the Subcommittee on Consumer Affairs and Coinage. Hearing, 103rd Congress, 1st session. May 14, 1992. Washington, D.C., G.P.O. 1993. 370 p.

U.S. Congress. Senate. Committee on Banking, Housing, and Urban Affairs. Problems in Community Development Banking, Mortgage Lending Discrimination, Reverse Redlining, and Home Equity Lending. Hearings, 103rd Congress, 1st session. Feb. 3-24, 1993. Washington, D.C., G.P.O. 1993. 831 p.

U.S. Congress. House. Committee on Banking, Finance and Urban Affairs. Subcommittee on Consumer Credit and Insurance. President Clinton's Community Reinvestment Act Reform Initiative and Enforcement of the Federal Fair Lending Laws. Hearing, 103rd Congress, 1st session. Oct. 21, 1993. Washington, D.C., G.P.O. 1994. 370 p.

U.S. Congress. Senate. Committee on Banking, Housing, and Urban Affairs. Fair Lending Enforcement and the Data on the 1992 Home Mortgage Disclosure Act [HMDA]. Hearing, 103rd Congress, 1st session. Nov. 4, 1993. Washington, D.C., G.P.O. 1994. 152 p.

Bibliography

Van Order, Robert., Margrett Weston, and Peter Zorn. "Racial Discrimination in the Mortgage Credit Market: Evidence from Default Behavior." Manuscript, Cornell University (1993).

Wienk, Ronald E., "Discrimination in Urban Credit Markets: What We Don't Know and Why We Don't Know It," Housing Policy Debate, Vol. 3, Issue 2 (1992), pp. 217-240.

Yezer, Anthony, Robert Phillips, and Robert Trost. "Bias in Estimates of Discrimination and Default Mortgage Lending: The Effects of Simultaneity and Self-Selection," Journal of Real Estate Finance and Economics, Vol. 9, No. 3, Nov. 1994, pp. 197-216.

Yezer, Anthony M., ed., Fair Lending Analysis: A Compendium of Essays on the Use of Statistics, American Bankers Association, Washington, D.C., 1995.

Yinger, John. "Discrimination in Mortgage Redlining: A Literature Review and Recommendations for Future Research," Paper presented at Home Mortgage Lending and Discrimination: Research and Enforcement Conference, May 18-19, 1993, Washington, D.C.

Zandi, Mark. "Boston Fed's Study Was Deeply Flawed," American Banker, Aug. 19, 1993.

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web Home Page at:

<http://www.gao.gov>

**United States
General Accounting Office
Washington, D.C. 20548-0001**

**Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100**

**Official Business
Penalty for Private Use \$300**

Address Correction Requested

