UPHOLDING THE SPIRIT OF CRA: DO CRA RATINGS ACCURATELY REFLECT BANK PRACTICES?

HEARING

BEFORE THE

SUBCOMMITTEE ON DOMESTIC POLICY

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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UPHOLDING THE SPIRIT OF CRA: DO CRA RATINGS ACCURATELY REFLECT BANK PRACTICES?

WEDNESDAY, OCTOBER 24, 2007

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC POLICY,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2154, Rayburn House Office Building, Hon. Dennis J. Kucinich (chairman of the subcommittee) presiding.

Present: Representatives Kucinich, Cummings, and Davis.

Staff present: Jaron R. Bourke, staff director; Noura Erakat, counsel; Jean Gosa, clerk; Natalie Laber, press secretary, Office of Congressman Dennis J. Kucinich; Leneal Scott, information systems manager; Kristina Husar, minority counsel; and Larry Brady, minority senior investigator and policy advisor.

Mr. KUCINICH. The committee will come to order. The Domestic Policy Subcommittee of the Oversight and Government Reform Committee will now come to order.

Today's hearing will examine the Community Reinvestment Act's rating system. Specifically, this hearing will investigate how accurately CRA ratings reflect bank practices.

Now, without objection, the Chair and the ranking member will have 5 minutes to make opening statements, followed by opening statements not to exceed 3 minutes by any Member who seeks recognition.

And, without objection, Members and witnesses will have 5 legislative days to submit a written statement or extraneous materials for the record.

At the outset, I want to point out that Mr. Issa has been called to California concerning the fires that are devastating so much of the south part of the State. And so, our thoughts and our prayers are with the people of California and with Mr. Issa and his constituents as they endure this severe threat of fire.

I want to thank Mr. Issa's staff for their cooperation. And, certainly, any Member from the Republican side who shows up will be invited to fully participate.

I thank you.

And, with the consent of Mr. Issa and his office, we are going to start this hearing.

I want to welcome the witnesses. I am going to proceed with an opening statement, and then we will invite you to join in the discussion.

This is the third in a series of hearings on subprime lending and the response of regulators. Our first hearing in March examined the subprime mortgage industry and the problem of foreclosure, the pay-day lending industry and the enforcement of the Community Reinvestment Act.

In our second hearing, the subcommittee took a closer look at the foreclosure crisis in Cleveland and its relationship to the Federal Reserve Board.

And in this hearing, "Upholding the Spirit of the Community Reinvestment Act: Do CRA Ratings Accurately Reflect Bank Practices?", we are exploring the coincidence of persistent discrimination in lending and a 98-percent passing rate among banks on their CRA exams. We hope, by the end of this hearing, we can identify a few solutions that will enhance the CRA and its enforcement by the regulators so that it better reflects discriminatory practices by regulated banks.

Congress enacted the Community Reinvestment Act in 1977 to combat redlining practices by the banks. As Mayor of Cleveland at the time, I was one of the first mayors to sign a Community Reinvestment Act agreement to hold banks to account for their history of discrimination. CRA made illegal the banking practice of arbitrarily and systematically refusing service to low- and moderate-income and minority communities.

The CRA applies to federally insured depository institutions and is enforced by regulatory review. Enforcement is delegated to four Federal agencies: the Federal Deposit Insurance Corporation, the Federal Reserve System, the Office of Thrift Supervision and the Comptroller of the Currency.

The regulatory banking agencies have a powerful enforcement tool: the authority to deny or approve a banking institution's application for a new charter, a new branch, a merger or an acquisition. Banking regulators exercise this authority based on an institution's CRA rating, which measures the bank's performance to meet the credit needs of its communities. Failure to meet the credit needs of its communities can translate, via the CRA and its rating, into a missed opportunity for the bank to acquire more wealth, making the CRA rating a critical incentive for banks to serve its minority and low- and moderate-income communities.

But, since 1990, the banking regulators gave failing grades in just 225 of 60,194 CRA exams.

Take a look at the slide. The staff has put up a slide on the board. I don't know how your vision is, but if you can see that, you are better than I am.

But, today, 98.4 percent of all regulated banks passed the CRA. Compare this to 1990, when only 90.4 percent of regulated banks received a passing CRA rating. Does this significant rise of the number of banks that passed the CRA suggest that, in 2007, banks are improving their lending practices? Does a passing grade accurately reflect bank lending practices? Well, not necessarily.

Let us look at slide two.

According to a recent study conducted by the National Coalition for Community Reinvestment, 24 of the 25 largest U.S. metropolitan municipalities and their surrounding areas have fewer banking branches in densely populated urban centers than the less populated suburbs. Today, nearly 14 million households, or 21 percent of all U.S. households, are unbanked, meaning they have no relationship to a bank or credit union. Other households are underbanked, in that they have deposit accounts but often seek services from pay-day lenders and check cashers.

Not only do minority communities have less access to banks, but, according to the 2004 HMDA data, when they do have access, African American and Latino populations receive a disproportionate share of higher-rate home loans.

Slide three.

Even after accounting for differences in risk, borrowers of color were more than 30 percent more likely to receive a higher-rate loan than white borrowers.

So our question is this: How can banks be passing the CRA at such high rates while the HMDA data shows statistically significant racial discriminatory lending practices and while bank services for low- and moderate-income communities are diminishing? We invited Federal banking regulators here today to help us answer that question.

In exploring this conundrum, this subcommittee identified several regulatory and statutory issues that raised red flags. These include the discretionary latitude exercised by banking regulators, the lack of transparency of the CRA exam process and incongruency of the 1999 Gramm-Leach-Bliley Act and the CRA.

The regulations surrounding the review of banks are broad and undefined. Although the regulations stipulate that evidence of discrimination adversely impacts a bank's CRA rating, the regulators do not stipulate a mandatory downgrade in the face of such evidence. As we dug deeper into the matter, we found cases where the Department of Justice prosecuted a bank for Fair Housing and Equal Credit Opportunity Act violations while simultaneously the Federal regulator issued a bank a passing CRA rating.

Case in point: In 2006, the Department of Justice filed suit against Old Kent Bank for violating the FHA and the ECOA. In its complaint, the Department of Justice alleged that, in spite of regulation, Old Kent Bank circumscribed its lending area in the Detroit metropolitan statistical area to exclude—to exclude—most of the majority-African American neighborhoods by excluding the city of Detroit.

Between 1997 and 2001, the Federal Reserve Bank not only gave Old Kent passing CRA ratings, but it also approved Old Kent's significant branching activity. In January 1996, Old Kent had 18 branches in the Detroit MSA. Not a single one was in the city of Detroit. By March 2000, it had expanded to 53 branches located in every county of the Detroit MSA except for the city of Detroit, which, at that point, was 81 percent African American.

Now, how can the Fed see this map, refer the case to the Department of Justice for prosecution and give Old Kent Bank a passing CRA rating? We asked the Fed that question, and we were told, in the Fed's discretion, the bank's practices were reasonable and legal.

If discretionary latitude is broad enough to deem this donut hole reasonable, then perhaps it is too broad.

But regulatory discretion does not explain everything. Something in the regulations makes it possible for the CRA rating to not reflect discriminatory practices.

Now, in 1999, the Sixth Circuit Court of Appeals upheld a finding against Flagstar Bank for discrimination against minority borrowers. In 2001, a Federal court in Indianapolis found a written pricing policy developed by Flagstar so overtly discriminatory that it ruled against Flagstar on summary judgment. During the period of Flagstar's violations, the Federal regulator, the Office of Thrift Supervision, conducted five CRA examinations. It awarded Flagstar four satisfactory ratings and one outstanding rating. Significantly, the outstanding rating was awarded after the summary judgment finding in 2003.

Now, how can Flagstar be awarded with passing CRA grades while it is being prosecuted for its discriminatory practices?

We learned that one way a bank can mitigate a low CRA rating is by agreeing to take corrective action to address its discriminatory practices. Discriminatory practices are found during a fair lending exam, the findings of which are not made public, unlike the CRA exam. Not only is the fair lending exam secret, but so, too, are the negotiations on corrective actions between the regulatory agency and the bank. This, I think, flies in the face of the CRA spirit, which was borne out of public protest and sustained by public participation.

According to the Treasury Department, CRA-related home lending in low- to moderate-income communities increased in Metropolitan areas in which lending institutions and community groups negotiated CRA agreements. An informed public and a participating public is a hallmark of the CRA. By negotiating corrective actions behind closed doors, banks and the regulators create generic solutions that may not be appropriate for all. In exchange for generic solutions and the exclusion of public participation, banks like Flagstar maintain their good reputations and are afforded the privileges associated with passing CRA grades.

Then there is another problem that has nothing to do with the regulations at all but instead is a problem with the law. In March 2000, the Gramm-Leach-Bliley Act effectively allowed financial institutions to merge with insurance companies, security underwriting firms and mortgage lending companies for the first time in history. But the CRA was not amended to reflect this financial development.

As a result, while a loan offered by a bank or thrift is subject to CRA review, that same loan evades CRA scrutiny if it is offered by that bank or thrift's affiliated mortgage company, finance company or nondepository affiliate. This loophole enables banks to move their financial assets to noncovered affiliates to reduce their CRA obligations.

Subprime borrowers are especially vulnerable to these unregulated lenders. According to RealtyTrac, Inc., which compiles statistics on home ownership, last month foreclosures totaled 225,538, double the number a year ago. Would the numbers be different if these companies were the subject of CRA obligations? Has this

legal loophole enabled a surging foreclosure crisis? And if this is indeed the case, has Congress allowed the CRA to become obsolete in certain respects?

We hope that, with the insight of Federal banking regulators as well as community groups and advocates, we can answer some of these questions and find a way to restore the Community Reinvestment Act and uphold its spirit.

With that, my opening statement is concluded.

[The prepared statement of Hon. Dennis J. Kucinich follows:]

Opening Statement
Congressman Dennis J. Kucinich, Chairman
Domestic Policy Subcommittee
Oversight and Government Reform Committee

"Upholding the spirit of the CRA: Do CRA Ratings Accurately Reflect Bank Practices?"
2154 Rayburn HOB – 2 P. M.
Wednesday, October 24, 2007

Good afternoon and welcome.

This is the third hearing in a series of hearings on subprime lending and the response of regulators. Our first hearing in March examined the subprime mortgage industry and the problem of foreclosure, the pay day lending industry and the enforcement of the CRA. In our second hearing, the Subcommittee took a closer look at the foreclosure crisis in Cleveland and its relationship to the Federal Reserve Board. And in this hearing, "Upholding the spirit of the CRA: Do CRA ratings accurately reflect bank practices?" we are exploring the coincidence of persistent discrimination in lending and a 98% passing rate among banks on their CRA exams. We hope that by the end of this hearing we can identify a few solutions that will enhance the CRA and its enforcement by the regulators so that it better reflects discriminatory practices by regulated banks.

Congress enacted the CRA in 1977 to combat redlining practices by banks. As mayor of Cleveland at the time, I was one of the first mayors to sign a CRA agreement to hold banks to account for their history of discrimination. CRA made illegal the banking practice of arbitrarily and systematically refusing service to low- and moderate-income and minority communities. The CRA applies to federally insured depository institutions and is enforced by regulatory review. Enforcement is delegated to four federal agencies, the Federal Deposit Insurance Corporation, the Federal Reserve System, the Office of Thrift Supervision, and the Comptroller of the Currency.

The regulatory banking agencies have a powerful enforcement tool: the authority to deny or approve a banking institution's application for a new charter, a new branch, a merger, or an acquisition. Banking regulators exercise this authority based on an institution's CRA rating, which measures the banks' performance to meet the credit needs of its communities. Failure to meet the credit needs of its communities can translate, via the CRA rating, into a missed opportunity for the bank to acquire more wealth, making the CRA rating a critical incentive for banks to serve its minority and low and moderate income communities.

But since 1990, the banking regulators gave failing grades in just 225 of 60,194 CRA exams. Take a look at this slide **(point to slide 1)**. Today 98.4% of all regulated banks pass the CRA. Compare this to 1990 when only 90.4% of regulated banks received a passing CRA rating. Does the significant rise of the number of banks that pass the CRA suggest that in 2007, banks are improving their lending practices? Does a passing grade accurately reflect bank practices?

Not necessarily.

Take a look at this slide **(point to slide 2)**. According to a recent study conducted by the National Coalition for Community Reinvestment, 24 out of the 25 largest U.S. metropolitan municipalities and their surrounding areas have fewer banking branches in densely populated urban centers than the less populated suburbs.

Today, nearly 14 million households, or 21 percent of all US households, are 'unbanked,' meaning that they have no relationship to a bank or a credit union. Other households are 'underbanked' in that they have deposit accounts but often seek services from payday lenders and check cashers.

Not only do minority communities have less access to banks, but according to the 2004 HMDA data, when they do have access, African-American and Latino populations receive a disproportionate share of higher rate home loans. **(Point at slide 3)** Even after accounting for differences in risk, borrowers of color were more than 30 percent more likely to receive a higher rate loan than white borrowers.

So our question is this: how can banks be passing the CRA at such high rates while the HMDA data show statistically significant racial discriminatory lending practices and while bank services for low- and moderate-income communities are diminishing? We invited the federal banking regulators here today to help us answer that question.

In exploring this conundrum ourselves, the Subcommittee identified several regulatory and statutory issues that raised red flags. These include:

- ❖ the discretionary latitude exercised by banking regulators;
- ❖ the lack of transparency of the CRA exam process; and
- ❖ the incongruency of the 1999 Gramm-Leach-Bliley Act and the CRA.

The regulations surrounding the review of banks are broad and undefined. Although the regulations stipulate that evidence of discrimination adversely impact a bank's CRA rating, the regulations do not stipulate a mandatory downgrade in the face of such evidence. As we dug deeper into the matter, we found cases where the Department of Justice (DOJ) prosecuted a bank for Fair Housing and Equal Credit Opportunity Act violations, while simultaneously the federal regulator issued the bank a passing CRA rating.

Case in point: In 2006, the DOJ filed suit against Old Kent Bank for violating the FHA and the ECOA. In its complaint, the DOJ alleged that in spite of the regulation, Old Kent Bank circumscribed its lending area in the Detroit Metropolitan Statistical Area to exclude most of the majority African American neighborhoods by excluding the City of Detroit. **(Point to slide 4)**

Between 1997 and 2001, the Federal Reserve Bank not only gave Old Kent passing CRA ratings, but it also approved Old Kent's significant branching activity. In January 1996, Old Kent had 18 branches in the Detroit MSA. Not a single one was in the City of Detroit. By March 2000, it had expanded to 53 branches, located in every county of the Detroit MSA except for the City of Detroit which at that point was 81% African-American.

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This, I think, flies in the face of the CRA's spirit, which was born out of public protest and sustained by public participation. According to Treasury Department, CRA-related home lending in low- to moderate-income communities increased in metropolitan areas in which lending institutions and community groups negotiated CRA agreements. An informed public and a participating public is the hallmark of the CRA. By negotiating corrective actions behind closed doors, banks and their regulators create generic solutions that may not be appropriate for all. In exchange for generic solutions and the exclusion of public participation, banks like Flagstar maintain their good reputations and are afforded the privileges associated with passing CRA scores.

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We hope that with the insight of the federal banking regulators as well as community groups and advocates, we can answer some of these questions and find a way to restore the CRA and uphold its spirit.

Mr. KUCINICH. And any Member who shows up will be given an opportunity to participate in the questions.

The subcommittee is now going to receive testimony from the witnesses before us. I want to start by introducing our first panel.

Ms. Sandra Thompson is director of the Federal Deposit Insurance Corporation's Division of Supervision and Consumer Protection, where she directs risk management and consumer protection examination activities relating to approximately 5,200 FDIC-supervised institutions. Ms. Thompson previously served as the FDIC's deputy to the vice chairman and led the Corporation's Bank Secrecy Act and anti-money laundering supervisory activities. Prior to joining the FDIC in 1970, Ms. Thompson was an associate at Goldman Sachs and Co. in New York City. She holds a degree in finance from Howard University.

Welcome. I appreciate your presence here.

Next, I would like to introduce Ms. Sandra Braunstein, who I had the privilege of having come to Cleveland to participate.

And I appreciated your presence there, as well as here.

Ms. Braunstein is director of the Division of Consumer and Community Affairs for the Board of Governors for the Federal Reserve System. She currently oversees the implementation of the Federal Reservice System polices and programs regarding community and economic development. Ms. Braunstein also serves as the board's liaison to the Consumer Advisory Council and provides leadership to various consumer education and research activities. Before joining the Federal Reserve Board in 1987, Ms. Braunstein held positions in economic and community development for nonprofit, Government and private-sector organizations. She is a graduate of American University.

Thank you, again, for being here.

Ms. Montrice Yakimov—is that correct?

Ms. YAKIMOV. Yakimov.

Mr. KUCINICH. Yakimov—is the managing director for compliance and consumer protection at the Office of Thrift Supervision. Ms. Yakimov coordinates the agency-wide compliance and consumer protection programs at the Office of Thrift Supervision, including overseeing the agency's Community Reinvestment Act program. Prior to becoming the FRB in 2005, Ms. Yakimov served as senior vice president and director of regulatory affairs at the Conference of State Bank Supervisors. She has advised the Federal Financial Institutions Examination Council Supervision Task Force on a broad range of State banking issues and has extensive knowledge of Federal and State consumer protection statutes and regulations.

I appreciate you being here.

Finally, Ms. Ann Jaedicke is the Deputy Comptroller for Compliance Policy for the Office of the Comptroller of the Currency. Ms. Jaedicke is responsible for policy and examination procedures relating to consumer issues and anti-money laundering. She chairs the FFIEC's Consumer Compliance Task Force and sits on its Bank Secrecy Act Task Force. Earlier in her career, Ms. Jaedicke served as the director for the OCC's Large Bank Division and also managed its Problem Bank Division. 2001 to 2002, she led projects to re-

structure OCC's six districts in OCC's Washington, DC, headquarters.

Thank you for appearing.

I want to, again, thank all the witnesses.

Before we begin, it is the policy of the Committee on Oversight and Government Reform to swear in our witnesses before they testify. I would ask that you would rise and raise your right hands.

[Witnesses sworn.]

Mr. KUCINICH. Let the record reflect that the witnesses have answered in the affirmative.

And you may be seated.

I ask that each of the witnesses now give a brief summary of their testimony and keep the summary under 5 minutes in duration. I would like you to bear in mind that your written statement will be included in the hearing record.

So, Ms. Thompson, let us begin with you.

STATEMENTS OF SANDRA L. THOMPSON, DIRECTOR, DIVISION OF SUPERVISION AND CONSUMER PROTECTION, FEDERAL DEPOSIT INSURANCE CORPORATION; SANDRA F. BRAUNSTEIN, DIRECTOR, DIVISION OF CONSUMER AND COMMUNITY AFFAIRS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; MONTRICE GODARD YAKIMOV, MANAGING DIRECTOR FOR COMPLIANCE AND CONSUMER PROTECTION, OFFICE OF THRIFT SUPERVISION; AND ANN F. JAEDICKE, DEPUTY COMPTROLLER FOR COMPLIANCE POLICY, OFFICE OF THE COMPTROLLER OF THE CURRENCY

STATEMENT OF SANDRA L. THOMPSON

Ms. THOMPSON. Thank you.

Chairman Kucinich and members of the subcommittee, I am the director of supervision and consumer protection for the Federal Deposit Insurance Corporation. In this role, I oversee the agency's bank supervision activities, including both safety and soundness and compliance with consumer protection and fair lending laws.

I appreciate the opportunity to testify today on behalf of the FDIC regarding the enforcement of the Equal Credit Opportunity Act and the Fair Housing Act and how the FDIC considers compliance with the fair lending laws in assigning CRA ratings to financial institutions.

As you stated, the purpose of CRA is to encourage banks to serve the credit needs of their entire communities. At the time CRA was enacted, there was a severe shortage of credit available to low- and moderate-income neighborhoods and concern about racial redlining and discrimination. While CRA and the Federal fair lending laws have had significant positive impact, there still remains much work to be done.

This afternoon, I would like to focus my statement on a few key points.

First, the FDIC is committed to protecting consumers and ensuring that the institutions under our supervision adhere to the letter and spirit of the fair lending laws. When the FDIC finds practices that violate these laws, we take action to ensure that the practices cease and that harm to consumers is remedied, using a range of

supervisory and enforcement tools. Where the violation appears to involve a pattern or practice of discrimination, the FDIC refers the case to the Department of Justice.

Second, from January 1, 2002, through September 30th of this year, the FDIC cited banks for substantive fair lending violations in 237 examinations. Although most fair lending violations cited had already been corrected by the bank or were promptly corrected at the direction of examiners, more serious violations were addressed through informal and formal enforcement actions. In all cases, banks were required by the FDIC to remedy the harm experienced by affected consumers and to advise the consumers of their right to pursue legal action. And they were ordered to stop engaging in discrimination. During the same 5-year period, the FDIC has referred 181 findings of illegal discrimination to the Department of Justice.

Third, in addition to performing fair lending reviews, as part of every compliance exam FDIC examiners separately evaluate the CRA performance of the approximately 5,200 institutions we supervise. Fair lending violations are one of the factors considered in determining CRA ratings. Since 2002, fair lending violations have resulted in several CRA rating downgrades.

In conclusion, CRA was adopted to address redlining and, over its 30-year history, has made a significant contribution to the revitalization of many low- and moderate-income communities in both urban and rural areas. Fair lending examinations are critical to achieving complete and accurate CRA reviews. The FDIC is committed to using CRA and fair lending laws in the continuing effort to address the credit needs of low- and moderate-income areas and individuals.

That concludes my statement, and I would be happy to respond to any questions the subcommittee might have.

[The prepared statement of Ms. Thompson follows:]

EMBARGOED UNTIL DELIVERY

STATEMENT OF

SANDRA L. THOMPSON
DIRECTOR
DIVISION OF SUPERVISION AND CONSUMER PROTECTION
FEDERAL DEPOSIT INSURANCE CORPORATION

on

UPHOLDING THE SPIRIT OF CRA: DO CRA RATINGS ACCURATELY REFLECT BANK PRACTICES?

before the

DOMESTIC POLICY SUBCOMMITTEE

of the

OVERSIGHT AND GOVERNMENT REFORM COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

October 24, 2007
2154 Rayburn House Office Building

Chairman Kucinich, Ranking Member Issa and members of the Committee, I appreciate the opportunity to testify today on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding the enforcement of the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA) and how the FDIC considers compliance with these laws, often known as the "fair lending" laws, in assigning Community Reinvestment Act (CRA) ratings.

CRA was signed into law thirty years ago on October 12, 1977.[1] The purpose of CRA is to encourage banks to serve the credit needs of their entire communities, including low and moderate income neighborhoods. At the time CRA was enacted, there was a severe shortage of credit available to low and moderate income neighborhoods and concern about racial redlining and discrimination. While CRA and the federal fair lending laws have had significant positive impact, there remains much work to be done. My testimony will describe the fair lending review conducted as part of consumer compliance examinations, the separate CRA performance evaluation process, and the FDIC's supervisory and enforcement actions to enforce these laws. Finally, I will explain the effect of fair lending violations on the CRA ratings we assign.

FDIC's Fair Lending Examination Program

The FDIC is committed to protecting consumers and ensuring that the institutions under our supervision adhere to the letter and spirit of the fair lending laws. When the FDIC finds practices that violate these laws, we take action to ensure that the practices cease and that harm to consumers is remedied, using a range of supervisory and enforcement tools.

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[1] *See* 12 U.S.C. § 2901 et seq.

Applicable laws

The fair lending laws applicable to FDIC-supervised institutions -- ECOA and FHA-- are somewhat different in scope and applicability.[2] While ECOA applies to all credit transactions, FHA applies to housing-related credit. ECOA and FHA both prohibit creditors from discriminating against any applicant in any stage of a credit transaction on the basis of race, color, religion, national origin, or sex. In addition, FHA prohibits discrimination on the basis of familial status and handicap, while ECOA includes prohibitions against discrimination based on age, marital status, public assistance income, and the exercise of rights under the Consumer Credit Protection Act. ECOA also requires that a creditor take or refrain from taking certain actions regarding what information can be sought in an application process, what notices are mandated to be provided to an applicant, and when a spouse can be required to co-sign a loan.

Fair lending reviews

FDIC conducts a fair lending review as part of every regularly scheduled consumer compliance examination of the institutions we supervise.[3] Our examiners also have the authority -- outside of a regularly scheduled examination -- to visit any FDIC-supervised institution to investigate a concern that has been brought to our attention.[4]

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[2] *See* 15 U.S.C. § 1691et seq., and 42 U.S.C. § 3605 et seq.

[3] Consumer compliance examination intervals depend on an institution's size and most recent examination ratings. *See* examination frequency table incorporated in the FDIC Compliance Examination Handbook at: http://www.fdic.gov/regulations/compliance/handbook/html/chapt02.html#Examination

[4] For example, the FDIC conducts a fair lending review when it receives a consumer complaint of discrimination.

To conduct a fair lending review, examiners follow the Interagency Fair Lending Examination Procedures.[5] These procedures were developed by the federal financial institution regulatory agencies in consultation with the Departments of Justice (DOJ) and Housing and Urban Development (HUD). Pursuant to the procedures, examiners begin by reviewing a bank's lending operations to determine the areas at most risk for discrimination. Examiners next analyze the bank's reasons for approving and denying loans, and, as part of this analysis, conduct interviews of bank personnel to determine the bank's underwriting and pricing criteria, both as written and as actually implemented. Examiners also conduct individual loan file reviews -- focusing on targeted loan products -- to obtain and confirm the underwriting and pricing criteria. If a file comparison shows differences in treatment, the examiner determines whether these differences are based on a prohibited factor.

Review of Home Mortgage Disclosure Act (HMDA) data also is an important component of fair lending reviews, and provides examiners with valuable information about a bank's home mortgage operations. In addition to considering loan application information, FDIC examiners review HMDA pricing data as a part of each fair lending examination of banks required to report the data.[6] Where the data show a larger pricing disparity for minorities or women in one or more product areas than is evident for other FDIC-supervised institutions, examiners scrutinize the institution's lending more closely.

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[5] These procedures have been incorporated in the FDIC Compliance Examination Handbook, which is published on the Internet at: http://www.fdic.gov/regulations/compliance/handbook/html/chapt04.html.

[6] HMDA does not require all institutions to report HMDA data. However, all institutions are required under ECOA to retain information regarding an applicant's race, sex, age, ethnicity, and marital status, for dwelling secured transactions. *See* 12 C.F.R. §§ 202.12 and 202.13(a). This information retention requirement is particularly significant for the FDIC because it supervises many small banks not subject to HMDA reporting requirements, so the ECOA data is available to examiners who retrieve the information from loan files during fair lending reviews.

When examiners identify a potential fair lending violation, they consult with FDIC fair lending and legal staff at the regional office. If FDIC regional staff concurs with the finding of a likely violation, a formal letter is sent to the bank apprising its management of the finding and the bank is provided an opportunity to respond. In the event the institution's response does not provide credible nondiscriminatory reasons that refute the evidence of discrimination, the FDIC cites the violation in the examination report and seeks corrective action. As required by ECOA,[7] a referral is made to DOJ with a recommendation that an appropriate civil action be instituted where the fair lending violation appears to involve a pattern or practice.

Regardless of whether a fair lending violation constitutes a pattern or practice that must be referred to DOJ, the FDIC requires that corrective action be taken for all violations. Isolated, technical violations of ECOA that do not involve discrimination can be addressed by informing bank managers of the violations and working with them to ensure compliance. In more serious cases, the FDIC seeks additional relief. Prospective remedies include requiring a bank to change policies and procedures that contributed to discriminatory conduct, to better train its employees, to establish community outreach programs, or to change its marketing strategy or loan products to better serve all segments of the community being served.

If a violation involves harm to individual consumers, the FDIC also will seek retrospective relief. This includes identifying customers who may have been subject to discrimination and offering credit if the customer(s) were improperly denied credit. If loans were granted on disparate terms, the bank may be required to modify those terms and refund any

[7] 15 U.S.C. § 1691e(g).

excess amounts paid by customers. The FDIC also may require restitution for out-of-pocket expenses incurred as a result of the violation.

Volume of fair lending violations and the FDIC response

During the period from January 1, 2002 through September 30, 2007, FDIC examiners completed 11,042 compliance examinations. In 237 of those examinations, the FDIC cited banks for substantive fair lending violations -- violations that involved discrimination on a prohibited basis. In 3,585 of the examinations, the FDIC cited technical fair lending violations, such as improper information gathering or inadequate record retention.

Although most fair lending violations are promptly corrected at the direction of examiners, informal enforcement actions such as a Memorandum of Understanding or a Board Resolution can be used to document a problem and the bank's commitment to address it. For a particularly serious violation, a formal public enforcement action such as a Civil Money Penalty or a Cease-and-Desist Order can be used. Restitution can be required as part of either formal or informal actions. In connection with the 237 examinations where substantive fair lending violations were cited, as described above, the FDIC obtained 41 Board Resolutions, 32 Memoranda of Understanding and one Cease-and-Desist Order to ensure that corrective action occurred. With regard to the remaining 163 examinations, we did not have to take such action with the banks in question because the banks either had already ceased the practice or took corrective action during our examination, and any necessary individual remedies.

Referrals to the Department of Justice

As noted above, ECOA requires the FDIC to refer pattern or practice cases to DOJ.[8] However, the standard for an FDIC referral does not require that the FDIC have sufficient evidence to prove a violation by a preponderance of the evidence.[9] This standard is therefore lower than the evidentiary standard required for DOJ to proceed with an action in court. Consequently, DOJ conducts its own independent investigation, which may be broader and more time consuming than the investigation conducted by the FDIC.

Once a case has been referred to DOJ, it has concurrent jurisdiction to address the violation. In the Policy Statement on Discrimination in Lending, the FDIC and other federal regulators agreed that when a referral has been made, the "agencies will coordinate their enforcement actions and make every effort to eliminate unnecessarily duplicative actions."[10] The FDIC is currently reviewing all cases involving possible discriminatory practices that have been referred to DOJ for appropriate enforcement action. We intend to pursue these cases aggressively and to move forward in a timely manner.

The statutory remedies available to DOJ differ from those available to the FDIC. The FDIC can order the bank to cease and desist from a discriminatory practice and pay restitution to

[8] For an FHA violation that does not also constitute a pattern or practice violation of ECOA (and thus trigger referral to DOJ), the FDIC must provide notice to HUD and to the applicant. *See* 12 U.S.C. § 1691e(k).
[9] *See* Policy Statement on Discrimination in Lending, April 15, 1994, 59 FR 18266-01 at 18271.
[10] *See* footnote 9.

those injured by the discrimination. DOJ can seek these same remedies, as well as punitive damages for the aggrieved party.[11]

Since 2002, the FDIC has referred to DOJ 181 findings of illegal discrimination under ECOA. DOJ deferred to the FDIC's administrative handling of the matter in 169 of the cases during that time frame.[12] In those cases, the banks were required by the FDIC to remedy the harm experienced by affected consumers and to advise the consumers of their right to pursue legal action, and ordered to stop engaging in illegal discrimination.

Improvements to FDIC Fair Lending Examination Program

The FDIC regularly reviews all of its examination programs and supervisory activities to determine whether changes can be made to improve their effectiveness. In 2001, the FDIC created the position of Senior Fair Lending Specialist in the Washington Office to provide expert advice and counsel to examiners and to help oversee the fair lending examination program. In 2004, Fair Lending Examination Specialist (FLEX) positions were created in FDIC regional offices to increase the availability of subject matter experts. The FLEXs work with the Senior Fair Lending Specialist to ensure consistent application of policies and procedures, assist with the most difficult and complex examinations, and review proposed fair lending actions. They also serve as the principal instructors for the one week Fair Lending Examination School that all compliance examiners attend as part of their basic training.

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[11] 15 U.S.C. §1691e(h).

[12] The examination date where a discrimination violation is cited, the referral to DOJ, and any subsequent referral back to the FDIC for administrative handling may not occur in the same calendar year.

In addition to the Fair Lending School, a new Advanced Compliance Examiner School includes a day-long module on how to conduct fair lending examinations based on the HMDA pricing data. This training incorporates lessons learned from the first two years of working with that data, which resulted in some of the most complex fair lending reviews FDIC examiners had experienced. Fair lending training also is conducted at regional and field office training conferences, and through national teleconferences. For example, a recent presentation reviewed DOJ redlining cases and relevant procedures that examiners should use when they identify risk factors during fair lending and CRA examinations.

FDIC's CRA Review and Evaluation Process

CRA was intended to expand access to credit and reduce discriminatory credit practices. Consistent with safe and sound operations, CRA assigns regulated financial institutions a "continuing and affirmative" obligation to help meet the entire credit needs of their communities, including the needs of low and moderate income neighborhoods.[13]

CRA Performance Reviews

Consistent with statutory requirements, FDIC examiners evaluate CRA the performance of the approximately 5,200 institutions under the Corporation's supervision.[14] For most institutions, this performance is evaluated under tests that draw distinctions among institutions

[13] *See* 12 U.S.C. §2901(a).

[14] As with consumer compliance examinations, an institution's size and examination history determine the frequency with which its CRA performance is evaluated. The CRA frequency schedule incorporates limits imposed by the Gramm-Leach-Bliley Act of 1999 on CRA evaluations of small institutions, i.e., those with $250 million in assets or less, that have previously received strong CRA ratings. *See* 12 U.S.C. §2908.

based on their size and business strategies.[15] When conducting CRA evaluations, examiners consider factors such as the business opportunities available, as well as the size and financial condition of institutions.[16]

Lending institutions with assets greater than $1.033 billion (adjusted annually) are subjected to a three-part examination.[17] These banks are evaluated through a lending test that considers the number and percentages of loans made to low- and moderate-income individuals and communities. They also are subject to investment and service tests that consider, respectively, the number and types of investments and services provided in low- and moderate-income communities.[18] In recent years, the FDIC and the other banking regulators established a streamlined examination for "intermediate small banks" (ISBs).[19] ISBs undergo a lending test and a community development test.[20] The community development test scrutinizes the amount and responsiveness of an ISB's community development lending, investing, and services.[21] This approach was intended to permit ISBs to make use of a flexible combination of community development activities tailored to both the needs of the community and the capacity of the bank.[22] ISBs are required to achieve satisfactory ratings on both the lending and the community development test to receive an overall CRA rating of "Satisfactory."[23]

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[15] Notably, all institutions may develop their own strategic plans to fulfill CRA responsibilities, subject to public comment and agency approval. *See* 12.CF.R. §§345.21(a)(4) and 345.27.
[16] *See* FDIC Compliance Handbook, Chapter XI (Community Reinvestment Act), http://www.fdic.gov/regulations/compliance/handbook/html/chapt11.html.
[17] *Id.* at §345.21(a)(1).
[18] *Id.* at §345.21(a) and §§345.22-345.24.
[19] With the understanding that the asset range would be adjusted annually to take inflation into account, ISBs were initially defined as institutions with assets of $250 million to $1 billion. Currently, ISBs have assets that range between $258 million and $1.033 billion. *Id.* at §345.12(u)(1).
[20] *Id.* at §345.26(a)(2).
[21] *Id.* at §345.26(c).
[22] *See* 70 FR 44256, 44259-60 (Aug. 2, 2005).
[23] *See* 12 CFR §345, Appendix A at (d)(3)(i).

Small banks[24] are evaluated under a test that focuses on their lending performance. The test encompasses the following five criteria: a "reasonable" loan-to-deposit ratio; the percentage of loans in the bank's assessment area; the bank's distribution of loans to individuals of different income levels and to businesses and farms of different sizes; the geographic distribution of loans; and the bank's record of responding to written complaints about its lending performance in its assessment area.[25] Most FDIC-supervised institutions qualify as "small" under CRA.

CRA Performance Context and Data Used by Examiners

An institution's performance under all of the relevant CRA tests is judged in the context of information about the institution, its community, its competitors, and its peers. Examiners consider the following information, as appropriate, in order to assist in understanding the context in which the institution's performance should be evaluated: (1) the economic and demographic characteristics of the assessment area(s); (2) lending, investment, and service opportunities in the assessment area(s); (3) the institution's product offerings and business strategy; (4) the institution's capacity and constraints; (5) the prior performance of the institution and, in appropriate circumstances, the performance of similarly situated institutions; and (6) other relevant information.[26] Some of these elements, such as the lending, investment, and service opportunities in the area, are difficult to assess. However, advances in technology and the availability of various economic, demographic and business data through private and public sources greatly assist examiners as they evaluate an institution's performance context.

[24] Small banks were originally defined as institutions with less than $250 million in assets. As with institutions of other sizes, the asset maximum is adjusted annually to take inflation into account. Currently, the cap is $258 million. *Id.* at §345.12(u)(1).
[25] *Id.* at §345.26(b).
[26] *Id.* at §345.21(b).

In addition, large banks must report information about their small business, small farm, and community development loans.[27] If a bank is a HMDA reporter, examiners can consider the institution's historical mortgage loan performance as well as its performance against other market participants, including the performance of other federally supervised institutions and independent mortgage companies. In the absence of HMDA or other reported data, examiners sample an institution's home mortgage, small business, small farm, and community development loans, as applicable. Consumer loans are also sampled if the institution requests that they be reviewed or if they represent a substantial majority of the institution's business.

Achieving Accuracy and Consistency

The FDIC follows a number of procedures designed to promote accuracy and consistency in the CRA evaluation process. Before examiners are permitted to lead a CRA performance evaluation, they must complete a commissioning process which includes specialized CRA training. Extensive written guidance is available to examiners as they prepare performance evaluations. Once evaluations are written, the evaluations are subject to supervisory review before they are finalized and published. In addition, we periodically conduct field and regional office reviews that sample and assess the quality of performance evaluations that have already been issued. The FDIC continually assesses our efforts to achieve consistency and accuracy in CRA evaluations and to adjust and expand procedures as warranted. This is an ongoing process.

[27] *Id.* at §345.42.

CRA Evaluation Process

Upon the conclusion of each examination, the examiner prepares a written evaluation of the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods.[28] The written evaluation must have a section available for public disclosure.[29] The FDIC and other financial institution regulatory agencies facilitate public review of CRA evaluations by posting them on their Internet websites.

Each CRA evaluation must contain the institution's rating and a statement describing the basis for the rating.[30] While the content of the public evaluation varies depending on the nature of the institution examined and the assessment method used, the public portion of the evaluation generally contains the following information:

- The institution's CRA rating;
- A description of the financial institution;
- A description of the financial institution's assessment area; and
- Conclusions regarding the financial institution's CRA performance, including the facts, data, and analyses that were used to form such conclusions.[31]

[28] *See* 12 U.S.C. §2906(a)(1).
[29] *See* 12 U.S.C. §2906(a)(2).
[30] *See* 12 U.S.C. §2906(b)(1)(iii).
[31] *See* FDIC Compliance Handbook, Chapter XI (Community Reinvestment Act Performance Evaluation Templates), http://www.fdic.gov/regulations/compliance/handbook/html/chapt11.html.

Nature and Effect of CRA Ratings

The agencies assign each institution one of four performance ratings: "Outstanding," "Satisfactory," "Needs to improve," and "Substantial noncompliance."[32] Determining the CRA rating for an institution involves an assessment of a number of qualitative and quantitative factors against the backdrop of the institution's performance context. To foster consistency in this process, the agencies rely on a matrix which sets forth a description of the elements of the various tests and what performance level is required for each of the ratings.[33]

Unlike fair lending violations, which can be addressed through mandatory corrective action and financial penalties, CRA is enforced through the application process and the public disclosure of ratings. The FDIC takes an institution's CRA performance into account when evaluating its applications for deposit facilities.[34] Such applications must be submitted when an institution proposes to open a branch, relocate a home office, merge, or acquire another institution.[35] In evaluating these applications, the FDIC must take into account the applicant institution's CRA performance, as well as the views expressed by any interested parties about an institution's CRA performance.[36] The FDIC can deny or conditionally approve applications based on CRA concerns.[37]

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[32] *See* 12 U.S.C. §2906(b)(2).
[33] *See* 12 CFR §345, at Appendix A (FDIC publication of ratings matrix used by all of the financial institution regulatory agencies.)
[34] *Id.* at §345.29.
[35] Of course, where an applicant proposes to charter a new institution, the FDIC also considers how the applicant proposes to meet its CRA objectives. *See* §345.29(b).
[36] *Id.* at §345.29(c).
[37] *Id.* at §345.29(a).

The Effect of Fair Lending Violations on CRA Ratings

Consistent with interagency regulatory guidance, illegal credit practices, including violations of the fair lending laws, are considered when evaluating CRA performance and may result in a lower CRA rating. The FDIC regulation covering discriminatory or other illegal lending practices, amended in 2005, states that:

> The FDIC's evaluation of a bank's CRA performance is adversely affected by evidence of discriminatory or other illegal credit practices in any geography by the bank or in any assessment area by any affiliate whose loans have been considered as part of the bank's lending performance.[38]

Evidence of discriminatory or other illegal credit practices considered as part of the CRA evaluation includes, but is not limited to:

- discrimination against applicants on a prohibited basis in violation, for example, of the Equal Credit Opportunity Act or the Fair Housing Act;
- violations of the Home Ownership and Equity Protection Act;
- violations of section 5 of the Federal Trade Commission Act;
- violations of section 8 of the Real Estate Settlement Procedures Act; and
- violations of the Truth in Lending Act provisions regarding a consumer's right of rescission.[39]

The 2005 amendments strengthened the CRA regulations in several respects. First, they expressly incorporated into the regulation the specific statutory examples cited above. Second, the amendments clarified that illegal credit practices carried out in any geography could be

[38] *Id.* at §345.28(c)(1).
[39] *Id.*

adversely considered by the regulators. This part of the amendment made clear that the agencies could consider lending discrimination that had occurred outside a financial institution's CRA assessment area.[40] Finally, the amendments added express coverage of illegal credit practices by an affiliate within the institution's assessment area if the relevant lending was considered as part of the institution's CRA performance evaluation.

The effect of an illegal credit practice by an institution is determined in the overall context of the institution's CRA performance. The FDIC's regulation states that in determining the effect of evidence of such practices on the bank's assigned rating:

> the FDIC considers the *nature, extent, and strength* of the evidence of the practices; the policies and procedures that the bank . . . has in place to prevent the practices; any corrective action that the bank . . . has taken or has committed to take, including voluntary corrective action resulting from self-assessment; and any other relevant information.[41]

In order to determine the impact of an illegal credit practice on an institution's CRA rating, examiners follow a deliberative process. First, they use interagency examination procedures[42] to assign a preliminary CRA rating based in the performance tests described earlier. Examiners then review the results of the institution's most recent compliance examination, which includes the fair lending review, to determine whether evidence of discriminatory or other illegal credit practices has been found. If that is the case, examiners consider the nature, extent,

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[40] Under the CRA regulations, a bank chooses one or more assessment areas within its geographic regions which the FDIC uses to evaluate the bank's record of helping to meet the credit needs of its community. *Id.* at §345.41.
[41] 12 CFR § 345.28(c)(2) (emphasis added)
[42] These procedures have been incorporated into the FDIC Compliance Handbook at Chapter XI (Community Reinvestment Act), http://www.fdic.gov/regulations/compliance/handbook/html/chapt11.html

and strength of the evidence, as required by the regulation. Through this analysis, they determine the extent to which illegal credit practices will affect the institution's CRA rating.

For FDIC-supervised institutions evaluated between January 1, 2002 and September 30, 2007, fair lending violations resulted in 14 CRA rating downgrades: three downgrades to "Satisfactory", and eleven to "Needs to Improve."

Conclusion

The CRA was adopted to address redlining and over its 30-year history has made a significant contribution to the revitalization of many low and moderate income communities in both urban and rural areas. Fair lending examinations are critical to achieving complete and accurate CRA reviews. The FDIC is committed to using CRA and fair lending laws in the continuing effort to address the credit needs of low and moderate income areas and individuals.

Mr. KUCINICH. Thank you very much.
Ms. Braunstein.

STATEMENT OF SANDRA F. BRAUNSTEIN

Ms. BRAUNSTEIN. Thank you, Chairman Kucinich and members of the subcommittee. I appreciate this opportunity to discuss the implementation of the Community Reinvestment Act and the enforcement of fair lending laws by the Federal Reserve System.

The Federal Reserve has a longstanding commitment to ensuring that every bank it supervises complies fully with Federal financial consumer protection laws, including fair lending laws, and that every bank meets its obligations under the CRA.

Consumer compliance supervision, which includes the administration of CRA and fair lending laws, has been a separate function at the Board and the Federal Reserve Banks for more than 30 years. The Federal Reserve Banks are instrumental in carrying out the Board's mission of consumer protection through their supervision of the approximately 900 State member banks for which the system has regulatory responsibility.

Federal Reserve consumer compliance examiners focus exclusively on consumer compliance supervision and are required to complete a comprehensive training program that includes specialized intensive coursework on CRA and fair lending. A specialized fair lending enforcement section at the Board works closely with Reserve Bank staff to provide guidance on fair lending matters and to ensure that the fair lending laws are enforced consistently and rigorously throughout the system.

When conducting fair lending examinations, consumer compliance examiners perform two distinct functions. First, examiners make sure that management is committed to fair lending and has the appropriate system, policies and staff in place to prevent violations.

Second, examiners determine if the bank has, in fact, violated the fair lending laws. Because the Federal Reserve requires the banks we supervise to devote significant resources to fair lending and because we examine them routinely for fair lending compliance, we expect fair lending violations to be rare among the banks we supervise. Such violations are, indeed, rare. But when they do occur, we do not hesitate to take strong action, including referrals to the Department of Justice.

Our record of referrals to Justice demonstrates our firm commitment to enforcing the fair lending laws. In 2007, thus far we have referred six institutions. These referrals included matters of ethnic and racial discrimination in mortgage pricing, racial discrimination in the pricing of automobile loans, restrictions on lending on Native American lands, and restrictions on row-house lending that discriminated on the basis of race.

Discrimination and other illegal credit practices will adversely affect a bank's CRA evaluation. In our evaluation of a bank's CRA performance, we take into account evidence that a bank engaged in illegal lending discrimination or other illegal credit practices. At the conclusion of CRA examinations, the examiners prepare a separate CRA public performance evaluation that describes a bank's

record of helping to meet the lending service and investment needs of their communities.

Examiners assign a CRA rating that reflects the institution's overall CRA performance. If examiners find fair lending violations or find other illegal credit practices, examiners seriously consider such findings when they determine the appropriate CRA rating. Examiners consider the nature and extent of discriminatory practices, the policies and procedures in place to prevent such practices, and corrective action taken by the bank.

Examiners may downgrade the rating otherwise earned to "needs to improve" or "substantial noncompliance." However, examiners assess the totality of the bank's record in the community in making this determination. Whether or not the examiner lowers the rating, they report their findings of discrimination in the public performance evaluation.

The Federal Reserve is committed to safeguarding consumer rights in financial services. The key to this commitment is ensuring that every bank that the Federal Reserve supervises meets the credit needs of its community and complies fully with fair lending laws. Our supervisory process evaluates each bank's compliance with the fair lending laws and takes that record into account when evaluating its CRA performance.

Thank you very much.

[The prepared statement of Ms. Braunstein follows:]

For release on delivery
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Statement of

Sandra F. Braunstein

Director, Division of Consumer and Community Affairs

Board of Governors of the Federal Reserve System

before the

Subcommittee on Domestic Policy

Committee on Oversight and Government Reform

U.S. House of Representatives

October 24, 2007

Chairman Kucinich, Ranking Member Issa, and members of the Subcommittee, I appreciate this opportunity to discuss the Community Reinvestment Act (CRA) and its implementation by the Federal Reserve System. I serve as the Director of the Federal Reserve Board's Division of Consumer and Community Affairs. The Federal Reserve's responsibilities include rulewriting and enforcement for many federal laws that safeguard consumer rights in financial services and promote access to credit, including the CRA and the fair lending laws. The Federal Reserve is committed to the fundamental purposes of these consumer protection laws, including the CRA's purpose of encouraging insured depository institutions to help meet the credit needs of the local communities in which they are chartered, consistent with their safe and sound operation.

In my testimony today, I will first provide an overview of the Federal Reserve System's Consumer Compliance Supervision Program, and then address the examination processes for both fair lending and the CRA. Finally, I will describe how we consider fair lending violations when we evaluate a bank's CRA performance.

An Overview of Consumer Compliance Supervision

The Board has a long-standing commitment to ensuring that every bank it supervises complies fully with federal financial consumer protection laws, including the fair lending laws, and that every bank meets its obligations under the CRA. This commitment is rooted in the Board's mission, which specifically calls for the effective implementation of statutes designed to inform and protect the consumer. The Federal Reserve fulfills this mission in four complementary ways. The first is regularly examining supervised financial institutions for compliance with consumer protection laws and regulations. This includes taking supervisory action as appropriate to enforce the laws and resolve any consumer complaints. The second is

rulewriting--issuing regulations, either separately (as with the Equal Credit Opportunity Act) or jointly with other federal agencies (as with the CRA), to implement consumer financial services and fair lending laws. The third is promoting consumer education through publications and through partnerships with other organizations. And the fourth is promoting community development and fair access to credit by conducting outreach and educational activities directed toward lower-income communities and traditionally underserved markets.

Consumer compliance supervision, which includes the administration of the CRA and fair lending laws, has been a distinct function at the Board and the Federal Reserve Banks for more than thirty years. The Board's Division of Consumer and Community Affairs (DCCA) is staffed with approximately 100 professionals, including attorneys, analysts, and economists who have responsibility for carrying out the Board's programs relating to rulemaking, policy development, community affairs, consumer education, examiner training, fair lending enforcement, and oversight of the supervisory and consumer complaint functions at the Reserve Banks. A specialized Fair Lending Enforcement Section within the division works closely with Reserve Bank staff to provide guidance on fair lending matters and to ensure that the fair lending laws are enforced consistently and rigorously throughout the Federal Reserve System.

The Federal Reserve Banks are instrumental in carrying out the Board's mission of consumer protection through their supervision of the approximately 900 state member banks for which the System has regulatory responsibility. As of June 30, 2007, the twelve Federal Reserve Banks had a professional staff of 287 specializing in consumer compliance. Federal Reserve consumer compliance examiners focus exclusively on consumer compliance supervision and are required to complete a comprehensive training program that includes specialized, intensive coursework on CRA and fair lending. The examination force is complemented by supervisory

staff and management at each Reserve Bank who also dedicate their energies to consumer compliance activities.

One objective of our consumer compliance examination program is to identify and control compliance risks before they harm consumers. In conducting a consumer compliance examination at a state member bank, examiners review the commitment and ability of bank management to comply with consumer protection laws and the bank's actual compliance with such laws. Examinations follow a risk-focused approach tailored to fit the risk profile of the bank. This approach directs supervisory attention and resources to the products, services, and areas of the bank's operations that pose the greatest risk to consumers. Our examiners prepare a stand-alone consumer compliance examination report bearing a distinct consumer compliance rating for each state member bank we supervise. These confidential reports include an evaluation of the bank's compliance management program, a summary of the fair lending review, and a discussion of identified violations of laws and regulations.

When examiners identify banks with weak and ineffective compliance programs, they take appropriate supervisory action, including documenting the weaknesses in the examination report. Banks with a poor record of compliance[1] are examined more frequently than those with favorable records.[2] To ensure that banks with performance deficiencies give appropriate attention to supervisory concerns, we may require them to enter into informal enforcement actions, such as a Memorandum of Understanding. When necessary to obtain compliance with

[1] In evaluating a bank's overall compliance with consumer regulations, the Federal Reserve uses an interagency uniform rating system. The rating system is based upon a scale of 1 through 5 in increasing order of supervisory concern. Thus "1" represents the highest rating, and ratings between "3" and "5" reflect escalating degrees of deficient performance and supervisory concern.

[2] Banks with less than satisfactory compliance or CRA ratings are typically examined every twelve months. Banks with assets greater than $250 million and satisfactory or better ratings are examined every twenty-four months. Small banks (i.e., those with assets less than $250 million) with satisfactory or outstanding ratings are typically examined every forty-eight to sixty months.

consumer protection laws, we can use formal, public enforcement actions, such as civil money penalties, Written Agreements, or Cease and Desist Orders. However, most banks voluntarily address any violations and weaknesses in compliance management programs that our examiners identify.

Examiners also prepare a separate CRA public performance evaluation that describes a bank's record of helping to meet the lending, service, and investment needs of their communities. The public performance evaluation includes a CRA rating that reflects the institution's overall CRA performance as dictated by the statute.[3] The interagency CRA regulations and examination procedures also stipulate that examiners will take any adverse findings from the fair lending review conducted as part of the consumer compliance examination, as well as findings of other illegal credit practices, into consideration when assigning a CRA rating.

Fair Lending Supervision

Central to the fair lending laws and the strength of our economy is the principle that each individual should have equal access to credit, without suffering discrimination based on race, ethnicity, national origin, gender, or certain other factors not related to creditworthiness. The Board takes a multi-pronged approach to promoting fair access to credit. We rigorously enforce the fair lending laws through the examination function. We also promote fair lending through rulemaking, consumer education, economic and consumer research, and the investigation of individual consumer complaints. My remarks today will focus on our fair lending examination responsibilities.

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[3] Pursuant to the CRA statute, the public performance evaluation must include a CRA rating for the institution for each state where the bank maintains a branch, and for each multistate metropolitan statistical area (MSA) in which the bank has branches in more than one state of the multistate MSA.

Evaluating a bank's compliance with the fair lending laws, namely the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA), is an integral part of every consumer compliance examination conducted by the Federal Reserve. Following the Interagency Fair Lending Examination Procedures, each fair lending examination includes an assessment of the bank's fair lending risk across its business lines. Based on this assessment of risk, examiners identify specific business lines on which to focus, and in every examination they evaluate in detail at least one product or class of products.

When conducting these evaluations, consumer compliance examiners perform two distinct functions. First, examiners evaluate the bank's overall fair lending compliance program. They make sure that management is committed to fair lending and has the appropriate systems, policies, and staff in place to prevent violations. They also assess whether the bank devotes a level of resources to consumer compliance that is commensurate with its size, the complexity of its business lines, and the fair lending risk posed by its business practices. Examiners require that every bank makes fair lending a high priority, from the loan officer up to the board of directors. If a bank's staff or systems fall short, examiners direct the bank to take corrective action.

Second, examiners determine if the bank has, in fact, violated the fair lending laws. They review lending policies and practices to make sure they are not discriminatory. Examiners also test the institution's actual lending record for specific types of discrimination, such as underwriting discrimination in consumer loans, or pricing discrimination in mortgage or automobile lending. This testing for discrimination may use statistical techniques, manual reviews of loan files, or both. When examiners find evidence of potential discrimination, they

coordinate closely with the Board's Fair Lending Enforcement Section, which brings additional legal and statistical expertise to bear.

Because the Federal Reserve expects the banks we supervise to devote significant resources to fair lending, and because we examine them routinely for fair lending compliance, we expect fair lending violations--especially those involving a pattern or practice of discrimination--to be rare among the banks we supervise. Our experience has been that such violations are indeed rare, but when they do occur, we do not hesitate to take strong action. If we have reason to believe that an institution has engaged in a pattern or practice of discrimination under ECOA, the Board, like the other federal banking agencies, has a statutory responsibility under that Act to refer the matter to the Department of Justice (DOJ), which reviews the referral and decides if further investigation is warranted. A DOJ investigation may result in a public civil enforcement action or settlement. The DOJ may instead return the matter to the Federal Reserve for administrative enforcement. When this occurs, we ensure that the institution corrects the problems and makes appropriate amends to the victims.

We take our responsibility to refer matters to the DOJ seriously. To date in 2007, we have referred six institutions after concluding that we had reason to believe that they had engaged in a pattern or practice of discrimination. These referrals involved:

- ethnic and racial discrimination in mortgage pricing,
- racial discrimination in the pricing of automobile loans,
- restrictions on lending on Native American lands,
- restrictions on row house lending that discriminated on the basis of race,
- discrimination against unmarried people in the underwriting of consumer loans, and
- discrimination on the basis of marital status by improperly requiring spousal signatures.

In 2006, we referred four institutions to the DOJ for a wide range of issues after concluding that we had reason to believe they had engaged in a pattern or practice of discrimination. These issues included pricing discrimination in auto lending, mortgage redlining, and age discrimination.

Our referral record, which is publicly documented in our annual reports to Congress, demonstrates the Board's strong commitment to rigorous fair lending enforcement. Our referrals account for two of the three public fair lending enforcement actions that the DOJ has brought in the past five years based on agency fair lending referrals. One of these enforcement actions involved redlining in mortgage, consumer, and small business lending; the other involved marital status discrimination in the pricing of automobile loans.[4]

Even if a bank's fair lending violations do not constitute a pattern or practice, the Federal Reserve makes sure they are remedied by the bank. For example, when we find isolated violations where a bank has illegally required spousal signatures on loan documents, constituting discrimination on the basis of marital status, we direct the bank to offer to release the spouse from any obligation for repayment of the debt. As discussed in more detail below, we consider any findings of fair lending violations--whether or not they constitute a pattern or practice--when we evaluate a bank's CRA performance.

CRA Examinations

The CRA affirms that federally insured banks and thrifts have an obligation to help meet the credit needs of the entire communities they serve, including low- and moderate-income neighborhoods, in a safe and sound manner. The statute requires the federal financial supervisory agencies to evaluate the performance of depository institutions they supervise in

[4] See United States v. First American Bank, Civil Action No. 04C 4585 (N.D. Ill. July 13, 2004), and United States v. Compass Bank, Civil Action No. 07-H-0102-S (N.D. Ala. January 12, 2007).

meeting this obligation, and directs the agencies to assign one of four ratings--Outstanding, Satisfactory, Needs to Improve, or Substantial Noncompliance--to describe an institution's performance. Each rating encompasses a range of performance outcomes that are further detailed in the interagency regulations and examination procedures. The statute requires that an institution's CRA evaluation, its rating, and supporting quantitative and qualitative data, be made public.

During a CRA examination, examiners assess the bank's performance within the context of all relevant factors, such as its business strategy, capacity, and constraints, the overall economic conditions and credit needs in its assessment area, and the availability of community development activities appropriate to the institution. Our attention to the performance context also reflects the obligation of federally insured depository institutions to help meet the specific credit needs of the particular communities in which they are chartered in a safe and sound manner. Thus, we do not apply a single performance template to all depository institutions and all communities.

The community also has a role in the CRA examination process. The public can offer comments on an institution's CRA performance. Our examiners review the bank's public comment file and take any comments into account when evaluating its overall CRA performance.

The agencies' CRA regulations specify different performance expectations, and therefore different evaluation methods, depending on an institution's size and its operations. A large institution, one with assets of $1.033 billion or more, is examined according to performance criteria under three separate tests. These tests measure the institution's performance with respect to making and purchasing loans, providing qualified investments, and supplying services in its

local community. A small institution, one with assets of less than $258 million, is examined under a streamlined method that focuses primarily on its lending performance. An institution with assets of at least $258 million, but less than $1.033 billion, is reviewed according to performance under a lending test and a community development test. In addition, wholesale and limited purpose institutions are subject to a community development test, which focuses on community development lending, investments, and services. Alternatively, any institution, regardless of its size, may elect to have its CRA performance evaluated under a strategic plan tailored to the needs of its community. The strategic plan is developed with community input, and must be approved by the institution's primary regulator.

Discrimination and other illegal credit practices are contrary to meeting the credit needs of a community and, as I will discuss, will adversely affect a bank's CRA evaluation. There are, however, important differences between the CRA and the fair lending laws. The fair lending laws prohibit discrimination on specific bases, such as the applicant's race, national origin and sex, but do not impose affirmative obligations on banks to serve low- or moderate-income communities. The CRA, on the other hand, recognizes that insured depository institutions have an affirmative obligation to help meet the credit needs of their entire communities, including low- and moderate-income areas, and requires the relevant supervisory agencies to evaluate their performance. The statute, however, does not address the distribution of credit with respect to the prohibited bases contained in the relevant fair lending laws.

A bank's CRA performance is evaluated, therefore, primarily on the distribution of its lending within its assessment area across borrowers and neighborhoods of different income levels. For residential mortgage lending products, CRA evaluations consider the distribution of loans across low-, moderate-, middle-, and upper-income borrowers and areas, with a special

focus on lending to low- and moderate-income borrowers and areas. For small business lending products, CRA evaluations consider the distribution of small loans (loans of $1 million or less) across businesses with differing levels of revenue, with a particular focus on loans to firms with annual revenues of $1 million or less. For institutions of appropriate size, CRA evaluations also focus on their record of making investments in their communities, and of meeting the needs of their assessment areas through the provision of retail and community services.

A bank's CRA performance is evaluated within its assessment area. Under the CRA regulations, a bank must delineate an assessment area or areas that correspond to commonly recognized metropolitan areas or political subdivisions that surround its main office, branches and deposit-taking ATMs in which the bank has originated or purchased a substantial portion of its loans. The assumption underlying this approach is that branches, and certain ATMs, serve as the deposit-taking arm of the institution and, therefore, define its community for reinvestment purposes. The assumption also encompasses one of Congress's findings in passing the CRA--that regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business.

A bank is permitted to limit its assessment area to the portion of a political subdivision it can reasonably be expected to serve. But, the assessment area may not reflect illegal discrimination and may not arbitrarily exclude low- or moderate-income geographies, taking into account the bank's size and financial condition. Although the assessment area is not separately evaluated as an aspect of CRA performance, the delineation is reviewed for compliance with the assessment area requirements of the regulation at the outset of the CRA examination. An assessment area that is not in compliance with regulatory requirements will be redrawn by the examiners and the CRA evaluation will be based on this new delineation.

Pursuant to the CRA regulations, the evaluation of a bank's CRA performance takes into account evidence that a bank engaged in illegal lending discrimination or other illegal credit practices that are inconsistent with helping to meet community credit needs.[5] Federal Reserve examiners conduct a fair lending review concurrently with, or close in time to each CRA evaluation, and the findings from that review are factored into the CRA evaluation.

The public CRA performance evaluation summarizes a bank's record of complying with the fair lending laws, and states whether violations were found and, if so, whether they negatively impacted the bank's overall CRA rating. Pursuant to the CRA regulations, various factors relating to the violations will be considered when determining the bank's assigned CRA rating, including the nature and extent of discriminatory practices, the policies and procedures in place to prevent such practices, and corrective action taken by the bank. A finding of discrimination could result, for example, in a downgrade of the rating otherwise earned to either Needs to Improve or Substantial Noncompliance, or from Outstanding to Satisfactory. However, if the discrimination was isolated, or occurred despite the existence of internal controls to prevent such practices, the violation may be reported in the written CRA Performance Evaluation without actually lowering the bank's CRA rating. This reflects the fact that each rating encompasses a range of conduct and performance. An inadvertent or isolated violation may not be sufficient to move the bank's overall performance assessment out of that range. I would like to give examples to illustrate different outcomes in CRA examinations.

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[5] In addition to findings involving discrimination in violation of the ECOA or FHA, other violations that affect the evaluation of a bank's CRA performance include: violations of Section 32 of the Home Ownership and Equity Protection Act (HOEPA), which addresses "high cost" mortgages; violations involving kickbacks and unearned fees under Section 8 of the Real Estate Settlement Procedures Act (RESPA); violations of the Truth in Lending Act's (TILA) provisions regarding a consumer's right of rescission; and unfair or deceptive practices in violation of Section 5 of the Federal Trade Commission Act (FTC Act).

The 2001 CRA performance evaluation for First American Bank, Carpentersville, Illinois, provides an example of a bank whose CRA rating was downgraded as a result of fair lending violations. The public CRA performance evaluation explains that the examiners' review of the bank's delineated assessment areas raised substantive concerns, leading to the delineation of a new assessment area. The examiners then evaluated the bank's CRA record based on the revised assessment area. The CRA performance evaluation notes that the bank would have received a CRA rating of Needs to Improve, but that the rating was downgraded to Substantial Noncompliance, the lowest possible rating, as a result of substantive fair lending violations. As documented in the DOJ's publicly filed complaint, the Federal Reserve concluded that there was reason to believe that the bank had engaged in illegal redlining, in violation of the ECOA, and referred the matter to the DOJ. The Federal Reserve's referral led to an investigation by the DOJ, which was ultimately resolved in a consent decree filed in July 2004.

First State Bank of Porter, Porter, Indiana, provides an example of a situation where examiners did not downgrade the bank's CRA rating based on identified fair lending violations for the reasons articulated in the 2006 public CRA performance evaluation, which states:

> Bank management is knowledgeable overall regarding the substantive provisions of anti-discriminatory laws and regulations. Policies and procedures have been implemented to ensure compliance with the regulatory requirements of the Equal Credit Opportunity Act (implemented by Regulation B) and the Fair Housing Act. Nevertheless, during the examination, a substantive violation of Regulation B was identified involving a product advertisement. The extent of the violation was limited in nature.
>
> The bank's CRA rating was not negatively impacted by this violation due to the bank's overall level of compliance with fair lending laws and regulations, the limited nature of the violation, the bank's record of meeting the credit needs of the local community, the enhanced policies and procedures the bank has in place to ensure continued compliance, and management's prompt, voluntary implementation of corrective action.

Thus, as the examples illustrate, fair lending violations are taken into account in the CRA performance evaluation and can affect the overall CRA rating.

Conclusion

The Federal Reserve is committed to safeguarding consumer rights in financial services. Key to this commitment is ensuring that every bank the Federal Reserve supervises meets its CRA obligation and complies fully with the federal fair lending laws. It is essential that every bank fulfills its obligation to help meet the credit needs of the communities that it serves, including low- and moderate-income-neighborhoods, while not discriminating on any prohibited basis in granting credit to individuals. Our supervisory process evaluates each bank's compliance with the fair lending laws and takes that record into account when evaluating its CRA performance. Finally, our record of referrals to the DOJ demonstrates our firm commitment to enforcing the fair lending laws.

Mr. KUCINICH. Thank you, Ms. Braunstein.
Ms. Yakimov.

STATEMENT OF MONTRICE GODARD YAKIMOV

Ms. YAKIMOV. Good afternoon, Chairman Kucinich and members of the subcommittee. Thank you for the opportunity to present information regarding the activities of the Office of Thrift Supervision on issues related to the Community Reinvestment Act and fair lending enforcement.

In my testimony today, I will describe how OTS examines for CRA compliance, compliance with fair lending laws, and how violations of fair lending laws and other illegal credit practices affect the CRA ratings we assign to savings associations.

The Community Reinvestment Act calls for insured depository institutions covered by the act to help meet the credit needs of the communities in which they operate. The Office of Thrift Supervision's implementing regulation requires the agency to assess a savings association's record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation.

Additionally, the CRA requires OTS to consider each institution's record when evaluating an application for new branches or relocation of an existing branch, mergers, consolidations and other corporate activity. The regulations and examination procedures require examiners to consider such factors as the volume of mortgage and small-business lending within the savings association's designated assessment area, the volume in dollar of lending to low- and moderate-income people, small-business lending, small-farm lending and mortgage lending in low- and moderate-income geographies. Additionally, in some instances, performance is based on a savings association's community development lending and investments, along with the ability to provide retail services to low- and moderate-income individuals.

OTS assigns savings associations one of four ratings to meet the credit needs of the communities they serve: outstanding, satisfactory, needs to improve, or substantial noncompliance.

So, through the CRA examination function, OTS reviews thrift institutions' record of meeting the financial needs of the communities they serve, including their record of lending to low- and moderate-income individuals.

Separately, fair lending reviews are an integral part of the OTS supervision to determine compliance with consumer protection laws and regulations. OTS examiners conduct a fair lending assessment during each comprehensive exam, every 12 to 18 months. In addition to HMDA, data examiners also use other information in their investigations, including consumer complaints, risks associated with the savings association's business channels, and the adequacy of the institution's compliance risk management system.

Through fair lending exams, OTS examiners seek to detect all forms of discrimination, such as redlining, as well as discrimination relating to pricing, marketing and underwriting. If unlawful discrimination is found, OTS will make a referral to the Department of Justice or the Department of Housing and Urban Development in accordance with Federal fair lending laws.

Depending on the outcome of the referral and the nature of the violation, OTS may also take other actions to fully resolve the matter. For example, when applicable, the OTS directs the institution to cease violative activity, provide remedies to harmed parties, and improve its fair lending compliance controls and policies.

Additionally, and notably for today's hearing, the Office of Thrift Supervision's CRA regulations indicate that a finding of discrimination or other illegal credit practice will adversely affect the savings association's CRA performance. Such evidence includes, for example, certain violations of Equal Credit Opportunity Act, Fair Housing Act, Real Estate Government Procedures Act, Section 5 of the FTC Act and the Homeowners Equity Protection Act. The extent to which the finding of discrimination or other illegal practice affects the CRA rating is determined by factors such as the nature and extent of the evidence, the policies and procedures that the savings association has in place to prevent discrimination or other illegal credit practices, and corrective action that the savings association has undertaken or has committed to take, including volunteers.

Since 1990, in 37 instances OTS has reduced the CRA rating of an institution in response to evidence of discriminatory or other illegal credit practices. In five cases, the downgrade was from "outstanding" to "satisfactory." In 29 cases, the rating declined from "satisfactory" to "needs to improve." And in three cases, the rating declined from "needs to improve" to "substantial noncompliance."

Both CRA and fair lending are critical parts of our compliance examination function at OTS. While we believe the regulation examination procedures equip us to monitor both of these critical areas, we note that refinements to our processes are certainly something that we consider on an ongoing basis. We have taken such steps as building new econometric models, adding additional training and additional resources here in Washington to support our subject-matter experts in the field.

Ensuring that CRA ratings accurately reflect not only how effectively thrifts serve the communities they serve but that they are doing so in compliance with fair lending laws and in the spirit of the Community Reinvestment Act are key priorities at OTS. Thank you for raising this important issue, and I look forward to answering your questions.

[The prepared statement of Ms. Yakimov follows:]

Embargoed until
October 24, 2007, at 2:00 pm

Statement of

Montrice Godard Yakimov
Managing Director for Compliance and Consumer Protection
Office of Thrift Supervision

concerning

Upholding the Spirit of the CRA: Do CRA Ratings Accurately Reflect Bank Practices?

before the

Subcommittee on Domestic Policy
of the
Committee on Oversight and Government Reform
United States House of Representatives

October 24, 2007

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Statement required by 12 U.S.C. 250: The views expressed herein are those of the Office of Thrift Supervision and do not necessarily represent those of the President.

Testimony on Upholding the Spirit of the CRA:
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United States House of Representatives
October 24, 2007

Montrice Godard Yakimov
Managing Director for Compliance and Consumer Protection
Office of Thrift Supervision

I. Introduction

Good afternoon, Chairman Kucinich, Ranking Member Issa, and Members of the Subcommittee. Thank you for the opportunity to present information regarding the activities of the Office of Thrift Supervision (OTS) on issues related to the Community Reinvestment Act (CRA) and fair lending enforcement. Consumer protection, maintaining the safety and soundness of the thrift industry, and ensuring the continued availability of affordable housing credit are the three primary responsibilities of the OTS.

In my testimony today, I will describe the OTS CRA examination program, including the resources that we devote to this critical function, our use of fair lending data to develop CRA evaluations, and an overview of some examples of this process. I will also address the issues raised in the Chairman's invitation letter and attempt to provide you with the sense of purpose and priority with which OTS Director Reich has charged our Compliance and Consumer Protection Division to proactively address CRA and related fair lending issues.

II. The OTS CRA Process

The Community Reinvestment Act of 1977 encourages each insured depository institution covered by the Act to help meet the credit needs of the communities in which it operates. The CRA's implementing regulation (12 CFR Part 563e) requires OTS to assess a savings association's record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operations. Additionally the CRA requires OTS to consider each institution's record when evaluating a savings association's application for new branches or relocation of an existing branch, mergers and consolidations, and other corporate activities.

An institution's capacity to help meet community credit needs is influenced by many factors, including its financial condition and size, resources, legal impediments (such as investment limits) and local economic conditions that could affect the supply of, and demand for, credit. An examiner is required to consider such factors when evaluating a savings association's performance under CRA.

The OTS uses the Interagency CRA Examination Procedures to conduct routine CRA examinations on a regularly scheduled basis. In general, OTS conducts a CRA examination of a savings association, with a prior "Satisfactory" rating or better and with assets of $250 million or more, every 24-36 months. For savings associations with a rating of "Satisfactory" or better, and assets of less than $250 million, OTS examines every 48-60 months in accordance with the parameters set in Section 712 of the Gramm-Leach-Bliley Act. Savings associations with less than "Satisfactory" ratings of any asset size may be examined as often as every 6 to 18 months.

The CRA regulations and examination procedures embody clear, flexible, and sensible performance criteria that:

- Accommodate differences in institutions and their communities.
- Minimize burden.
- Promote consistency and objectivity and
- Allow the examiners to exercise their judgment (within parameters set by the regulation), rather than unduly adhere to rigid procedures.

The CRA regulations and corresponding examination procedures provide different evaluation methods to respond to basic differences in institutions' structures and operations. They provide one streamlined assessment method for small institutions (those with assets of less than $250 million) that emphasizes lending performance; an assessment method for intermediate small institutions (those with assets between $250 million and $1 billion) that emphasize lending performance and community development; an assessment method for large, retail institutions (those with assets of $1 billion or more) that focuses on lending, investment, and service performance; and an assessment method for wholesale and limited-purpose institutions that is based on community development lending, investment and service activities. In addition, the regulation also allows any institution, regardless of size or business strategy, the choice to be evaluated under a strategic plan.

Both the regulations and the examination procedures promote and establish evaluation methods based on objective data that institutions can also use to measure their own performance. The examiner considers various data in assessing the savings association's CRA performance. The regulations and examination procedures require the examiners to consider factors such as the volume of mortgage and small business lending within the savings association's designated assessment area; the volume and dollar of lending to low- and moderate-income people, small businesses and small farms; and loan

penetration in low- and moderate-income geographies. Additionally, in some instances performance is based on a savings association's community development lending and investments, along with its ability to provide retail services to low- and moderate-income individuals.

OTS judges a savings associations' CRA performance in the context of information about the institution, its community, its competitors, and among its peer institutions. At the conclusion of the CRA assessment methods previously discussed, OTS prepares a written public evaluation of the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods. The evaluation contains the rating of the institution's performance in helping to meet the credit needs of its community and also contains a supporting conclusion describing the basis for the rating. OTS assigns a savings association one of four ratings:

- An "Outstanding" rating record of meeting community credit needs.
- A "Satisfactory" rating of meeting community credit needs.
- A "Needs to improve" rating of meeting community credit needs, or
- A rating of "Substantial noncompliance" in meeting community credit needs.

Since the inception of the CRA regulation, OTS has considered as an indicator of CRA performance evidence of discriminatory or other illegal credit practices. When such evidence is present, it is a major adverse factor in the final rating. The absence of such evidence is a neutral consideration.

III. Overview of Fair Lending Laws & Examination Approach

OTS examiners utilize comprehensive interagency fair lending examination procedures that enable them to assess compliance with the Equal Credit Opportunity Act (ECOA), implemented by Regulation B, and the Fair Housing Act. The Equal Credit Opportunity Act prohibits discrimination based on race or color, religion, national origin, marital status, age, the applicant's receipt of income derived from public assistance, and the applicant's exercise of any right under the Consumer Credit Protection Act.

The Fair Housing Act prohibits discrimination in transactions involving residential real estate including: making a loan to buy, build, repair or improve a dwelling; purchasing real estate loans; selling, brokering or appraising residential real estate; or selling or renting a dwelling. The Fair Housing Act, implemented through regulations promulgated by the U.S. Department of Housing and Urban Development, prohibits discrimination based on race or color, national origin, religion, sex, familial status, or handicap.

Through the examination process, OTS identifies and monitors potential or existing risks relating to Fair Lending compliance. We conduct comprehensive examinations every 12-18 months (depending on thrift asset size). In between regularly

occurring exams, we engage in off-site monitoring. This includes following up on any issues raised during previous examinations and monitoring for changes in products, management, or services.

Through our examination procedures, OTS examiners evaluate whether savings associations and other thrift institutions violate fair lending laws by discriminating based on race, color, national origin, religion, sex, familial status, handicap, marital status, age, receipt of public assistance, or exercise of rights under the Consumer Credit Protection Act. Specifically, OTS examiners evaluate whether such institutions:

- Fail to provide information or services – or provide different information or services regarding any aspect of the lending process. This includes communications about 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 loan type; or
- Use different standards to evaluate collateral and related factors.

A. OTS' Fair Lending Oversight Program

Fair lending reviews are an integral part of OTS's supervision to determine compliance with consumer protection laws and regulations. OTS examiners conduct a fair lending assessment during each comprehensive examination. In addition to the HMDA data, examiners also use other information in their investigations, including consumer complaints, the likely risks of an institution's business channels, and the adequacy of the institution's compliance-risk management system. From January 1, 2000 to September 30, 2007, OTS examinations cited 697 institutions for violations of ECOA, with 1337 total violations noted.

Examiners seek to detect all forms of discrimination, such as redlining, underwriting, pricing, or marketing. If unlawful discrimination is found, the institution is referred to the Department of Justice or the Department of Housing and Urban Development, in accordance with federal fair lending laws. Depending on the outcome of the referral and the nature of the violation, the OTS may also take other action to fully resolve the matter. For example, when applicable, the OTS directs the institution to provide remedies to harmed parties and improve its fair lending compliance controls and policies. As mentioned before, evidence of discrimination or illegal credit practices also adversely affects an institution's CRA rating.

IV. How Fair Lending Violations Adversely Affect a Savings Association's CRA Rating

Section 563e.28(c) of the OTS's CRA regulation indicates that a finding of discrimination or other illegal credit practice will adversely affect a savings association's CRA performance, along with other factors such as the nature and extent of the evidence, the polices and procedures that the savings association has in place to prevent discrimination or other illegal credit practices, and corrective action that the savings association has undertaken or has committed to take, particularly voluntary corrective action resulting from self-assessment and other relevant information. Indeed, the evaluation of every financial institution covered by CRA since the first CRA rules went into effect in the late 1970s has considered, as an indicator of performance, evidence of discriminatory or other illegal credit practices. When such evidence is present, it is a major adverse factor.

Evidence of discriminatory or other illegal credit practices considered as part of the CRA evaluation includes, but is not limited to:

- discrimination against applicants on a prohibited basis in violation, for example, of the Equal Credit Opportunity Act or the Fair Housing Act;
- violations of the Home Ownership and Equity Protection Act;
- violations of section 5 of the Federal Trade Commission Act;
- violations of section 8 of the Real Estate Settlement Procedures Act; and
- violations of the Truth in Lending Act provisions regarding a consumer's right of rescission.

OTS routinely considers discriminatory or other illegal practices when evaluating the CRA performance of its institutions. Accordingly, since 1990, there have been 37 instances in which the OTS downgraded the CRA rating of an institution in response to evidence of discriminatory or other illegal credit practices.

While the consideration of discriminatory and illegal practices is extremely significant, it is viewed in the context of corrective actions the association makes to address this concern as mandated by the common regulation on this point The OTS is required to consider other factors, such as the nature and extent of the evidence, the polices and procedures that the savings association has in place to prevent discrimination or other

illegal credit practices, and corrective action that the savings association has undertaken or has committed to take, particularly voluntary corrective action resulting from self-assessment and other relevant information.

V. Conclusion

Both CRA and fair lending compliance are critical parts of the compliance exam function at OTS for thrift institutions. You have raised important questions about an institution's CRA assessment, that it must reflect its record of not only meeting the credit needs of the communities it serves, but that it must do so in compliance with fair lending laws and without engaging in illegal credit practices.

While we believe existing regulations and examination procedures equip the OTS to examine and monitor both of these critical factors, we note that refinements can certainly be made as our experience with fair lending issues grows. As part of our efforts to enhance our examination capabilities, we have added additional staff resources, including a new Fair Lending Specialist based in Washington to augment the fair lending subject matter experts in our regional offices. We have worked to develop new fair lending econometric models and tools. We have provided additional training to our examiners and during the past 14 months, we have undertaken a systemic review of our compliance policies and examination procedures to identify areas to strengthen our effectiveness in examining for compliance with federal consumer protection laws.

I look forward to your questions.

Mr. KUCINICH. Ms. Yakimov, thank you for your testimony.

I have been informed that there is a vote on, and so what we are going to do is this. I am going to recess the committee for 20 minutes, and that would bring us to about 5 minutes before the hour. We will begin with Ms. Jaedicke's testimony, and then we will go to questions of the witnesses.

So I would ask that you return in 20 minutes, and we will start again. Thank you so much. And thank you for your testimony. Thank you.

The committee is in recess.

[Recess.]

Mr. KUCINICH. The committee will now come to order.

I want to thank the witnesses for their patience. The House has just completed its business for the day, so I don't think we will have any other interruptions.

We will hear from Ms. Jaedicke, and then we will go to questions of the witnesses. And, again, I thank you for your indulgence.

The Chair recognizes Ms. Jaedicke.

STATEMENT OF ANN F. JAEDICKE

Ms. JAEDICKE. Chairman Kucinich, I am Ann Jaedicke, deputy comptroller for compliance policy at the Office of the Comptroller of the Currency. I am pleased to appear before you today to discuss the OCC's fair lending and Community Reinvestment Act examination processes. I will also discuss how a national bank's CRA evaluation and rating can be adversely affected by evidence of unlawful discrimination.

Let me begin by saying there is no room for unlawful lending discrimination in the national banking system, and the OCC fully expects banks to serve the credit needs of their communities, including needs in low- and moderate-income areas. The OCC has a comprehensive and rigorous fair lending oversight program, which is the foundation for ensuring that national banks comply with fair lending laws.

We also conduct examinations of national banks to evaluate whether they are meeting the credit needs of their communities as required by the Community Reinvestment Act. At each CRA examination of a national bank, the examiner not only evaluates the manner in which the bank is meeting the credit needs of the community, but the examiner also considers the nature and extent of any unlawful discrimination or other illegal credit practices in which the bank may have engaged.

The joint CRA regulations of the Federal banking agencies provide that evidence of unlawful discrimination or other illegal credit practices has an adverse effect on a bank's CRA evaluation. Therefore, if there is evidence of unlawful discrimination, that information is taken into account in the bank's CRA evaluation, and the examiner's findings are discussed in the public performance evaluation [PE].

The interagency CRA rules further provide guidance on the factors that will be considered in determining whether a bank's CRA rating should be adjusted as a result of such evidence. These factors include, among other things, the nature of the violation, the

extent of the problem, whether the bank self-identified the issue, and whether the bank has initiated corrective action.

Let me assure you that the OCC treats evidence of fair lending violations as a negative factor when assessing the CRA performance of national banks, and we have lowered the CRA ratings of national banks in several instances based on such evidence. For example, ratings have been lowered from "outstanding" to "satisfactory" and from "satisfactory" to "needs to improve" based on discriminatory or other illegal credit practices. In other instances, the OCC has described the violations in the CRA PE and has taken them into account in evaluating the CRA performance but has determined that lowering a rating was not appropriate based on an assessment of the applicable factors in the regulation.

In addition to conducting CRA examinations, the OCC has a fair lending supervisory program designed to assess the level of fair lending risk in every national bank. As part of this process, the OCC assesses compliance with fair lending laws and regulations; we obtain corrective action when significant weaknesses or deficiencies are found in a bank's policies, procedures and controls related to fair lending; and we ensure that enforcement action is taken when warranted, including referrals to the U.S. Department of Justice and notifications to the U.S. Department of Housing and Urban Development.

Our fair lending supervisory process has several features that, in combination, result in a risk-based approach to our fair lending supervision. We combine our examiner's knowledge of the bank and its products and markets with analytical information about loans made by the bank and with information from consumers and community groups. Using this information, we focus our fair lending examinations on banks that show the greatest potential for fair lending issues.

I appreciate the opportunity to discuss the important nexus between fair lending and helping to meet community credit needs. The OCC is committed to ensuring that our evaluation of national bank CRA performance appropriately reflects any evidence of unlawful discrimination consistent with the interagency CRA regulations. Along with our robust fair lending examination and enforcement process, the CRA process is an important tool in Federal law that we use to address and to prevent unlawful discrimination.

I will be pleased to answer any questions that you may have.

[The prepared statement of Ms. Jaedicke follows:]

For Release Upon Delivery
2:00 p.m., October 24, 2007

TESTIMONY OF

ANN F. JAEDICKE

DEPUTY COMPTROLLER FOR COMPLIANCE POLICY

OFFICE OF THE COMPTROLLER OF THE CURRENCY

BEFORE THE

SUBCOMMITTEE ON DOMESTIC POLICY

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

OF THE

U.S. HOUSE OF REPRESENTATIVES

OCTOBER 24, 2007

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

INTRODUCTION

Chairman Kucinich, Ranking Member Issa, and members of the Subcommittee, I am Ann Jaedicke, Deputy Comptroller for Compliance Policy, at the Office of the Comptroller of the Currency (OCC). I am pleased to appear before you today to discuss the OCC's fair lending and Community Reinvestment Act (CRA) examination processes, and to discuss how a national bank's CRA evaluation and rating can be adversely affected by evidence of unlawful lending discrimination.

The OCC has a comprehensive and rigorous fair lending oversight program, which is our foundation for ensuring that national banks comply with the fair lending laws. Additionally, the OCC conducts CRA examinations of national banks to evaluate whether they are meeting the credit needs of their communities. The CRA evaluation process provides the OCC with an opportunity to incorporate evidence of discriminatory credit practices into the assessment of a national bank's efforts to meet its communities' credit needs.

My testimony will describe the OCC's supervisory and enforcement process for fair lending compliance, our process for evaluating CRA performance, and the relationship between fair lending compliance and the assessment of CRA performance. Our regulations and supervisory procedures ensure that discriminatory practices that are found to violate the fair lending laws are taken into account in evaluating a national bank's CRA record of performance.

In particular, my statement will discuss how the federal banking agencies' joint CRA regulations provide that evidence of substantive fair lending violations will adversely affect the evaluation of a bank's CRA performance. Consistent with the

regulation and guidance, at each CRA examination, OCC examiners consider a national bank's fair lending compliance, and if there is evidence of unlawful discrimination, that information is taken into account in the bank's CRA evaluation and the examiner's findings are discussed in the bank's public performance evaluation (PE). The interagency CRA rules further provide guidance on the factors that will be considered in determining whether a bank's CRA *rating* should be adjusted as the result of such evidence. These factors include the nature of the violation, the extent of the problem, whether the bank self-identified the issue, whether the bank has initiated corrective action, whether the bank has a compliance monitoring system, and any other relevant information. Examiners evaluate these factors on a case-by-case basis. Pursuant to the interagency CRA rules, the OCC takes into account evidence of fair lending violations as a negative factor in assessing the CRA performance of national banks, and we have lowered the CRA ratings of national banks in several instances based on such evidence.

I. THE OCC'S SUPERVISORY AND ENFORCEMENT PROCESS FOR ENSURING COMPLIANCE WITH FAIR LENDING LAWS

A. The Supervisory Process

1. *Background.*

National banks are among the most extensively regulated commercial enterprises in the United States. The OCC comprehensively examines these institutions to ensure that they operate in compliance with applicable banking laws, regulations, and supervisory guidance and in a safe and sound manner.[1]

Assuring fair access to credit and fair treatment of national bank customers are fundamental responsibilities of the OCC as administrator of the national banking system.

[1] 12 U.S.C. § 481.

In this regard, two federal statutes form the foundation for protecting consumers from discrimination in credit transactions: the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act. ECOA and its implementing regulation prohibit discrimination against applicants for credit on the basis of race, color, religion, national origin, sex, marital status, age, receipt of public assistance income, or the exercise of rights under the Consumer Credit Protection Act.[2] ECOA designates the OCC as the enforcing authority with respect to national banks.[3] The Fair Housing Act prohibits discrimination in residential real estate-related transactions based on race, color, religion, national origin, sex, familial status, or handicap.[4] The OCC enforces the Fair Housing Act as part of its authority to ensure national banks' compliance with applicable law.[5] Accordingly, the OCC examines national banks for compliance with the Fair Housing Act as well as ECOA.

The OCC has a nationwide network of examiners who comprehensively supervise all national banks in the national banking system. Our fair lending supervisory and enforcement process is designed to assess and monitor the level of fair lending risk in every national bank; assess compliance with fair lending laws and regulations; obtain corrective action when significant weaknesses or deficiencies are found in a bank's policies, procedures, and controls relating to fair lending; and ensure that enforcement action is taken when warranted, including referrals to the United States Department of Justice and notifications to the United States Department of Housing and Urban Development (HUD).

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[2] 15 U.S.C. § 1691(a); 12 C.F.R. § 202.4.
[3] 15 U.S.C. § 1691c(a)(1)(A).
[4] 42 U.S.C. § 3605.
[5] *See* 12 U.S.C. § 1818.

The OCC uses a combination of analytical tools, lending information, and risk-based targeted fair lending examinations to identify and test for potential discriminatory practices. As described in greater detail below, our supervisory process entails several steps including: (1) risk assessment and screening; (2) on-site examinations and, if appropriate, statistical analysis; and (3) enforcement and referrals.

2. *OCC Fair Lending Risk Assessments.*

The foundation of the OCC's supervisory process is the detailed, core knowledge that examiners develop and maintain about each bank's organizational structure, culture, business lines, products, services, customer base, and level of risk. The OCC's examination guidance directs examiners to consider fair lending risk as part of our supervisory process, including the nature, scope, and volume of the bank's activities, the quality of the bank's risk management systems and personnel, findings in previous risk assessments, and whether there have been recent changes in products, systems, or processes that may affect fair lending risk. Examples of factors related to fair lending that may be considered, as appropriate, in conducting risk assessments include Home Mortgage Disclosure Act (HMDA) data; types of products offered; origination channels, including reliance on third party brokers; pricing, underwriting, and compensation policies and procedures; internal controls, self-evaluations, and self-testing activities; servicing values, market environment, and profitability; loan application processes; complaint data; comments in the bank's CRA public file;[6] and the bank's own audit results.

[6] Banks are required to maintain a public file that includes, among other materials, written comments received from the public for the current year and the preceding two years specifically relating to the bank's performance in helping to meet community credit needs. 12 C.F.R. § 25.43.

3. *OCC Fair Lending Screening Process.*

While regular risk assessments allow examiners to establish a fair lending risk profile and supervisory strategy for each national bank, this process is augmented by the OCC's annual fair lending screening process. Through a successive series of steps and filters, the OCC identifies those institutions, loan products, markets, and prohibited basis categories that appear at greatest risk for discriminatory practices. When combined with our regular risk assessments, this screening process is central to our risk-based approach to fair lending supervision, because it focuses on the institutions where we then conduct our most in-depth fair lending examinations. The OCC periodically reviews and modifies its screening process to enhance its effectiveness, and to incorporate new sources of risk information as they become available.

The OCC uses HMDA data as part of the screening process. Each year, after the OCC receives HMDA data for national banks,[7] OCC economists run the data through multiple screens developed by OCC fair lending experts. These screens test for national banks that are outliers when compared to all national banks in terms of disparity ratios by race, ethnicity, and sex for: 1) denial rates; 2) the incidence of reported "rate spread" loans;[8] and 3) the presence of other indicators in HMDA data relating to possible differences in treatment in terms and conditions.

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[7] The Federal Reserve Board collects and compiles HMDA data and reviews the data for errors on behalf of the federal banking agencies. The reported information includes data on type and purpose of the loan; race, ethnicity and gender of the borrower and co-borrower; geographic location of the property; "rate spread" and HOEPA status; and action taken on the application. For a given year, the OCC generally receives HMDA data for national banks from the Federal Reserve in June of the following year. These files contain data on approximately eight million loan applications received by national banks during the prior calendar year.

[8] The term "rate spread" refers to the requirement in Regulation C (HMDA) that lenders report the spread between the APR on the loan and the rate of Treasury securities of comparable maturity. The requirement is triggered if the APR exceeds the Treasury security rate by 3 percentage points, for first lien loans, and by

In addition to these screens, the OCC analyzes HMDA data and Census Bureau data to assess application patterns in metropolitan statistical areas. We also incorporate information from the pricing screens that the Federal Reserve Board develops.

Finally, our annual screening lists contain two random sample components. First, the entire population of national banks is randomly sampled to develop a list of banks that will receive in-depth fair lending examinations. Even banks that do not report HMDA data face the possibility of an in-depth examination in any given year.[9] Likewise, banks that do not trigger our risk-based screening criteria face that possibility. The OCC also randomly samples OCC-supervised credit card banks to develop a separate list of those institutions that will receive fair lending examinations.

After we have developed preliminary screening lists, the lists are sent to examiners of the banks identified on the list for review.[10] The banks that appear on the final screening lists receive an in-depth, on-site fair lending examination.

4. *OCC Fair Lending Examinations.*

After we identify banks that appear to exhibit the highest fair lending risk through our fair lending risk assessment and screening, the next step is the fair lending examination itself. As part of our fair lending examinations, we use interagency fair lending examination procedures and additional OCC-developed analytical tools to evaluate whether different outcomes in lending decisions are the result of unlawful discrimination. Our examiners rely on the detailed examination guidance contained in

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5 percentage points, for subordinate lien loans. The term "rate spread loan" refers to a loan that meets these reporting thresholds. *See* 12 C.F.R. § 203.4(a)(12).

[9] For example, banks are not subject to HMDA reporting requirements in 2007 if they have assets of $36 million or less or if they do not have a home office or branch in a metropolitan area.

[10] In a small number of instances, banks may be added to, or removed from, the list based on recommendations by examiners concerning the level of fair lending risk.

interagency fair lending examination procedures, which were developed with the other Federal Financial Institution Examination Council (FFIEC) agencies.[11] These procedures contain guidance for assessing risks of unlawful behavior involving overt discrimination, underwriting and pricing discrimination, steering, and discriminatory redlining and marketing.[12]

When our examiners encounter information indicating different lending outcomes for similarly situated individuals or groups, our supervisory approach is to evaluate the factors a bank relies on to explain its credit decisions. We then reach our own conclusions about whether these factors are valid, business-related, and nondiscriminatory, and whether they do in fact explain the outcomes. If disparities remain that cannot be attributed to legitimate factors, then examiners preliminarily conclude that there is reason to believe that the disparities are the result of unlawful discrimination, and we then move to the enforcement and referral process described below.

For banks that have a large volume of applications, as well as a variety of loan product types, OCC economists may develop a statistical model to compare information from large numbers of files and to test for potential unlawful discrimination. The statistical model is an automated comparative file review of all applications or originations in a given population, such as all files relating to a particular loan product. This statistical tool allows us to compare and evaluate a large number of files simultaneously. As part of this process, examiners first review the bank's underwriting

[11] Comptroller's Handbook, *Fair Lending Examination Procedures* (Apr. 2006) (*Examination Procedures*), *available at* http://www. occ.treas.gov/handbook/fairlep.pdf. The OCC's *Examination Procedures* incorporate the Interagency Fair Lending Examination Procedures, as well as OCC-specific supplemental material.

[12] *Id.* at pp. 23-29.

and pricing policies, and then work with quantitative experts to construct a statistical model to test for potential disparate treatment. Once a model is developed, we focus on the magnitude and significance of the estimated disparities between prohibited basis groups and a control group, using standard statistical tests. These techniques help to identify particular applications or originations that appear to be outliers or to identify applicants who appear to be similarly situated, but who experienced different credit decision outcomes. The corresponding loan files then can provide examiners with a better starting point for file-by-file comparison than that which could be achieved through random selection.

In mid-size and community banks, many of which have smaller volumes of loans and less diversity in loan types, a fair lending examination typically involves a comparative file review, rather than the use of statistical analysis. Examiners review files to compare denied versus approved applicants who are similarly situated, or to compare the terms and conditions offered to such applicants. The fair lending examination procedures provide guidance on how to determine sample sizes and the types of files to compare.[13]

For all banks, when potential unlawful discriminatory results are found, examiners present their findings to bank management for an explanation. If the bank's explanation is inadequate to rebut preliminary examination findings, the findings are documented, and decisions are made on what OCC supervisory or enforcement action should be taken and on whether the matter must or should be referred to the Department of Justice or HUD.[14] This process is discussed in more detail below. Additionally, even

[13] *Id.* at pp. 16-17, 37-52 & App. D.
[14] *Examination Procedures,* at pp. 66-68 & App. C.

if no violation is found, where specific practices or a lack of adequate controls expose the bank to unacceptable risk that a fair lending violation could occur, the OCC will direct bank management to modify its practices or policies to address that risk.

B. The Enforcement Process

The OCC has broad enforcement authority to address violations of law, including ECOA and the Fair Housing Act.[15] Under this authority, we may take a variety of actions against banks and individuals, including cease and desist orders (which, in some circumstances, may direct the payment of restitution to affected customers), formal agreements, civil money penalties, and the removal and prohibition of "institution-affiliated parties" from participation in the banking industry. The agency also may take informal actions, such as entering into memoranda of understanding with the bank and actions pursuant to the safety and soundness order process.[16]

In addition to our independent enforcement authority, ECOA requires the OCC to refer matters to the Department of Justice "whenever the agency has reason to believe that 1 or more creditors has engaged in a pattern or practice of discouraging or denying applications for credit" in violation of ECOA's nondiscrimination provisions.[17] In cases not involving a pattern or practice of violations, the OCC has discretion to make a referral to the Department of Justice when it has reason to believe that discrimination has occurred or when it is unable to obtain compliance with the ECOA's provisions.[18] ECOA also requires the OCC to notify HUD when there is a reason to believe that a creditor has violated ECOA and the Fair Housing Act, but the matter is not referred to the

[15] 12 U.S.C. § 1818.
[16] 12 U.S.C. § 1831p-1; 12 C.F.R. Part 30.
[17] 15 U.S.C. § 1691e(g).
[18] *Id.*

Department of Justice.[19] Further, Executive Order 12892 requires each executive agency to forward to HUD information suggesting a violation of the Fair Housing Act. The information also must be forwarded to the Department of Justice if it indicates a possible pattern or practice of discrimination in violation of the Fair Housing Act.[20] Finally, a 1991 Memorandum of Understanding between HUD and the federal banking agency members of the FFIEC requires the agencies to notify HUD of complaints that appear to allege a violation of the Fair Housing Act.

Before the OCC takes an enforcement action or makes a referral, banks are provided with a letter containing preliminary findings of discrimination and are given an opportunity to respond in writing. If, after the response is considered, the supervisory office continues to believe that violations of ECOA or the Fair Housing Act occurred, the matter is reviewed by appropriate legal staff and senior OCC officials before final determinations are made regarding enforcement actions and referrals to the Department of Justice and HUD. In determining the appropriateness of an OCC enforcement action and the type of relief to seek, the OCC considers the nature of the violation, the extent of the harm, voluntary remedial action, and other factors.[21]

In 1994, the OCC became the first federal banking agency to use its cease and desist authority to take a public enforcement action against a bank under ECOA.[22] Over the next decade, the OCC took several other enforcement actions based on violations of

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[19] *Id.* at § 1691e(k).
[20] Executive Order 12892, Leadership and Coordination of Fair Housing in Federal Programs: Affirmatively Furthering Fair Housing § 2-204 (Jan. 17, 1994), *reprinted in* 42 U.S.C.A. § 3608 note (West 1994).
[21] Interagency Fair Lending Policy Statement, 59 Fed. Reg. at 18,272 (1994) (discussion of factors federal banking agencies will consider in determining appropriate enforcement sanctions and remedial measures).
[22] *In the Matter of First National Bank of Vicksburg, Mississippi*, No. 94-220, Stipulation and Consent Order (Jan. 21, 1994).

the fair lending laws.[23] These actions typically required the bank to change or enhance its policies and procedures and to take corrective actions to redress consumer harm, such as by paying restitution.

Since 1993, we have also made referrals to the Department of Justice and/or notified HUD of 38 matters under the referral and notification provisions of ECOA. Additionally, pursuant to the 1991 Memorandum of Understanding, the OCC has forwarded to HUD 92 complaints of discrimination filed with our Customer Assistance Group over the past five years.

Several of the OCC's referrals to the Department of Justice have resulted in public consent decrees or settlement agreements resolving litigation instituted by the Department. These matters have addressed a variety of loan products and types of alleged discriminatory conduct.[24] In other instances, after a referral, the Department of Justice has declined to take action and has requested that the OCC handle the matter through its own supervisory and enforcement processes. In several instances, the CRA rating of the bank involved in these matters was lowered.[25]

As previously noted, the OCC also has available a variety of supervisory mechanisms to address problematic practices or weaknesses in controls before such

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[23] *See In the Matter of: First Central Bank, N.A., Cerritos, California,* No. 99-13, Stipulation and Consent Order (Feb. 12, 1999), *available at* http://www.occ.treas.gov/ftp/release/99-23a.txt; Household Bank (SB), National Association, Las Vegas, Nevada, No. 2003-17, Formal Agreement (March 25, 2003), *available at* http://www/occ.treas.gov.FTP/EAs/ea2003-17.pdf.

[24] *See, e.g., U.S. v. First National Bank of Vicksburg*, Consent Decree (S.D. Miss. 1994), *available at* http://www.usdoj.gov/crt/housing/documents/vicksburgsettle.htm (settling allegations of race discrimination in the pricing of unsecured home improvement loans); *U.S. v. Huntington Mortgage Co.*, Settlement Agreement (N.D. Ohio 1995), *available at* http://www.usdoj.gov/crt/housing/documents/huntingtonsettle.htm (settling allegations of race discrimination in charging overages on mortgage loans); *U.S. v. Associates National Bank*, Settlement Agreement (D. Del. 2001), *available at* http://www.usdoj.gov/crt/housing/documents/assocsettle.htm (settling allegations of discrimination against Spanish speaking applicants and cardholders in credit card lending).

[25] *See, e.g.,* Public Disclosure, Associates National Bank, pp. 1, 5 (May 30, 1997), *available at* http://www.occ.treas.gov/ftp/craeval/jan99/22277.pdf; Public Disclosure, First National Bank of Gordon, pp. 3, 8 (Sept. 21, 1993).

issues lead to potential violations and formal enforcement actions or referrals to the Department of Justice would be necessary. Our fair lending supervisory process entails a number of steps, in ascending order of consequence, including our assessment and screening processes to identify banks exhibiting higher fair lending risks, fair lending examinations of those banks, corrective actions to address deficiencies, and finally, where necessary, enforcement actions to address violations of law or deficiencies in bank controls. Formal enforcement actions and referrals to the Department of Justice generally should be necessary only if the preceding measures have failed to ensure compliance with the fair lending laws. Our goal is to address fair lending risk through comprehensive and escalating supervision -- before it develops into illegal practices requiring referrals and enforcement.

When the OCC finds practices or weaknesses that could expose the bank to an unacceptable risk that a fair lending violation could occur, for example, we direct bank management to modify its practices or policies to address that risk. Significant problems can be addressed in a variety of ways, including through findings and conclusions, or as MRAs of bank management and boards of directors, in written reports of examination. To assist institutions in strengthening fair lending controls, our examiners also may provide supervisory recommendations. These may be contained in examination reports, or in other communications to the institution. These elements of the OCC supervisory process help to prevent bank practices from reaching the point where enforcement action or referrals to the Department of Justice are warranted.

II. THE OCC'S PROCESS FOR ASSESSING CRA PERFORMANCE

The Community Reinvestment Act[26] encourages each insured depository institution covered by the Act to help meet the credit needs of the communities in which it operates. The CRA applies only to banks and savings associations the deposits of which are insured by the Federal Deposit Insurance Corporation.[27] Affiliates of insured depository institutions that are not themselves insured depository institutions are not directly subject to the CRA.

The CRA requires each federal financial supervisory agency to assess the record of each covered depository institution in helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operations. The law also directs the agencies to take that record into account when deciding whether to approve an application by the institution for a deposit facility.[28]

Neither the CRA nor its implementing regulations provide hard and fast rules or ratios applicable to the examination or application processes. Rather, the rules contemplate an evaluation of each lender's record taking into consideration the individual institution's business model.

An institution's capacity to help meet community credit needs is influenced by many factors, including its financial condition and size, resource constraints, legal impediments, and local economic conditions that could affect the demand and supply of

[26] 12 U.S.C. § 2901 *et seq.* Credit unions, as well as non-depository institutions like mortgage companies, are not covered by the CRA.
[27] *Id.* §§ 2902(2), 2903(a)(1), 1813(c)(2).
[28] *Id.* § 2903(a)(1).

credit. Examiners must consider these factors when evaluating an institution's performance under CRA.[29]

The CRA regulation prescribes different evaluation methods tailored to respond to differences in institutions' structures and operations. For example, the regulation provides a streamlined assessment method for small institutions with assets of less than $258 million.[30] The small bank performance evaluation emphasizes lending performance by focusing on the bank's loan-to-deposit ratio, the percentage of loans made within the bank's assessment area, and the distribution of loans among borrowers and geographies of different incomes.[31] Intermediate small institutions, those with assets of at least $258 million but less than $1.033 billion, are examined under the same lending performance criteria as the smaller institutions, but also are evaluated on the community development activities in which they engage.[32]

Large banks – those with assets of at least $1.033 billion – are evaluated under three tests: the lending test, the investment test, and the service test.[33] The lending test performance criteria focus on the number and amount of loans originated in the bank's assessment area, the distribution of the bank's lending to individuals and geographies of different income levels, and the number and amount of the bank's community development loans.[34] The investment test is used to evaluate the number and amount of the bank's investments with a primary purpose of community development,[35] while the

[29] 12 C.F.R. § 25.21(b).
[30] *Id.* at §§ 25.12(u)(1), 25.26(a).
[31] *Id.* at § 25.26(b).
[32] *Id.* at § 25.26(a)(2), (b)-(c).
[33] *Id.* at § 25.21(a).
[34] *Id.* at § 25.22(b).
[35] *Id.* at § 25.23.

service test considers the retail and community development services that the bank has offered.[36]

Banks that are designated as wholesale or limited-purpose institutions are evaluated only on their community development activities.[37] Finally, the regulation allows any institution, regardless of size or business strategy, the choice to be evaluated under a strategic plan.[38] This type of flexibility and customizing permits institutions to be evaluated fairly and in conformance with their business approach.

Examiners review HMDA data, if the bank is a HMDA reporter, to gauge the number and amount of home mortgage loans and the loan distribution among borrowers and geographies of different incomes.[39] Similarly, if the bank is a large bank subject to CRA data reporting requirements, examiners review CRA data regarding small business, small farm, and community development loans. Prior to the examination, examiners often request additional relevant information from the bank.[40] For example, examiners may request information about (1) other relevant loan data that the bank would like examiners to consider; (2) investments that the bank has made that it would like considered; (3) branch location information, along with information about branches that were opened or closed during the examination cycle; (4) the types of banking products (loan and deposit) offered by the bank; (5) the bank's delineated assessment areas; and (6) the bank's performance context.

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[36] *Id.* at § 25.24.
[37] *Id.* at § 25.25.
[38] *Id.* at § 25.27.
[39] *See* Large Institution CRA Examination Procedures, at pp. 1, 4 (Feb.2006), available at http:/www.occ.treas.gov/ftp/bulletin/2006-17a.pdf; Small Institution CRA Examination Procedures, at p. 4 (Feb. 2006), available at http:www.occ.treas.gov/ftp/bulletin/2006-17b.pdf.
[40] *Id.* at pp. 117-119.

Upon the conclusion of CRA examinations, the OCC provides banks with written performance evaluations (PEs), which, unlike banks' Reports of Examinations, are publicly disclosed documents.[41] In a PE, conclusions are made about each performance criterion for the type of bank evaluated (e.g., large, intermediate small, small, etc.). These conclusions are supported by facts and data, which may be found either in the narrative discussion of the PE or in tabular form. A bank's rating(s) are derived from the conclusions about each performance criterion. An intrastate bank will have only one rating – a bank-wide rating. An interstate bank will have ratings for each state in which it has at least one branch or main office and for each multistate metropolitan area if it has at least one branch or main office in more than one state of the multistate metropolitan area, as well as a bank-wide rating. By statute, the ratings that a bank may receive are "Outstanding," "Satisfactory," "Needs to Improve," and "Substantial Noncompliance."[42]

The CRA limits the frequency of CRA examinations in institutions with aggregate assets of not more than $250 million that were rated Outstanding or Satisfactory in the most recent CRA examination. Such an institution is not subject to a routine CRA examination more often than (1) once every 60 months, if it received an Outstanding rating on its most recent examination; or (2) once every 48 months, if it received a Satisfactory rating on its most recent examination. The statute provides the OCC with discretion to examine these institutions more or less frequently, however, upon reasonable cause, as determined by the OCC.

For institutions with total assets of $250 million or less that received a rating of less than Satisfactory in the most recent CRA examination, the statute provides the OCC

[41] *See* 12 U.S.C. § 2906(b); 12 C.F.R. § 25.42(a)(2).
[42] 12 U.S.C. § 2906(b)(2).

with discretion to conduct routine CRA examinations as frequently as the OCC deems necessary.[43] The OCC ordinarily will begin a CRA examination for these institutions within 36 months of the close date of the prior examination.[44] For institutions with assets of more than $250 million, CRA examinations are normally scheduled to begin within 36 months after the close date of the last CRA examination.

III. THE EFFECT OF EVIDENCE OF ILLEGAL DISCRIMINATION ON A NATIONAL BANK'S CRA RATING

Beginning with the CRA regulations adopted by the federal banking agencies in 1978, one of the factors taken into consideration during a CRA performance evaluation has been evidence of prohibited discriminatory or other illegal credit practices.[45] In 1995, when the OCC and the other banking agencies revised their CRA regulations, evidence of discriminatory or other illegal credit practices was included as a factor that could adversely affect a bank's CRA evaluation.[46] The interagency regulations provided that, in determining the effect on a bank's assigned rating, the appropriate agency would consider the nature and extent of the evidence, the policies and procedures that the bank had in place to prevent discriminatory or other illegal credit practices, any corrective action that the bank had taken or has committed to take, particularly voluntary corrective action resulting from self-assessment, and other relevant information.[47] In July 2001, the agencies adopted guidance that explained that an institution engages in discriminatory credit practices if it discourages or discriminates against credit applicants or borrowers on

[43] 12 U.S.C. § 2908(a)(3).
[44] The OCC uses the term "close date" to refer to the supervisory office approval date.
[45] 12 C.F.R. § 25.7(f) (1979).
[46] 60 Fed. Reg. 22,156, 22,183 (May 4, 1995) (*codified at* 12 C.F.R. § 25.28(c) (1996)).
[47] *Id.*

a prohibited basis, in violation, for example, of the Fair Housing Act or ECOA (as implemented by Regulation B).[48]

In 2005, the agencies revised their joint CRA regulations to clarify that a bank's evaluation is adversely affected by discriminatory or other illegal credit practices by the bank regardless of whether the practices involve loans in the bank's assessment areas or in any other location.[49] The revised rule also provides that a bank's CRA evaluation is likewise adversely affected by evidence of discrimination or other illegal credit practices by any affiliate in connection with loans inside the bank's assessment areas, if any loans of that affiliate have been considered at the bank's election in the bank's CRA evaluation.[50] The adverse effect on the bank's CRA rating of illegal credit practices by an affiliate is limited to affiliate loans within the bank's assessment areas because, under the regulation, a bank may elect to include as part of its own CRA evaluation only those affiliate loans that are within the bank's assessment areas.[51]

Consistent with the regulation and guidance, at each CRA examination, examiners refer to a bank's fair lending evaluation to determine whether the bank's CRA evaluation should be affected by evidence of lending discrimination, and the examiner's findings are discussed in the public performance evaluation (PE). If no evidence of discrimination is found, this will be noted in the PE.

In determining the impact of a substantive fair lending violation or abusive lending practice on the CRA rating, interagency CRA regulations require the agencies to

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[48] Community Reinvestment Act; Interagency Questions and Answers Regarding Community Development, 66 Fed. Reg. 36,620, 36,640 (July 12, 2000). In 2005, the OCC codified the substance of this guidance. 70 Fed. Reg. 44,256, 44,267 (Aug. 2, 2005) (*codified at* 12 C.F.R. § 25.28(c)(1)(i) (2006)).
[49] 70 Fed. Reg. 44,256, 44,267 (Aug. 2, 2005) (*codified at* 12 C.F.R. § 25.28(c)(1)(i) (2006)).
[50] *Id.*
[51] *Id.* at p. 44,263.

consider a number of factors. These factors include the nature of the violation, the extent of the problem, whether the bank self-identified the issue, whether the bank has initiated corrective action, whether the bank has a compliance monitoring system, and any other relevant information.[52] Decisions about the impact of evidence of illegal discrimination on a bank's CRA rating are made on a case-by-case basis and supported in the bank's report of examination and CRA PE.

The CRA PE language discusses substantive violations or findings resulting from illegal discrimination and other illegal credit practices inconsistent with helping to meet community credit needs that adversely affect the evaluation of an institution's CRA rating. A CRA PE would not include a description of the fair lending supervisory activities when no substantive violations have been found.

In several instances, the OCC has concluded that a national bank's CRA performance was adversely affected by evidence of unlawful lending discrimination. In some cases, the bank's rating was lowered to Needs to Improve based on substantive violations of the fair lending laws.[53] In one instance, the bank was rated Satisfactory because of its discriminatory or other illegal credit practices, even though it had otherwise demonstrated Outstanding CRA performance.[54] In other instances, the OCC has described the violations in the CRA PE and taken them into account in evaluating

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[52] 12 C.F.R. § 25.28(c)(2).
[53] *See, e.g.*, Public Disclosure, Spirit of America National Bank, pp. 1, 7 (Oct. 15, 2002), *available at* http://www.occ.treas.gov/ftp/craeval/aug03/22183.pdf; Public Disclosure, First Central Bank, N.A., pp. 1, 8 (June 18, 1998), *available at* http://www.occ.treas.gov/ftp/craeval/oct98/18695.pdf.; Public Disclosure, Associates National Bank, pp. 1, 5 (May 30, 1997), *available at* http://www.occ.treas.gov/ftp/craeval/jan99/22277.pdf.
[54] *See* Public Disclosure, Household Bank (SB), N.A., pp. 5, 9-11 (Apr. 30, 2001), *available at* http://www.occ.treas.gov/ftp/craeval/jan04/22675.pdf.

CRA performance, but has determined that lowering a rating was not appropriate based on its assessment of the circumstances.[55]

Generally, evidence of illegal discrimination is detected by bank examiners and then, as described above, appropriate enforcement action is taken and matters are referred to DOJ as required or appropriate. In these situations, the OCC will be able to take such information into account during the bank's next CRA examination. In rare circumstances, a CRA PE may not reflect fair lending issues that are the subject of a subsequent DOJ investigation, because of the timing of the CRA examination and the discovery of evidence of substantive fair lending violations. This is the situation with respect to the pending investigation by the Department of Justice of the First National Bank of Pontotoc. In such cases, including the fair lending investigation of the First National Bank of Pontotoc, the OCC will evaluate any findings by the Department of Justice and evidence of unlawful lending discrimination will be considered at the bank's next CRA evaluation. Also, the OCC will conduct its own review as appropriate of the fair lending implications of conduct that is under investigation by the Department of Justice.

CONCLUSION

I appreciate the opportunity to discuss the important nexus between fair lending compliance and helping to meet community credit needs. The OCC is committed to ensuring that our evaluation of national banks' CRA performance appropriately reflects any evidence of unlawful discrimination, consistent with the interagency CRA

[55] *See, e.g.*, Public Disclosure, Belk National Bank, p. 6 (May 6, 2002), *available at* http://www.occ.treas.gov/ftp/craeval/mar03/23726.pdf; Public Disclosure, Dillard National Bank, p. 8 (Oct. 9, 2001), *available at* http://www.occ.treas.gov/ftp/craeval/feb02/18777.pdf.

regulations. Along with our robust fair lending examination and enforcement process, the CRA process is an important "tool" in federal law that we use to address, and to help prevent, unlawful discrimination.

I will be pleased to answer any questions that you may have.

Mr. KUCINICH. Thank you very much for your testimony, Ms. Jaedicke.

We are pleased to be joined by Mr. Davis of Illinois. Thank you for being here and for your participation.

I want to start off with Ms. Thompson.

Ms. Thompson, in a meeting, FDIC representatives told my staff that they are not proud of their failure to note Centier's discriminatory practices. Would you agree that this is the FDIC's general attitude toward the Centier example?

Ms. THOMPSON. Mr. Chairman, as the head of supervision and consumer protection, I can assure you that is the FDIC's position on how we handled that particular situation.

Mr. KUCINICH. And, Ms. Braunstein, my staff's experience with the Fed was a lot different. During their meeting, a Fed representative told my staff that the Fed did not make any mistakes in their CRA examination of Old Kent Bank. This is despite the Department of Justice prosecution against Old Kent Bank for FHA and ECOA violations.

I was reading Bloomberg news accounts of this meeting today, and you are quoted as saying, if this quote is accurate, that banks can always do more.

Is your position that Old Kent Bank could have done more—that is, by following the law—or that, in the Fed's view, Old Kent Bank was compliant with the CRA?

Ms. BRAUNSTEIN. Congressman, that incident took place 8 years ago, and the institution no longer exists. The people who were involved in that matter at that time no longer work for the Federal Reserve. And it is, frankly, impossible for me to reconstruct what took place at that time to really opine one way or another.

I will tell you that, based on the circumstances that ensued, we find the situation to be very troubling. And we do take redlining very seriously, and we have proven that with our record of referrals to Justice for redlining cases. We are not hesitant to pull the trigger when we identify redlining.

It is very difficult—it is basically impossible for me to address the specific facts.

Mr. KUCINICH. But you are familiar with the case?

Ms. BRAUNSTEIN. I am familiar with what we know at this time about the ratings. I don't have the benefit of talking to the examiners to find out how they made their judgments.

Mr. KUCINICH. Can you say that Old Kent Bank was misgraded?

Ms. BRAUNSTEIN. I would have to try to reconstruct how they came to that conclusion. And I don't think that I can reconstruct their thought processes from 8 years ago.

Mr. KUCINICH. Well, you said a moment ago it was troubling.

Ms. BRAUNSTEIN. I also don't think that it is a fair representation to take one case out of thousands of bank exams we use and try to characterize our entire record.

Mr. KUCINICH. This isn't about characterizing your entire record, although your entire record is in question here. It is about trying to see how the Fed responds when questioned about a specific case which seems to be quite an egregious example of a lack of oversight.

Now, I will take into consideration that this was 8 years ago, that the institution is gone, that the players are gone. But it would be instructive for this committee to be able to learn from the Fed should it have been done differently, would you do it differently, or don't you know enough about it to make an assessment, which, to me, would mean that we still are in the category of lessons to be learned. So help us out, please.

Ms. BRAUNSTEIN. Well, I don't think I know enough about that specific case to make a determination. However, I will tell you that we are constantly looking at ways to improve our processes around examinations for Community Reinvestment Act as well as fair lending. We constantly tweak our procedures. We constantly try to find ways to improve. As I said this morning, there is always room for banks to improve; there is certainly always room for us to improve.

Mr. KUCINICH. So the Fed can always do more?

Ms. BRAUNSTEIN. And I will commit to you we will continue doing that.

Mr. KUCINICH. Would you then agree with the statement the Fed could always do more?

Ms. BRAUNSTEIN. Absolutely, absolutely.

Mr. KUCINICH. Thank you.

My 5 minutes has expired. I want to go to Mr. Davis for the next round of questions.

The Chair recognizes Mr. Davis. Thank you.

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

And I want to thank the witnesses for being here and for participating.

The Department of Justice filed a complaint against First National Bank of Pontotoc, MS, in April 2006, alleging that First National's former vice president violated the Equal Credit Opportunity Act and that the bank is responsible for the discriminatory conduct during the vice president's tenure. The complaint alleged that while he was serving as the vice president at First National in 2003 and 2004, he had sought sexual favors in return for favorable loan decisions. He left the bank in May 2004.

During this time between 1993 and 2003, the OCC gave First Bank passing scores, even as the vice president in question was stepping down. In fact, the 2004 CRA exam of First National states that in the, "fair lending or other illegal credit practices review," an analysis of public comments and consumer complaint information was performed according to the OCC's risk-based fair lending approach. Based on its analysis of the information, the OCC decided that a comprehensive fair lending examination would not need to be conducted in connection with the CRA evaluation this year. The latest comprehensive fair lending examination was performed in 1998.

I would like to ask you, Ms. Jaedicke, you did not conduct a fair lending exam of First National because your agency felt that the risk-based approach that you use—as a result, there was no need for an exam. Is that correct?

[The prepared statement of Hon. Danny K. Davis follows:]

OPENING STATEMENT
CONGRESSMAN DANNY K. DAVIS
DOMESTIC POLICY SUBCOMMITTEE
OVERSIGHT AND GOVERNMENT REFORM COMMITTEE
"UPHOLDING THE SPIRIT OF THE CRA: DO CRA RATINGS ACCURATELY REFLECT BANK PRACTICES"

WENDESDAY, OCTOBER 24, 2007

2154 RHOB- 2:00 P.M.

I'd like to begin by thanking Chairman Kucinich and Ranking Member Issa for continuing the investigation of predatory lending. In today's hearing, we're examining the federal regulatory agencies role in upholding, or ensuring compliance of the Community Reinvestment Act (CRA). It's common knowledge that CRA was spawn from national grassroots pressure for affordable housing. Yet today we're called upon to scrutinize coincidences that raise concerns as to whether or not CRA vague mandates (language) and exams are fulfilling intended purposes; to provide credit, including homeownership opportunities to underserved populations and commercial loans to small businesses.

Indeed, we've provided a litany of problems for your consideration including:

- Data that reveal a disproportionate share of African-American and Latinos receiving higher rate home loans withstanding risk assessments, borrower's income and property location;
- Non-disclosure of fair lending exams and lack of transparency, thereby compromising communities of their right to participate in public negotiations; and
- CRA's lack of uniform standards, where "reasonableness" of assessment areas, as well as "nature, extent and strength of evidence" of discriminatory practices are at the discretion of examiners.

Moreover, the case of the Fed satisfactory rating and approval of Old Kent's expansion of branches throughout predominantly white suburbs encircling and excluding the City of Detroit and merger with Fifth Third in 2003, a large depository institution with locations in ten states, is particularly perplexing. Especially in light of the Fed acceptance of Old Kent's "assessment area", which ultimately lead to the Department of Justice (DOJ) prosecution of Old Kent for FHA and ECOA violations.

This outcome illustrates a clear disconnection between the Fed and DOJ's interpretations of CRA's mandates. More broadly, the aforementioned outcomes raise questions about CRA's language, interpretation and financial regulators. Specifically:

- Does CRA's current language provide financial institutions too much leverage in determining "assessment areas" and inadvertently contribute to discriminatory conditions?
- Are financial regulators exercising due diligence when administering CPA exams and upholding the creditability of CRA exams?
- How is it that two reasonably intelligent government agencies have "two different" interpretations of CRA mandates?
- Is CRA fulfilling its intended purpose to provide credit, including home ownership opportunities to underserved populations and commercial loans to small businesses?

I submit these questions to the Oversight and Government Reform Committee and guest panelists for consideration and input.

Ms. JAEDICKE. Yes, sir, at the time, based on the information we had during our 2004 CRA exam.

And let me add that the issues at First National Bank of Pontotoc are quite disturbing to us, but the allegations surrounding the bank emerged contemporaneously with the exam that we were doing in 2004. Shortly thereafter, the Department of Justice opened up an investigation and asked us to stand down. So when the Department of Justice finishes their investigation and we have their findings, we will take them into account as part of the next CRA examination.

Mr. DAVIS. Could you explain to us what your risk-based approach is?

Ms. JAEDICKE. Certainly. Our fair lending supervision process really has three features.

The first is the knowledge and experience that our bank examiners have with the banks that they supervise. And that involves the bank's products and services, its customer base, the type of communities they operate in, the type of complaints they are receiving from consumers or community groups. Examiners process that information as they receive it. And if, based on any of that information, they decide that they are concerned about a fair lending issue, they can initiate a fair lending exam. That is the first feature.

The second feature of our fair lending supervisory process is really analytically based. We process information from the HMDA data submitted by banks each year and additional information that lets us screen the population of national banks to look for banks that may have disparate issues or issues that cause us concern, raise questions about fair lending. If we find that, we will put those banks on a list to be examined in the coming year.

And the third feature is a random sample. We select a group of banks to be examined in the coming year each year, so that there are banks that, if we perhaps have no other reason to look at those banks for fair lending issues, are examined anyway.

Mr. DAVIS. And is the fair lending exam meant to be complaint-based, that, as a result of complaints, you determine——

Ms. JAEDICKE. No, sir, it is not solely complaint-based. But, certainly, if we had complaints or information from community groups that caused us concern, it could initiate a fair lending exam.

Mr. DAVIS. So the purpose of the exam to regulate the banks and ensure that they are in compliance with fair lending laws like the FHA and the ECOA, if you wait for a consumer to tell you that they are in violation of those laws, then it is your job just to follow-up. I am saying, if you get complaints and the consumers are saying, "We think that they are violating thus and so," is it your task to just followup?

Ms. JAEDICKE. We certainly would followup if we had complaints like that. But that is not the sole basis that might lead to a concern on our part around fair lending issues.

I will give you another example. If a national bank were to choose to enter a new market that would involve lending to a Hispanic customer base or an African American customer base and we had reasons to be concerned about the products they were offering, that might cause an examiner to initiate a fair lending exam.

Again, if we saw information in the HMDA data filed by national banks every year that caused us to be concerned—and we analyze that information every year—that could cause us to initiate a fair lending exam.

So, a variety of different things could occur that would cause us to initiate a fair lending exam.

Mr. DAVIS. And, finally, let me just ask you, is it possible that because there has not been a fair lending exam in 6 years for this particular bank before the case was brought to the Department of Justice's attention, that First National may be violating other lending laws but you just weren't aware of them because there was no examination of the bank?

Ms. JAEDICKE. I think in the situation of First National-Pontotoc—which is a bit unusual because it involves sexual harassment, and sexual harassment, by its very nature, is surreptitious—it would be an issue that would be quite difficult for us to uncover as part of a bank examination.

Nonetheless, once the Department of Justice concludes its investigation, we will review the findings of that investigation, take them into consideration in our next CRA exam. And if there are other indications in that investigation of something we feel like we need to look at at First National Bank of Pontotoc from a fair lending standpoint, we will do that.

Mr. DAVIS. So there may be others, but you just really wouldn't know, because of the nature of the examination.

Ms. JAEDICKE. Yes, sir.

Mr. DAVIS. Thank you very much.

And, Mr. Chairman, I want to thank you for your indulgence. I know that my time has ended.

Mr. KUCINICH. We are going to go to another round of questions.

I continue to be concerned about the Fed's approach to enforcement. We have just reviewed the fact that the Old Kent Bank case was 8 years old. The Fed has had 8 years, a lot of time to learn from experience.

Now, the 1997, 1999 and 2001 exams had virtually the same language on Old Kent's compliance with anti-discrimination laws. Here is how it reads: "the bank is in compliance with the substantive provisions of anti-discrimination laws and regulations, including the Equal Credit Opportunity Act [ECOA], and the Fair Housing Act. No substantive violations were noted. The bank is also in compliance with the technical requirements of the Community Reinvestment Act. The public file and CRA notices were reviewed and deemed to be in compliance."

Ms. Braunstein, who oversaw the work of this CRA examiner?

Ms. BRAUNSTEIN. The CRA examination was done by the Federal Reserve Bank of Chicago. All the exam work is done by the Reserve Banks. And there are various layers of management over those examiners. There are certainly layers of management at the Reserve Bank itself, as well as examinations are a delegated function in the Federal Reserve System, so ultimately reported to Washington, DC.

Mr. KUCINICH. So the structure of oversight, you have the examiner and then someone who reviews the work of the examiner. Who would that be?

Ms. BRAUNSTEIN. Correct. That would be probably a reviewing person at the Reserve Bank.

Mr. KUCINICH. And then who would check that work?

Ms. BRAUNSTEIN. I would imagine their management, whether it is a vice president of the Reserve Bank, a manager or assistant vice president, depending—each Reserve Bank has a different hierarchy.

Mr. KUCINICH. So is there an oversight body involved here in reviewing an examiner's conclusion?

Ms. BRAUNSTEIN. Well, yes, absolutely, on every examination. Also, I will add that the examinations ultimately come into Washington and that people at the Board do review a portion of those examinations, looking for consistency and making sure policies are being enforced.

Mr. KUCINICH. Now, in this particular case, the record shows that the examiner's conclusion was not questioned by a Federal oversight body and it basically concurred. Why was this examiner's conclusion, which I had recited to you earlier, not questioned by a Fed oversight body?

Ms. BRAUNSTEIN. Well, I don't know that it wasn't. If a conclusion is questioned, it doesn't mean that would necessarily show up in the report. What you see in the report is the final conclusion. That doesn't preclude that there was some discussion. And there, again, it is nothing that I can reconstruct, to tell you whether that happened or not.

But I also just want to add that our examiners undergo very rigorous training, specifically in CRA and fair lending. That is a specialty at the Fed. These examiners are doing consumer compliance work. They are not doing safety and soundness work. They are trained. There is always a degree of subjectivity and judgment that goes into these examinations. And we train our examiners. We continue to—we have continuing training for them. And, at some point, we have to trust their judgment.

We do discuss—management does discuss conclusions with them. And so, that would not necessarily show up in the report, but it doesn't mean it didn't go on.

Mr. KUCINICH. I would like you to look at this map now. And we had described the map to you earlier. Would you call this reasonable?

Ms. BRAUNSTEIN. Well, I can't see what the legend is over there, what the different colors mean.

Mr. KUCINICH. The red area represents no branches. And it also happens to be the city of Detroit.

Let me refresh your memory about the context of this, OK? You see a donut hole around the city of Detroit, which is 81 percent African American. The Department of Justice filed suit against Old Kent Bank in 2004 for violating the Fair Housing Act and the Equal Credit Opportunity Act. The Department of Justice cited a Section 228 violation and said, "Instead of defining its assessment area in accordance with Regulation BB, Old Kent Bank circumscribed its lending area in the Detroit MSA to exclude most of the majority-African American neighborhoods by excluding the city of Detroit. And as of March 2000, Old Kent still did not have a single branch in the city of Detroit."

Now, I am contrasting that with the statement that the Fed made with regard to Old Kent's compliance with anti-discrimination laws. These are quotes from the 1997, 1999 and 2001 exams. "The bank is in compliance with the substantive provisions of anti-discrimination laws and regulations, including the Equal Credit Opportunity Act and the Fair Housing Act. No substantive violations were noted. The bank is also in compliance with the technical requirements of the CRA."

The public file and CRA notices were reviewed and deemed to be in compliance. I am going to ask you again, look at the map. Would you call it reasonable?

Ms. BRAUNSTEIN. I find it very troubling, but, again, there are other things that go into the consideration of an assessment area, such as the banks, what is reasonable for the bank to be serving, considering the location of its branches. Like I say, I don't have——

Mr. KUCINICH. I'm going to have to stop you a minute. I want you to look with your eyes, OK? Then I want you to look with your heart and see if you can tell me, when you look at that, everything—you have an African American population there in the city of Detroit. It corresponds neatly with what's in red. Then you have the rest of the area in terms of assessments. And you see where the CRA it said that they are in compliance; and they are clearly not, if you look at the map.

Ms. BRAUNSTEIN. Well, like I say, I find this very troubling. And I will say this. If this were to come before me today on an exam that we were doing, I would have serious questions about it.

Mr. KUCINICH. Would you say this is what red-lining looks like?

Ms. BRAUNSTEIN. It certainly could, yes.

Mr. KUCINICH. Did the Fed refer the Old Kent case to the Department of Justice?

Ms. BRAUNSTEIN. No, it did not.

Mr. KUCINICH. Why didn't the Fed take any of its enforcement actions before then?

Ms. BRAUNSTEIN. That I cannot answer.

Mr. KUCINICH. And why didn't the Fed at least hold the public hearing during any one of its CRA exams?

Ms. BRAUNSTEIN. Well, are you talking about applications?

Mr. KUCINICH. I'm talking about during the process of an examination, review of the CRA.

Ms. BRAUNSTEIN. We don't hold public hearings during examinations.

Mr. KUCINICH. That's the point.

Ms. BRAUNSTEIN. We hold public meetings during applications.

Mr. KUCINICH. Well, OK, I am talking about applications.

Ms. BRAUNSTEIN. OK. We hold—and I will tell you in that sense I know in terms of the Fifth Third application.

Generally in any application we are looking most closely at the record of the acquiring institution. Because especially if there are problems with the target and the acquiring institution has a good record, we have conversations with them to make sure that they are going to bring the target institution up to the standards that they currently have.

Mr. KUCINICH. Now your enforcement authority under the CRA is the ability to assign a low rating, which would impede a banking

institution's ability to expand by merging with other banks, acquiring other companies and branching. You didn't exercise that authority when you examined Old Kent, but you had another chance to exercise your authority when Old Kent applied to merge with Fifth Third Bank. Did you hold a public hearing to discuss the merger?

Ms. BRAUNSTEIN. No, we did not.

There are a couple of things there. One is, the Justice Department investigation was still under way so we had absolutely no idea of what their findings were at that time. Also, as I said before, we are looking much more closely at the acquiring institution rather than the target, and Fifth Third was the acquiring institution.

Mr. KUCINICH. Did you see the map, though? Did anybody look at the map, and—I mean, let's set aside the Department of Justice for a minute.

Ms. BRAUNSTEIN. During an application, we generally look at the exams. The exams figure into the process, the previous examinations.

Mr. KUCINICH. And so you didn't hold—you did or didn't hold a public hearing?

Ms. BRAUNSTEIN. We did not hold a public——

Mr. KUCINICH. Did you condition Fifth Third's acquisition on serving Detroit?

Ms. BRAUNSTEIN. As far as I know, we did not.

Mr. KUCINICH. Why didn't you do that?

Ms. BRAUNSTEIN. I don't know. I can't answer that.

Mr. KUCINICH. All right. You could have done that; is that correct? You have the power to do that?

Ms. BRAUNSTEIN. We do have the power to condition.

Mr. KUCINICH. An acquisition. So you had the power to condition an acquisition on serving a population, which, by just a quick look at a map, you could tell that there was red-lining going on and you didn't do it. Now did you solicit feedback from the community to decide what the acquiring bank would need to do to better serve the community?

Ms. BRAUNSTEIN. With any application we have a public comment process.

Mr. KUCINICH. And what about the public comment process on that particular case? Did you go out to the community? You didn't hold hearings, you said, but how was the public able to know that there was an opportunity to come?

Ms. BRAUNSTEIN. Anytime there's an application, it is advertised in community groups or anybody—citizens, whoever, other financial institutions—anybody can file public comments with us.

Mr. KUCINICH. And how are people advised of that?

Ms. BRAUNSTEIN. We—its—there's a newspaper notice. There is—you know, generally, it's never been a problem for people to know about that.

Mr. KUCINICH. Did you take out newspaper ads in the African American community to let people know that they could comment?

Ms. BRAUNSTEIN. I am not aware of exactly where it was advertised at that time. That was a number of years ago.

Mr. KUCINICH. I think it would be instructive.

Let me make clear something for those who are in the audience and may be watching, that staff has met with the Fed and there really aren't any surprises, that we're going in-depth here into talking about Old Kent. This is not something that we're just pulling out of a hat. This is a very serious question that is quite blatant.

And, of course—as a personal concern, I know Mr. Davis, who represents Chicago, has a personal concern here; and I share it. But we also have a situation in Cleveland where we see people couldn't get loans. They are thrown into subprimes, they end up not being able to meet the requirements, they lose their homes, and we've got whole neighborhoods that are being decimated.

And, you know, the public policy issue here, frankly, is one where if banks are permitted to avoid the requirements of the CRA and then people can't get the loans, they then get thrown into the clutches of subprime lenders, the most predatory of lenders out there; and then they are going to get destroyed financially and lose their homes.

So, to go back to the Fed, do you understand why this committee feels the Fed has not only a legal obligation here but a moral obligation to the people of the United States to exact oversight in a manner which insists on compliance with the letter of the law? Do you understand why this committee has a concern about the imperative of Fed enforcement here?

Ms. BRAUNSTEIN. Congressman, we share that concern. We take these matters extremely seriously, and we have shown that through our fair lending record, our record of referrals to Justice. Like I say, I cannot explain how this case happened, but we have not hesitated to pull the trigger when we have found red-lining in other financial institutions. It is not like we have no record of pulling the trigger on cases like this.

Mr. KUCINICH. Well, you know, when you look at the wreckage that subprime loans are leaving in neighborhoods across America and when you look at the lack of the apparent lack of effective oversight of CRA—because if people had the money, if they got the loans from the prime lenders whose responsibility it is under CRA, they wouldn't have been thrown into the arms of the subprime lenders. That's the point.

With all due respect—and, again, I am very grateful that you are here; we couldn't do this hearing without you—but we also can't have an effective oversight without the Fed's active participation. And at this point, notwithstanding your profession of concern, a quantitative assessment does not rest in your favor. And while the Fed and all the members of the Fed can go home tonight and rest easy in their townhouses and their apartments and in their homes, as they should be able to do, there are millions of Americans who maybe are losing their homes and are out of their homes and some of them on the street. This is not a small matter.

The Chair recognizes Mr. Davis.

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

Ms. Braunstein, let me ask about voluntary corrective action. Does this regulation suggest that if a bank corrects its discriminatory behavior, then the regulator will not reflect the discriminatory practice in the CRA exam?

Ms. BRAUNSTEIN. No, it does not suggest that at all. In fact, even if a bank corrects its behavior, if there was a pattern of practice of discrimination, we have reason to believe that there was, despite a correction, we will make a referral to Justice. We also will reflect the discrimination in the public evaluation of the CRA report.

Mr. DAVIS. So you're not grading the bank based on its performance exactly, are you? Or is it some performance and some of what it says it's going to do?

Ms. BRAUNSTEIN. Well, there's a difference between—I'm trying to—I'm not sure I understood your question, but there's a difference between the CRA rating that is given and the public evaluation report. The rating is part of the report. So I think what we're saying, and this is true of all of us, is that in some cases a finding of discrimination may not result in a downgrading of the rating. However, even if that happens, it will be reflected in the written report on CRA.

Mr. DAVIS. Let me ask you, if a bank like Old Kent says, in 2001, we're sorry, we'll open up a branch in the city of Detroit, even though we haven't done so as of yet, we're legally mandated to do for the past 5 years, would this bank get a lower CRA rating or would this satisfy the requirement?

Ms. BRAUNSTEIN. If we find a red-lining violation, first of all, we would be mandated to refer that to Justice; and, second of all, something that egregious would likely result in a downgrade in this hearing rating.

Mr. DAVIS. And let me go to other members of the panel.

Of course, we have data that reveals a disproportionate share of African American assessments, African American and Latinos receiving higher-rate home loans, notwithstanding location, income. We see non-disclosure in fair lending exams and lack of transparency, thereby compromising entire communities of their right to participate in public negotiations; and CRA's lack of uniform standards where reasonableness of assessment areas, as well as nature, extent and strength of evidence of discriminatory practices are at the discretion of the examiner.

I guess what I'm really trying to arrive at is this business of when is enough or how do you decide? The question then becomes, what level of evidence is sufficient to adversely impact an agency's CRA valuation?

Ms. Thompson, perhaps I would——

Ms. THOMPSON. Well, a couple of things. At the FDIC, consumer protection is very important. Not only do we look at access to credit, which was very relevant 30 years ago and it is just as relevant today, we look at cost of credit. Because in many of the low-income and moderate-income neighborhoods, they are proliferated by high-cost credit products that may or may not be offered by financial regulated entities such as financial institutions.

At the FDIC, we are encouraging unbanked and underserved persons to come into the banking sector. And through our examination process we think one violation is one too many, and we always advise the bank to take corrective action.

To the extent that we find patterns and practices of either denial of credit or high-cost credit, we take action relatively quickly; and we take that information and we factor it into the rating for the

compliance exam for that institution and also the CRA rating. This year alone the FDIC has made 13 referrals to the Department of Justice for fair lending issues, and we've also downgraded two institutions in 2007 with respect to their CRA rating. This is something very important to the FDIC, it is important to our chairman, and we want to ensure that our examiners take corrective action where appropriate.

Mr. DAVIS. Thank you.

Ms. Yakimov, how would you respond to that?

Ms. YAKIMOV. We look at the fair lending record of our institutions very closely. We look at the HMDA data. We combine it with factors that aren't included in the HMDA data like loan to value, the broker compensation, credit score. And fair lending reviews take place at every comprehensive exam, every 12 to 18 months. We do target reviews. We've, as I said, built some additional models and tools to run the data through.

And, again, if we see evidence of discrimination or other illegal credit practices, that will have an impact. Not only will that be reflected in the fair lending evaluation, but it will also have an impact on the CRA rating. And we look again at the scope of the evidence, we look at the CRA performance of the institution in its totality, but that's a significant factor if we do find those concerns.

Mr. DAVIS. Ms. Jaedicke.

Ms. JAEDICKE. Congressman, findings of illegal credit practices of discrimination adversely affect the CRA ratings of national banks. Equally important, a poor lending record by a national bank or a bank that is not serving the credit needs of its community, including low- and moderate-income areas, is equally likely to get an adverse CRA rating.

Mr. DAVIS. You know, I'm always amazed that, in spite of the fact that we've had CRA now for 30 years, and yet, when we look at certain communities in certain areas, we don't seem to get a tremendous amount of difference in some of those. The same groups continue to have the most difficult time, still continue to pay the most for credit, still seem to not be able to acquire, in many instances, decent credit.

Is there something else that any of you might be able to think of that might be missing? I mean, I happen to actually live in the community that was a hotbed of the generation of activity that resulted in CRA. A woman named Gail Cincotta used to live in the same neighborhood where I lived. As a matter of fact, I was a member of Gail Cincotta's first organization, the Organization for a Better Austin, before she left and came to Washington and organized the National Training and Information Center. So I've kind of seen this over the period of time.

What else could perhaps—if there's anything?

Ms. THOMPSON. Congressman, I happen to have been privileged to have been born and raised on the south side of Chicago, which is the home of CRA, as you well know, but I can tell you that at the FDIC we take a very proactive approach to economic inclusion.

We have within our organization a concerted effort to try to bring the unbanked and underserved persons that the chairman referenced in his opening statements into the banking sector. In eight territories we have formed alliances with community groups, finan-

cial institutions and other regulators to try to find out why people are not coming into the banking system, and we are trying to figure out ways to encourage them to participate more fully in the financial services that are offered by regulated entities. Because, again, so often in these communities many of the occupants are subject to higher-cost products, whether it is financial services or not.

This is a very important initiative to our chairman, and we do take proactive steps to try to encourage the regulators to work with community groups and financial institutions to try to better address this issue.

Mr. DAVIS. Ms. Braunstein.

Ms. BRAUNSTEIN. Congressman, I would add to that we don't lose sight of the fact of the accomplishments of CRA over the last 30 years. It has been documented differently in different places, but I don't think anyone would argue that CRA has brought billions of dollars into neighborhoods that previously had very little, if any, bank investment or bank participation.

I do believe there is a lot more to be done and needs to be done both on the part of the regulators as well as on the part of the financial institutions. I also think that, unfortunately, CRA is not the panacea or the answer to everything, all the problems that exist economically in low-income communities, and it will never be able to solve all the problems.

Ms. YAKIMOV. I would add we have seen a real democratization in credit, and I think it is incumbent upon us for both sides of our houses to function effectively. So we're talking a lot about CRA and the provision of credit particularly to low- and moderate-income people. We want the types of credit that are sustainable, that allow people to stay in their homes. So we need to make sure that underwriting is what it ought to be. That's another part of what we're called upon to do. And I think we issued guidance in the last—recently going back to 2006 that really began to move the industry to what our expectations were in terms of sound underwriting. They are both important.

Ms. JAEDICKE. I would add that I think it is very important for us as regulators to help keep the dialog going between banks and community groups. I know at the OCC in the last 5 years we've held a thousand meetings with different community groups around the country, trying to understand what the needs are so that we can make better assessments in our CRA exams and we can help banks understand what communities need.

I also think financial literacy is always an important issue, and to the extent that we can contribute as regulators in those areas I think we should. And I think we need to closely look at what's happening in the subprime market and the environment we are working in now to see if we can learn how people are being affected by the current environment.

Mr. DAVIS. Well, let me thank you again, Mr. Chairman. Let me thank all of you. I will have to dash away to something else.

But I do want to say that I would certainly agree, relative to some of the impact that CRA has actually had, even from a personal experience, I actually sat on the board of a bank for 10 years as a result of my community being engaged to the extent that we

held up the purchase of a bank until there was an agreement with our reinvestment policy, and it has been a good experience. And I actually sat there with no personal interest in the bank, I didn't own any of the stock and only left after I got elected to Congress because I wouldn't have time to go to the meetings at all. So I think that CRA has had some impact, can have even more; and I think an activated community is probably one of the best things that I really can think of to help make sure that the concepts really work.

So I thank you all; and I thank you, Mr. Chairman, again for your indulgence.

Mr. KUCINICH. Mr. Davis, it's an honor to have you on this subcommittee, because you and I share a passionate commitment to people in urban areas, and these economic issues are fundamental to people's survival.

I just heard Ms. Jaedicke talk about financial literacy; and, you know, it's a generally accepted provision in the marketplace to say caveat emptor, let the buyer beware. People buy credit. When you consider the fact that bankruptcies are at an all-time high in the United States, that foreclosures are at an all-time high, this isn't just a question of financial literacy. This really goes to the heart of why we've asked the regulators to come before this committee. This is a question of your responsibility.

No one questions the efficacy of the Community Reinvestment Act. I was one of the first mayors in the United States to use the Community Reinvestment Act almost 30 years ago to benefit—29 years ago—to benefit a neighborhood in the city of Cleveland. You know the efficacy of the Community Reinvestment Act is not at issue here.

We have a crisis in America with people getting tricked, having their lives ruined by predatory lenders and by prime lenders who are not fulfilling their obligations under the Community Reinvestment Act because the regulators don't make them do it.

Now, I just want to go down—so, thank you, Mr. Davis. I just want to go down the panel. Ms. Thompson, when is it discriminatory practice egregious enough to result in a CRA failure? What does it take?

Ms. THOMPSON. Well, we think one discrimination is one too many. And we do look at the institution's record with regard to their lending practices to persons, and we try to determine whether or not it is a pattern or practice, and we do require institutions to take corrective action.

At the FDIC, we do have a number—we have four institutions that are substantially not complying with regard to their CRA rating, and we have about 31 are in the needs-to-improve category.

Lending and discrimination is something that we take very seriously at the FDIC. We have an extensive training program where we train our examiners to look at fair lending issues, to look at community reinvestment, to talk to people in communities and get as much information as we can.

The CRA rating is a huge reputational issue for an institution, and we want to make sure that we have all the facts that we possibly can to make a decision. Again, we take pride in our examination program, and even one violation is one too many.

Mr. KUCINICH. I appreciate your saying that.

I'm going to ask staff here in light of some of these comments, and maybe you are already working on doing this, to look at the issue of mergers and acquisitions, the growth of the value of banks during the period that's under study here to see how banks have been able to increase their wealth, their holdings while we have seen a commensurate decline in the ability of people in the inner cities to get credit. I want to take a look at that.

I would like—I want to go back to Ms. Braunstein. What takes an applicant to the point of failure? When is a discriminatory practice egregious enough to result in a CRA failure? What does it take?

Ms. BRAUNSTEIN. Well, I can't—there is no specific measurement of that, but I will tell you when we look at their CRA evaluation, we are looking at the totality of them serving the convenience and needs of their communities.

As part of that, we do look at whether or not there are findings of discrimination. There are cases—we're talking here in the case of a red-lining case where there is—that would be a very egregious case. However, we find discrimination on things like spousal signatures that were required that shouldn't have been, which is also serious and we make referrals to Justice on this, and that may show up in the evaluation. But if it took place in a very small part of the institution, maybe with a rogue loan officer, and it is a larger institution and otherwise it is doing a good job of serving its community, it could be that CRA rating is not downgraded in that case.

Mr. KUCINICH. Spousal signatures, OK. What about race?

Ms. BRAUNSTEIN. Racial discrimination, we would look at very closely and see—I would think that would result in a downgrading. I can't sit here—I was sworn in—and say that there was no other—there is no possibility of a case where that would not—where that would not be——

Mr. KUCINICH. Yeah. Students in class, sorry, your work is not good enough. We can't give you a C. We are going to downgrade you to a D. Or students in class, sorry, you fail. There is a world of difference, is there not, between an institution being downgraded and failed on a CRA examination?

Ms. BRAUNSTEIN. There is absolutely a big difference.

Mr. KUCINICH. Do you want to explain to the committee what the difference is between being downgraded and failed?

Ms. BRAUNSTEIN. You can be downgraded from an outstanding to a satisfactory, and you are still getting a passing rating.

Mr. KUCINICH. Right.

Ms. BRAUNSTEIN. Like from an A to a B.

Mr. KUCINICH. If you failed—somebody fails a test in a school, they don't pass the grade, what happens when someone fails a CRA examination?

Ms. BRAUNSTEIN. Well, it is publicly available information, so it causes, you know, a problem for them in that area.

Mr. KUCINICH. Like for example?

Ms. BRAUNSTEIN. Well, for one thing, it's an embarrassment to the institution publicly. It also does cause them problems in the application process, which I'm sure is what you're getting at.

Mr. KUCINICH. Right, right, right. So if it causes someone a problem in their application process, what does that mean? Spell that out a little bit. What would be the implications?

Ms. BRAUNSTEIN. Well, the implications would be it would be much more difficult for them to expand their operation.

Mr. KUCINICH. To?

Ms. BRAUNSTEIN. Expand their operations.

Mr. KUCINICH. Right. And so really would limit their growth, correct?

Ms. BRAUNSTEIN. It would be a factor that would be considered, and it make the hurdle rate much higher for them to get an application approved.

Mr. KUCINICH. Right. So what would it take, what would someone have to do to really fail?

Ms. BRAUNSTEIN. I—every bank is—for one thing, we don't do CRA on a bell curve, so we look at each bank in and of itself——

Mr. KUCINICH. So it is pass/fail? Is it pass/fail?

Ms. BRAUNSTEIN. No, it could be, as is the case, most people pass. We're not guaranteeing that there are going to be so many failures and so many As on the other end of the curve. And it is—this is a rating that is done by looking at the totality of the banks serving their community credit needs; and depending on the size of the institution, that would also make a big difference.

Mr. KUCINICH. OK.

Ms. BRAUNSTEIN. If you have one of these huge national institutions and they have a problem in one little market and then in the other 150 markets they are serving they are doing just fine, how much do you weigh that? I mean, there are subjective judgments.

Mr. KUCINICH. That's very interesting. Because let's say an institution had a little problem in Detroit, let's say, an 81 percent African American population in the city. All of a sudden, the credit dries up. They are serving the rest of the area very well nationally with interstate banking. Conceivable. Someone could look at an inner city area and be out of it, serve every place else very well. Well, we just move on.

This is what I'm concerned about because everyone on the panel here, you only failed 225 banks out of 60,000 plus banks evaluated in the past 17 years; and here we have a massive wave of foreclosures going on. There's a connection. This committee is determined to get to the connection, and someone has to take responsibility here. We have all the regulators here.

Now, I want——

Ms. BRAUNSTEIN. Taking discrimination out of it, it is not surprising that most banks pass CRA, considering it has been around for 30 years, and they know what it is that they are supposed to do at this time. In that sense, that is not a surprising statistic. When they are told the same thing over and over again, most banks get it in terms of CRA at this point in time.

Now, you could postulate that there is something inherently wrong with CRAs that banks should, you know, could pass, but it is what it is, and most banks do get it. And after 30 years, as with most other parts of the examination, whether it is safety and soundness or otherwise, banks know what they are supposed to do.

Mr. KUCINICH. We are going to move on, but I just want to make a comment. This is a copy of the Constitution of the United States. Now taking the 13th and 14th amendment out of this, there is a lot of people that could pass muster in a lot of reviews, but there's a reason why we have protection under the law, there is a reason why the Department of Justice will inevitably have to go after someone. Because the underpinnings of someone's failing a review is a violation of someone's civil rights.

So I want to go to Ms. Yakimov here. What is a discriminatory practice? When is it egregious enough to result in a CRA failure?

Ms. YAKIMOV. We would look at the institution's fair lending record. We would look at whether or not we found a pattern of practice for material fair lending concerns. That would be assessed in our fair lending exam, which is kind of a separate function from the CRA exam, but they connect at the point we are looking at the institution's record of meeting the credit needs, financial services needs of its community.

So we look at its lending performance, its penetration. How much lending does it do in the assessment area, how many investments and how many services, depending upon the size of the institution. We look at the CRA performance within all of that context and then look at whether or not we found problems with fair lending and other illegal credit practices. And if we find that, in 37 cases since 1990 at OTS we have had these downgrades, many needs-to-improve or even worse. So it's——

Mr. KUCINICH. You don't want to fail them, though, do you?

Ms. YAKIMOV. Well, no, I don't think that's the case. I think our examiners, if they identify failure to meet the needs of the community within the CRA context, failure to abide by the fair lending laws, that absolutely is something that we wouldn't hesitate to act upon and to downgrade the institution. So we would look at their whole record and we try to take all of that into context.

Mr. KUCINICH. You know, see, what strikes me in this testimony so far is that there seems to be an aversion to talking about failure. That could be one of the underlying reasons why we've ended up with so many foreclosures. With the proliferation in the subprime market, with prime lenders not having to abide by the letter of the CRA, that this all fits in together. Because you just don't want to talk about failure. Because there is some kind of a culture here that regulators have.

And this isn't, by the way—this isn't to cast aspersions on this group of regulators, because we know in many areas that industries have enormous influence in the regulatory process all across the economy. So it isn't just like there's a massive disconnection here. In a sense, there is a consistency; and we appreciate you being forthcoming as you are to try to help us work it out.

Now, I would like to——

Ms. BRAUNSTEIN. Congressman, we did downgrade First American Bank for red-lining to substantial noncompliance, which is the lowest rating.

Mr. KUCINICH. There is a difference between downgrading and failing, because what happens is——

Ms. BRAUNSTEIN. That failed them. That's the failing grade.

Mr. KUCINICH. OK, that was a failure. Thank you.

Ms. BRAUNSTEIN. Yes, yes.

Mr. KUCINICH. Thank you.

I want to go back to Ms. Yakimov. I want to ask you about the Flagstar case. You had a CRA examiner award Flagstar a satisfactory grade when a court found Flagstar liable for discriminatory practices against minority borrowers. Now is that true?

Ms. YAKIMOV. Yes.

Mr. KUCINICH. How was your CRA examiner able to give a satisfactory grade to Flagstar? How did that happen?

Ms. YAKIMOV. Right, it is a more than legitimate question. I will share with you what I pieced together as we looked through the exam reports and so forth. This is in the public performance evaluation. I have a little feedback here.

Here—our examiners identified a strong record in Flagstar. I will give you a couple of examples of the things that they identified in the performance evaluation. One was, they originated $23.6 million in community development loans. They exceeded their peers in lending to low and moderate income census tracks and low to moderate income individuals. They made significant qualified investments, $2.3 million in 2001; $9.6 million in 2004. They expanded their branch network, including in low and moderate income census tracks; 13 percent expanded their branch—their footprint in low and moderate income census tracks.

So we looked at all of that and still—we looked at all of that; and our examiners felt that their record, because of—those were just some examples—and looked at their peers based on asset size and determined that normally that institution would have been awarded an outstanding CRA rating but because of the concern about the litigation we downgraded the rating in 2001 to satisfactory.

So our CRA reg—and we are sure the same reg is on this point—is that a finding of discrimination or other illegal credit practice has an adverse effect. It has an adverse impact. It doesn't go as far as—it doesn't go as far as to put parameters around there.

In other words, if you meet the overall spirit of CRA and all in the lending, investment and services, the reg doesn't take—from the statute doesn't take you from here, outstanding, to all the way to substantial noncompliance. It does say it has an adverse effect, impact; and that's what happened in this instance.

Mr. KUCINICH. And Flagstar was—appealed the decision, right?

Ms. YAKIMOV. That's my understanding.

Mr. KUCINICH. Even if Flagstar was appealing the decision, didn't your examiners find the discriminatory practices we are talking about during the CRA examination?

Ms. YAKIMOV. The evaluation of fair lending would have been dealt with in a fair lending exam, as opposed to a CRA exam per se where we bring all the tools and the models to bear in assessing fair lending.

Mr. KUCINICH. If I may, wasn't it true that OTS found it? It is just a different division.

Ms. YAKIMOV. Oh, yes. Oh, yes, absolutely. That's right.

Mr. KUCINICH. So what I'm wondering, if you could help this subcommittee, how could your examiners overlook this discriminatory practice? Was there deficiency in the examination process itself?

Was your CRA examiner underqualified? Could you let this committee know?

Ms. YAKIMOV. Sure. The reg calls upon us to look at the extent of the evidence, the quality of the evidence, the corrective actions that were taken, the policies and procedures to prevent illegal discrimination. Those are all the factors that we consider when we determine the extent of a downgrade, and so our examiners looked at all that.

I'm not an attorney, and I especially don't want to say anything that's not quite right. But my understanding of the litigation in Flagstar's case was that there were two cases, one fairly small in terms of a class action, a fairly small number of litigants. Most of those litigants were dismissed in the first area of litigation. I believe it was 1994.

The second case again resulted in—resulted from a policy that Flagstar put in place to prevent charging minorities more than nonminorities. So they had a policy in place that said, to my understanding—I am happy to firm this up more, if you like, after the hearing, but my understanding in looking at this was they said, you know, we want to make sure that we don't charge minorities more than nonminorities. So we have a policy where we're going to cap the overage, the amount that can go into broker compensation, basically, the overall cost of the loan for nonminorities at—they are going to potentially be paying more than minorities. So it was a case of reverse discrimination.

And so the second case was about reverse discrimination, where I think a Caucasian couple had alleged this problem.

And so, in some instances, you have an institution that has maybe made a judgment to change their policy to make sure that they didn't discriminate against in minorities and it resulted in this policy.

But to your broader point, we did look at the litigation, we looked at the scope of it, we examined their fair lending policies, procedures, their HMDA data, and, based on all that, we determined that a downgrade was called for, and it did take place.

Mr. KUCINICH. I want to ask something. Because we are right on this case, and this is somewhat mystifying, and perhaps you could help explain it to the subcommittee. Instead of downgrading Flagstar, you gave it an outstanding rating. You actually gave them a higher grade after a court ruled on summary judgment that its written policy was discriminatory.

Ms. YAKIMOV. The policy I just mentioned of reverse discrimination?

Mr. KUCINICH. I want to know how could that happen? Could you explain how that could happen, that they actually failed, but they passed?

Ms. YAKIMOV. I'll attempt to. We downgraded in the prior CRA exam. The 2004 CRA exam did not reflect the 2003 class action suit, again a fairly limited scope of affected borrowers. What we did look at was the corrective action the institution had took, we looked at their overall CRA performance, their loan penetration and low moderate income census tracks, their service activities, their investments; and based on all of that, some of the data that I mentioned earlier, we——

Mr. KUCINICH. So you're saying the written vio—their written policy was not enough of a violation, is that what you're saying?

Ms. YAKIMOV. I'm saying that the examiners looked at the totality of Flagstar's CRA performance and determined in this instance there wasn't a second downgrade. You are right. It was—an outstanding rating was given. I would say, Chairman Kucinich, that in our examination process there is a level of judgment where well-intended, skilled and trained people may arrive at different conclusions. I wasn't privy to this case.

Mr. KUCINICH. I understand.

Ms. YAKIMOV. But——

Mr. KUCINICH. In retrospect, what does it look like to you? You've got someone who—you have a summary judgment, written policy was discriminatory. Instead of a downgrade they got an upgrade, an outstanding.

Ms. YAKIMOV. Right.

Mr. KUCINICH. How does—what does that say?

Ms. YAKIMOV. I think it is a legitimate question that you've asked.

My read of the exam reports and talking with the examiners, the reason they arrived at the conclusion to award an outstanding rating was based on totality of how——

Mr. KUCINICH. And that they promised to take corrective action.

Ms. YAKIMOV. Well, it was a rendering of their—for example, an expansion of their branch network, their overall lending activity, their service activity. The sense was that this institution, based on its asset size, had an outstanding CRA performance. A matter of judgment, given the litigation, should there have been a second downgrade? You know, it's—I think it's a fair question.

Mr. KUCINICH. Well, do you think that it's a fair observation to say that, in this case, the bank wasn't graded on its performance; instead, it was graded on what it promised to do?

Ms. YAKIMOV. No, I don't. I think we looked at their performance leading up to that examination cycle. We looked at the data, not a promise, but we looked at the data.

The correction action—corrective action had taken place prior to that exam report, the second CRA exam rating.

Mr. KUCINICH. Didn't Flagstar expand its banking operations to an additional State as well as to an added metropolitan area in the States it was in at this time? And shouldn't Flagstar lose its privilege to open new branches, to acquire other holdings or merge with other banks, given their record?

Ms. YAKIMOV. The CRA rule says a noncompliance needs to improve. A failing CRA rating is the trigger point for impact with respect to applications. The assessment of Flagstar CRA performance did not rise to that level. It was downgraded once. It wasn't downgraded a second time.

And, yes, they had taken corrective actions. For example, they eliminated that policy. They made—they reimbursed borrowers that were impacted by that reverse discrimination policy. And, again, they looked at—our examiners looked at the institution's full record with respect to CRA, and that's the determination that we came to.

You mentioned—you asked before about levels. And, yes, the examination comes in, there's a review at the regional office, there was a determination made that, looking at the totality of the performance, that was the appropriate rating.

Mr. KUCINICH. So Flagstar gets an upgrade. Are you ever concerned that a case like this could send a signal to the rest of the industry: Don't worry, practice discrimination, the worst thing that can happen is you get caught, get a slap on the hand, higher grade maybe. Does that concern you?

Ms. YAKIMOV. What concerns me is that we carry out our responsibility with respect to fair lending, with respect to CRA and compliance across the board in an effective way that looks at the totality of the circumstances. In 37 cases, we have made downgrades to our institutions' CRA rating.

Again, I take your point, though. I don't want to sound overly defensive. I think——

Mr. KUCINICH. What we're trying to do is to look at the relationship between the role of the regulators, the enforcement of the CRA or lack thereof, its implications for access to credit, for people in low- and moderate-income areas——

Ms. YAKIMOV. Right.

Mr. KUCINICH [continuing]. The impact of discriminatory lending——

Ms. YAKIMOV. Uh-huh.

Mr. KUCINICH [continuing]. The growth of subprime loan products——

Ms. YAKIMOV. Uh-huh, uh-huh.

Mr. KUCINICH [continuing]. In those same areas, implications for predatory lending, the rise in bankruptcies and foreclosures.

Ms. YAKIMOV. Uh-huh.

Mr. KUCINICH. This is all part of the whole, and we have regulators here who I think could play a role in starting to give the public a little bit more protection.

So I'm looking, for example, Ms. Yakimov, between 1999——

Ms. YAKIMOV. Right.

Mr. KUCINICH [continuing]. And 2006, according to the information the committee has——

Ms. YAKIMOV. Uh-huh.

Mr. KUCINICH [continuing]. You only referred two cases to the Department of Justice, once in 2001 and once in 2004. Now, this could on one hand suggest that the banks that you regulate are fair lenders, which is clearly not the case in light of the Flagstar case, or it could suggest you are enforcing sanctions left and right, or it might suggest that your threshold for discrimination is very high and perhaps inconsistent with the Fair Housing Act and the Equal Credit Opportunity Act. Which one is it?

Ms. YAKIMOV. Well, if I may, I'm happy to address that, but I did want to go back to——

Mr. KUCINICH. You know what? First answer my question. Then go back to what you want to talk about.

Ms. YAKIMOV. Sure, that's fine.

You asked about our record of referring fair lending violations to the Department of Justice. The Director, John Reich, has been on board at OTS for about 2 years and has made it a real commitment

in bringing on a team, including myself, to take a robust look at how we examine compliance. We've made some changes to further strengthen our compliance examination program, including a recent action to make sure that our compliance examiners are focusing on compliance, making sure that we do—we add more tools to look at fair lending, more models, more data to manipulation.

I believe that those actions will result in even more robust fair lending assessments, and we have communicated that throughout our agency.

I would say that our examination force is not reluctant to refer, but I do believe that OTS, I think for all agencies, is the process of continually looking at how to strengthen your training, your tools and your focus is important; and that's something that we've taken very seriously, including a robust look at top to bottom in compliance over the last 14 months. We've made a series of changes.

So I take your point. The data kind of speaks for itself. I believe with some additional actions that we've taken that there may be more activity in that area.

Mr. KUCINICH. What I would like you to do, since you mentioned that you made some changes, and I would ask that each of the regulators represented here provide to the committee what steps—specific steps that you have taken in light of what we've learned over the last few years with the dynamics that we're discussing here, the dynamics being questions about CRA, the level of CRA enforcement, the access to credit in low- and moderate-income areas, foreclosure rates, factoring in subprime lending to come up with a—both what you can do from this point on to further strengthen the enforcement of the Community Investment Act and, based on your experience with that act, to inform this committee if there's any changes in the CRA that the Congress could make that would make it easier for you to be able to perform your regulatory functions.

Now, if you could do that in our—because the committee is going to continue to pursue this matter. And we're not—I'm not interested in "gotcha". I'm interested in trying to see what we can do as a matter of public policy to go from this point on to provide some protection for American families who are trying desperately to get access to credit. We still—you know, even with all the foreclosures, the problem remains. It's intensified.

I just want to go to Ms. Jaedicke here, and this will be the last question that I'm going to pose to the members of the panel. I want to thank you for your patience here. This is one of the most critical opportunities that we have to see if we can make any changes that would provide some additional protection to American consumers who want to be homeowners.

According to a 2003 National Training and Information Center Study, which looked at the year 2001, 15 of the top 25 lenders or 60 percent of the top 25 lenders in the United States were not strictly regulated by the Community Reinvestment Act. Since Gramm-Leach-Bliley, which was 1999, depository institutions can acquire a number of financial institutions, including insurance companies, security firms, mortgage companies. These companies are exempt from the CRA because they are nondepository institu-

tions. That means that a depository institution which is subject to the CRA can have a failure instead, can evade CRA scrutiny. This demonstrates an incongruency between the CRA and Gramm-Leach-Bliley. As a result, there is no law mandating the majority of most significant lenders have to meet the credit needs of their communities, and currently no regulatory agency has the authority to investigate the lending practices.

Ms. Jaedicke, who regulates insurance companies, mortgage lending companies, security firms and other nondepository financial institutions?

Ms. JAEDICKE. There are a lot of different regulators for those entities. Depending on if it is a mortgage company, they may be regulated by HUD; if they are subsidiaries of national banks, they are regulated by us.

Mr. KUCINICH. Now, that is—see, I just pointed out about Gramm-Leach-Bliley, that there are nondepository institutions that are exempt.

Ms. JAEDICKE. That are exempt from CRA, sir?

Mr. KUCINICH. Yeah. A depository institution which is subject to CRA can have affiliates that evade CRA because of Gramm-Leach-Bliley, which includes insurance companies, security firms, mortgage companies. These are, by definition, nondepository institutions.

So I want to go back to the question. In light of the CRA, which is what we're talking about, these firms essentially in terms of CRA aren't regulated, right?

Ms. JAEDICKE. CRA applies to depository institutions, that's correct.

Mr. KUCINICH. That's the point. Unless somehow they are selected to be included in the exam by some, which is unlikely. Would everyone agree with that? OK.

So the affiliates' lending practices if—really don't get reviewed if their depository affiliates don't elect to include them in the CRA exam; is that correct?

Ms. JAEDICKE. Yes, sir. If the depository institution decides to include loans made by an affiliate because they are in their assessment area to get positive CRA credit, then we also attribute any illegal or discriminatory practices that we find.

Mr. KUCINICH. But if they are not going to include them, they are not going to be looked at right?

Ms. JAEDICKE. That's correct.

Mr. KUCINICH. So isn't it possible that a CRA-regulated bank can move its financial assets to noncovered affiliates to reduce its CRA obligations?

Ms. JAEDICKE. It is possible for them to move their assets into other affiliate organizations, yes. And it might affect the CRA questions and issues. But you have to understand there are other regulatory agencies who could enforce the fair lending issues or deal with illegal discrimination issues.

Mr. KUCINICH. Isn't it possible for a CRA-regulated bank to build wealth in its community while its non-CRA-regulated affiliates can strip that same community through predatory lending or predatory practices; is that possible?

Ms. JAEDICKE. If the affiliate loans are not included in the bank's CRA rating in terms of getting credit for CRA, then the illegal practices, discriminatory practices, don't carry over.

Mr. KUCINICH. This goes back to the challenge that I posed to all the members of the panel, and that is, does the CRA adequately reflect today's financial markets? And what I would like to hear from you—in writing, really—is whether you think the CRA should be revised to better reflect today's financial markets. It would be good to hear from you on that.

Does anyone else on the panel want to respond to that question or the underlying spirit of the question? Does anyone have anything to say on the record before we move on? Anyone?

I want to thank this panel. You've spent a lot of time. We've been here a few hours now and more than that. And you are each individuals who do have an in-depth knowledge of your institutions, which favors the work of this committee greatly. And I look forward to working together with you on this.

I appreciate that you're really making an effort here. And each one of us represents some face of institutional power and responsibility, finds ourselves sometimes at a loss to be able to account for the deficiencies in the institutions that we represent.

And so I appreciate your willingness to work with this committee, and I want to thank you for the time that you've spent. And we'll remain in communication on these issues. This panel is dismissed.

We're going to call the next panel. And again I want to thank you so much. Just a very important panel. Thank you.

We will be calling the next panel to come forward. As the panel comes forward, I want everyone to know that this is the Domestic Policy Subcommittee. We're continuing our investigation of regulatory enforcement of the Community Reinvestment Act, and we've had an excellent panel from various regulators who assist this committee in its ongoing probe.

I want to thank the second panel here for its participation and for their patience, because we certainly have gone to great lengths with the first panel. I thank the members of the second panel for their patience in waiting to hear the testimony of the regulators.

In the interest of time, what we are going to do is, I am going to make a brief introduction of each member of the panel, swear in the witnesses and then go directly to their testimony.

Mr. Calvin Bradford is a Board member of the National Training and Information Center, founded in 1973 as a research and technical support provider to National People's Action and other community organizations. This is a group that builds grass-roots leadership, spearheaded the Community Reinvestment Act; and their efforts have resulted in over $1 trillion to low- and moderate-income families across the United States through their aggressive advocacy on behalf of the public.

And this is a group that has been involved in more community reinvestment agreements than any other organization in the country.

Thank you, Mr. Bradford.

Mr. Carr. Mr. James Carr is the chief operating officer for National Community Reinvestment Coalition, advisory member of the

Federal Reserve Bank of San Francisco, Center for Community Development Investments. He has been with Fannie Mae Foundation, director for Tax Policy, assistant director of the U.S. Senate Budget Committee, has done work in various scholarly journals.

We appreciate you being here, Mr. Carr.

Dr. Richard Marsico.

Mr. MARSICO. Mister. I am not a doctor. My mother wishes I was, but I am not.

Mr. KUCINICH. I had that same thing for a while too.

OK, Professor Marsico.

Mr. MARSICO. Marsico.

Mr. KUCINICH. Marsico, professor of law, New York Law School and director of the Justice Action Center. Professor Marsico's specialty is community reinvestment and fair lending. He has authored a book, Democratizing Capital, the History, Law and Reform of the Community Investment Act.

He is a graduate of Fordham and Harvard Law. Thank you.

Mr. Van Tol—is that correct—director of economic justice for Rural Opportunities. It is a nonprofit. It works on building assets and providing services for underserved individuals in communities in seven States and Puerto Rico, the Rural Opportunities, Inc., one of the largest nonprofit, first-time homebuyer programs in rural United States.

Mr. Van Tol has been active on the National Community Reinvestment Coalition, was president of Fairness and Rural Lending which works out of Wisconsin.

I want to thank you, by the way, for replacing Mr. Irvin Henderson, who couldn't join us because of circumstances beyond his control. Mr. Henderson did submit his testimony; we are going to include it for the record.

[The prepared statement of Mr. Henderson follows:]

FOR THE RECORD WRITTEN TESTIMONY

IRVIN M. HENDERSON

IMMEDIATE PAST CHAIR OF THE NATIONAL COMMUNITY REINVESTMENT COALITION AND FOUNDING CHAIR OF THE COMMUNITY REINVESTMENT ASSOCIATION OF NORTH CAROLINA

Before the

DOMESTIC POLICY SUBCOMMITTEE

OVERSIGHT AND GOVERNMENT REFORM COMMITTEE

Wednesday, October 24, 2007
2154 Rayburn HOB
2:00P.M.

Mr. Chairman:

Thank you and the committee for the opportunity to submit testimony on "Community Reinvestment, Grass Roots Support and the Bank Regulatory Agencies".

Substance over process was the mantra that reverberated throughout the regulatory community after the rewriting of the Community Reinvestment Act regulations during 1993-1995. This process, led by Comptroller of the Currency Gene Ludwig, stressed the evaluation of the community development context. Communication with community reinvestment groups, consumer advocates, small business advocates, community development groups and the social entrepreneurial community is a necessary and integral component of this oversight of the banking industry. It is through this bi-lateral communication that input can be received about persistent industry issues, especially in the areas of compliance with the CRA, fair lending and best practices. In these areas of compliance, the industry has consistently underperformed under less stringent oversight from the four primary banking regulators and the credit union regulator. However, the converse is also true in that the industry has made its greatest and most sustainable gains in the areas of compliance and performance during heightened regulatory scrutiny and public support of these ideals from the bully pulpits of the heads of the regulatory agencies.

Throughout the U.S. banking landscape from '89-the nineties, we saw 1) development of higher quality training in fair lending compliance, 2) the advent of multiple language

marketing and information materials, 3) more diversity in the hiring of personnel, 4) increased investment in community development infrastructure, 5) increased investment in community-based development capacity 6) significant research in community credit needs and economic development needs and more executive suite interest in the community engagement profile of the institution on the whole. At the first speech ever made to a community reinvestment conference by a Chairman of the Federal Reserve, Alan Greenspan stated at the Annual Meeting of the National Community Reinvestment Coalition that CRA lending and investing was safe and important to the economy. He also said that discrimination did still exist and would not be tolerated. Immediately, the emphasis from regulators, chief executives and heads of compliance, the press and community advocates increased geometrically. Once again under Comptroller Ludwig and his peers, banking institutions stepped up their compliance and there was growth in community group capacity to monitor and dialogue with the industry. The result was growth in wealth creation, democratization of credit, increases in information deep into underserved populations, and bank profits from these "new markets". Community Reinvestment works and it is good for neighborhoods, families, shareholders and the nation. However, it only works when all of the components – banks, community groups and regulators are providing the healthy tension of oversight and compliance. The public dialogue about the correct levels of reinvestment, the correct levels of scrutiny covering disparate impact and disparate treatment and the correct scope and scale of the institution's commitment to the community is one of the greatest examples of participatory governance and corporate accountability in this country's history. All elements of this tenuous yet powerful equation are to be applauded when they protect the vulnerable and provide opportunity for the underserved.

The problems are the grade inflation that is occurring (especially in the grade of outstanding), lax enforcement of fair lending and an environment that exudes ease of compliance for the industry. Bankers perceive a de-emphasis of the CRA and thus less need to respond to community needs. They are more comfortable with minimalist investment strategies, limited bank personnel for reinvestment, curtailed outreach and less innovative product development. An example is the current regulatory practice of allowing a community reinvestment investment to count from exam to exam without regard to current reinvestment needs and credit needs analysis. Before, the banks had incentive to continue to look for complex and innovative reinvestments that could address complex credit needs. Therefore there was more competition and valuation of quality, qualified investments, which fed the creation of effective vehicles for community development. All of this occurred prior to the current mortgage tsunami and represents portfolios that performed as well as most mainstream loans. The investments did not return levels as high as some other investments, but after an evaluation of multiple bottom lines, the accompanying business and community goodwill generated made these investments well worthwhile. (It is a misnomer to construe that the current credit crisis has beset the country because a lot of unworthy borrowers got credit that they could not handle. 95% of borrowers caught in this crisis can meet their current obligations, however they cannot meet the predatory reset amounts that were never underwritten based on their current data. Faulty products that were designed to generate quick profits for brokers, securitizers, secondary market makers and mortgage companies flooded the

market with greedy capital from investors chasing high returns. As they sought customers who would tolerate high fees, rates and policies, they began to target, minorities, immigrants, elders and novice borrowers.)

As a trustee of a bond fund that specializes in community reinvestment securities, I recognize a significant decrease in demand for these securities as regulatory scrutiny has changed with the most recent redefining of classes of banks and structure of the three community reinvestment tests. Similarly, there is increased evidence that regulators are allowing "round-tripping" of community reinvestment securities, whereby banks approaching an exam will buy portfolios of mortgage-backed securities that may plug a hole in what the bank is holding to show compliance, and then sell those same securities back to the seller at a click fee profit after the exam.

However, the most egregious lack of oversight can be found within community comments on a merger or during an exam provide evidence of fair lending or CRA compliance violations and the regulator does not investigate but instead simply takes the banks' versions of the issues, providing little of no enforcement environment that would promote good behavior. Not only should the regulator investigate, but they should in most cases, make a referral to the Department of Justice, however, this occurs less when the regulator relates more to the institutions as clients as opposed to their real "only client", the American people. A specific example is the Wachovia acquisition of SouthTrust in '04. The NC Fair Housing Center, under Stella Adams, submitted to the OCC a comment that included pairs testing of the lenders that provided substantial evidence of disparate treatment. The regulatory agency ruled that there were no violations and made no referral to the Department of Justice. In another instance the Community Reinvestment Association of NC under Peter Skillern, submitted comment during the SunTrust NCB merger that showed a discriminatory pricing pattern for loans below $75,000, once again to the OCC and there was no referral to Justice.

This lack of regulatory activity puts a considerable damper on the abilities of community reinvestment organizers to get participation from consumers and volunteers as they seriously question whether their efforts will have any impact when the regulator is siding with the regulated more often than not. How can we get people to give up time, talent and treasure when the authority that they are supposed to count on is not listening and is not acting in their behalf? This is the essential issue with regard to lax enforcement and poor regulation. Anything hat stymies consumerism benefits the industry and undermines the public good.

Some of the leadership among the regulatory agencies are opening lines of communication and are attempting to find the fault lines within their agencies, but when this attitude does not trickle down to the examiner and the field contact, the institutions feel little pressure to respond. In a 2001 speech then Comptroller Hawke spends a significant part of his speech talking about the need for lean efficient regulation from the perspective of the banker and his desire to preserve a collegial relationship with the industry. To his credit, he does state that this relationship cannot get in the way of oversight on important issues. We must always ensure that the community's needs are

important issues. Former FDIC Director Powell, a former small banker from Texas moved expeditiously after his appointment to reduce the regulatory burden for small banks and often saw himself as a protector for the institutions as opposed to the protector of the consumers of the institutions' products.

It is clear to all that these regulators must be concerned about the institutions, but when their concern for the banks outweighs their desire to fulfill their role as regulator of the banks and protector of the consumer, the balance has been lost.

Irvin M. Henderson

Mr. KUCINICH. But I want to thank Mr. Van Tol for joining us on such a short notice and coming in from New York.

I would ask the witnesses to please stand and raise your right hands.

[Witnesses sworn.]

Mr. KUCINICH. Thank you.

Let the record reflect that the witnesses have answered in the affirmative.

As with panel I, I am going to ask each witness to give an oral summary of your testimony and keep the summary under 5 minutes in duration. Your complete written statement will be included in the hearing record.

Mr. Bradford, let us begin with you. Thank you.

STATEMENTS OF CALVIN BRADFORD, BOARD MEMBER, NATIONAL TRAINING AND INFORMATION CENTER; JAMES H. CARR, CHIEF OPERATING OFFICER, NATIONAL COMMUNITY REINVESTMENT COALITION; DR. RICHARD MARSICO, PROFESSOR OF LAW, NEW YORK LAW SCHOOL, AND DIRECTOR, JUSTICE ACTION CENTER; AND HUBERT VAN TOL, DIRECTOR, ECONOMIC JUSTICE, RURAL OPPORTUNITIES, INC.

STATEMENT OF CALVIN BRADFORD

Mr. BRADFORD. Thank you Mr. Chairman. My oral statement is actually in my written statement as well, so I would like to take my 5 minutes to address a couple of issues that didn't come up before that I think need some attention.

First, I guess I would like to respond to some of the Flagstar issues, because I was an expert in both of the Flagstar cases that came up. And I'm kind of disappointed that at this point, after the OTS has been asked about this since 2002, that they still don't seem to understand the case.

The first case wasn't just a couple of applicants. There was also a suit filed against them, based on testing, the Pattern and Practice case that they settled out of court. And the reinvestment activities that the bank was given credit for, that you mention, to compensate them for their record, were actually things they had to do because of the settlement in Detroit—opening branches and doingreinvestment that they wouldn't have done on their own.

And, second, the Written Policy Statement case. In the 30 years that I've been doing fair lending work, I've never seen a case or an institution manage to make a plaintiff out of ever single person who applied for a loan, but that's actually what they did.

It wasn't a small case. It involved the entire Nation. It was a written policy for their entire mortgage operation. And what happened was, applicants had a case because they were charged too much for loans.

It also turned out that the African American applicants had a case. Because the brokers couldn't charge them as much for a loan, they didn't make as many black loans as they did before, and so they were discriminated against too. And for the OTS not to understand what a fundamental violation that is of the Fair Housing Act and to come here, I think, and to try and defend it as something positive the bank was doing is so fundamentally wrong that it

makes you concerned about whether they even understand what the Fair Housing Act is all about.

The second issue, I guess I think we could spend a little moment on, is talking about the affiliate issues because we could cover that a little more.

For one thing, if you look in the CRA process, a lender can choose to include the affiliates in the analysis, so they would be included. But then when you look at the fair lending record, the regulators look at the fair lending exam, the fair lending exam specifically excludes anything about the affiliates. In fact, they are prohibited from even talking to the affiliate as part of the exam process. So you've got another incongruity there about these things matching up.

Now, in my own testimony, I realize that, just using Citicorp as an example and not claiming there's something wrong with their lending, you see some issues about the affiliates that relate to the representative of the Comptroller's comments. Just because the affiliate is included in the CRA exam doesn't mean that it got a fair lending review.

Because of the way they look at it—for example, there's a Citigroup company called Citicorp Trust. Citicorp Trust makes thousands of only subprime loans across the United States; its only community reinvestment area is Wilmington, DE, but it operates nationwide. So its CRA exam only covers Wilmington, DE. It works through Primerica, the largest financial services company in the country, which is part of Citigroup. And it only makes refinanced loan consolidation, debt consolidation, refinanced loans; and it has a special office which is mentioned in the CRA exam by the OTS, whose sole purpose is to solicit existing customers, essentially flip the loans.

I'm not saying they did something wrong on these loans, but they give them an outstanding rating because they had more loans in low-income neighborhoods than any other lender. But that's precisely the concern we have had about subprime loans; there are too many of them in low-to-moderate-income neighborhoods.

So in the CRA exam process they make no effort to look at the nature of these loans and the way they were marketed and the substance of these loans. So even when the affiliate loans are included, they may be included in this process in a way that's really detrimental to the community.

And the other issue I discovered was that even though this company makes thousands of loans, one of the largest subprime lenders Citibank has around the country, when other Citigroup subsidiaries, savings and loans and banks, elected to include all their affiliates, neither the OCC or the OTS ever included the loans of Cititrust, this big, major subprime lender, it seems to me, a clear violation of the rule that you are supposed to include them.

In Chicago, for Chicago's Citicorp Savings bank, that actually meant that in their CRA areas, in 1 year, 85 percent of the subprime loans were not included; and for the next year, it would have increased the level of subprime loans by over 600 percent had they included this affiliate. So they are just plain not included, and it seems to me we should be concerned about that.

So I would have those issues.

The other issue I'll mention just before I stop is that if you look at the CRA exams, in the fair lending part it says that you're supposed to look at the fair lending exam. If you look at the fair lending exam, it tells you to go look at the CRA exam. The CRA exam you're supposed to look at because it is going to tell you if there's racial discrimination.

But under the CRA, there's no analysis done by race, so it couldn't possibly tell you about race discrimination. And these have been on the books now for over a decade. And you would think that agencies that seriously were concerned about fair lending would have eliminated this obvious and clear incongruity in these kinds of things.

So I'll just end there because I know you have the whole written statement. Thank you.

Mr. KUCINICH. Thank you, Mr. Bradford.

[The prepared statement of Mr. Bradford follows:]

Seduced and Abandoned: The Federal Fair Lending Enforcement "Effort" Under the CRA

Testimony of Calvin Bradford for the National Training and Information Center (NTIC) before the Subcommittee on Domestic Policy of the House Committee on Oversight and Government Reform
October 24, 2007

Thank you Chairman Kucinich, Mr. Issa, and members of this Committee for this chance to review the performance of the federal agencies charged with the enforcement of the lending laws and the Community Reinvestment Act (CRA). My name is Calvin Bradford. I am a board member of the National Training and Information Center (NTIC).

This month is the 30th anniversary of the passage of the Community Reinvestment Act. Senator William Proxmire introduced the Community Reinvestment Act (as Senate Bill 406) in January of 1977. The bill was the product of interactions between legislators, officials of the South Shore Bank in Chicago (a community development bank), and leaders of the anti-redlining movement – especially the National People's Action (NPA) led by Gale Cincotta, of Chicago.

I am particularly proud to be here today before so many Committee members who represent the strength of the community reinvestment movement. The original organizing that led to the NPA came from Chicago. NPA was founded and initiated its national anti-redlining campaign at a meeting of community groups in 1973 in Baltimore. Over the 35 years of NPA's activities, Cleveland has always been a source of continuing national leadership and initiative.

Summary of Written Statement
(Oral Statement)

For institutions that are chartered by the Federal government and/or that receive the substantial benefits and protections of deposit insurance, the activities of acquisitions, mergers, and branching are not a right, but are a privilege. The Community Reinvestment Act was intended to ensure that institutions that failed to meet the convenience and needs of their local communities would not be eligible for these financial privileges. Moreover, the CRA was intended to be one of the major tools in the eliminating of racial redlining and discrimination in lending.

In the 1995 revisions to the CRA regulations, the agencies eliminated key aspects of the CRA enforcement. They eliminated the evaluation of the institution's assessment of community credit needs. In essence, they eliminated the role of the community and made the CRA process a private affair between the lender and the regulator. By what first appeared to be subtle changes in the delineation of the CRA assessment area, they actually "permitted" institutions to draw their CRA assessment areas in any way they pleased as long as the regulator could be convinced that it was a "reasonable" area for the institution to serve. In spite of some language about not discriminating and not excluding

low- and moderate-income areas, what was reasonable was ultimately left to the subjective discretion of the examiner.

At the same time, the regulators eliminated the assessment factors related to evidence of illegal discrimination. What remained was simply an instruction to consider any evidence of discrimination after the examiner had used the new scoring system to assign the CRA rating. Unlike the formal assessment factors, there were no guidelines and no scores associated with the examiner's review of evidence of discrimination. There was only the instruction to consider any actions that the lender may have made to correct the problems. All of this was left to the subjective opinion of the examiner. Ironically, while the fair lending examinations and other statements by these agencies indicate that discrimination is more likely to occur where decisions are made subjectively and without clear standards – the agencies created precisely such a subjective process to evaluate evidence of discrimination itself. In a CRA system based on numerical scores, the assessment of discrimination effectively counted for nothing

Still, there appears to be enough language in the past and current CRA regulations, interpretive statements, and fair lending examination guidelines to convince any "reasonable" person that racial redlining in the delineation of the assessment area and any substantive act of discrimination by the lender would result in a failing CRA rating. Indeed, the interpretive comments for the most recent CRA regulations stated flatly that, "evidence of willful discrimination should result in an automatic 'substantial non-compliance" rating."

In the examination process, institutions are allowed to decide whether to include the loans from their holding company affiliates. As the examples in my written statement demonstrate, this choice may radically change the lending patterns used in a CRA examination at the choice of the institution. Moreover, this may ignore the role of affiliates in other markets where their patterns may reflect discrimination. In addition, while the CRA examinations rely on previous fair lending examinations for evidence of discrimination, the fair lending examinations actually prohibit the examiners from analyzing the lending practices of holding company affiliates.

In addition to issues related directly to the CRA examination process, the "sunshine" provisions of the Gramm-Leach-Bliley Act of 1999 allow the regulatory agencies at their pure discretion to impose arbitrary and extreme punishments on community groups and citizens who dare to comment on a lender's performance and engage in reinvestment agreements. Yet, no obligations are placed on the performance of lenders in such agreements. This Congressionally approved intimidation of American citizens has produced, as the banking lobby had hoped, a chilling effect on community involvement in the CRA.

My written statement shows the extent to which the regulatory agencies have simply decided that they are above the civil rights laws and that no discrimination can exist if they do not recognize it. I have reviewed three cases where the Department of Justice sued major metropolitan institutions for discrimination in explicitly redlining the

entire city of Detroit or the minority portions of Gary, Indiana, and Chicago while the regulatory agencies gave these same lenders high CRA marks. The agencies continued to reward these lenders by approving their applications for branches, mergers, and acquisitions while the redlined communities have continued to suffer from disinvestment and subprime abuses.

I have included one case where the lender was twice found in violation of the fair lending laws in Federal court and was rewarded by the regulatory agency by raising its grade to Outstanding and continuing to approve its applications for banking privileges. I have included another case where a lender under a Cease and Desist order for a pattern and practice of discrimination violations switched to another regulatory agency and received a passing CRA rating just before it settled a discrimination suit with the Department of Justice that imposed new obligations for corrective actions.

Finally, I have included a case where the Department of Justice sued a bank and its vice president for his alleged sexual harassment of female loan applicants, including seeking sexual favors for loan approvals. In this case, the regulatory agency which was examining the bank during the period of the harassment had not done a fair lending examination in six years and had decided that there was no need to do one during the period when the harassment occurred. The bank got a passing CRA rating.

For the regulators, their clever and narrow use of the regulations they drafted to control their own behavior allow them to treat these regulations as a kind of regulatory "signing statement" where they can use their own discretion to reinterpret or ignore lending behavior that would violate the fair lending laws.

Is this what Congress intended for the CRA?

At the end of my written statement are eleven recommendations for changes in the CRA, repeal of the sunshine act, changes in the fair lending examinations, and support for fair lending enforcement. I would be glad to respond to any questions or concerns that you may have and NTIC would be glad to provide the Committee with additional information on points and issues that might not be addressed adequately in our limited time here today.

The CRA: Built to Be a Fortress in the War Against Racial Redlining

Last March I brought to this Subcommittee's attention several cases where the regulatory examiners had given passing and even Outstanding CRA ratings to lending institutions that were simultaneously being sued by the Department of Justice for both racial redlining and discrimination in lending. In one case, the lender had twice been found liable for lending discrimination in Federal court. Nonetheless, the regulatory agencies continually reported that they did not find violations of the fair lending laws in these institutions and continued to grant them license to expand their financial power in the marketplace by allowing them to engage in branching, mergers, and acquisitions.

In order to try to explain how this could happen, I am submitting for the record some comments on the development of the CRA, its intent, and its regulatory history, and the relationships between the CRA and the fair lending examination process. I believe this will provide a valuable context for understanding both the reasons why the regulatory agencies did not enforce the fair lending laws in these CRA evaluations and also the seriousness of the agencies' failures to enforce fair lending laws in general.

Some of the problems we are dealing with today come from a lack of understanding about the history and intent of the CRA and a fundamental failure of the regulatory agencies to fulfill their obligations under the fair lending laws. I had the good fortune to be able to work with the legislators, community groups, and reinvestment advocates who developed the Home Mortgage Disclosure Act (HMDA) and with these same people and members of the South Shore Bank who are responsible for the CRA. I have also been fortunate enough to have been part of the research staffs for two of the special state commissions and tasks forces on redlining in the 1970s and to be part of the research staff for the National Commission on Neighborhoods. Among the more than 50 lending suits where I have served as an expert are two major lending suits where I provided background information on the history of the segregated housing finance markets and where the courts made important rulings on redlining.[1]

Let me take you back to the nation in 1977. As a result of the urban riots of the 1960s and the growth of the civil rights movement, government policies in the late 1960s and 1970s finally focused on the role discrimination played in the formation of segregated communities and in the process of economic disinvestment from these communities. Among the most powerful forces of disinvestment was the redlining of minority communities by the lending and real estate industries – a practice that had once even been endorsed by the rulings of the Supreme Court in supporting racially restrictive covenants. The nation's leading housing program – FHA – literally invented redlining in mortgage lending in the 1930s, with actual maps with lines defining neighborhoods where loans should not be made. As the FHA influenced the underwriting standards for the private markets, redlining was incorporated into the appraisal and underwriting standards of the lending industry. The principle is that if the Federal government uses a lending standard, then the private sector cannot be criticized for adopting that same standard.

Thus, minority inner-city neighborhoods were cut off from FHA loans, which were overwhelming made by the independent mortgage banking industry. These neighborhoods were also cut off from the major sources of conventional loans that were made (and held in portfolio at that time) primarily by savings institutions and commercial banks.[2]

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[1] These two cases (*Honorable, et al. v. Easy Life Real Estate System, et al.* and *Hargraves, et al. v. Capital City Mortgage Corporation and Thomas K. Nash*) provided the bases for court opinions that defined reverse redlining (the concentration of high cost or high risk loans predominantly in minority markets) as a violation of the Fair Housing Act.

[2] (See "Neighborhood Reinvestment," Chapter 1 in *People Building Neighborhoods: Final Report to the President and the Congress of the United States,* The National Commission on Neighborhoods, 1979).

In the late 1960s as a result of civil rights pressures, the FHA reversed its redlining and literally pumped existing and new high risk FHA programs into minority neighborhoods. The interventions failed to deal with the lack of conventional lenders in the minority market – for the bank regulatory agencies did nothing to reverse the practices of the savings institutions and commercial banks. Most of all, the interventions failed to take account of the financial opportunities which the racially segregated home lending market provided for exploiting racial segregation and racial change.

In a misguided effort to draw FHA lenders into inner-city areas that had previously been redlined, FHA first eliminated its Aeconomic soundness@ standard (which had been the basis for the previous redlining) in favor of absurd underwriting standards that are déjà vu in relation to some of the subprime standards of today. For example, a 1968 FHA Mortgagee Letter stated that properties were to be rejected only in "those instances where a property has so deteriorated or is subject to such hazards ... that the physical improvements are endangered or the livability of the property or the health or safety of its occupants are seriously affected@ (August 2, 1968).

This lack of concern for the soundness and condition of homes resulted in many FHA homebuyers being sold homes that were defective and in need of major repairs. Moreover, the opportunity to exploit the pent up demand for home ownership in the minority communities and the opportunities to feed racial fears and foment racial resegregation through panic peddling and the resulting profits on high volumes of loans and the lack of limits on loan fees led to massive fraud and abuse in the FHA programs in minority areas and areas of racial change.

In his 1973 book (*Cities Destroyed for Cash*), Brian Boyer collected the minority FHA communities created by FHA into a single mythical city (Romney City, named after George Romney, the Secretary of HUD who pushed the program). Boyer concluded that Romney City had 350,000 houses (about half of them already boarded up) and a population of 1,400,000 - equal to the sixth largest city in the United States. Describing the FHA scandals as a "$70 billion slum" (in 1973 dollars, of course), Boyer provides this evaluation:

> The national solution to the black riots of 1966, 1967 and 1968 was the FHA low-income housing programs, but what they have done is destroy the homes and neighborhoods of the poor, giving millions of people a glimpse of hope yet quickly snatching it away.
>
> In addition, the policies of the real estate and mortgage industries, compounded by the FHA programs, have created the flight of ethnic and working whites out of our cities into the suburban noose around the ghetto. They created class bitterness and hatred where none needed to exist. Where, at least, no new bitterness and hatred were called for. These industries and the FHA worked the economic levers that kept this

> society physically segregated. Some of it was the product of ignorance, but none of it was accidental.
>
> Nor have urban blight and abandonment been the result of processes no man understood or could prevent, as the official line pretends. Instead, the destruction of our cities has come about solely for profit.... (at page 20).

As several of you on this Subcommittee know from experience, whole sections of cities such as Detroit, Chicago, Cleveland, Philadelphia, Baltimore, Boston, Atlanta, and Washington were devastated by the concentration of foreclosures and abandoned buildings. FHA was the predatory lender of the 1970s.

The anti-redlining movement grew out of neighborhood organizations combating the wave of mortgage foreclosures and deterioration that they saw emanating from the FHA scandals and the lack of sound conventional lending by savings institutions and banks in minority and racially changing communities. A 1973 study by a city agency in Baltimore provided the first intensive study of an entire city's mortgage lending records and provided the first classifications of different mortgage markets for different communities defined by race and class.[3] Other studies in Philadelphia, Chicago, and other cities followed – often done by painstaking individual searches of property transfer records by local community groups. The results of these studies provided the factual basis for the community claims that the savings institutions and banks had cut off minority and racially changing and diverse communities from conventional lending while leaving them to the plague of FHA abuses.

In the spring of 1973, in Baltimore, these neighborhood organizations came together and formed the National People's Action launching the national campaign against racial redlining.[4] This led to a two-pronged national legislative campaign. First, there was the campaign for the Home Mortgage Disclosure Act, which, in its original form, forced the disclosure of mortgage lending by savings institutions and commercial banks - the prime source of conventional loans. Overwhelmingly, the data from the HMDA showed what the community leaders had claimed, that little lending was done by savings institutions and banks in minority and racially changing or diverse areas.

The second part of the legislative campaign sought ways to outlaw the redlining of minority and racially changing or diverse communities which were typically older neighborhoods with concentrations of low- and moderate-income residents. Armed with the HMDA, the community anti-redlining movement helped to develop the CRA as part of this legislative effort in the battle against racial redlining.

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[3] See "Homeownership and the Baltimore Mortgage Market", Home Ownership Development Program, City of Baltimore, 1973)

[4] Soon after this, the National Training and Information Center (NTIC) was formed as a non-profit educational and training organization that provided research and technical assistance to neighborhood organizations combating disinvestment.

Working largely through NPA, community groups wanted a law that required the conventional mortgage lenders to serve their communities and end the redlining. At the same time, a group of investors seeking to purchase a bank for the purpose of reinvestment had successfully challenged the efforts of a bank in the South Shore community of Chicago to leave the community after it had changed racially. This example of the use of the existing bank regulatory process highlighted the potential role for community groups to intervene in the established process of granting charters and approving applications for mergers, acquisitions, and branches.

Research on the existing regulatory process for chartering financial institutions and approving applications for mergers, acquisitions, and new branches had shown that each applicant must define a community that the new institution would serve. And the language stated that the chartered institution was to service both the "convenience and needs" of that community. There was, however, no regulatory process to ensure that these defined communities were actually served once the institution received its charter.

Taking account of the lack of regulatory requirements to ensure that the chartered institutions served the credit needs of their communities and drawing on the model of the South Shore Bank, Senator William Proxmire (Chairman of the Senate Committee on Banking, Housing, and Urban Affairs) began to outline legislation that would encourage lenders to act more like the South Shore Bank. In December of 1976, Senator Proxmire circulated a letter with an initial rough draft of a bill to be known as the "Community Reinvestment Act". Also attached to the letter was a conceptual outline which explained clearly the rationale and intent of the proposed legislation.

In the conceptual outline attached to his letter, Senator Proxmire stated that, "The federal bank regulatory agencies have considerable leverage over financial institutions. One of the most significant powers is the authority to approve or deny applications for deposit facilities." The Senator went on to note:

> The authority to operate new deposit facilities is given away free to successful applicants even though the authority conveys substantial economic benefit to the applicant. Those who obtain new deposit facilities receive a semi-exclusive franchise to do business in a particular geographic area. The government limits the entry of other potential competitors into that area if such entry would unduly jeopardize existing financial institutions. ... The government provides deposit insurance through the FDIC and the FSLIC [Federal Savings and Loan Insurance Corporation] with a financial backup from the U.S. Treasury. The government also provides ready access to low cost credit through the Federal Reserve Banks or the Federal Home Loan Banks.

The Senator's outline continued:

> In return for these benefits, financial institutions are required by law and regulatory policy to serve the "convenience and needs" of their communities as a condition for acquiring new deposit facilities. ... However, in practice, the regulators have tended to ignore credit needs and have focused primarily on

> deposit needs.[5] The regulators have thus conferred substantial economic benefits on private institutions without extracting any meaningful quid pro quo for the public. ... The proposed legislation directs the bank regulatory agencies to use their leverage in approving applications for deposit facilities in a way that will benefit local communities. ... The bill would not inject any radically new element into the deposit facility application and approval process already in place. Instead, it merely amplifies the "community need" criteria already contained in existing law and regulation and provides a more explicit statutory statement of what constitutes "community need".

The Senator saw a need to define a "primary savings service area" from which the institution draws "more than one-half of its deposit customers, to assess the credit needs of that community, and to demonstrate how it has served those needs. The original draft of the act generally institutionalized the process that had been used by the investors in the South Shore Bank in keeping the bank from moving out of the community. The draft required the financial regulatory agencies to consider the institution's record of serving its local community when approving applications for charters, mergers, acquisitions, and branches, and to encourage testimony by community and consumer groups at hearings related to the applications.[6]

National People's Action was already working with Senator Proxmire and saw the development of the Community Reinvestment Act both as a vehicle to build an economic development banking industry in the United States and as an opportunity to end racial redlining by the banks and savings institutions.[7] With the technical support of NTIC, these groups advocated some changes in the language of the Act. They recommended some of the language that is now part of the CRA, such as language that lenders have a "continuing and affirmative obligation to meet the credit needs of the communities they are chartered to serve". This made meeting the credit needs an ongoing obligation rather

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[5] One of the main claims of the anti-redlining movement was that banks and savings institutions took the deposits from their communities and siphoned them off into the white and suburban communities.

[6] Draft of the Community Reinvestment Act attached to a letter from Senator Proxmire dated December 17, 1976.

[7] Running parallel to and in concert with the movement against redlining was the reinvestment movement seeking to build private lending programs to reinvest in the communities that had been redlined. While the World Bank and other foreign aid programs were designed to support economic growth in third world economies, there was no real program in the United States to support reinvestment in the disinvested communities that existed in depressed rural areas and in so many inner city communities. The reinvestment movement saw the need to develop the investment, lending, and programmatic skills necessary to revitalize disinvested communities. Together, community action groups, the growing base of community-based development corporations, and the South Shore Bank, in particular, provided both a political base for action and sound practical applications as support for making reinvestment part of the banking business. While it is beyond the scope of these hearings to review the development banking side of the Community Reinvestment Act, largely from the efforts of community-based initiatives and scores of negotiated community reinvestment agreements with individual lenders, a wide range of successful programs have been developed even though these agreements have never been recognized by the bank regulatory agencies and even though neither the regulatory agencies (including the Treasury Department), HUD, nor the Department of Commerce have ever taken seriously the role of building an economic development banking industry.

than one that only needed to be reviewed if the lender sought an application for an acquisition, merger, or branch.

They also recommended changes that would make it harder for institutions to define service areas that avoided what the community organizations termed "historically underserved" or "historically neglected" communities. They specifically recommended defining these as census tracts "which are characterized by minority or racially changing populations, lower income households, or an older housing stock." They recommended defining the "primary service area" for savings institutions as "that geographic territory which includes the areas in which the institution originates 80% of its loans and all other areas which are as close as or closer to the association's facilities as such areas." The "primary service area" for commercial banks was defined as "that geographic territory from which the institution receives 80% of its consumer deposits and all other areas which are as close as or closer to the bank's facilities as such areas." The concept was to define the service areas essentially as a circle around the facilities where the radius ran from the facility to the census tract with loans farthest from the facility. NPA wanted this type of language in the Act to ensure that lenders could not gerrymander their areas to avoid minority areas and the nearby communities which were typically older areas with low- and moderate-income residents.

At this time, the large savings institutions and banks that were of most concern to the community groups typically had their main office, or a major office, in the central business district of the central city of the metropolitan areas where they operated. The thinking on the "primary service area" was that one should start at this central office and aggregate the deposits (or loans) from each census tract moving in ever expanding concentric circles until the circle (as limited by natural boundaries) encompassed 80% of the deposits (or loans). In this way, even if the lender skipped over inner-city minority and racially changing and diverse communities and the low- and moderate-income white communities adjacent to the minority and diverse communities in order to reach white and higher-income communities farther away, the institution's service area for the CRA would have to include all these communities.

While race was clearly at the heart of redlining, community groups were also concerned that the process of racial resegregation and panic-peddling caused disinvestment in white or racially changing and diverse communities next to or near areas that were already minority or were, themselves, in the process of change. These nearby and adjacent communities were typically comprised of an older housing stock and concentrations of low- or moderate-income residents. The groups wanted to make sure that integration, itself, did not produce disinvestment and discourage white communities from welcoming minority neighbors without the fear of financial disinvestment. Thus, they had proposed a definition of historically underserved communities that was not only based on race, but was based on income and an older housing stock.

NPA's recommendations also contained extensive additions of requirements for affirmative marketing programs to reach "minority groups" and all persons in the "historically underserved area", annual reports from the regulatory agencies of the

deposits and loans within the service area neighborhoods, examinations to ensure that there is "no discrimination in the quoting or application of conditions, terms, or in the case of real property, the appraisal, due to the geographic location of the applicant or the subject property", and that the regulatory agencies develop an annual review of performance and use the full range of their enforcement authority against institutions with unsatisfactory ratings.[8]

NPA's recommendations were considered and some were incorporated into Senate Bill 406 when it was submitted at the end of January of 1977. The bill contained the language about the "affirmative and continuing obligation" of lenders to serve their local communities. The bill defined the local community as the "primary savings service area", which was, itself, defined as "a compact area contiguous to a deposit facility from which such facility obtains or expects to obtain more than one-half of its deposit customers." The bill required institutions to "analyze the deposit and credit needs" of this community and it instructed the regulatory agencies to "encourage testimony at public hearings on applications". The bill did not include the definition of "historically underserved" communities and it did not include the various detailed requirements for lending programs and fair lending oversight that were recommended by the community groups.

Generally, NPA was told that the detailed provisions were not appropriate for a bill and were more appropriately left to the implementing regulations. NPA was told that adding such details that are normally part of the regulatory process made it harder to move the bill through Congress. Additionally, NPA was assured that with the prohibitions against lending discrimination in the Fair Housing Act of 1968 and the recently-enacted Equal Credit Opportunity Act (ECOA), existing laws already provided enough protection for minorities in the area of lending and it would simply be redundant and confusing to add further anti-discrimination language to the bill.

The Fair Housing Act already prohibited discrimination by lenders against lending to minorities. In just the past year (1976) in Ohio, the *Laufman* case had established that redlining was covered by the Fair Housing Act.[9] The Federal Home Loan Bank Board had filed its own amicus brief in support of the decision in the *Laufman* case. The FHLBB was the regulator of the nation's largest savings and loans and mutual savings banks, which were the largest conventional home lenders at this time. Moreover, the Equal Credit Opportunity Act (ECOA) had just been passed in 1976, giving more direct prohibitions against racial discrimination in lending of any kind. Fair lending was clearly the law of the land already – and the bank regulatory agencies were mandated to affirmatively enforce the fair lending laws.

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[8] This is taken from a draft of the Community Reinvestment Act with revisions from NTIC. The draft is undated, but it was most likely in January of 1977.

[9] *Laufman v. Oakley Building & Loan Co.*, 404 F. Supp. 791 (S.D. Ohio 1975), 72 F.R.D 116 (S.D. Ohio 1976), and 408 F. Supp. 489 (S.D. Ohio 1976).

Aside from the fair lending laws, lawsuits, and court decisions, the campaign for the Home Mortgage Disclosure Act had brought national attention to the issues of redlining by banks and savings institutions, and the bill for the CRA was often simply referred to as an anti-redlining bill. The work of the National Commission on Neighborhoods had begun and it was designed to focus national attention on redlining and disinvestment issues. HUD had held "public meetings" (the HUD version of a hearing) that focused on racial redlining and it had just published a book on these meetings and the history of redlining.[10] The Department of Justice had sued the largest professional appraisal organizations and the major mortgage company and savings industry trade organizations for incorporating discriminatory practices into their appraisal and underwriting processes, respectively.[11]

In light of these and many other related development and activities, it did seem that it would be inconceivable to interpret the Community Reinvestment Act provisions in a way that would not consider race discrimination in both the definition of the service area and in the evaluation of the institution's lending and services. Therefore, in the final drafting, the bill was made as simple as possible with the understanding that the regulatory agencies would resolve the specifics through the regulations that would implement the Act.

NPA remained skeptical about not including more specific language about the definition of the service area and against discrimination. The banking lobby opposed the bill completely. The regulatory agencies opposed the bill, but with the fallback position that if the bill was passed, it should be simple and leave them the typical role of dealing with the implementation in the regulation. Nonetheless, community groups did not openly oppose the simple version of the bill. In the final version of the bill, the definition of local community service areas was left to the regulatory process. All that survived of the language referring to "historically underserved" communities was the added provision that the lender was required to serve the needs of low- and moderate- income communities.

The specific language in the Act related to low- and moderate-income areas was, itself, part of the racial anti-redlining intent of the Act. While many of us reluctantly accepted the conventional wisdom of the time (naively it now seems) that with the clear prohibitions against lending discrimination in the existing laws, no one could possibly construe the CRA as not intended to prohibit racial redlining, there was nothing in federal law to protect the low- and moderate- income communities that were not already predominantly minority.

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[10] See Calvin Bradford and Dennis Marino, *Redlining and Disinvestment as a Discriminatory Practice in Residential Mortgage Loans*, U.S. Department of Housing and Urban Development, 1977.

[11] See *U.S. Department of Justice v. American Institute of Real Estate Appraisers et al.* (Civil Action Number 76-C-1448). The settlement by the American Institute of Real Estate Appraisers in 1977 made fundamental changes in appraisal theory and training to eliminate past forms of discrimination.

The term "historically underserved communities" in some of the draft recommendations for the CRA bill were intended to forbid the redlining of not only minority communities but other adjacent or nearby communities that might suffer disinvestment as a result of their proximity to minority areas. This term, however clear to the community advocates, did not have any existing statutory meaning. There was a general belief that high income communities were too lucrative for lenders to ignore, but that low- and moderate-income communities would be threatened by disinvestment if they were seen as in the path of racial change. Therefore, it seemed imperative to place special language in the bill that would protect these low- and moderate-income communities and let the fair lending laws serve as the existing protection of minority areas.

Even though it was not written into the legislation, the action of the investors who challenged the effort of the bank in the South Shore community of Chicago set the precedent for any entity to file a formal challenge against any of these covered applications on the basis of a lender's failure to adequately serve its community. The role of the CRA challenge was established without having to be written into the law, though the language instructing the regulatory agencies to encourage community testimony at application hearings was omitted from the Act itself.

Now You See It – Now You Don't: Regulatory Slight of Hand and the Disappearance of Racial Protections in CRA Enforcement

The omission of specific language on serving minority communities has, unfortunately, been used by both the banking community and the regulatory agencies to claim that race is simply not a focus of the CRA. Of course, as indicated above, at the time the bill was drafted, the obligations of lenders to serve minorities and the anti-redlining purpose of the bill was claimed to be so clear that this language was not needed.

"Now you see it, and now you don't" may be the best way to describe the CRA protections against racial discrimination in the regulatory process. There is clear evidence that community groups were not alone in their assumption that racial discrimination was an essential part of the CRA and its enforcement.

Immediately after the CRA was passed, HUD had contracted for a report on the likely impact of the CRA. The report includes sections on what the examination process should look like and what types of resources should be used in the examination process. At the beginning of the section on the examination of the institution's record is the statement, "The first almost elementary aspect of any assessment should be an evaluation of the lenders (sic) record under the Fair Housing Act, Equal Credit Opportunity Act, and related non-discrimination regulations. A lender in violation of these provisions is, *a priori*, not meeting the needs of his community" (emphasis added).[12]

[12] Warren Dennis, "Working paper No. 24 - The Community Reinvestment Act of 1977 – Its Legislative History and Its Impact on Applications for Changes in Structure Made by Depository Institutions to The Four Federal Financial Supervisory Agencies", Credit Research Center, Krannert Graduate School of

For support for this statement, the report cites a no more convincing source than the testimony of the representative of the Federal Home Loan Bank Board at the hearings on Senate Bill 406. The report goes on to review how such anti-discrimination reviews can be done, also citing the hearings on Senate 406 regarding anti-redlining regulations in California that were developed for the savings and loan department there as part of its review of lending institutions. The report continues:

> Examiners should be given a program for analyzing Home Mortgage Disclosure Act data as an integral part of the CRA review. Loan locations should be plotted on race and income coded census tract maps, with overlays for the different types of loans on the report. This device gives the examiners a tool for reviewing the institution's designation of "market area" and spotting "gerrymandered neighborhoods."

Discrimination, Redlining, and the Initial Regulations in 1978

Unfortunately, from the issuance of the first implementing regulations in October of 1978, there was evidence that the regulatory agencies would not require lenders to define their local community definitions in ways that would ensure the elimination of racial redlining.[13] These regulations provided for three ways of defining the local community area. The first method required using existing boundaries, such as entire Metropolitan Statistical Areas (MSAs) or counties. If an institution chose this method, it would typically avoid redlining. The second method allowed for defining the local community reflected some of the *general concepts* in the draft CRA legislation by providing for a local community defined the institution's lending patterns. In this case, the institution was to delineate an "effective lending territory" defined as "that local area or areas around each office or group of offices where it makes a substantial portion of its loans and *all other areas equidistant from its offices as those areas*" (emphasis added). On the other hand, there was also a third option where the institution could "use any other reasonably delineated local area that meets the purposes of the Community Reinvestment Act and does not exclude low- and moderate-income neighborhoods".

The regulatory agencies were left with great discretion to decide what would be interpreted as "a substantial portion" of an institution's loans. The most encouraging language was related to the lending territory where the local community would essentially be defined by areas around the office, or offices and all other areas "equidistant" from those areas. The regulators provided for the most discretion in the third option, where an institution could define any type of area it pleased as long as it

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Management – Purdue University, 1978, under a contract with HUD, pages 80-81. In a foreshadowing of the problems that we are addressing today, the report warns that aside from the Federal Home Loan Bank Board, the bank regulatory agencies have little experience with fair lending enforcement and the understanding of the fair lending laws. The report even notes that "the Federal Reserve Board continues to contest its obligations under the Fair Housing Act."

[13] The regulations and the introductory comments are found in the *Federal Register*, Volume 43, Number 198 for Thursday, October 12, 1978, at pages 47114 to 47155.

could convince the regulator that this did not unreasonably exclude low- and moderate-income areas. Although there is often a substantial overlap between low- and moderate-income areas and minority areas, they are not the same. Over the evolution of the CRA regulations, this third option has provided the most leeway for allowing institutions to gerrymander their service areas and continue redlining.

On the positive side, the regulations set up twelve assessment factors. These included factors related to the process that the institution had used to contact local organizations and assess local credit needs. Two of these factors related directly to fair lending. Factor "D" (also commonly referenced as assessment factor number 4) took account of "any practices intended to discourage applicants for the types of credit set for in the institution's CRA statement(s)". Assessment factor number "F" (also commonly referenced as assessment factor number 7) took account of "evidence of prohibited discriminatory or other illegal credit practices".

In the introductory section for the regulations (titled "Supplementary Information"), the regulatory agencies comment on assessment factor "F" by noting that it "refers chiefly to violations of the Equal Credit Opportunity Act and the Fair Housing Act." The commentary goes on to state that "some commentators felt that 'violations' could be determined only by a court. However, the Agencies believe evidence of violations found by examiners would be a material consideration in evaluating applications covered by the CRA."

The substance and comments on the interpretation of factor F was, perhaps, the most encouraging part of the regulations in terms of tying the CRA to the prohibition of discrimination and redlining. Clearly, the courts had already determined that the Fair Housing Act prohibited redlining and the agencies were stating that the Fair Housing Act was one of the two main laws to be used in assessment factor F. Second, these comments made it clear that the threshold for evidence of a violation was not only a finding in court, but findings by the examiners as well. Here, the regulations did seem to follow the concept that a lender that violated the fair lending laws would fail the CRA exam.

The Guidelines for Disclosure of Written Evaluations 1990

Further light was shed on the inclusion of fair lending in the CRA process when the agencies released the Uniform Interagency Community Reinvestment Act Guidelines for Disclosure of Written Evaluations.[14] Here, the Agencies showed how the twelve individual assessment factors were actually grouped into five major "performance categories". The first category covered two assessment factors under the heading of "Ascertainment of Community Credit Needs." The second category grouped three assessment factors under the heading of "Marketing and Types of Credit Offered and Extended." The third category grouped two assessment factors under the heading of

[14] These guidelines were released by the Federal Financial Institutions Examination Council on April 25, 1990, as part of an amendment to the CRA that required the release of a public version of the CRA rating and exam for each institution.

"Geographic Distribution and Record of Opening and Closing Offices". The fourth category grouped assessment factors D and F under the heading of "Discrimination and Other Illegal Practices." The final category grouped three assessment factors under the heading of "Community Development."

The guidelines then provided profiles of how each of these five groupings of assessment factors is related to the ratings given to the institution. Under Category IV (Discrimination and Other Illegal Practices) the guidelines read in part, "The institution is evaluated in this category on its compliance with antidiscrimination and other related credit laws, *including efforts to avoid doing business in particular areas* or illegal screening" (emphasis added).

The CRA is not a "credit law". Income is not a protected class and the antidiscrimination laws do not prohibit treating low- and moderate-income areas differently from other areas unless that has a disproportionate effect on a protected class.[15] The statements concerning "efforts to avoid doing business in particular areas or illegal screening" can only be related to the Fair Housing Act or ECOA.

In relating this category of assessment factors to the CRA ratings, the guidelines indicate that in order to receive a passing CRA rating of Satisfactory or Outstanding, the institution needs to be in substantial compliance with all antidiscrimination laws and regulations. A failing grade of Needs to Improve is given to any institution where "substantive violations are noted on an isolated basis" and a rating of Substantial Noncompliance is given to an institution that "has demonstrated a pattern or practice of prohibited discrimination, or has committed a large number of substantive violations of the antidiscrimination laws and regulations".

Under these guidelines, a lender with even an isolated substantive violation of the fair lending laws should clearly receive a failing rating on these factors. Thus, it is the standards for these fair lending laws and not any other standard in the CRA, that must be used to determine if the institution has violated any "discrimination and other illegal practices". That is, the CRA does not amend the fair lending laws or require that they be applied in some special way to institutions covered by the CRA.

The Restructuring of the Regulations in 1995 - The Historical Context

In December of 1993, the Federal agencies responded to a request by President Clinton to revise the CRA regulations to make them more objective and effective. This was done during a period of increased awareness of racial redlining and discrimination by regulated lenders. In May of 1988, the *Atlanta Journal/Constitution* ran a Pulitzer Prize winning series on racial redlining and discrimination by the banks and savings institutions in Atlanta ("The Color of Money" by Bill Dedman). This refocused national attention on lending discrimination and helped lead to changes in the HMDA that

[15] ECOA does prohibit discrimination against an individual based on the source of one's income coming from a form of public welfare, but no law protects persons or areas based on their income, *per se*.

produced individual loan data by race and ethnicity. By 1993, these data were routinely used by the regulatory agencies and the public in reviewing racial lending patterns.

Also, the Department of Justice began a series of lending discrimination cases against depository lenders, beginning with Decatur Federal, the main lender criticized in the Color of Money series. DOJ settled its case against Decatur Federal in 1992. The complaint cited the exclusion of most of the African-American communities in Fulton County (which includes Atlanta) as a violation of both the Fair Housing Act and the Community Reinvestment Act. The consent decree required the lender to expand its CRA area to include all of the minority areas it had previously excluded in Fulton County. This began a series of DOJ cases against depository institutions where the exclusion of minority areas from the lender's CRA community was cited as a violation of the fair lending laws.

In June of 1993, DOJ began its investigation of Chevy Chase in the Washington, D.C., metropolitan area. The resulting complaint also included charges of racial redlining in the delineation of the Chevy Chase CRA community. The settlement (in August of 1994 prior to the publication of the final CRA regulations) required the lender to include all of the District of Columbia in its CRA service area.

Therefore, during the period of the reform of the CRA regulations, racial redlining was clearly defined as a violation of the fair lending laws and the CRA by the Department of Justice. The DOJ settlements included a section on CRA compliance focused on expanding the service areas to include minority communities.

Restructuring of the Regulations and the Assessment of Discrimination

In December of 1993, the regulatory agencies proposed major changes to the CRA regulations, allegedly to streamline the process and provide for a wide range of investment and development activities. As noted in the December 7, 1993, memo to the Federal Reserve Board from its staff seeking approval to publish the proposed regulations, the new regulations were the response from President Clinton to "develop more objective, performance-based assessment standards that minimize compliance burden while improving performance."

As part of the background for the regulations, the Fed had sought advice from its own Consumer Advisory Council. In the list of its recommendations for CRA reform the first item was that "evidence of willful discrimination should result in an automatic "substantial noncompliance" CRA rating."[16] This seems no more than a restating of the ways in which the existing two fair lending assessment factors were to be applied.

[16] This list was attached to the December 3, 1993 memo from the staff to the Federal Reserve Board, but this item was not mentioned in the entire 32 page summary of the proposed regulations by the staff that had developed the regulations.

In the introductory section of the proposed regulations (titled "Supplementary Information"), the Agencies stated flatly that a "financial institution is not serving its entire community adequately if it is discriminating illegally."[17] The comments went on to summarize the language in the proposed regulations relating to evidence of illegal discrimination. "Therefore, there would be a rebuttable presumption that an institution would receive a composite rating of less than satisfactory if the institution committed an isolated act of illegal discrimination of which it has knowledge that it has not corrected fully or is not in the process of correcting fully or engaged in a pattern or practice of illegal discrimination that it has not corrected fully."

In the proposed regulations, however, these considerations of illegal discrimination were no longer direct assessment factors. Newly proposed revisions of the CRA regulations eliminated the original twelve assessment factors and replaced them with three "tests". There would be a lending test, an investment test, and a service test. The lending test did not include an analysis of racial disparities. The two factors related to discrimination had been eliminated and replaced by the statement reviewed above.

While it appeared that a lender with an isolated but substantive violation of the fair lending laws would automatically fail the CRA exam, many community groups criticized the provision throughout the regulations that continually provided the institution with a private internal opportunity to rebut a rating or finding while providing no such opportunity for the community and general public. Since the exam procedures regularly provide for interaction with the lender, the lender surely has an opportunity to respond to the examiner's concerns prior to the examiner making a finding. This "rebuttable presumption" simply gave the lender a special second, and secret, chance to influence the examination process.

In a revised set of proposed regulations in October of 1994, the agencies claimed that they were responding to this concern by removing the institution's right of rebuttal, but at the same time, they also removed the provision that required a failing CRA rating when evidence of illegal discrimination was found.[18] The final regulation published on May, 4, 1995, only indicates that "evidence of discrimination or other illegal credit practices adversely affects the [regulatory agency's] evaluation of the [institution's] performance." This is followed by a statement that the agency will consider the "nature and extent of the evidence" and any corrective actions that the institution has taken (for example §25.28(c) in the version for the OCC).[19]

In the final regulations, the three assessment tests all have pages of prescribed guidelines as to how they are to be determined. They even have a numerical scoring system assigned to them and to the overall "composite" rating from the three assessment

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[17] See *Federal Register*, Volume 58, Number 243, Tuesday, December 21, 1993, pages 67466 to 67508.
[18] The proposed regulations appear in the *Federal Register*, Volume 59, Number 194 for Friday, October 7, 1994, pages 51232 to 51324.

[19] See the final regulations published in the Federal Register, Volume 60, Number 86 for Thursday, May 4, 1995, pages 22156 to 22223.

factors (at page 22170 in the *Federal Register*). The consideration of illegal discriminatory practices is tacked onto the composite rating after it has already been calculated. There is only a single vague sentence relating to how an examiner will take discrimination into account. There is no scoring system of any kind for taking account of discrimination. In an objective – and numerical - rating system, it has no assigned values. One might reasonably suggest that in this context, it counts for nothing.

Ironically, while the fair lending examination procedures of the regulatory agencies essentially alert the examiner to purely subjective underwriting practices as a place where unequal treatment is likely to exist, the determination of evidence of violations of the antidiscrimination laws in the CRA exam is left purely to the subjective opinions of the examiner. Moreover, this subjective process for treating the evaluation of discriminatory practices does not conform to the request from President Clinton to develop more objective and performance based standards.

Critical Changes in the Delineation and Treatment of the Service Area

Next, the local community service areas were eliminated in the CRA regulations and were replaced by the delineation of an "assessment area". These "assessment areas" are the geographic areas used in the CRA examinations. Therefore, unless these areas are challenged by the regulatory agency, the assessment tests are applied only to how well the institution serves these particular geographic areas. I believe it is important to quote the exact language contained in the interpretive introduction to the final regulations, as it reflects the thinking of the regulatory agencies in regard to this issue. With respect to the changes in the designation of the "delineated community", selected sections of the introductory interpretive section read:

> *...the agencies have decided to place a different emphasis on the institution's specific delineation and the methods used by the institution to establish that delineation.*
>
> *The agencies do not expect that, simply because a census tract or block numbering area is within an institution's assessment area, the institution must lend to that census tract or block numbering area.* (emphasis added) The capacity and constraints of the institution, its business decisions about how it can best help to meet the needs of its assessment area, including those of low- and moderate-income neighborhoods, and other aspects of the performance context, would be relevant to explain why the institution is not serving portions of the assessment area(s).
>
> The rule also clarifies that an institution's delineation of its assessment area(s) is not separately evaluated as an aspect of CRA performance, although the delineation will be reviewed for compliance with the assessment area requirements of the rule. If, for example, an institution delineated the entire county in which it is located as its assessment area but could have delineated its assessment area as only a portion of the county, it will not be penalized for lending only in that portion of the county, so long as that portion does not reflect illegal discrimination or arbitrarily exclude low- or moderate-income geographies.

> To simplify the process of delineating an assessment area, the final rule encourages institutions to establish assessment area boundaries that coincide with the boundaries of one or more MSAs or one or more contiguous political subdivisions, such as counties, cities, or towns. *An institution is permitted, but is not required, to adjust the boundaries of its assessment area(s) so as to include only the portion of a political subdivision it reasonably can be expected to serve.* (emphasis added) This provision gives institutions some flexibility in their delineations, particularly in the case of an area that would otherwise be extremely large, of unusual configuration, or divided by significant geographic barriers. As with the 1994 proposal, however, such adjustments may not arbitrarily exclude low- and moderate-income geographies from the institution's assessment area(s).
>
> Equidistant Principle. The 1994 proposal would have adopted the effective lending territory principle from the current regulations in slightly modified form. The 1994 proposal would have explicitly linked an institution's CRA obligations to the areas around its branches and deposit-taking ATMs, rather than its other non-deposit taking offices.
>
> The service area delineated by the institution would have had to include all geographies around its branches in which the institution originated or had outstanding during the previous year a significant number and amount of home mortgage, small business and small farm, and consumer loans and any other geographies equidistant from its branches and deposit-taking ATMs.
>
> *The final rule eliminates the equidistance principle as a required part of the delineation of an assessment area. This change provides institutions greater flexibility in their delineations.* (*Federal Register*, Vol. 60, No. 86, page 22171, emphasis added).

While the regulations maintained the general requirement that the assessment area must consist of "whole geographies" and "may not reflect illegal discrimination", these general provisions were subject to the specific regulations about how the area may be drawn.[20] First, one needs to understand that "geographies" are defined in the regulations as "census tracts", not counties or metropolitan areas, etc. Second, the regulation states that the area must "include geographies in which the bank has its main office, its branches, and its deposit-taking ATMs, as well as *the surrounding geographies in which the bank has originated or purchased a substantial portion of its loans*." (emphasis added) Third, whatever the method of defining the assessment area the regulations provide that "a bank may adjust the boundaries of its assessment area(s) to include only the portion of a political subdivision that it reasonably can be expected to serve". Finally, we must recall that in defining the area, these regulations eliminated the "equidistant" requirement which was seen by the community groups as the one standard that could actually limit the ability of the institution to skip over or surround minority areas without including them in the service area.[21]

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[20] While the language for each agency is essentially the same, the quotations here are taken from the regulations in §25.41 for the Comptroller of the Currency.

[21] In the "Community Reinvestment Act Interagency Questions and Answers Regarding Community Reinvestments (*Federal Register*, Volume 66, Number 134, Thursday, July 12, 2001, at page 36641) under

The Scoring System and the Lending Test

In the revised regulations, CRA ratings are produced by a scoring system assigned to the various tests. Ratings are based on performance within the lender's assessment area(s). In addition to its own activities, a lender may elect to include the lending of all of the affiliates of its holding company. Based on a review of the examination procedures and many public CRA evaluations, when the lending of affiliates is included in the examination, all of the lending is aggregated together and no separate analysis is done of the patterns for different affiliates. Only the loans of the affiliates inside the assessment area are included in the analysis. The analysis gives credit for high levels of penetration in the assessment area without regard for the type or risk level of the loans. Based on this system, a lender that receives an Outstanding on the lending test is assigned 12 points. In the overall composite, a lender needs only 11 points to get a Satisfactory rating overall. Therefore, a lender who gets an Outstanding rating in the lending test passes the CRA exam. Moreover, while the regulators give lip service to taking account of challenges to an application by third parties, they make it clear that a CRA examination and its rating "is an important, and often controlling, factor in the consideration of an institution's record".[22]

Given these regulations, a lender who made no loans or only a few loans in minority census tracts, but who made more loans in white census tracts, could draw the boundary of the assessment area as a collection of white census tracts around its facilities – even if there were minority census tracts that were "equidistant" from the facility. The determination of what is "reasonable" and what constitutes illegal discrimination is left to the subjective views of the examiner. Then, if the lender (either by itself or with its affiliates included) provided a high level of loans to this white area, it could be given an Outstanding rating in the lending test, resulting in a passing CRA grade. The passing CRA grade would make it extremely difficult for a challenge to block any applications of this lender.

The Optional Inclusion of Affiliates

In cases where the institution is part of a holding company, the CRA regulations allow institutions to include or exclude the lending activities of affiliates of that holding company for any particular type of loan. Where an institution decides to include the lending of the affiliates, all of the affiliate lending for that particular loan type are to be included in the examination.

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a section on the limitations on the delineation of an assessment area there is a single statement that the area cannot "arbitrarily exclude low- or moderate-income geographies". No mention is made relating to excluding minority areas.

[22] See, for example, "Community Reinvestment Act Interagency Questions and Answers Regarding Community Reinvestments (*Federal Register*, Volume 66, Number 134, Thursday, July 12, 2001, at page 36640)

Because Citigroup is the largest bank holding company with some extremely varied and complex affiliate structures, some of the problems with the treatment of affiliates by the regulators can be demonstrated in some examples from different depository institutions that are part of Citigroup. These examples highlight some key issues related to the treatment of affiliates as well as issues related to the CRA comment and challenge process, and issues related to the treatment of claims of discrimination and violations of other credit laws. *These historical examples are used to illustrate functional issues related to the practices of the regulators and not to make a case for or against the lending patterns of the mortgage lending subsidiaries and affiliates of Citigroup, which have been substantially restructured today.* Since 2003, NTIC and its grassroots leadership base from around the country have developed an effective partnership with Citifinancial and Citigroup. The partnership entails semi-annually meetings with top Citi executives, foreclosure prevention, REO re-development, affordable loan product development and support for financial education efforts in seven cities.

The first example is taken from the Comptroller's Public Evaluation of Citibank, NA in 2003. In the case of the evaluation of Citibank, NA, the institution chose to include all of the affiliate lenders of Citigroup in the CRA examination. The Comptroller lists seven affiliates where the HMDA data were combined with that of Citibank for the lending test. In this case, the Comptroller assigned an Outstanding rating for Citibank's lending test, guaranteeing it a passing CRA rating overall. Of course, we are not questioning the rating. We are concerned with the case as an example o the process used by the Comptroller and which, presumably, would be applied to other institutions as well.

The assessment area for Citibank is defined essentially as the New York City area and Long Island. In this case, even though Citigroup is the largest bank holding company in the United States and makes loans all across the country through various "affiliates", the Comptroller's evaluation was based on the lending patterns in just a few counties in the state of New York (essentially New York City and Long Island). Indeed, the evaluation states that, "despite the fact that the affiliates are nationwide lenders, CRA consideration was only given for those loans made in the bank's AAs [assessment areas]" (at page 7). For any other lender with affiliates that made loans nationwide, the same standard would be applied.

One affiliate, Citicorp Mortgage, was one of the largest lenders in the nation, yet only its role as part of the aggregate pattern of all the affiliate lenders in the assessment area was reviewed. Moreover, "93.7% of the HMDA loans in the local assessment area were provided by the bank and the affiliate, Citicorp Mortgage" (at page 7). One issue, then, is that the dominant pattern for the lending test may be determined by a single affiliate. While not suggesting that Citibank's performance would necessarily be different if the affiliates were not used, one can see as a practical matter the any institution's choice to include or exclude affiliates might radically change the lending pattern in a particular assessment area.

Another issue of concern is that the analysis of the lending patterns is generally done by reviewing the composite lending for the institution and all of the affiliates

combined. If a holding company channels different loan products through different affiliates, as was the case with Citigroup and many holding companies, then any disparate racial patterns associated with the segmented lending may be hidden. Since the CRA rewards lenders for the level of loans, an apparent fair distribution of loans in the merged data may mask, for example, the channeling of prime loans to predominantly white and higher income areas and the channeling of FHA and subprime loans to minority and low- and moderate-income areas.

Another reason to use the example of Citibank is that it provides a view of how the Comptroller dealt with a specific past issue of challenges to the lending practices of an institution acquired by Citigroup. Generally, the CRA evaluations rely simply on the aggregate lending patterns of the institution and all affiliates combined. The Comptroller's evaluation is somewhat unique in this regard as it does comment the separate impact of some of the subprime affiliate lending on the overall pattern as part of a special consideration related to recent CRA challenges and lawsuits against Citigroup in relation to the acquisition of The Associates, one of the nation's largest subprime lenders.

This evaluation covered a period from October of 2000 through June of 2003. This included the time right after Citigroup's acquisition of Associates First Capital Corporation, when a nationwide coalition of community groups mounted a CRA challenge based on the claimed discriminatory and predatory lending practices of The Associates (including such issues as packing credit life insurance into the loans). The challenge was denied and the acquisition took place. The Associates was generally merged into "CitiFinancial" affiliates.

Additionally, the Federal Trade Commission had sued Citigroup (as the successor parent company) for unfair and deceptive trade practices and violations of ECOA by The Associates. The initial settlement for that case was filed in February of 2003 and included a $215 million fund for restitution.

The "Fair Lending Review" section of the Comptroller's evaluation reads:

> We found no evidence of illegal discrimination or other credit practices. However, given the previous adverse publicity involving the bank's affiliates, including Citigroup's settlement with the FTC, the following comments are presented.
>
> With the acquisition of Associates First Capital Corporation in September 2000 and subsequent consolidation with Citifinancial, Citigroup has committed to resolve concerns that had been raised against the former Associates involving alleged deceptive and abusive lending practices.
>
> In considering any potential impact to our CRA assessment of Citibank, we acknowledge Citigroup's efforts to address individual customer concerns and the minimal impact that lending by the affiliate had to the overall lending in the bank's AAs. Therefore, although the concerns were considered, they did not significantly impact our CRA assessment of Citibank. (at page 11)[23]

[23] One may wonder about the scope of the evidence available to the Comptroller as a foundation for acknowledging "Citigroup's efforts to address individual customer concerns". Surely, some fundamental

The comment on the "minimal impact" of the affiliate relates sections of the lending test that report that two national subprime affiliates of Citigroup, CitiFinancial Mortgage Corporation (CFMC) and CitiFinancial, Inc. (CFI), were given a separate review. In accordance with the CRA examination procedures, this review only applied to the Citibank assessment area in the New York City area and Long Island. In the specific Citibank, NA assessment area, however, these lenders accounted for only "4.1% of the mortgage loans considered." The report concludes, "There was no difference at all in the bank's geographic distribution of home purchase and home improvement loans in low- and moderate-income geographies factoring CFMC and CFI loans."

While this does not cast doubt on Citibank's lending in its assessment area, this comment raises several issues about the CRA examination process. First, indicates how the lending patterns for the CRA reviews only look at geographic distributions by area income and not race and ethnicity.

Second, the Comptroller specifically notes patterns for home purchase and home improvement loans while the major claims of potential racial bias in subprime lending at this time were focused on refinance loans, about which the Comptroller's report is silent. Third, by looking only at the role of the CitiFinancial lenders in Citibank's local assessment areas, the larger role of these subprime affiliates in other markets is ignored. Hypothetically, if there was discrimination in the lending of any of these affiliates in some other area, that would be ignored and a lender would be allowed to use the lending of these affiliates in its assessment area alone to boost its CRA rating.

For example, in 2002, NTIC studied the distribution of prime and subprime loans between Citigroup's affiliates in 13 markets around the country from the 2000 HMDA data.[24] This study provides an example of how the role of subprime affiliates can vary from one market to another. In the New York City area, the market was for Brooklyn and Queens, where NTIC found that 11% of the loans were made by subprime affiliates. This was by far the lowest percentage of all the markets they studied. In Baltimore, 85% of the loans were made by the subprime affiliates. In Cleveland it was 93%. In Cincinnati, it was 94%. In Pittsburgh, it was 95%. In Syracuse it was 90%. Outside of the larger urban areas, the percentage of subprime loans was 94% in Des Moines, 96% in Wichita, and 96% in Central Illinois. This shows how one may get a very limited and unrepresentative view of the overall role of an institution's subprime affiliates when looking only at a single institution's assessment are in a CRA examination.

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changes were made to the practices of The Associates when it was folded into CitiFinancial. One may note, however, that at the same time that the Comptroller was examining Citibank, the Federal Reserve was investigating CitiFinancial for continued misrepresentations in marketing credit insurance, for violations of HOEPA, and for misrepresentations to the Federal Reserve investigators. In May of 2004, this investigation resulted in a Cease and Desist Order that included $70 million in civil money penalties.

[24] See NTIC, *Citigroup: Reinventing Redlining – An Analysis of Lending and Branch Disparities for Citigroup's Prime and Subprime Lending Affiliates*, June 2002. The percentages are taken from the summary table at page 13.

A fourth issue is whether the Comptroller's analysis actually does include all of the subprime affiliates. One affiliate which is missing from those listed by the Comptroller is Citicorp Trust, FSB (CTB). According to the CRA evaluation of CTB by the Office of Thrift Supervision (OTS) in May of 2004, this is a subsidiary of CitiFinancial Credit Company.[25]

Also according to the OTS evaluation, CTB works with another Citigroup company, Primerica Financial Services (PFS), to originate refinance loans. The OTS evaluation:

> PFS representatives forward completed loan applications to CTB for review and approval. Nationally, there are nine loan processing offices, called $.M.A.R.T. (Save Money and Reduce Taxes) Solution Centers, that accept and process the applications. In addition, CTB has a facility in Hanover, Maryland that is responsible for the solicitation of the existing customer base for refinancing. None of these is considered a retail banking office. (at page 5)

The OTS evaluation further states that, "CTB originates first and second mortgage products primarily for debt consolidation purposes rather than refinancing purposes" (at page 5).

As a conceptual issue, debt consolidation refinance loans sold with the solicitation of other credit and insurance products and solicited for continual refinancing (flipping) are the types of loans that have been subject to the most concerns for discrimination and abuse. We are not suggesting, here, that CTB engages in such abusive tactics, but simply that it is important for regulators to pay special attention to these loans.

If CBT had a depository institution in the New York City area with an assessment area overlapping with that of Citibank, NA, then one could understand that under the policy of not counting loans twice, these loans would be excluded from the affiliates included in the Citibank evaluation. The only assessment area defined for CTB, however, is for the Wilmington, Delaware, MSA. In this case, because CTB originates loans from many areas across the country, the OTS – a*t its own discretion* – selected 9 other metropolitan markets outside of CTB's assessment area for review as what it termed "Supplemental Evaluation Areas" to see if the lending patterns in these comparison areas reflected that same high level of service to low- and moderate-income areas as did the small share of CTB's loans in it actual assessment area.[26]

Therefore, by fiat, the OTS appears to have removed these large pools of subprime loans from the CRA evaluations of Citigroup depository lenders in any of the nine supplementary markets that it chose for comparison. Such a move is inconsistent

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[25] The OTS evaluation covers a lending period from 2001 to 2003. CitiFinancial Credit Company is also not listed as one of the affiliates in the Comptroller's evaluation of Citibank, NA.

[26] A list of these areas is found in Table 9 on page 15 of the OTS evaluation.

with the CRA regulations and allows a regulatory agency to essentially hide the loans of an affiliate when they should be counted. In the New York City MSA, for example, the HMDA data for CBT indicates that it had 1,251 loans in 2002 and 1,162 loans in 2003.[27] Since CBT is part of CitiFinancial and a subprime lender, these loans should have been included in the Comptroller's evaluation of Citibank, NA.

This action by the OTS in regard to the loans of CBT is not restricted to the case of Citibank, NA. Citibank, FSB, one of the largest federal savings banks in the nation also received a public CRA evaluation in 2003 that reflected the exclusion of the CBT loans. In this case, the OTS defined 8 assessment areas for Citibank, FSB, across the country.[28] These included the Chicago MSA, the Baltimore MSA, two Florida MSAs, the San Antonio MSA in Texas, MSAs in Connecticut and New Jersey, and the Washington, D.C. MSA. The lending test covered loans for all of 2002 and through June of 2003. Citibank, FSB also chose to have the Citigroup affiliates included in its evaluation.

The OTS also recognized the issues related to the acquisition of The Associates and reported that the aggregate level of lending by the CitiFinancial affiliates across the combined assessment areas was quite small. For example, it stated that for the loans made in 2003 (the first half of the year) only "408 are from affiliates that offer sub-prime loan products" (at page 17). As with the Comptroller's evaluation of Citibank, NA, the list of affiliates did not include CTB, stating that "The only HMDA-reportable affiliate operating within Citibank FSB's assessment areas that is excluded is Citicorp Trust Bank, fsb, which is subject to its own CRA evaluation by OTS" (at page 16).

Based on the HMDA data for 2002, CTB made 4,274 loans in the six assessment areas for Citibank, FSB. Meanwhile, the OTS evaluation reported only 5,041 loans from subprime affiliates in the assessment areas for 2003. Including Citicorp Trust Bank loans would have increased the number of these subprime affiliate loans by 85%. In 2003, CTB made 5,181 loans in the six assessment areas. Counting just half the year would be 2,590 loans. Meanwhile, the OTS evaluation reported just 408 loans from all affiliates for the first half of 2003. Including the estimated half year of CBT loans would have increased the number of these Citifinancial related subprime loans by 635%. Put another way, the OTS report which considered the subprime lending of Citifinancial affiliates to be negligible in 2003 included just 14% of the actual number of these loans.[29]

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[27] In the data presented here and in the CRA evaluations, both the loans originated and the loans purchased by the institution are counted in the lending test.

[28] Office of Thrift Supervision, Community Reinvestment Act performance Evaluation – Public Disclosure – Citibank, Federal Savings Bank, September 8, 2003. The evaluation covered lending from January 1, 2002, through June 30, 2003.

[29] There might be some discrepancies between the exact geographic areas used for the HMDA data from the selected MSAs and the assessment areas. The data for 2003 represents just half of the 2003 data because there is no way of actually calculating from the HMDA data which loans were originated or purchased in the first half of 2003.

There is also some question about the accuracy of the various Citifinancial loans that the OTS did include in its evaluation. My estimates of just loans originated by the Citifinancial affiliates used by the OTS indicates that there would have been 2,144 loans all of 2003. Half of this is 1,072. This is more than two and one half times the number used by the OTS.

Finally, the OTS review of Citicorp Trust Bank itself illustrates another issue with the way the CRA evaluations may work when the institution is primarily a subprime lender and no prime affiliates are included in the analysis. CTB received an Outstanding evaluation in the lending test because both in its lone assessment area and in the "Supplemental Evaluation Areas" hand picked by the OTS, CTB had higher levels of lending to low- and moderate-income areas than did the overall market (which includes both prime and subprime loans). Of course, we know from many studies and analyses of the HMDA data that subprime lending is more highly concentrated in lower-income areas and among lower-income borrowers. It is in these generally less sophisticated markets that the concerns over deceptive practices are greatest.

The CRA process simply gives high marks to a subprime lender for concentrating its loans in this lower-income segment of the market. This reveals just how shallow the lending test really is. While CRA examiners are prohibited from examining the actual loan practices of unregulated affiliates, they can, and should, carry out an examination of the marketing, underwriting, and servicing practices of the institutions they do regulate in the CRA process. Again, while we are not claiming any abuses by CTB in this statement, as a practical matter, high concentrations of subprime loans in these vulnerable markets could reflect either creative financial assistance or predatory and abusive lending. Regulators need to look at more than just the volume of loans to judge the meaning of high loan penetration rates in these lower-income (or minority) areas.

Therefore, from these examples, it is not clear that the regulators include all of the affiliates that should be included when an institution chooses this option. Moreover, a holding company can review the lending patterns of its affiliates and the areas covered by the assessment areas of its depository institutions and structure the choices concerning the inclusion of affiliates in ways that provide the most favorable lending picture for each institution subject to the CRA.

The Elimination of the Assessment of Credit Needs

Aside from placing "a different emphasis" on how a lender could delineate its CRA assessment area, removing a review of how the assessment area is defined as a specific factor in the CRA examination, and eliminating the direct assessment factors related to lending discrimination, the final regulations also eliminated other factors that were important to the assessment of an institution's fair lending.

For example, the rating factors that specifically addressed how the lender assessed the credit needs of its community service area were also eliminated. In the interpretive comments published with the May 4, 19995 regulations the agencies state that, "Under

the final rule, the agencies will neither prepare a formal assessment of community credit needs nor evaluate an institution on its efforts to ascertain community credit needs."

In the past, when citizens and organizations have placed comments in the lender's CRA file, these were reviewed as part of the factors related to the lender's assessment of credit needs. These comments, challenges, and other activities provided community organizations and the general public with a vehicle to define credit needs, propose the types of programs or loan products that could serve these needs, and also to identify possible redlining and discrimination issues in the delineation of the service area or in the operations of lending programs. Eliminating the assessment factors related to assessing community credit needs cut the public out of the CRA examination and rating process and reduced the CRA to a private relationship between the lender and the regulatory agency.

No Good Deed Goes Unpunished: The Attack on Community Participation by the Banking Lobby, the Regulators, and Congress

The "Sunstroke" Legislation

The Community Reinvestment Act was designed to protect minority and low-and moderate-income communities from redlining and disinvestment and to create the basis for a development banking industry for underserved communities in the United States. Community-based organizations have done their work.

With few resources and sheer determination, these organizations have led the way in identifying underserved markets, proposing real business solutions, and developing the public-private partnerships to provide the structural and institutional support to channel needed reinvestment into rural, small town, urban, and minority communities. The community-based organizations often created structures or institutional vehicles to channel investments into economic development and housing rehabilitation and development activities when they did not already exist.

Since the CRA was implemented, community-based organizations have been responsible for the creation of hundreds of Community Reinvestment Act agreements and programs. I have been involved personally in projects that have reviewed hundreds of Community Reinvestment Act agreements and programs. These agreements have resulted in well over 100 billion dollars of reinvestment in once redlined and ignored communities.

Aside from the model of South Shore Bank (now called Shorebank), virtually all of the most significant, most effective, and most creative reinvestment programs have their source in models that came from Community Reinvestment Act agreements. These include state-wide or local activities in most of the districts or states represented by this Committee, such as in the Boston, Chicago, Indianapolis, Baltimore, Cleveland, New Britain, and Waterloo areas or regional or statewide agreements as in California and Florida.

These agreements are not defined in the Community Reinvestment Act itself. They arose as part of the assessment of community credit needs and the active participation of the communities that the CRA was designed to serve. Often they evolved from the failure of the lending institutions to take active steps to comply with the CRA and the failure of the regulatory agencies to enforce the Act. Since there is no right to private action under the CRA, community groups and citizens working with a broad range of development organizations not only defined their credit needs but built the programs and capacity to meet those credit needs through the models provided by these formal CRA agreements. The agreements often arose from comments placed in the CRA file, from direct contacts and negotiations with lenders, and from challenges and testimony at CRA hearings on banking applications.

The so-called "CRA Sunshine Requirements (§711) of the 1999 Gramm-Leach-Bliley Act, represent the most reprehensible use of Congress with the banking lobby and the regulators to squash this history of citizen participation in the Community Reinvestment Act.[30] On the surface, this section of the Act may appear to recognize these agreements in requiring public disclosure of their contents, terms, and conditions. It might also appear on the surface that the Act brings some accountability to these agreements by requiring some disclosure by both the depository institutions (or any "affiliate" of the depository institution) and "each nongovernmental entity and person" that is a party to the agreement. In fact, the law is a bizarre form of intimidation designed to terrify community groups and individuals from making such agreements - or even from filing comments or making any contacts related to community credit needs and the CRA.

A CRA agreement is defined as any contract between "a depository institution or affiliate" and "a nongovernmental entity or person made pursuant to or in connection with the Community Reinvestment Act of 1977" (§48(a)). Essentially, any "nongovernmental entity or person" (indicated as an NGEP in the implementing regulations of the regulatory agencies) that has a "CRA communication" with the depository institution and then has a formal agreement with that institution is subject to the provisions of the sunshine requirements and enforcement actions. The implementing regulations for the Federal Reserve provide an example of the "CRA communications" that would subject an NGEP to the law:

> (a) *Definition of CRA communication.* A CRA communication is any of the following—
>
> > (1) Any written or oral comment or testimony provided to a Federal banking agency concerning the adequacy of the performance under the CRA of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate.

[30] The CRA Sunshine Requirements are amendments that add a Section 48 to the Federal Deposit Insurance Act (12 USC 1811 et seq.). References in this statement are to Section 48.

> (2) Any written comment submitted to the insured depository institution that discusses the adequacy of the performance under the CRA of the institution and must be included in the institution's CRA public file.
> (3) Any discussion or other contact with the insured depository institution or any affiliate about—
> (i) Providing (or refraining from providing) written or oral comments or testimony to any Federal banking agency concerning the adequacy of the performance under the CRA of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate;
> (ii) Providing (or refraining from providing) written comments to the insured depository institution that concern the adequacy of the institution's performance under the CRA and must be included in the institution's CRA public file; or
> (iii) The adequacy of the performance under the CRA of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate (12 CFR §207.2(b)).

Thus, virtually any person or organization that made a comment about its community credit needs, commented on or testified about the lender's past performance, or suggested a form of reinvestment could be subject to the law. As the implementing regulations of the Federal Reserve indicate, such an organization or person could be subject to all the disclosures and penalties of the sunshine requirements, even if the organization or person never actually signed an agreement with the institution. As an example of a covered agreement, the Federal Reserve regulations indicate that if a NGEP simply had a meeting with the lender and defined the specifics of a program and the lender later made a press release that reflected these conditions, this would be considered an agreement subject to the law (12 CFR §207.3(a)).

While depository institutions are required to provide only general data on the annual amounts of resources allocated to an agreement, the community organizations and individual parties are required to file detailed financial accountings of how each dollar that it received was spent (§48(c)).

The federal regulatory agencies may take the disclosure data and determine at their discretion that the community and any individual citizens who are party to the agreement have not fully complied with the disclosure laws. In this case, the regulatory agency is empowered by Federal law to declare the agreement "unenforceable".[31] Even more threatening, the regulatory agency may decide through its own interpretation of the agreement that the funds were not used properly by the community organizations or any individual citizens party to the agreement. In this case, the agency:

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[31] The right of the regulatory agencies to void a reinvestment agreement stands in contrast to their statements concerning CRA agreements in the interpretive comments preceding the 1995 regulations. In those comments, the agencies state, "The CRA requires the agencies to assess an institution's record of helping to meet the credit needs of its community, not to enforce privately negotiated agreements. Therefore, an institution's record of fulfilling these types of agreements is not an appropriate CRA performance criterion."

> May impose either or both of the following penalties:
>
> (i) Disgorgement by the offending individual of funds received under the agreement.
>
> (ii) Prohibition of the offending individual from being a party to any agreement described in subsection (a) for a period of not to exceed 10 years. (12 USC 1831 §48(f).

On the other hand, *there are no penalties defined in the law for a depository institution (or an affiliate) that violates the agreement in any way.* Indeed, the law specifically states that "no provision of this section shall be construed as authorizing any appropriate Federal banking agency to enforce the provisions of any agreement described" in the law (12 USC 1831 §48(g)).

This law has a chilling effect on any organization or person who would want to file CRA comments or participate in a challenge. If that organization or person later proposed a reinvestment program for that institution and the institution adopted the basic components of the program, these organizations and persons would be subject to the burdens and penalties of the so-called sunshine provisions while there are no penalties for the lender if it disregards its obligations in the agreement. Nothing is more contrary to the original intent of the CRA.

The Sounds of Silence

Since the implementation of the Gramm-Leach-Bliley sunshine provisions, only a handful of brave organizations in Cleveland, Massachusetts and a few other places have filed protests and comments on applications. For example, this Subcommittee requested and received from the Comptroller a list of all merger applications from 2000 to the present. The list includes several hundred applications. The applications involve many of the major institutions that have been the subject of protests in the past, yet the Comptroller has indicated that there has not been a single comment filed against these applications.

Linking the CRA to the Fair Lending Examination Process

In the revised CRA regulations the assessment of discrimination is left to the lone directive to take account of evidence of discriminatory behavior and consider whether changes should be made to the overall CRA rating already assigned to the lender in the systematic process for the various tests. In the examination procedures for the CRA, the regulators are instructed to use the most recent fair lending compliance exam as the basic source for locating evidence of discrimination. Therefore, these fair lending examination procedures need to be reviewed to understand how evidence of discrimination should be determined when completing the CRA exams.

In 1994, the FFIEC issued the Interagency Fair Lending Examination Procedures. The various fair lending examination procedures and guidelines for the individual regulatory agencies reflect the FFIEC guidelines with generally only minor variations.

We shall use examples from the specific guidelines for the Comptroller of the Currency, the Federal Reserve, or the Office of Thrift Supervision.[32]

First, in order to use the results of the most recent fair lending exam, there must be a recent exam. In the OCC process, some lenders are not identified for a regular exam and are only selected through a random process. This means that it may be many years before some lenders receive an exam.

Even if the lenders are chosen, the examinations are designed to be directed toward one or a few selected "focal points" rather than a full review.[33] Focal points relate to different types of discrimination issues such as redlining, marketing, steering, etc. In some cases these focal points can be determined by statistical analysis, though this requires that the lender have enough files of different loan types by different racial and ethnic groups to fit the requirements of the statistical models. Then, even within the selected focal points, the exam may be limited in scope and breadth. The Comptroller's procedures, for example indicate that only a limited exam may be done if there are "no unresolved fair lending complaints, administrative proceedings, litigation or similar factors" (at page 22).

This seems to suggest that if consumers do not actually file complaints, the regulatory agencies may do only a limited fair lending examination. Of course, lending is an area where consumers are often unaware of whether they have been treated differently from other applicants, so uncovering discrimination depends upon the regulatory agencies using their investigative powers to search for such differential treatment.

Where a lender operates in several metropolitan markets, the regulators are instructed to limit the exam to only what "can be reviewed readily in depth, rather than selecting proportionally to cover every market"[34] Thus, all the market areas for large lenders are not covered in the exam.

There are several sections of the exam procedures, such as the sections on loan product steering and marketing where the examination procedures refer to patterns that may segment the market between the lender and affiliates. For example, the Comptroller's procedures state that, "Institutions that make FHA and conventional loans and those that lend in both prime 'A' markets and in subprime markets (either directly or through affiliates), present opportunities for loan officers to refer or 'steer' applicants

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[32] These are the *Federal Reserve Consumer Compliance Handbook*, "Federal Fair Lending Regulations and Statues – Examination Procedures" (updated to January 2006), and *Comptroller's Handbook – Consumer Compliance Examination*, "Fair Lending Examination Procedures" (updated to April 2006), and Office of Thrift Supervision, *Examination Handbook*, Section 1200 (updated to March 2007).

[33] See, for example, pages 12 and 69 in the Comptroller's examination procedures.

[34] See, for example, page 3 in the Federal Reserve's examination procedures.

from one product or market to another" (at pages 45-46).[35] Nonetheless, the fair lending examinations specifically instruct the examiners to "limit the inquiry to what can be learned in the institution and do not contact the affiliate" (at page 15).[36]

This creates two issues. One issue is that affiliates are simply not examined. As the mortgage lending markets have changed dramatically over the past three decades since the CRA was passed, holding company affiliates often are the primary mortgage lenders. Moreover, some holding companies channel different loan products (FHA, subprime, jumbo, GSE conforming) through different affiliate companies. Therefore, the lack of any review of affiliates leaves a massive hole in the fair lending examination process. Second, at the election of the lender, CRA exams may include all of the affiliates of a lender's holding company. This creates a serious mismatch between the lending patterns subject to review in the fair lending exam and the aggregate patterns used in the CRA exam.

In the CRA exam, lending is only reviewed within the CRA assessment area, while no such restrictions are defined in the fair lending examinations. Therefore, the results of the fair lending exams are likely to reflect patterns that do not conform to the areas for the CRA exam. In addition to these inconsistencies and mismatches, the fair lending examinations provide very little guidance in how examiners are to compare the underwriting or marketing practices of a lender to the legal standards of the fair lending laws.

In quite uniform ways, the fair lending examination procedures for the regulatory agencies specifically cover redlining – and with specific references to the CRA. Taking references from the Federal Reserve procedures, examiners are told to look at recent CRA evaluations and "identify and delineate any minority areas within the lender's CRA assessment area or market area for residential loan products that are of a racial or national origin minority character." Examiners are then instructed to determine whether any such area "appears to be excluded, underserved, selectively excluded from marketing efforts, or otherwise treated less favorably in any way by the lender" (at page 16). On the same page, the procedures contain a special note indicating that while "the CRA assessment area can be a convenient unit for redlining analysis", examiners should look to all areas where the lender "could reasonably be expected to have marketed and provided credit"

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[35] A specific problem in the examination procedures relating to steering of FHA loans are the uniform comments that in reviewing steering between conventional and FHA products, the examiner should focus on loans greater than $100,000. Given the focus of FHA lending on lower valued homes, this seems odd. Perhaps in markets like California, DC, New York City or Boston, the high home values blind people to the reality that there are still vast markets where loans are under $100,000. This examination directive would eliminate many minority markets where loan values are disproportionately below $100,000 and where steering to FHA loans has historically been a major issue.

[36] In the interpretive introduction to the 1995 CRA regulations, the agencies also indicate how affiliates are not to be examined, stating that, "although lending by affiliates may be treated as lending by an institution, this treatment for CRA purposes will not permit a regulatory agency to examine any institution or its affiliate if it does not otherwise have such authority."

and that "some of those might be beyond or otherwise different from the CRA assessment area". This is reflective of introductory comments at the beginning of the examination procedures that reminded the examiner that, "In thinking about an institution's credit market, examiners should recognize that these markets may or may not coincide with the institution's CRA assessment area(s)" (at page 2).

As part of the redlining analysis, examiners are directed to review the lender's marketing procedures. The procedures states that, "A clear exclusion of the suspected redlined area from the lender's marketing of residential loan products supports the view that the lender did not want to do business in the area. *Marketing decisions are affirmative acts to include or exclude areas*" (at page 19, emphasis added). No marketing practice could be more clear and intentional that the delineation of the assessment area that the lender defines as its local community where it will be evaluated for CRA purposes.

Finally, the examination procedures indicate that redlining violates both the Fair Housing Act and ECOA whether the redlining results from purposeful actions or the effect of policies and practices.[37] Even if the exclusion of minority areas were unintended, it would have a discriminatory effect. The only defense against such effects is that there is a business necessity. In the exam procedures for the Federal Reserve this is defined as a "compelling business justification" (at page 21). The examination procedures for the Comptroller state that the "Justification must be manifest and may not be hypothetical or speculative" (at pages 8-9).

Above the Law: High CRA Ratings for Fair Lending Violations

In sum, the regulatory agencies have revised the CRA regulations to eliminate specific fair lending rating factors, to weaken citizen participation, to help lenders inflate their ratings, and to provide extreme flexibility in defining the CRA assessment area. Still, in the language of the regulators themselves, it seems clear that violations of the fair lending laws should automatically result in a failing rating.

The interpretive comments for the original 1978 CRA regulations stated that evidence of discrimination could be found by examiners even without a determination by a court. One would have every reason to believe that racial redlining would certainly be taken into account. The guidelines published in 1990 for disclosure of the CRA evaluations indicated that in reviewing evidence of discrimination, "the institution is evaluated in this category on its compliance with antidiscrimination and other related credit laws, *including efforts to avoid doing business in particular areas*" (emphasis added). These guidelines also indicated that even isolated cases of substantive violations of the fair lending laws would result in a failing CRA rating. Moreover, in the interpretive introduction to the present regulations, the agencies stated flatly that

[37] See, for example, page 53 of the Comptroller's procedures or page 15 of the Federal Reserve's procedures.

"evidence of willful discrimination should result in an automatic "substantial noncompliance" CRA rating."

The Fair Lending Examination process is defined as the source for seeking evidence of discrimination. Therefore, the CRA regulations recognize the standards of the fair lending laws as the basis for evidence of illegal discrimination to be used in the CRA rating process. The fair lending examination guidelines for all the agencies indicate that racial redlining violates the fair lending laws in either treatment or effect and that examiners should look beyond the CRA assessment area to see if redlining has occurred. Moreover, the fair lending examination guidelines specifically reference the CRA assessment areas in the sections on redlining.

The question, then, is how to explain the cases where the Department of Justice has filed discrimination claims against a lender or a lender has been found to have violated the fair lending laws in court while the regulatory agencies continue to give these institutions the high CRA ratings and continue to grant them branching, merging, and acquisition rights. A review of these cases illustrates the issue.

Basic Redlining Cases

In this context, we provide the following examples of racial redlining allowed by the CRA regulators but found by the Department of Justice (DOJ) to be in violation of the Fair Housing and Equal Credit Opportunity Acts, as well as in violation of the CRA:

The OTS and Mid America Federal

The Chicago metropolitan area is the largest African-American home lending market in the United States, and one of the largest Hispanic markets outside of the Southwest as well. Mid America is the largest independent thrift institution in the entire Chicago market. It is one of the largest mortgage lenders in the Chicago markets. Mid America is regulated by the Office of Thrift Supervision (OTS). Since 1994, the OTS has given Mid America four Outstanding ratings and one Satisfactory rating.

In 2002, DOJ filed suit against Mid America for violating the Fair Housing Act and the Equal Credit Opportunity Act.[38] In specifically citing Section 228 of the CRA regulations (Reg BB), the suit stated that, "In establishing its assessment area, also known as its community service area, boundaries under the Community Reinvestment Act of 1977, 12 U.S.C. §§2901-2906 ("CRA"), Mid America has, since at least 1996, excluded nearly all predominantly African American and African American/Hispanic neighborhoods in the Chicago MSA, even those located in close proximity to its branch offices." [See the attached map which reproduces the exhibit from the DOJ complaint.]

[38] Copies of the complaints and consent decrees for this and the other DOJ cases cited in this statement can be found on the DOJ website at http://www.usdoj.gov/crt/housing/caselist.htm#lending.

Even though it was a major lender in the white communities along Lake Michigan in the City of Chicago and in the northern suburbs, it defined its assessment area largely as a suburban area west of Chicago. Essentially, Mid America eliminated the minority communities within the City of Chicago and the southern suburbs.

Even if the OTS ignored the racial composition of Detroit, the regulations require lenders not to exclude low- and moderate- income census tracts from their CRA communities. According to the 2000 census, 91% of the low- and moderate-income census tracts in the City of Chicago, for example, are also minority census tracts. Looked at from another perspective, 86% of all the minority census tracts in Chicago are also low- or moderate-income census tracts. Thus, for many years, the Office of Thrift Supervision has allowed this major Chicago metropolitan area lender to exclude both low- and moderate-income and minority areas from its defined service area.

The DOJ suit cites the pattern of expansion of Mid America through the opening of branches in the Chicago metropolitan area. The complaint states that, "Mid America has engaged in a race-based pattern of locating or acquiring new offices. It has located or acquired new branch and other offices to serve the residential lending and credit needs of predominantly white areas but not those of predominantly African American or African American/Hispanic neighborhoods. Mid America has never opened any new full-service branch office in a majority African American or African American/ Hispanic neighborhood. As of March 1, 2002, of Mid America's 33 branch offices, only one, Broadview, is located in a census tract in which a majority of the residents are African American. However, the Broadview branch is the only non-traditional office operated by Mid America. In contrast to all its other branch offices, the Bank's Broadview office consists solely of an ATM machine and a lobby area located inside a K Mart. Moreover, the level of services offered at the Broadview branch is substantially less than that offered at Mid America's other branches. Every other branch office offers mortgage lending or investment services, or both; neither is offered at the Broadview branch."

Opening branches is a privilege that should be granted only to institutions that have satisfied their CRA obligations. By continually allowing Mid America to expand, the OTS was rewarding a major lender in the nations largest African-American mortgage market for engaging in racial redlining – the very practice that led to the creation on the CRA in the first place.

While DOJ settled the case by requiring the lender to open minority branches, to pay $10 million for special minority loans to compensate for past discrimination, and to develop outreach programs and to participate in existing special loan programs, the OTS still gave the lender a rating of Satisfactory after noting the lawsuit (the only rating below Outstanding that the OTS gave this lender since 1992). The OTS noted that in light of the lawsuit it could "not find the lender had not violated the fair lending laws". As the lender complied with the settlement order, the OTS gave the lender credit for expanded lending and raised the rating to Outstanding. Thus, the actions that Mid America was forced to take as the result of a consent order by a Federal court were used to raise its rating to Outstanding.

The Federal Reserve Board and Old Kent Bank

Between 1997 and 2001, the Federal Reserve Board had given three Satisfactory CRA ratings to Old Kent Bank, a major lender in the Detroit metropolitan area.[39] During this period, Old Kent defined its assessment area in terms of several counties and parts of counties that encircled the City of Detroit, but excluded the City of Detroit itself. A review of the Public CRA Evaluation reports indicates that the Federal Reserve Board was clearly aware of this exclusion and that it accepted this exclusion of Detroit and evaluated Old Kent based on the service it provided to the predominantly white suburban areas only.

In 2006, DOJ filed suit against Old Kent for violating the Fair Housing Act and the Equal Credit Opportunity Act. In specifically citing Section 228 of the CRA regulations (Reg BB), the suit stated that, "Instead of defining its assessment area in accordance with Regulation BB, Old Kent Bank circumscribed its lending area in the Detroit MSA to exclude most of the majority African American neighborhoods by excluding the City of Detroit." [See the attached map which reproduces the exhibit from the DOJ complaint.] The complaint also indicates that "As of March 2000, Old Kent Bank still did not have a single branch in the City of Detroit, where the population is more than 81% African American."

Even if the Federal Reserve ignored the racial composition of Detroit, the regulations require lenders not to exclude low- and moderate- income census tracts from their CRA communities. According to the 2000 census, 93% of the low- and moderate-income tracts in Detroit, are also minority census tracts. Looked at from another perspective, 86% of all the minority census tracts in Detroit are also low- or moderate-income census tracts. Thus, for many years, the Federal Reserve Board had allowed this major Detroit metropolitan area lender to exclude both low- and moderate-income and minority areas from its defined service area.

The DOJ suit cites the pattern of expansion of Old Kent through the opening of branches in the Detroit metropolitan area. The complaint states that, "As of January 1996, Old Kent Bank operated at least 18 branches in the Detroit MSA. Not a single one of these branches was located in the City of Detroit. As of March 2000, Old Kent Bank had expanded its business presence in the Detroit MSA to include a branch network of at least 53 branches, located in every county of the Detroit MSA. Virtually all of Old Kent Bank's branches were located in predominantly white suburbs." Opening branches is a privilege that should be granted only to institutions that have satisfied their CRA obligations. By continually allowing Old Kent to expand (and by later allowing the merger of Old Kent and Fifth Third), the Federal Reserve Board was rewarding a major lender for engaging in racial redlining.

The DOJ complaint also cited Old Kent for failing to provide equal lending services for both home mortgage and small business loans to the minority areas that were

[39] The 2001 rating was given after the FRB had approved the merger of Old Kent into First Third Bank.

illegally excluded from its CRA lending community. As a result, DOJ engaged in a consent order requiring corrective actions that had not been ordered by the Federal Reserve Board.

The FDIC and Centier Bank

Centier Bank is regulated by the FDIC. It serves a regional market in Northwest Indiana. The FDIC examined Centier four times between 1993 and 2003. Each time the bank was given a Satisfactory rating. This rating allowed the bank to continue to engage in branching and expansion activities which should have been denied had the institution bee given a failing CRA rating. Indeed, it has become clear that even when community challenges are made, a passing CRA rating provides the lender with a safe harbor. Therefore, challenges become a fruitless gesture for lenders with passing CRA ratings – and almost all lenders have passing CRA ratings.

While Centier's delineated service area literally surrounded the City of Gary (a predominantly African-American city), through at least most of 1999, almost all of the City of Gary, and all of Gary's predominantly minority census tracts, were excluded from the delineated community. In this year (according to the DOJ complaint), "the FDIC informed the Bank that its assessment area violated the CRA and its regulations." Even at this point, the FDIC continued to give the bank a Satisfactory rating.

In 2006, DOJ filed suit against Centier for violating the Fair Housing Act and the Equal Credit Opportunity Act. In specifically citing Section 228 of the CRA regulations (Reg BB), the suits stated that, "Instead of defining its assessment area in accordance with Reg BB, Centier long circumscribed its lending area in the Gary PMSA to exclude most majority-minority neighborhoods, including having two geographically separate assessment areas for many years. Until late 1999, Centier's CRA assessment area included only three majority-minority census tracts from Gary, East Chicago, and Hammond, despite the fact that a large number of minority tracts were adjacent to the non-minority tracts included in the assessment area." [See the attached map which reproduces the exhibit from the DOJ complaint.]

According to the 2000 census, 93% of the low- and moderate-income tracts in Gary, Indiana, are also minority census tracts. Looked at from another perspective, 87% of all the minority census tracts in Gary are also low- or moderate-income census tracts. Thus, for many years, the FDIC had allowed this major Northwest Indiana lender to exclude both low- and moderate-income and minority areas from its defined service area. In allowing the institution to continue to open branches in the areas outside of Gary, the FDIC was actually rewarding Centier for its discrimination.

The DOJ complaint also cited Centier for failing to provide equal lending services for both home mortgage and small business loans to the minority areas that were illegally excluded from its CRA lending community. As a result, DOJ engaged in a consent order requiring corrective actions that had not been ordered by the FDIC.

First American Bank – Can You Pass the CRA by Switching Regulators?

First American Bank serves the markets of the Chicago and Kankakee MSAs in Illinois. In 2001, the Federal Reserve Board gave the First American Bank a Substantial Noncompliance rating based on evidence of illegal discrimination. That evidence was turned over to the Department of Justice. In July of 2004, DOJ filed suit against First American Bank for violating the Fair Housing Act and the Equal Credit Opportunity Act. First American Bank was accused of serving only predominantly white areas in its markets. This complaint was a pattern or practice case based on both marketing and lending. According to the complaint, this evidence included "comments made by American Bank officials to examiners from the Federal Reserve Bank of Chicago with respect to the Bank's lending practices which are based on racial and ethnic stereotypes."

Meanwhile, First American Bank operated under a Cease and Desist Order from the Federal Reserve based on the prior evidence of discrimination. In November of 2003, First American Bank changed its regulator to the FDIC. In March of 2004, the FDIC gave First American Bank a Satisfactory rating, thus reinstating its privileges to engage in branching and other activities while the DOJ investigation was still ongoing. In July of 2004, four months *after* the passing CRA rating, DOJ settled the case with American Bank with a series of remedial actions that were to be taken in the future to correct past discriminatory behavior. The FDIC public CRA evaluation mentioned the Cease and Desist Order with the Federal Reserve, but did not mention the DOJ investigation.

While the analysis in the CRA public disclosure showed some sings of more lending in low- and moderate- income areas for some loan products, none of this dealt with the issues of the lack of service and lending in minority areas. With the DOJ investigation still ongoing, the FDIC could have recognized some improvement by the bank in upgrading its rating to Needs to Improve, which would have been clearly in line with the need to carry out more fully the remedies for its past discriminatory behavior. Instead, the FDIC granted the bank a full Satisfactory rating prior to the imposition of the remedies in the DOJ settlement.

Flagstar – Violating Your Way to an Outstanding Rating

If the regulatory agencies can't identify discrimination as blatant as that described in these examples of DOJ cases, then there is a fundamental problem that surely requires Congressional action to be corrected. Still, one might try to set aside these cases by claiming that these all involved settlements where the lenders claimed that they did no wrong. That is, these cases did not involve court decisions that fair lending violations occurred. Let us turn, then, to a case where there were such legal findings.

The case of Flagstar Bank, FSB, represents that rare exception where we actually have proof of fair lending violations that we can compare to the public comments of the institution's regulator and to the CRA ratings given to the bank before and after the violations occurred. This case illustrates how even multiple legal findings of discrimination can lead a lender to an Outstanding CRA rating.

- Between February of 1994 and November of 2005, during which time the OTS gave Flagstar Bank "Satisfactory" and "Outstanding" CRA ratings, this lender was sued several times in federal court for issues related to discrimination in lending. Flagstar, in contrast, was found liable for discrimination at trial or by the court in at least two of these cases.

- In 1999, a jury in Detroit found Flagstar liable for discrimination against minority borrowers, and plaintiffs were awarded damages. Later the Sixth Circuit Court of Appeals upheld one of these findings. In 2003, in a national class action suit, a federal court in Indianapolis found a written pricing policy developed by Flagstar management in 2001 so overtly discriminatory that the court ruled against Flagstar on summary judgment. The policy explicitly stated that pricing would be different for minority and non-minority borrowers. It appears that the discriminatory pricing policy was developed and implemented by Flagstar *while* the OTS was conducting its consumer compliance examination.

- The OTS conducted five CRA examinations and never found Flagstar in violation of discrimination laws. During this time period, Flagstar was given a "Satisfactory" CRA rating four times and was elevated to an "Outstanding" rating after the summary judgment finding in 2003.

Flagstar was one of the nation's twenty largest mortgage lenders during the period covered by this litigation. It sold loans to both Fannie Mae and Freddie Mac and was one of the largest underwriters of FHA loans through certification granted by HUD.

Moreover, Flagstar was allowed to expand significantly during this time period by opening numerous branches, expanding into a new state, and expanding to additional metropolitan areas in these states. The approval of its applications to expand was based, in part, on its CRA ratings. As a result, during the period from 1994 through 2005, Flagstar grew from just over $500 million in assets to nearly $13 billion in assets.

The actions taken by Flagstar as a result of the settlement of suits in Detroit were actually used to raise its later CRA rating. After the Federal Court in Indiana forced the elimination of its written racial pricing policy, the OTS gave Flagstar an Outstanding rating, finding no violation of fair lending laws in spite of two legal decisions. *As bizarre as it seems, Flagstar seems to have literally violated its way to an Outstanding rating.*

First National Bank of Pontotoc, Mississippi – Skipping the Exam

The final case concerns the First National Bank of Pontotoc, a small bank in Mississippi. DOJ filed suit against the bank and one of its vice presidents claiming that this person had engaged in sexual harassment of female loan applicants while serving at the bank in 2003 and 2004 (though the lawsuit was filed in April of 2006). The claim stated that this person had sought sexual favors in return for favorable loan decisions. This person left the bank in May of 2004.

The Comptroller released a public disclosure of the CRA exam for the bank in June of 2004. The claims of sexual harassment in the DOJ suit took place during the time period covered by the CRA exam. In the comment on evidence of discrimination, the Comptroller's report reads:

> An analysis of public comments and consumer complaint information was performed according to the OCC's risk based fair lending approach. Based on its analysis of the information, the OCC decided that a comprehensive fair lending examination would not need to be conducted in connection with the CRA evaluation this year. The latest comprehensive fair lending examination was performed in 1998. (at page 5)

Therefore, no fair lending examination had been done for this bank in six years. Moreover, the Comptroller's "risk based" approach to determining if an examination should be done was essentially based on consumers having to file complaints. Complaints may be useful in those cases where the victim has some sound factual evidence for believing that they have been discriminated against (which is unlikely in most lending cases) or in those cases where the victim does not feel threatened by the perpetrator (which would have been unlikely in the case of this alleged sexual harassment). On the other hand, the examination process is not designed to be a complaint driven process - yet that is what it seems to have become for the Comptroller in this case, and presumably in the cases of other institutions subject to the "risk based" process for selecting institutions for fair lending examinations.

Are the Regulators Above the Civil Rights Laws?

How can the regulatory agencies enforce the fair lending laws, follow their own regulations and examination guidelines and interpretations, and still reward institutions engaged in discrimination with high CRA ratings and continued banking privileges? I must admit, that for my own sense of logic and reason, I cannot see how this can be done. Unfortunately, the ways in which I can imagine that an agency might justify this behavior require the agencies to act is if the discretion they have given to themselves under their own regulations places them above the civil rights laws.

There are two key provisions of the CRA regulations that could be used in this perverse way. First, the current regulations allow institutions great flexibility in defining their assessment areas. Given a very narrow reading of the regulations, an institution is no longer required to serve the areas where they make most of their loans and all other areas "equidistant" from those areas, nor are they required to serve entire counties or metropolitan areas. Institutions may define their assessment areas as clusters of census tracts around their offices or where they choose to make loans. It would seem from the cases reviewed that these assessment areas can even adopt amorphous and amoeba-like shapes within metropolitan areas. While institutions are prohibited from making an assessment area delineation that involves illegal discrimination or one that arbitrarily excludes low- and moderate-income areas, this depends purely upon the discretion and subjective view of the examiner as to what the definition of "reasonable" is.

It would seem that any large urban lender that excluded minority census tracts from its assessment area by delineating an area that was less than an entire MSA or that represented only parts of counties or other major political divisions would at least be violating the fair lending laws based on the discriminatory effect of the assessment area. Even without a discriminatory intent, such an exclusionary assessment area would have to meet the disparate impact standard of providing a business necessity for failing to include the minority areas. As the fair lending guidelines of the Comptroller note, such a business necessity would have to be "manifest and may not be hypothetical or speculative".

In the case of Old Kent, for example, this would mean showing that no lender in Detroit could serve these markets without some substantial economic harm. Yet, Shorebank has a bank whose assessment area is the City of Detroit itself – and it survives well and receives Outstanding ratings for a broad penetration of loans in this market. Surely there are other lenders in the minority areas of Chicago and Gary that serve these communities at a profit as well – including, the original South Shore Bank in Chicago.

One would not suggest that the regulatory agencies are so ignorant that they do not know where the minority census tracts are located. Indeed, they attach racial data to the HMDA loan data and use these data in their fair lending examination procedures. Also, one would not suggest that the agencies do not understand their own fair lending regulations and examination procedures. This, unfortunately, leaves only the explanation that the agencies realize fully what these institutions are doing and that they consider this an appropriate business plan. In effect, the regulators are treating the discretion that they have given themselves in their own CRA regulations as a kind of "signing statement" indicating that they allow themselves to make decisions that are above and beyond the limits of the Federal civil rights laws that they are required to enforce. The business practices of a lending institution may, therefore, at the discretion of the regulator, trump any illegal discrimination.

This same unfortunate logic applies to the cases of Flagstar and First American Bank, and the general treatment of evidence of illegal discrimination. The current regulations require the agencies to take evidence of discrimination into account, after consideration of whatever they may deem corrective actions of the institution. Again, it is left to the pure discretion of the examiners as to how to treat discrimination – especially when it has no numerical value in the CRA rating system.

While the internal findings of CRA examinations are not part of the public disclosure, in one of the lawsuits against Flagstar, the internal examination by the OTS was entered into evidence. It revealed that the OTS had identified a minimum appraisal amount in a loan program as having a potential disparate impact. Indeed, the OTS had analyzed census data to make this point. Nonetheless, in the public evaluation, there was no mention of this issue. In some of the proprietary documents I have read in other lending cases I have worked on, I have also found internal comments about discriminatory practices that were not reflected in the public disclosures for the

institutions. This represents the discretion of the regulators for fair lending examination results that are never made public.

As for the example of Pontotoc National Bank, the CRA examination depends upon the most recent fair lending examination to provide evidence of illegal discrimination. If there is no recent fair lending examination, then there can be no evidence of discrimination – and the consideration of this factor is meaningless.

Is this what Congress intended?

Where Are We Now?

Thus, the regulatory agencies and the CRA "sunshine" requirements have twisted the CRA by:

(1) removing the obligation of depository institutions to define a local service in a way that eliminates racial redlining;
(2) removing the separate assessment of discriminatory actions from the formal rating process and;
(3) failing to develop and implement a sound fair lending examination process that includes both the subsidiaries and affiliates of a covered institution;
(4) relegating compliance with the fair lending laws to an undefined appendage of the rating process subject to the pure discretion of the regulatory agencies such that institutions can receive Outstanding CRA ratings while they violate the fair lending laws;
(5) removing the review of the institution's assessment of local credit needs from the evaluation process;
(6) removing the assessment of the institution's efforts to communicate with its community in defining credit needs;
(7) threatening community organizations and individuals who dare to comment on credit needs and who develop reinvestment programs;
(8) granting an institution a passing CRA rating if they have an Outstanding in the lending test (even if the lending area redlines minority communities);
(9) making challenges futile by granting an institution with a passing CRA rating a presumptive bias in favor of approving applications; and
(10) failing to regularly hold hearings when an application is challenged.

What Can We Do?

In reviewing the failure of the regulatory agencies, there are eleven recommendations that NTIC wants to make.

- First, the CRA should be amended to specifically include prohibitions against avoiding providing banking services (depository services, loans, and investments) in minority neighborhoods.

- Second, the CRA assessment area should specifically be defined to include full metropolitan areas or counties with a strict application of the fair lending laws to any areas that exclude minority areas. The definition of the delineated area should specifically exclude ringing or skipping over minority areas as well as low- and moderate-income areas.

- In the lending and investment tests, all affiliates of the institution's holding company should be included.

- Examinations should be made of all assessment areas and not just a sample or a selection of the largest.

- Evidence of discrimination by any affiliate or subsidiary of a holding company – or as a result of an overall (composite) lending or investment pattern or practice in any location in the United States should be counted as evidence of discrimination in every assessment area of all the lending institutions of the holding company covered by the CRA.

- Evidence of discrimination should require an automatic rating of Needs to Improve or worse for all CRA covered institutions within the holding company where evidence of discrimination is found.

- No institution with a Needs to Improve or worse rating should be granted any of the applications covered by the CRA until there has been a demonstrated change to overcome of the discrimination, including compensation of victims, payment of any penalties or award of damages, and any ordered or agreed to changes in practices or policies.

- While these recommendations will provide for a serious consideration of fair lending within the institutions and areas covered by the CRA and its examinations, these measures can only be effective if the fair lending examination process, itself, includes all affiliates, is subject to a regular schedule for all lenders, and results from clear revisions in the process to eliminate the failure to adequately cover such areas as marketing, steering, underwriting, and pricing.

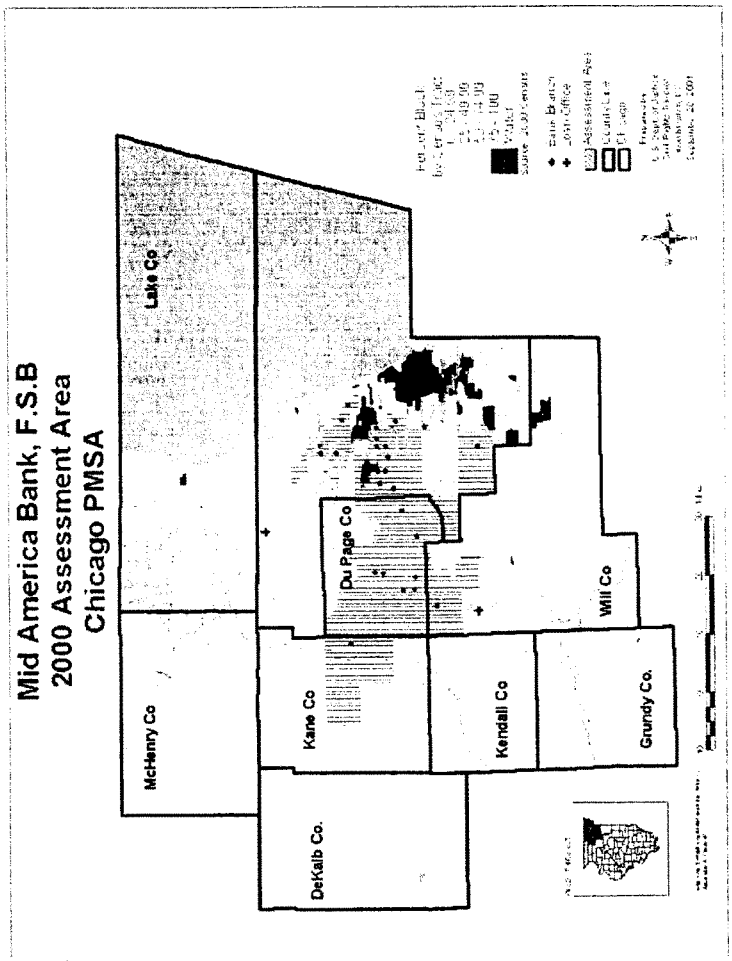
- These measures, however well implemented, still leave independent lenders without fair lending regulation and accountability. This issue needs to be addressed additionally by oversight of the enforcement efforts of DOJ, the FTC, and HUD with an eye toward basic reforms and the allocation of appropriate resources to these agencies.

- Most fair housing and fair lending issues are presently detected and addressed through training and/or direct negotiation or litigated by private community-based fair housing and community and not-for-profit organizations. Appropriate resources need to be provided to these organizations so that their dominate role in

fair lending enforcement and fair housing enforcement can be maintained and grow.

- Finally, the "Sunshine" provisions of the Gramm-Leach-Bliley Act should be repealed.

Complaint Exhibit 8 - United States of America v. Mid America Bank, fsb (N.D. Ill.)



Mr. KUCINICH. Mr. Carr.

STATEMENT OF JAMES H. CARR

Mr. CARR. Good afternoon, Chairman Kucinich. On behalf of the National Community Reinvestment Coalition and our 600 community nonprofit members across the country, we are honored to have the opportunity to speak to you today about this important act.

Since its enactment in the late 1970's, the Community Reinvestment Act has leveraged more than $4.5 trillion of loans and investments to families and individuals in the communities that have been most challenged in accessing credit. And lots of organizations, including Harvard University, and key Federal agencies, including the Treasury Department and the Federal Reserve, have concluded that those loans were done in a safe and sound manner.

Those investments have helped to build homes, launch or expand small businesses, build important community facilities and grow the wealth of otherwise financially vulnerable families. Yet despite all of its success, the goals of CRA have yet to be fulfilled.

Between 9 to 22 million households do not have a relationship with a major bank or savings institution. At the same time, millions more only have tenuous ties. And over the past decade and a half, high-cost lending has grown exponentially, disproportionately in moderate-income and minority communities.

Since 1993, for example, payday lending has grown from a modest 300 establishments to more than 25,000 to date. And we all know the story of subprime lending and, particularly, predatory lending and the disproportionate impact it has on minority and low-and-moderate-income communities.

In my written testimony, I highlight six recommendations that, if enacted, could greatly enhance the effectiveness of CRA to increase credit and capital and other banking services to disadvantaged communities; and they include such things as mandatory inclusion of nondepository affiliates and CRA exams, as well as the inclusion of institutions such as credit unions and mortgage companies under CRA. We recommend a series of provisions related to fair lending examinations, specifically, as well as a number of recommendations related to the assessment areas and how those procedures are developed.

In conclusion, let me just say, the consumers that function outside of the financial mainstream often operate in a cash or informal economy. A large and growing informal economy is not in the best interest of America. Financially stifling homeowners with unfair, unreasonable or otherwise deceptive and costly mortgage products is not in the interest of America. Families with negative savings rates are not in the interest of America. Communities unable to tap the credit markets for responsible and critical community facilities is not in the interest of America.

In 1960, Mr. Chairman, we put a man on the moon. It is hard to believe that 40 years later we can't put a consumer in a bank. In many respects, it is not a lack of will; rather, it is a lack of want, and that is a want to achieve on this important goal. It is not a dearth of financial expertise; rather, it is a lack of appreciation for the value of achieving that goal.

Achieving the goals of CRA are in the best, long-term, future interest of America, of our economy, of our society. But those interests cannot be measured by quarterly earnings, the principal gauge which businesses use to determine opportunity.

As a result, in addition to repairing the fabric of CRA so that it can achieve its important mission, we also turn to you and encourage you and ask that you work with us to help inspire the business community to do what currently it is not doing. And that is inspiring them to reach out and affirmatively want to help to improve markets that don't function effectively in this country.

At the end of the day, we know that when America is inspired, it will achieve. We put a person on the moon because we decided we needed to do that, and we were committed to it, and we did it. There is nothing stopping us from succeeding in our goals on CRA except the will and the want and the understanding that it is in the national interest.

And with that, I'll conclude; and I'm prepared to answer any questions you might ask.

Mr. KUCINICH. I thank the gentleman.

[The prepared statement of Mr. Carr follows:]

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

of

James H. Carr

Chief Operating Officer
National Community Reinvestment Coalition

Before the

United States House of Representatives
Subcommittee on Domestic Policy of the
Committee on Oversight and Government Reform

Washington, DC

Wednesday, October 24, 2007
2154 Rayburn Building
2:00

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Introduction

Good afternoon, Mr. Chairman and Members of the Committee. My name is James H. Carr and I am the Chief Operating Officer of the National Community Reinvestment Coalition (NCRC). I am honored to speak with you today on behalf of NCRC and its 600 community nonprofit member organizations, that are dedicated to increasing access to credit and capital, for low and moderate income and minority working families and communities.

We are pleased that you are conducting this hearing on the effectiveness of the Community Reinvestment Act (CRA) and the appropriate role of public participation in the CRA process. By establishing an affirmative and continuing obligation upon banks to serve their communities, CRA has leveraged a tremendous amount of credit and capital for traditionally underserved communities. NCRC calculates that banks have made CRA-related commitments to issue more than $4.6 trillion of loans and investments in minority and low- and moderate-income communities since CRA's enactment in 1977.[1] The success of CRA has been documented in research published by a range of respected research institutions and federal agencies including the Federal Reserve Bank, Treasury Department and Harvard University to name a few. Their conclusion is that CRA has increased safe and sound lending to minority and low- and moderate-income borrowers and communities.[2]

Yet, the full potential of CRA has not been realized. Three areas of weaknesses can be identified as contributing to the current shortcomings of the potential of CRA. They include: regulatory enforcement has not been consistent over time or geography, regulatory oversight has not kept pace with the changing financial services marketplace; and the reach of CRA is not sufficient relative to its stated goals. I will highlight six recommendations that, if enacted, could greatly enhance the effectiveness of CRA to increase greatly access to credit and capital in low and moderate and minority working communities across the nation.:

- Make mandatory the inclusion of a bank's non-depository lending affiliates and subsidiaries in CRA exams.

- Reform bank examination assessment area procedures so that the majority of a bank's loans are included in its CRA exams.

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[1] NCRC's *CRA Commitments*, via http://www.ncrc.org/policy/cra/CRA%20Commitments%2007.pdf.

[2] The Joint Center for Housing Studies at Harvard University, *The 25th Anniversary of the Community Reinvestment Act: Access to Capitol in an Evolving Financial Services System*, March 2002; Robert Litan, Nicolas Retsinas, Eric Belsky and Susan White Haag, *The Community Reinvestment Act After Financial Modernization: A Baseline Report*, produced for the United States Department of the Treasury, April 2000; *The Performance and Profitability of CRA-Related Lending*, Report by the Board of Governors of the Federal Reserve System, July 17, 2000; Raphael Bostic and Breck Robinson, *Do CRA Agreements Influence Lending Patterns?* July 2002, available via bostic@usc.edu.

- Require regulatory agencies to provide detailed descriptions of fair lending and safety and soundness reviews conducted as part of CRA exams.

- Require that regulators give banks failing CRA performance reviews when fair lending reviews uncover widespread discrimination at those institutions.

- Require CRA exams to examine lending and services to minority borrowers and communities.

- Require that regulatory agencies hold hearings upon request by community representatives, to address major bank business decisions or changes such as mergers and acquisitions.

- Require all banks and thrifts to submit CRA small business loan data indicating race, gender, and location of the borrower.

- Extend CRA coverage to credit unions and independent mortgage companies.

Review of Recommendations

Mandatory Inclusion of Non-Depository Lending Affiliates

One significant shortcoming of CRA regulation has been the regulatory practice of allowing banks and thrifts to choose whether to include their non-depository affiliates on CRA exams. Banks can evade accountability and effectively engage in redlining and other discriminatory practices by choosing not to include affiliates on their CRA exams. Not surprisingly, affiliates excluded from CRA exams often exhibit less success in lending to minorities and low- and moderate-income borrowers and communities than their depository counterparts.

The lack of CRA coverage, and its associated tighter regulatory reviews and public accountability, invites a greater opportunity for lending institutions to violate fair lending laws. In 2007, NCRC identified 35 lending institutions engaged in practices that include refusal to make loans under a minimum loan amount (usually $75,000 or $100,000), refusal to make loans to row homes, or even failing to offer loans to entire cities (including Baltimore and Philadelphia). In other cases, lending institutions will make loans but charge higher interest rates that are not justified by legitimate business necessity. Out of the 35 lending institutions that engaged in discriminatory practices, 26 were independent mortgage companies outside the scope of CRA. Of the institutions found to be engaging in redlining or other exclusionary practices, four were non-bank affiliates that were not included on their affiliated bank's CRA examinations.

NCRC has demonstrated that these policies violate the Fair Housing Act by disproportionately impacting minorities and other protected classes. NCRC has filed several fair housing complaints with the Department of Housing and Urban Development and with federal court.

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Reforming Assessment Area Procedures

NCRC's fair lending investigations have shown that inadequate procedures regarding the designation of assessment areas or geographical areas on CRA exams may encourage discriminatory policies. Under the current CRA regulations, assessment areas generally consist of geographical areas that contain bank branches. A significant number of lenders, however, are making loans in areas beyond their bank branches. In fact, financial institutions identified by NCRC's fair lending investigations have made significant amounts of loans through brokers in geographical areas beyond their bank branches. In one study, only 11% to 13% of the loans of four banks investigated by NCRC were in the banks' assessment areas.

Occasionally, the federal agencies will review a sample of loans outside the assessment areas to determine if lending performance outside assessment areas is consistent with performance inside the assessment areas.[3] But the agencies sampled loans outside the assessment areas for only one of the four banks we investigated in our study. With the great majority of lending activity outside of CRA exam review, it is not surprising to find more exclusionary lending practices at those institutions.

Providing Examination Descriptions

A major regulatory weakness that undermines CRA accountability and enforcement is the recent practice of providing to the public only cursory descriptions of the fair lending aspects of CRA examinations. The great majority of these reviews state in one to three sentences that no evidence of illegal or other discriminatory practices were found by the agencies. In contrast, the CRA exams in the 1990's described statistical tests conducted to probe for discriminatory lending. A cursory description of fair lending reviews decreases public confidence in the rigor of fair lending reviews and inhibits the public from effectively probing the types of anti-discrimination investigations undertaken by the agencies.

Evidence of discriminatory and illegal lending can result in downgrades of CRA ratings for banks if discrimination and illegal lending were widespread and the lender did not take action to end the practices. Unfortunately, there is no evidence to believe that the fair lending reviews conducted concurrently with CRA exams are rigorously testing for abusive, discriminatory, and illegal lending.

In most cases, even for the largest banks in the country, the fair lending section of the CRA exam reports in one to three sentences that the regulatory agency tested for evidence of illegal and

[3] The reviews of lending outside of assessment areas generally have not been satisfactory. The sample of loans usually consists of a minority of a bank's total loans. Also, the examiner typically issues vague conclusions such as lending outside the assessment area is consistent with lending inside the assessment area. The general public does not know what would happen if an examiner found that lending performance outside the assessment area was inconsistent with lending performance inside the assessment area. NCRC has not encountered a CRA exam in which performance outside the assessment area was inconsistent with performance inside the assessment area.

discriminatory lending and that no such lending was found.[4] There is no discussion of what precisely had been done to reach this conclusion. Meanwhile, excessive high-cost lending pervades financially vulnerable communities, compounding their financial challenges, and making access to the financial services mainstream more difficult.

In one instance, NCRC examined a thrift that specialized in subprime lending. The CRA exam report for that that thrift noted that it issued a high percentage of loans to low- and moderate-income borrowers. The CRA fair lending review, however, did not describe if the examiner made any efforts to determine if the subprime lending was conducted in a non-discriminatory manner or was consistent with safety and soundness. In another case, an exam mentioned that a bank specialized in adjustable rate lending, but the fair lending review did not mention whether the examiner assessed if the loans were offered in a non-discriminatory manner and whether they were safe and sound.

Fair lending reviews could be more valid if the federal agencies described to the public what types of fair lending reviews they conducted. For example, the agencies could explain if they probe for race or gender discrimination, or if they scrutinize loans for evidence of flipping or steering. In addition, if the fair lending reviews were sufficiently detailed, members of the general public could ask follow-up questions about whether the examiners considered other factors not mentioned in the fair lending reviews. Sufficiently detailed fair lending reviews would encourage substantive dialogue among lenders, CRA examiners, and the general public that could result in better fair lending enforcement and confidence that the spirit and letter of the law were enforced.

Providing more detailed descriptions of fair lending reviews should be straightforward. The agencies used to provide detailed descriptions in the fair lending section of CRA exams in the mid-1990's under the previous "assessment factor" format of CRA exams. For example, under Assessment Factor F, which assessed evidence of discriminatory or illegal practices, the Federal Reserve Bank of Richmond conducted matched file reviews of more than 300 loan applications in a CRA exam dated January 1996 of Signet Bank. The exam also described regression analysis, which sought to determine if race was a factor in loan rejections. The analysis considered variables not available in the HMDA data such as credit histories, the stability of employment, and applicant debt obligations. This type of substantive fair lending review provides the general public with confidence that the regulatory agency performed a detailed anti-discrimination analysis. Ironically, it was after the CRA regulations were reformed during the mid-1990s in an effort to improve the rigor of the exams that these descriptions of fair lending reviews disappeared from the CRA exams.

Moreover, although the spirit and letter of the law of CRA is to require banks to serve the communities in which they are located, findings of fair housing violations, as well as other

[4] For example, a federal agency had this to say on the CRA exam's fair lending review of one large bank with several affiliates, a number of whom make high cost loans: "We found no evidence of illegal discrimination or other illegal credit practices." That was the only sentence in the fair lending review section.
[5] The Gramm-Leach-Bliley Act instituted the "have and maintain" passing rating requirement.

obvious and egregious CRA violations, are sometimes not sufficient to preclude banks' receiving a passing CRA grade. All of the banks mentioned above, found to pursue redlining practices, have inadequate assessment areas, and that had affiliates excluded from CRA exams, passed their CRA exams. In these cases, the CRA grade inflation has removed incentives for the banks to end these egregious practices.

Raising the Bar on CRA Passing Grades

When a violation of anti-discrimination laws is discovered through fair lending reviews, it is common for the federal agencies to make a bank promise to eliminate the practice instead of lowering a CRA rating. CRA regulation specifies that examiners are to weigh the evidence and extent of a discriminatory and illegal practice when deciding whether to lower a CRA rating.

Some discretion in requiring corrective actions or lowering ratings is appropriate, but guidelines should specify when discrimination will lower ratings. Isolated instances of discrimination can be corrected through promised reforms. On the other hand, widespread discrimination should result in failed ratings. When a lender has identified an outlier branch manager or loan offer that practiced discrimination, it may be appropriate for the regulatory agency to allow the bank to take immediate action. In this case, a lower CRA rating may not have been justified due to the localized nature of the action and the fact it may be immediately eradicated.

When, however, a practice is institutionalized in underwriting criteria, it is necessary to enforce a failed CRA rating. Discriminatory underwriting, including prohibiting loans to row homes redlines entire communities. It is ineffective and insufficient to rely on the banks promise to reform. A failed CRA rating provides a significant deterrent against discriminatory behavior because a failed CRA rating prevents a bank holding company from acquiring a non-depository financial institution as long as the rating remains in place.[6] The punishment can be removed at the time of the next CRA exam, provided that the bank can undergo a thorough fair lending review and demonstrate that it has eradicated all discriminatory practices.

Another instrumental reform is examining a bank's lending performance to minorities in CRA exams similar to their lending performance to low- and moderate-income borrowers. Given the evidence of glaring lending disparities by race, NCRC has long called for CRA exams to explicitly examine lending and services to minority borrowers and communities.[7] Before the CRA regulatory reforms in the mid-1990's, CRA exams under Assessment Factor D would often use HMDA data to assess performance of lending to minorities similar to the approach employed in the Signet examination discussed above. This practice should be reinstated and

[7] NCRC's HMDA studies show that differences to lending by race have persisted over several years. We also show that disparities in branching by race of neighborhood is greater than by income level of neighborhoods. See NCRC's *Income is No Shield against Racial Differences in Lending* via http://www.ncrc.org/pressandpubs/documents/NCRC%20metro%20study%20race%20and%20income%20disparity%20July%2007.pdf, and *Are Banks on the Map* via http://www.ncrc.org/pressandpubs/documents/NCRCAreBanksontheMap.pdf

expanded given the reality that lending differences by race/ethnicity remain stubborn, persistent and significant.

Sharing Safety and Soundness Examination Findings

Despite CRA mandates that credit needs are to be met consistent with safety and soundness, there are no results in the CRA exams on this topic. Given current public policy concerns about predatory lending and foreclosures, the significance of this regulatory weakness cannot be overstated.

Holding Public Meetings and Hearings

CRA's effectiveness depends on the level of public accountability it establishes. Public hearings are the mechanism through which communities share their needs and perspectives with banks. Federal agencies also gain detailed and valuable information during the hearing process. Failure to hold public hearings therefore undermines community input and by extension, the effectiveness of CRA. Over the last several years, the federal agencies have dramatically decreased the number of public hearings, particularly in the case of merger applications. In fact, the last major merger applications that were subject to public hearings were the Bank of America and Fleet merger and J.P. Morgan Chase and Bank One merger in 2004. In 2006, Wachovia acquired the largest lender of exotic mortgages, World Savings, yet there was no public hearing on this merger that posed significant fair lending and safety and soundness issues. Likewise, Regions had proposed to take over Amsouth bank in 2006. Although this merger involved two of the larger banks in the South, the Federal Reserve declined to hold a public hearing when the merger clearly had ramifications for the recovery of the Gulf States. More recently, the Federal Reserve declined to hold a hearing on the merger of Bank of New York and Mellon although the Bank of New York had received low ratings on two of the three tests on their two most recent CRA exams.[11]

In some cases, mergers result in the possible closures of hundreds of branches, particularly for banks with overlapping markets. In other cases, merged institution may not be as responsive to community needs and projects. Sometimes, the bank being acquired has a decentralized and flexible means of engaging in community development lending and investing that facilitates

[11] Bank of New York received a low satisfactory on its lending and service test from the Federal Reserve Bank of New York on both its 2005 and 2003 CRA exams. In other words, the bank was close to failing on two CRA exams in succession. Yet, no public hearing on the merger occurred.

neighborhood-level housing and economic development initiatives. In contrast, the acquiring bank might have a centralized process that may not be as responsive. Finally, the focus in some mergers will be on fair lending and safety and soundness concerns related to high-cost and/or exotic mortgage lending.

Federal regulatory agencies rarely deny merger applications. Occasionally, they will approve the merger subject to specific conditions for improved CRA and fair lending performance or procedures. In other cases, regulatory agencies will convene hearings and meetings in an effort to encourage voluntary solutions worked out between lending institutions and community organizations. When bank merger applications involve public hearings or meetings, banks and community groups are more likely to negotiate CRA agreements.[12] CRA agreements are promises made by banks to make specified amounts of loans and investments to low- and moderate-income and minority working communities over a specified period of time period (see NCRC's publication *CRA Commitments*).[13]

Agreements also often contain considerable detail on carefully constructed products for minority and low- and moderate-income borrowers. For example, home mortgage products can include lower closing costs, waiver of private mortgage insurance, counseling requirements, and the establishment of Individual Development Accounts (IDAs) to help pay for down payments. Likewise, small business products may offer lower interest rates in exchange for small business owners receiving counseling. The small business products also feature lower loan sizes needed by the smallest businesses and are often provided to minority or women-owned small businesses. In contrast, when CRA agreements are not negotiated and banks announce unilateral commitments, there is little assurance that the commitments relate to the actual needs of the community as defined by residents of those areas.

In testimony before this committee earlier this year, an official representing the Federal Reserve Board (FRB) testified that the FRB has held only 13 public meetings since 1990 on mergers. This is less than one meeting per year in an era in which consolidations have changed profoundly the banking industry. In addition, the FRB representative stated that since 1988, the FRB received 13,500 applications for the formation of banks or the merger of institutions involving bank holding companies or state-chartered banks that were members of the Federal Reserve System. Yet, only twenty five of these applications were denied with 8 of these denials involving consumer protection or community needs issues.[14]

In the fall of 1999, major banking reforms were included in the Gramm-Leach-Bliley (GLB) Act that compounded some of these issues. In addition to permitting banks to merge with insurance companies and securities firms, the GLB Act allowed bank holding companies to acquire non-bank lending institutions without submitting an application subject to public comment on CRA

[12] CRA agreements are not required by the CRA statute or regulation, but substantive CRA agreements become more likely when regulatory agencies convene public meetings and hearings.
[13] NCRC's *CRA Commitments*, via http://www.ncrc.org/policy/cra/CRA%20Commitments%2007.pdf
[14] See http://www.federalreserve.gov/newsevents/testimony/braunstein20070521a.htm for Ms. Braunstein's testimony.

grounds. GLB also did not eliminate the optional inclusion of affiliates on CRA exams or fix assessment area procedures so that assessment areas would be required to cover the great majority of a bank's lending activities.

Inasmuch as GLB granted banks considerable new powers and expanded their markets, it would seem logical that GLB would also have ensured that the larger and more powerful banks would have enhanced requirements to serve their communities. Unfortunately, while GLB boosted the size and power of banks, it did not boost their obligations to their communities. Instead, GLB established a regulatory oversight system that undermines the intent of CRA to require banks to serve their communities through lending, investment, and service activities. As NCRC's case studies show, banks now can grow and evade CRA and fair lending responsibilities by placing lending activities in affiliates and making larger numbers of loans outside of assessment areas.

The weaknesses introduced into CRA by GLB have been recognized by various Members of Congress. Representatives Luis Gutierrez and Thomas Barrett, for example, introduced legislation (CRA Modernization Act in 2000 and 2001) that would have required inclusion of affiliates and would have fixed assessment area procedures so that the great majority of loans would be included in CRA exams. More recently, similar provisions were included in a bill offered by Representatives Eddie Bernice Johnson and Luis Gutierrez referred to as The CRA Modernization Act of 2007 or HR 1289. Unfortunately, problems exacerbated by GLB remain. They hamper effective enforcement of CRA. In the process, they undermine access to banking services to millions of hard-working and deserving families.

The Office of Thrift Supervision (OTS) used to require the holding of a meeting between merging thrifts and community groups when such a meeting was requested by a community group that had requested a meeting and submitted written comments pertaining to the merger. This procedure should be implemented by all the agencies. Meetings, as distinguished from public hearings, usually involve relatively small number of stakeholders, including regulatory officials, a few community leaders, and representatives of the merging institutions. These meetings are easy to convene and provide valuable dialogue.

When regulatory agencies receive several requests from community groups or citizens for a public forum, they should hold public hearings in addition to any meetings that might take place. Public hearings are more involved than meetings in that several community groups, citizens, elected officials, and others testify. Meetings allow for in-depth dialogue and debate among a handful of important stakeholders but public hearings become necessary when hundreds of citizens and community organizations wish to testify. Regulatory officials must afford them the opportunity to testify so that the officials can understand the gravity of the situation and the importance of the banks to the affected communities.

Extending CRA Coverage

CRA coverage should be extended to credit unions; NCRC studies have found that non-CRA covered credit unions provide a lower percentage of their loans to minorities and low- and

moderate-income borrowers and communities than do banks.[15] CRA should also apply to independent mortgage companies; NCRC has uncovered several mortgage companies engaged in redlining and other discriminatory practices. The CRA Modernization Act would also require merger applications when banks seek to acquire mortgage companies and other non-depository institutions.

Providing Increased Data on Small Business Lending

CRA small business loan data should be submitted by all banks and thrifts and should include the race and gender of the small business borrower. Small business loans are critical to the overall flow of capital in communities and the lack of this important financial service can undermine an otherwise positive engagement of banks in low and moderate income and minority communities. Moreover, inasmuch as major disparities in lending to minorities exist in the small business loan market, similar to those in the home mortgage market, data on this lending should include key demographic data on the borrowers.

Conclusion and Recommendations

As we celebrate the 30th anniversary of CRA, it is useful to look back as well as forward. Looking back, we see a law that has stimulated the flow of billions of dollars each year to lower-income and minority communities to expand homeownership and promote healthy communities. Looking back we also see, however, major areas of weakness in the law and concomitantly, areas for improvement in the flow of capital and credit to families and businesses that need it the most. The recommendations we make today, if enacted, would greatly promote the goal of CRA to improve the flow of capital and credit to communities. Those recommendations include requiring broader coverage of a bank's activities in CRA examinations; enhanced disclosure of the details of fair lending and safety and soundness examinations; more rigorous standards to receive passing CRA grades, particularly in the case of fair lending violations; more specific examination of lending performance and practices to minority consumers; more public meetings and hearings on bank mergers and related major business events; and extension of CRA to credit unions and independent mortgage companies.

Many of the ideas we recommend today are included in The CRA Modernization Act of 2007 (H.R. 1289) and we encourage its passage. Improving access to the financial mainstream is important to the families and businesses, the communities in which they reside or operate, and the nation as a whole. We applaud the work of this Committee and look forward to continuing to work with you on this important issue.

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[15] See NCRC's *Credit Unions: True to their Mission* via http://www.ncrc.org/policy/states/cu_report2.php

Mr. KUCINICH. Professor Marsico.

STATEMENT OF RICHARD MARSICO

Mr. MARSICO. Thank you. As I was listening to the testimony, I found myself writing and rewriting my own oral testimony until finally I've thrown it out, and I have really two points that I would like to make.

And the first point is that one of the problems with the CRA performance evaluations not reflecting bank performance is that the agencies have too much discretion in evaluating banks and generally tend to exercise it in a way that overstates or overrates bank performance.

No two CRA performance evaluations look alike. The agencies have discretion about the criteria they will use to evaluate bank lending, the benchmarks they will use to measure whether the banks have satisfied the criteria, and how to evaluate whether the banks have satisfied the criteria or not.

So, for example, a performance evaluation might state it is going to look at the percentage of loans that the bank made to low-and-moderate-income neighborhoods. It will compare that, for example, to the percent of such loans by all lenders in the community. And then it will sort of say, the bank is closed, the bank didn't quite make it, the bank didn't quite reach or maybe the bank did do a little better than the benchmark.

But there's no sort of definitive statement of whether the bank has satisfied the criteria or not; and as a result, the agencies tend to ignore bank performance that does not meet the criteria that the performance evaluations have established. So they have this discretion to decide not only what criteria to look at and what the benchmarks will be, but then when the bank doesn't meet the benchmark, they have the discretion to say, well, that's OK we're not going to hold that against the bank and it will get passing grades on the performance evaluation anyway.

So one thing I would urge the subcommittee to consider is whether there should be a standard set of criteria to use to look at bank lending, a standard set of benchmarks; and then requiring the agencies to make definitive conclusions about what happens when a bank does not meet those benchmarks.

The second point I would like to make is that there has been a lot of discussion about the fact that the agencies may not be taking into account in the CRA evaluations the results of the fair housing and equal credit evaluations that go on separately from the CRA evaluation. And I want to make another related point, which is, the agencies do not evaluate lending by race in their own CRA evaluations.

They evaluate lending by income, but they do not evaluate lending by race, the justification for this being that the community reinvestment statute says the banks have an obligation to meet the credit needs of their entire communities including low-and-moderate-income neighborhoods.

The agencies have apparently seized on that to say, therefore, we don't look at race when we do these reports. I tend to disagree with that. I believe there is sufficient legislative history that would support a showing that Congress was also worried about racial redlin-

ing, not just income redlining, and therefore the agencies should take race into account when doing their CRA evaluations.

And the failure to take race into account has some very significant consequences. For example, you won't see in a CRA performance evaluation report, generally, any statistics that would compare a bank's subprime lending on the basis of race. You won't find what we might call "disparity ratios" in there that compare the percentage of African Americans who receive subprime loans or the percentage of whites who receive subprime loans, because they don't look at race.

So the evaluation report can show a lot of lending in low-and-moderate-income neighborhoods, but might not show that lending might be because they are making a lot of subprime loans and that those subprime loans may be disparately distributed based on race.

So my two points would be, simply create some more accountability in the CRA exams by establishing set criteria and benchmarks and what will happen if the banks don't reach the benchmarks, and require the agencies to consider lending by race when they do their performance evaluations.

Thank you very much.

[The prepared statement of Mr. Marsico follows:]

Richard Marsico
Domestic Policy Subcommittee of the
Oversight and Government Reform Committee
Wednesday, October 24, 2007
2154 Rayburn HOB – 2:00 P.M.

Thank you for the opportunity to testify this afternoon. This Committee=s hearing, AUpholding the spirit of the CRA: Do CRA ratings accurately reflect bank lending practices?,@ is especially timely as this year marks the thirtieth anniversary of the CRA=s passage. As we reflect on the role the CRA has played in its thirty years, it is clear that while the CRA has influenced banks to make more loans in underserved communities, there is room for improvement. Community groups have played a significant role in enforcing the CRA, but their efforts have been undermined by agency discretion in enforcing the CRA as well as the agencies= failure to evaluate bank lending according to race when conducting CRA performance evaluations.

In my testimony, I will address four issues:

1. the intended role of community groups in CRA enforcement;
2. the impact of regulatory discretion on community group CRA enforcement;
3. the agencies= failure to consider lending by race when conducting CRA performance evaluations; and
4. the role community groups can play in working with banks to end lending discrimination.

The Intended Role of Community Groups in the CRA

The intended role of community groups in the CRA is to help enforce the law by acting as watchdogs over bank lending practices, meeting with banks and the federal banking regulatory agencies (the

Aagencies@) to highlight bank successes and failures at meeting community credit needs, and filing administrative challenges to bank expansion applications with the agencies on the grounds that the banks have not met their CRA obligations. In essence, community groups are private attorneys general under the CRA and their Aenforcement from below@ has influenced banks to increase their lending to underserved neighborhoods.

By giving this role to community groups, the CRA has Ademocratized capital."[1] The CRA has democratized decisions about the distribution of capital by extending at least part of the decision-making Afranchise@ to previously Adisenfranchised@ people. Community groups have used this franchise, in turn, to influence banks to make billions--if not trillions--of dollars of loans to people who might not otherwise have received them, allowing the recipients to participate in the economic mainstream, further democratizing the economy.

The Legal Structure of the CRA

The seeds for democratizing capital are contained in the legal structure of the CRA. The CRA imposes on banks a Acontinuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered,@ including low- and moderate-income (ALMI@) neighborhoods.[2] The CRA requires the agencies to enforce bank obligations to meet community credit needs.[3]

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[1] *See Richard Marsico*, DEMOCRATIZING CAPITAL: THE HISTORY, LAW, AND REFORM OF THE COMMUNITY REINVESTMENT ACT 3-4 (2005).

[2] 12 U.S.C. ' 2901(a)(1) and (3)(2000).

[3] The agencies and the banks they regulate are the Comptroller of the Currency (national banks); Board of Governors of the Federal Reserve System (state chartered banks which are members of the Federal Reserve System and bank holding companies); Federal Deposit Insurance

The CRA requires the agencies to enforce the CRA in two different ways. First, it requires each agency to examine periodically each bank it regulates to determine whether the bank is helping to meet community credit needs and to issue a written public evaluation report--including a rating--evaluating the bank=s CRA performance.[4] Second, the agency must take a bank=s CRA record into account when considering certain bank expansion applications.[5]

The agency that receives the application has the power to grant it (which happens the overwhelming majority of the time), deny it (which happens very rarely), or condition it on improved CRA performance (which happened with some frequency in earlier years, but less frequently now).[6]

The Impact of CRA Challenges

When a bank files an expansion application, any member of the public may file comments opposing the application on the grounds that the bank has failed to meet its CRA obligation with the agency that

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Corporation (state chartered banks and savings banks which are not members of the Federal Reserve System); and Office of Thrift Supervision (savings associations and savings and loan holding companies). 12 U.S.C. ' 2902(1).

[4]12 U.S.C. ' ' 2903(a)(1), 2906.

[5]The applications subject to the CRA are applications for a charter for a national bank or federal savings and loan association; for deposit insurance for a newly chartered bank; to open a branch; to relocate the home office or a branch office; to merge or consolidate with, or to acquire the assets or assume the liabilities of, a bank; and to become or merge with a bank holding company. 12 U.S.C. ' 2903(a)(2)-(3).

[6]*See, e.g.*, 12 C.F.R. ' 228.29(c)(2007).

regulates the bank (known as a ACRA challenge@).[7] Community groups, on behalf of LMI neighborhoods and predominantly minority neighborhoods, have frequently filed such challenges.

The seeds for democratizing capital planted in the CRA have borne fruit. The opportunity for community groups to file CRA challenges to expansion applications has given them a significant voice in decisions about the distribution of loans. Banks fear CRA challenges for several reasons: there is there is a chance--however slight--that the challenge could be upheld and the application denied; the challenge could delay the regulatory approval process and either make the merger less attractive financially or cause it to fall through; a challenge could be costly and time-consuming; or a challenge could result in bad publicity.[8]

Banks feel pressure either to avoid challenges or to resolve them once filed. The most common way for banks to avoid or resolve challenges is by entering into lending agreements with community groups (known as ACRA agreements@) or issuing unilateral CRA commitments.[9] These CRA agreements and commitments share several common features, most significantly a commitment to lend a specific dollar amount of a particular type of loan or loans (for example, affordable housing and small business loans) to a particular neighborhood or to individuals with specified characteristics, over a specified time period.[10] The National Community Reinvestment Coalition has estimated that between 1977 when the CRA was passed and 2005, banks entered into CRA agreements or issued unilateral commitments promising $4.2 trillion in loans to

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[7] *Id.*, at '228.29(b).

[8] *See Marsico, supra* note 1, at 133.

[9] *Id.*

[10] *See Marsico, supra* note 1, at 135.

underserved communities.[11]

The Effect of Regulatory Discretion on the Effectiveness of Community Group CRA Enforcement

[11] NATIONAL COMMUNITY REINVESTMENT COALITION, CRA COMMITMENTS 1 (Summer 2005).

Both the CRA statute[12] and the federal banking regulatory agencies= CRA regulations[13] give the agencies broad discretion in enforcing the CRA. Although the statute places an affirmative obligation on banks to meet the credit needs of their communities and requires the agencies to enforce this obligation, the statute does not establish performance standards or other criteria with which to evaluate a bank=s performance. Similarly, although the CRA regulations establish tests for evaluating CRA compliance and specify several criteria the agencies are to examine, including lending, investment, and banking services, the regulations do not establish benchmarks against which to measure a bank=s CRA performance. The agencies have chosen to exercise their discretion in a way that undermines the democratizing tendency of the CRA and the ability of community groups to enforce the law. When they evaluate banks and decide bank expansion applications they do not use consistent or objective standards and they do not enforce the law strictly. In the absence of definite standards to measure bank lending performance and strict enforcement, it is difficult for community groups to hold banks accountable for poor lending records.

CRA Performance Evaluations

My study of a sample of CRA performance evaluations (ACRA PEs@) the agencies issued between 1997 and 2001 reached several conclusions about how the agencies conducted CRA PEs and the extent of their discretion:

1. The agencies did not use a fixed set of criteria for evaluating bank lending.

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[12]12 U.S.C. ''2901-2908 (2000).

[13]The agencies= CRA regulations appear at 12 C.F.R. pts. 25 (Comptroller of the Currency); 228 (Federal Reserve); 345 (Federal Deposit Insurance Corporation); and 563e (Office of Thrift Supervision)(2007).

2. The agencies used subjective and imprecise standards for evaluating bank lending.
3. The agencies did not define the level of lending necessary to satisfy the lending criteria they used.
4. The agencies did not define the weight of the criteria they used.
5. The agencies often evaluated similar performances by different banks on the same criteria differently.
6. The agencies frequently gave banks higher ratings than they deserved based on bank performance pursuant to the criteria the agencies used to evaluate their performance.[14]

The agencies also exercised their discretion to give high CRA ratings to banks. Each year from 1997 to 2003, the federal banking agencies gave satisfactory CRA ratings to between 97.1% and 98.9% of banks they evaluated.[15]

Decisions on Expansion Applications

My study of more than 100 written decisions on bank expansion applications that considered the bank=s CRA record that the Federal Reserve or Comptroller of the Currency issued between 1997 and 2003 found many similarities between how the agencies evaluated bank lending in CRA PEs and how they evaluated lending when considering expansion applications.[16] The decisions did not use a fixed set of criteria for evaluating bank lending and they used subjective terms when applying the criteria. The decisions generally listed facts about the bank=s lending, emphasized strengths and excused weaknesses, and did not disclose the

[14]*See Marsico, supra* note 1, at 90-106. I have reviewed many CRA PEs issued in recent years and do not see any reason to change these conclusions.

[15]*See Marsico, supra* note 1, at 130. The four possible CRA ratings are outstanding, satisfactory, needs to improve, and substantial non-compliance. *Id.*, at 83.

[16]*See Marsico, supra* note 1, at 107-113.

reasoning they used in reaching their decisions. Often, the decisions acknowledged the accuracy of critical public comments about bank lending but nevertheless granted the application without further comment.

The Agencies= Failure to Consider Lending by Race in CRA Performance Evaluations

When conducting CRA PEs, the agencies do not evaluate lending by the race of the borrower or by the racial composition of the neighborhood. They do not consider the number or dollar value of loans to African-Americans, Latinos, or predominantly minority neighborhoods. They do not consider the percentage of the bank=s loans to these groups compared with the percentages of loans to these groups by all lenders in the aggregate. Instead, they consider the results of a separate fair lending examination of the bank and take that examination into account when giving a bank its CRA rating.[17] A poor result on the bank=s fair lending examination, however, does not mandate a failing CRA rating.

The agencies= justification for not considering lending by race in CRA PEs is that the language of the CRA addresses lending according to income, not race.[18] This explanation is untenable. The CRA=s legislative history shows that Congress intended the CRA to eliminate redlining based on race as well as income.[19] Although the CRA explicitly requires a bank to meet the credit needs of its entire community, including LMI neighborhoods, this language does not prohibit the agencies from considering lending to other communities, especially in light of Congress= intent to eliminate racial redlining.

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[17] *See, e.g.*, 12 C.F.R. '25.28(c)(2007).

[18] *See Marsico*, *supra* note 1, at 178.

[19] *See Marsico*, *supra* note 1, at 90.

The Value of Community Participation in the Process of Rectifying a Bank=s Discriminatory Practices

Bank discriminatory practices can take many different forms, including redlining, reverse redlining, disparate treatment, and disparate impact. There are two significant ways community groups can play a role in rectifying these. First, they can gather and publicize data about bank lending patterns. Second, they can enter into agreements with banks, similar to the CRA agreements described above, that contain provisions that will help end a bank=s discriminatory lending practices. This role is consistent with the intended role for community groups in the CRA enforcement process, but is undermined by regulatory discretion in enforcing the CRA and the agencies' failure to consider lending by race in their CRA PEs.

Discriminatory Practices

The following is a non-exhaustive list of discriminatory lending practices:

1. Redlining: Redlining is the practice of refusing to lend in a community because of characteristics of the neighborhood--such as the income level or race or ethnicity of its residents--that are unrelated to the creditworthiness of particular borrowers in the neighborhood.

2. Reverse Redlining: This type of discrimination is the opposite of redlining. Instead of refusing to lend in particular neighborhoods because of the racial composition of the neighborhoods, banks and other lenders target predominantly minority neighborhoods for higher-price subprime loans.

3. Disparate treatment: Lenders practicing this type of

discrimination treat minority loan applicants less favorably than white loan applicants because of their race. An example of disparate treatment occurs when a lender grants a loan to a white person but denies a loan to a similarly situated minority person. Another example is when a lender charges a higher interest rate to a minority person than a similarly situated white person.

4. Disparate impact: Lenders practicing this type of discrimination employ policies or practices that are not discriminatory on their face but have a disproportionately negative impact on persons or communities of color. For example, a lender=s policy that it will not make a loan for less than a certain threshold amount might have a disparate impact if property values in predominantly minority neighborhoods are lower that property values in predominantly white neighborhoods.

Rectifying Lending Discrimination Through Gathering and Publicizing Information

Community groups have played an important role in rectifying lending discrimination by gathering and publicizing data about bank lending made available by the Home Mortgage Disclosure Act (AHMDA@)[20] that shows that banks treat white applicants and minority applicants differently. This publicity led to strengthened enforcement of the CRA and the Fair Housing Act (AFHA@) and subsequently to increased lending in underserved neighborhoods.

In 1991, the Federal Reserve released HMDA data that for the first time contained information about the race of home mortgage loan applicants and the racial composition of the neighborhoods in which the property that was the subject of the loan application was located. The data showed that, nationally, lenders rejected home mortgage loan applications

[20]12 U.S.C. ' '2801-2810 (2000).

from African-Americans more than twice as frequently as loan applications from whites, from Latinos approximately 1.4 times more frequently as loan application from whites, and for loans to purchase property located in predominantly minority neighborhoods more than twice as frequently as applications to purchase property located in predominantly white neighborhoods.[21] Community groups, newspaper reporters, national advocacy groups, and scholars issued studies about this data that confirmed it on the national and local levels.[22]

Using the data, community groups increased their CRA advocacy efforts and pressured the federal banking regulatory agencies to improve their enforcement of the CRA and the Department of Justice (ADOJ@) to enforce the Fair Housing Act (AFHA@).[23] The government agencies responded; the banking regulators strengthened the CRA regulations and tightened their enforcement and the DOJ brought several lending discrimination cases, the first cases they had brought against lenders under the FHA.[24]

These efforts were successful. By 1997, the national market share of conventional home mortgage loan approvals to African-Americans, Latinos, and predominantly minority neighborhoods stood at 5.6%, 5.0%, and 2.6%.[25] These levels represented increases from their 1991 levels of

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[21]Glenn B. Canner & Dolores S. Smith, *Home Mortgage Disclosure Act: Expanded Data on Residential Lending*, 77 FED. RES. BULL. 859, 870, tbl. 5 (1991).

[22]For examples of such studies, *see Marsico*, supra note 1, at 168, n.114.

[23]Richard Marsico, *Shedding Some Light on Lending: The Effect of Expanded Disclosure Laws on Home Mortgage Marketing, Lending, and Discrimination in the New York Metropolitan Area*, 27 FORD. URB. L.J. 481, 499-511 (1999).

[24]*Id.*

[25]*Id.*, at 499.

80.6%, 21.9%, and 36.8%, respectively.[26]

Agreements between Community Groups and Banks to End Discriminatory Lending Practices

As described above, community groups have traditionally entered into agreements with banks designed to redress weaknesses in their CRA lending records. Many of these agreements also contain provisions that will help rectify discriminatory lending practices. There is no reason that community groups and banks cannot enter into similar agreements to help end lending discrimination. In such an agreement, a bank might agree to:[27]

1. Make a specific dollar amount of home mortgage loans in predominantly minority neighborhoods or to minority borrowers.[28]
2. Offer affordable home mortgage loan terms and conditions, including
    a. lower-interest rates;
    b. no minimum loan size;
    c. reduced points;
    d. reduced downpayment amounts; and
    e. waived mortgage insurance.[29]
3. Utilize flexible underwriting standards, including standards relating to
    a. Credit history, including allowing loan applicants to explain credit problems;
    b. Employment history, including substituting the

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[26] *Id.*

[27] These examples are from CRA COMMITMENTS, *supra* note 11.

[28] *Id.* at 16-22.

[29] *Id.* at 22-26.

requirement that an applicant work at the same job for two years for a requirement that the employee work continuously for two years;

c. Income source, including counting as income social security, public assistance, unemployment benefits, and income from self-employment and part-time employment;

d. Mortgage debt/income and overall debt/income ratios --increasing the ratios from the traditional 28%/36% to, for example, 33%/40%; and

e. Property appraisal, including employing minority appraisers.[30]

4. Pay community groups to provide home loan counseling to potential borrowers.[31]

5. Conduct a Asecond review@ of rejected loan applications from minority borrowers.[32]

6. Conduct lending discrimination testing.[33]

Conclusion

Community groups have an important role in CRA enforcement. Their role has been weakened by agency discretion in enforcing the CRA and the agencies' failure to consider lending by race when conducting CRA PEs. Limiting agency discretion and requiring them to consider lending by race in CRA PEs could allow community groups to work more successfully to end lending discrimination.

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[30] *Id.* at 26-29.

[31] *Id.* at 32.

[32] *Id.* at 32-33.

[33] *Id.* at 33.

Mr. KUCINICH. Before we go to Mr. Van Tol, I would just like the committee to take note of something that Professor Marsico just said. I think it would be helpful if we put some statistics side by side: the number of subprime loans, the number of loans generated in an area, the percentage of those loans that went to minorities as prime loans, the number of subprime loans that were generated, the percentage that went to minorities.

Now, we've done half the equation, I think, already for this committee. But I think it would be helpful if we put them side by side because that would then get to your question. And then, of course, you look at the number of CRA reviews and the number of favorable reviews, number of unfavorable reviews, and then we know where it goes from there.

So I just wanted to just stop the music for a second. Let's go back to Mr. Van Tol.

You are recognized. Please proceed.

STATEMENT OF HUBERT VAN TOL

Mr. VAN TOL. Good afternoon Chairman Kucinich and Congressman Cummings. My name is Hubert Van Tol, and I'm the Director for Economic Justice for Rural Opportunities, Inc., in Rochester, New York. Thanks for the opportunity.

Our organization is a member of the National Community Reinvestment Coalition, and we support the comments and written statement of Jim Carr on NCRC's behalf. Today, I want to speak, however, as a long-time grass-roots CRA activist who has found and still finds the CRA law an enormously powerful tool for individuals and organizations that do grass-roots community development work.

In my limited time today, I'll just touch on the way that discrimination in lending has become more subtle and more damaging, and the failure of the regulators with their use of the fair lending exam and the CRA exam to keep up with the changes in lending.

I first became aware of the Community Reinvestment Act in 1985 while working for a local community development corporation in Memphis, TN. At that time, discrimination in access to credit was raw and blatant. For instance, we found lenders whose mortgage underwriting guidelines explicitly stated that they would not lend in areas of incipient decline. Their guidelines specified minimum loan amounts that excluded most of the houses in the African American neighborhoods in Memphis.

Mr. KUCINICH. Would you state that again?

Mr. VAN TOL. Their guidelines specified minimum loan amounts that would exclude by their size. There were $35,000 and $50,000 minimums, and in effect, the houses in the African American neighborhoods were selling for less than that at that time. So they would not lend to those areas because they didn't meet their minimum loan guidelines.

There was bad home mortgage disclosure data. For instance, in the case of one company, they showed the loans in inner-city Memphis averaging $1 million apiece. This is 8 years after the passage of the CRA and 10 years after the passage of the Home Mortgage Disclosure Act. And the regulators on their own had not come to the conclusion that there were any problems with that.

So it took community organizations like us really pounding on them and using the bully pulpit and tool of public relations for a year before the regulators began asking questions. And I think you're seeing an aspect of the same phenomenon now. It depends on the leadership at the top and how their attitude toward consumer regulation happens.

In 1986, our organization attempted dialog with the banks, but we didn't really have dialog until the regulators got in there and failed—well, they didn't fail them on their CRA exam, but in two cases we had them deny mergers and a new bank branch application, and that created the impetus for real change to happen.

But today, the discrimination for the most part doesn't involve access to credit, which was the issue then, but rather the fact that minority neighborhoods are really targeted with inferior loan products, high fees, high interest rates, unfavorable terms. They are targeted regardless of the credit scores of the individual borrowers within those neighborhoods. And when a group of people are targeted for bad financial products, it creates a cascading effect, a self-fulfilling prophecy, if you will, as they are so risky loan products which, over time, put stress on their financial situations and have the practical effect of driving down their individual credit scores and making them, "riskier borrowers."

And the banks have really facilitated this shift by doing a poor job of marketing in those neighborhoods, removing their branches from neighborhoods. They provide the lines of credit used by the brokers and the mortgage lenders. Some of them service those subprime loans. The investment bank cited, the bank often is securitizing those loans even while they are proudly saying that the retail division doesn't do subprime lending. So when a bank's fair lending examination is done, there's no public indication that this entire range of bank involvement in a subprime market that targeted at minority borrowers is looked at. And in spite of the efforts of community activists, it is rare that a bank service an investment test, and the CRA exam itself looks at all of these issues in a comprehensive way.

This has been the single most egregious area of discrimination in lending over the past decade, this targeting of inferior loan products to minority neighborhoods, and it has really been the marketing that's been a tremendous problem.

In the 2½ years that I have been working for Rural Opportunities which, as you said, does work in seven States and Puerto Rico and is one of the largest rural operators of the first-time homebuyer program, there have been no visits to me by a CRA examiner, or to my organization, to ask us what our opinion is of the banks that they are about to do CRA exams on. And I think it just reflects the fact that they have become much more lackadaisical about this.

There is this attitude that works its way through the bureaucracy and the banks quickly lower their standards to the minimum needed to get a passing grade.

Thank you very much.

[The prepared statement of Mr. Van Tol follows:]

Hubert Van Tol

Director for Economic Justice

Rural Opportunities Inc.

Rochester, New York

Domestic Policy Subcommittee

Oversight and Government Reform Committee

Wednesday, October 24, 2007

2154 Rayburn HOB

2:00 P.M.

Good afternoon Mr. Chairman and members of the Domestic Policy Subcommittee. My name is Hubert Van Tol, I am the Director for Economic Justice for Rural Opportunities Inc. of Rochester, New York and I do want to thank you for this opportunity. Our organization is a member of the National Community Reinvestment Coalition and we support the comments and written statement of Jim Carr on NCRC's behalf.

Today I want to speak, however, as a longtime grassroots CRA activist who has found and still finds the CRA law an enormously powerful tool for individuals and organizations that do grassroots community development work. Unfortunately I also find the power of the law being gradually eroded by changes in the lending industry and the unwillingness or inability of the regulators to adjust the CRA regulations to keep up with changes in the industry. In my limited time today I'd like to touch on just two issues, 1. the way that discrimination in lending has become more subtle and more damaging, and the failure of the regulators with their use of the fair lending exam to keep up with those changes and 2. the structural changes in the industry that have had the effect of diminishing the scope of CRA as larger and larger shares of bank lending are being done outside of the geography of a lender's assessment area.

I first became aware of the Community Reinvestment Act in 1985 while working for a local community development corporation in Memphis, Tennessee. At that time the discrimination in access to credit was raw and blatant; for instance we found lenders whose mortgage underwriting guidelines explicitly stated that they would not lend in "areas of incipient decline." Their guidelines specified minimum loan amounts that excluded most of the houses in the African American sections of Memphis. (Interestingly NCRC is finding some of this same kind of behavior popping up again among non-CRA covered entities.)

Back in 1985 and 1986 our organization attempted dialog with the lenders about these issues; when our requests for meetings were rebuffed we documented our concerns with the regulators. After we began raising these issues, the regulators regularly sought our organization out for comments when they were doing CRA exams, when all else failed to get a lenders

attention, in a couple of cases they actually denied a lender's application to open a new branch or to merge. This active engagement by the regulators on these issues radically changed the dynamic and brought lenders that had previously been resistant to change to the table to work out these issues and eliminate the practices that were designed to avoid lending in African American neighborhoods.

In the past decade, however the situation has shifted dramatically. Access to credit is usually not the issue any more, as almost anyone who can put steam on a mirror has been able to get credit. The problem has instead been discrimination in the quality of the loans provided. Only a few banks have strategically focused on getting branches into neighborhoods populated with people of color and figuring out how to market to a population that is by and large distrustful of them because of their history and practices. There has, however, been a boom in mortgage lending in those neighborhoods, usually not led by the banks, but rather by the non-bank lenders, fueled by the efforts of brokers, who are not covered by CRA and don't have regular fair lending examinations.

Once again, the discrimination for the most part doesn't involve access to credit, but rather the fact that minority neighborhoods are targeted for inferior loan products with high fees, high interest rates and unfavorable terms. They are targeted regardless of the credit scores of the individual borrowers within those neighborhoods. When a group of people are targeted for bad financial products it creates a cascading effect, a self-fulfilling prophecy if you will, as they are sold risky loan products, which over time put stress on their financial situation and have the practical effect of driving down individual credit scores and making them riskier borrowers.

The banks have facilitated this shift by doing a poor job of marketing, removing their branches from neighborhoods or maintaining poor quality branches. They provide the lines of credit used by the brokers and the mortgage lenders, some of them service many of these subprime loans, the investment divisions of these banks are often involved in securitizing the same subprime loans that the retail part of the bank proudly proclaims that it is not involved in. And yet when a bank's Fair Lending examination is done, there is no indication that this entire range of bank involvement in a subprime market targeted at minority borrowers is looked at, and in spite of the efforts of community activists, it is rare that a bank's service and investment test in the CRA exam itself looks at all of these issues in a comprehensive way.

The single most egregious area of discrimination in lending over the past decade has been in this targeting of inferior loan products to minority neighborhoods without much attention being paid to the individual borrower's credit histories. Most of these loans have been made by brokers and the current CRA and Fair Lending examination regime is allowing this to happen.

I mentioned earlier that in my work in Memphis in the late 1980s and 1990s, the regulators regularly checked in with us to ask for comments on individual banks. On the other hand in two and half years in my current position with Rural Opportunities, our organization has never been called on by a regulator's CRA examiner, other employees there can't remember the last time they were called on.

Since Rural Opportunities does work in seven states and Puerto Rico, and is one of the largest rural operators of first time home buyer programs in the country, since we do a significant amount of micro lending and small business lending

through our CDFI subsidiary, you would think the examiners would be interested in hearing our perspective about the availability of credit. But when you have leadership at the major regulators, which is recent year has been essentially indifferent to good consumer regulation, that attitude works its way through the bureaucracy, the examinations become pro forma, and the banks quickly lower their standards to the minimum required to receive passing grades. If there is a silver lining to the mortgage crisis, it does at least appear to be encouraging the regulators to take their consumer regulation responsibilities more seriously.

While I believe the regulatory leadership bears a great deal of the responsibility for the weakening of CRA examinations, I do also want to emphasize the need to update CRA to deal with structural changes. NCRC has provided a good overview in their written testimony; I'd like to focus just a little attention on the current problems with small business lending.

In the rural counties of upstate New York, approximately 75 percent of all small business loans as measured by the CRA data, are now made by credit card lenders, many of them are affiliates of major bank holding companies. Most of these lenders have no assessment areas in those rural counties and so the fact that they have created a structure to make credit card loans with poorer terms and higher rates available in some geographies, without making their whole line of small business loans available, is never addressed more than superficially in their CRA examination because this lending is occurring outside their CRA assessment areas.

The assessment area basis for CRA examinations is broken. Assessment areas are based on the geography of their deposit-taking branches and deposit-taking branches are becoming less and less relevant to where institutions are actually doing

business. One fact illustrates this neatly. The three biggest banks in this country, Bank of America, JP Morgan Chase and Citigroup, are roughly the same size in total assets. Yet Bank of America has more than five times as many branches as Citigroup does in the United States, and with those additional branches they have a much more extensive geography covered by assessment areas around the country.

They're domestic and international assets are skewed differently and so the five to one ratio isn't exact, but the essential fact is that because they have structured themselves differently and have different strategies for raising capital the geographical extent of their CRA requirements is quite different. In New York State all of Citigroup's assessment areas are now in the New York City area. They have none at all in upstate New York, but they have CitiFinancial offices selling a less favorable loan product all over rural New York. Their credit card arm is one of the largest small business lenders in many rural counties upstate counties according to the available CRA data, and yet they have no CRA obligation at all in those counties.

I encourage you to look carefully at the whole range of issues being raised today. It's time for significant reform of this vitally important law in order to update the tools we need to keep discrimination in lending in check and to make sure that all of communities, urban and rural, are fairly served by this country's lenders.

Mr. KUCINICH. Thank you.

Just to put this in context, I happen to be the Chair of the Domestic Policy Subcommittee. It is a committee that has a pretty broad reach in every area in the government with the exception of affairs governing the military and most of the State Department.

Years ago, 30 years ago, I was mayor of a city; I was elected mayor of the city of Cleveland. I could see the kind of effects, beginning to percolate back then, of people not having access to credit, which is why when at the first opportunity the city of Cleveland, under my administration, pursued an action under the CRA against an institution in a neighborhood known as the Kinsman neighborhood in Cleveland, Kinsman/Mount Pleasant. And we saw community groups participating because they were the first ones that had the information about what the lack of access to credit was doing.

And it wasn't just for credit for the purposes of home ownership; it was credit for small businesses, because people are trying to engage in some commerce in a community.

So I just want you to know that what you brought here, just as individuals, is highly respected in terms of the commitment that you make with your life in looking at these issues which are so devastating on a personal level. Because we sometimes get lost in the minutia and broad, quantitative assessments that can be very devastating.

But when you take it down to an individual level, somebody has great hopes: They are finally going to get a chance to own a home, and somebody markets a loan that turns out to be predatory. OK, no documents? Wow, we're going to have our home. And we know what happens from there. I mean, this thing is so broad it has caused a shakeout on Wall Street—not a small matter. You know, from Main Street to Wall Street we see what happens.

And, Mr. Bradford, deliberate subversion of the CRA, deliberate effort to circumvent Federal fair lending laws, what do you think?

Mr. BRADFORD. I'm not so sure. I don't know if it is deliberate, but—it is more inconceivable, I guess, from my point of view. These agencies have the regulations in the examination procedures that say, you should look for redlining. They tell you how to do it. They say to look outside the assessment area to see if they include them, and then they don't do that.

I think another example—again, from the OTS—that is of concern, I think people have been suggesting that if there's any kind of concern about discrimination, it shows up in the public evaluations. And that's not true. The agencies are very protective of the internal examinations they give them. And I know in a couple cases I've been involved in, where attorneys have asked the agencies for copies of those, they've not only not given them to them, but threatened to go to court if they tried to use them.

Mr. KUCINICH. So the agencies protect the lenders?

Mr. BRADFORD. They do.

But in the Flagstar case, the internal exam was submitted as part of the trial record, so I can talk about that because it wasn't my responsibility.

Mr. KUCINICH. Please do.

Mr. BRADFORD. And at that examination the OTS identified an appraisal practice that Flagstar had that had a minimal appraisal amount, and they wouldn't make any loans to anybody below the appraisal amount, which is pretty much like what you were saying before. It is the classic kind of discriminatory-effect policy, not only that the OTS had done a systematic analysis of the HMDA data and the census data to show the bank that this had a disparate impact on minority neighborhoods; and yet when it came to the public evaluation, they had that standard little clause that they could find no violations of the Fair Housing Act.

Well, that just wasn't correct because they had in great detail shown these to the bank and required the bank to do something about it.

So there's always that. And I've seen it in other cases I can't talk about, because they weren't a public trial record; but I've seen it over and over again, that there are issues like that come up that the public doesn't know about. And so that gives me concerns.

I think, as I said in my testimony, they sort of treat the regulations like a kind of regulatory signing statement; that we don't care what the Justice Department thinks fair lending is, we get to reinterpret it ourselves.

And in the case of Old Kent that you were going through, for them to say, well, it is a reasonable area because now, after 1995 when we changed the definition of "delineation of service area," we said you could keep defining these little areas where you made your loans around all your offices and that would be OK. And so, in the case of Old Kent, you just kept opening offices in the suburbs and making your little circles around them; and when you put them all together you grieve the city of Detroit, but you didn't serve the city of Detroit.

And they said, well, that's an OK business practice for the bank. But in their fair lending examination, they say that would be a disparate impact; and the only defense for a disparate impact is a business necessity, a compelling business necessity. The OCC says it can't be hypothetical, it has to be real, it has to be impending.

South Shore Bank's only assessment area—it is called Shore Bank now—in the city of Detroit, whatever bank is the city of Detroit. They make lots of money, they get outstanding ratings. So evidently you can do business in Detroit in a profitable way. So what would the business necessity defense be for Old Kent or anyone else; or in America Bank in Chicago or First Bank in Chicago, both of whom had these amoeba-shaped areas in the suburbs? It is inconceivable to me that the regulatory people don't understand their own regulations and don't understand the fair lending laws.

So I guess they feel they are above the civil rights laws.

Mr. KUCINICH. Because in your written statement you said that the CRA intended to prohibit discriminatory practices based on race as well as income, but today only expressly prohibits discrimination based on income.

Mr. BRADFORD. That's right. That's because at the time when Proxmire was proposing it and we were working on the language, ECOA had just been passed the year before and the Fair Housing Act had been in effect for a while and there had already been all these redlinings. HMDA was just passed the year before that. We

were told by the congressional aides and by the people drafting the legislation that it would be just redundant to put that in the act, everybody understood that was there.

But there's no Federal protection by income, so they said, we'd better put that in the legislation because even though race is clearly already covered, income wasn't. So that's why that survived in the act.

Mr. KUCINICH. So how would the CRA be enhanced if regulatory agencies automatically failed banks that have discriminatory and other illegal practices?

Mr. BRADFORD. Well, I'll give you an example. If you looked at Flagstar Bank during the period these violations were taking place, they went from an institution of $500 million to an institution of $13 billion; that is, they increased their size by 26fold because they had the privilege of inquiring and branching and merging with people during this time.

And if they'd failed the CRA, they probably wouldn't have had that privilege. So that's a pretty serious issue for a lending institution.

Mr. KUCINICH. That's actually the same question, sensitive question, I asked the representative of the Fed. Because if you get failed at that first level when your worth is $500 million, you don't get to $13 billion.

Mr. BRADFORD. Well, that would be, what we all believe would be the case.

Mr. KUCINICH. Well, but the point is, that is, if there is an active regulation and people are failed or something else happens.

And that is that the volume of access increases to people in an underserved population, low-and-moderate-income areas, as well as by virtue of definition, people of color.

Mr. BRADFORD. Right. But the intention of the act at that time, which I think still holds true, was to increase the access to prime lending and to target prime lending, not to just increase the access to FHA loans or subprime loans.

Mr. KUCINICH. No. I understand that. Good point, absolutely. I'm glad you pointed that out.

But since today people of color end up, more often than not, being in that low-and-moderate-income area, they have a disproportionate—a disproportionate burden if the CRA is not enforced.

And so, Mr. Carr, I wanted to talk about your testimony. You discussed how banks make a significant amount of loans outside of their assessment areas and therefore go undetected by Federal regulatory agencies. How can that be legally possible? Could you explain that?

Mr. CARR. Yes. In fact, because the procedures that define assessment areas generally require that a bank report within the areas, which are defined as its assessment areas in which it has CRA-covered institutions that have locations, the general location around their bank branches, and so to the extent that institutions are allowed to, they have affiliates that are not covered.

In one particular study which we examined, four major banks, we found that as little as 11 to 13 percent of the total lending actually was covered, was concluded to be covered, because the institu-

tions were not included in the review, the mortgage lending institutions were not included in the review. And what that does is greatly undermine any effectiveness of CRA enforcement for that lending activity.

Mr. KUCINICH. Mr. Carr, presently, banks, regulatory agencies are only describing banking lending activities in one to three sentences.

How can community groups benefit from a more detailed description of the fair lending review in the CRA exam?

Mr. CARR. Well, that is one of the more odd and unusual circumstances in a major change from the 1990's in which, in fact, the Federal agencies used to provide detailed information about the types of statistical tests that were employed. Was it matched, peer testing, etc.; what types of statistical models were used, and on.

Today, the reviews are often in a sentence that just simply says that a bank has passed its fair lending test. And what that does is, it disallows community organizations and civil rights attorneys and others who might have an interest in the act to actually explore what exactly was done, to comment as to whether there are things that were clear omissions or where improvements in those examinations could take place.

Mr. KUCINICH. Thank you.

Professor Marsico, in your written testimony, you mention that community groups and banks can enter into CRA agreements which are designed to redress weaknesses in the bank's CRA lending records. In your opinion, do corrective actions agreed on by the banks and their Federal regulators achieve the same goals?

Mr. MARSICO. I have not seen any of those corrective agreements. I don't believe that they are made public. And I think one of the people today referred to those agreements, and I don't think mentioned that they are made public, which, if true, is a problem. Because one of the reasons that the agreements between the lenders and banks and community groups work is that they are publicly made and they are agreed upon, and they have monitoring reports that are issued publicly and periodic meetings with the community groups to show what they are doing.

Mr. KUCINICH. So you're saying the very lack of transparency on agreements between banks and Federal regulators can constitute a subversion of the principles of the Community Reinvestment Act.

Mr. MARSICO. Yes, I believe it should all be transparent. I don't why the results of the fair lending exams are not made public. The CRA performance evaluations are made public.

Frankly, it is very odd when you get to the fair lending portion, when it says the results of the exam showed no violation yet, they don't show you the results when they've just gone through 100 pages of information about the CRA record of the bank.

Mr. KUCINICH. I'm going to come back to you, but I want to introduce a member of our panel who has been an outstanding representative on so many economic issues affecting urban America.

Mr. Cummings and I have worked on a broad range of social and economic concerns relating to access to credit, health care infrastructure. I want to introduce the distinguished gentleman from Baltimore, Maryland, Elijah Cummings.

Thank you, Mr. Cummings.

Mr. CUMMINGS. Thank you, Mr. Chairman. I have only a few questions.

As I was sitting here, gentlemen, I was thinking when you're an African American in the position that I'm in and you talk about race, or even if you're white and talk about race, and you say that people are being discriminated against and suffering, do you know what people usually say? They usually say, Here they go again, here they go again, it is all their fault. And when you come with the kind of evidence that you presented here today, I mean, you're actually laying it out there. This is it.

And I was thinking to myself, a few years back we had a woman who is now a bishop in the AME Church, Bishop Vashti McKenzie. In Baltimore, one of the things that she did is, she began to look at what the banks were doing. And she, I think, saw, for example, that maybe African Americans were not getting the loans that they were rightfully due, and started looking at a number of issues.

And so what she did was bring the churches together; and they said, basically, if you want to do business with us—and they had about, I can't remember how many churches; probably 15 to 20 churches, thousands of people—you've got to come right.

This is where I'm going with this. I'm trying to figure out, how does the—first of all, most people who are being victimized don't even know they are being victimized. And I'm trying to figure out a two-track solution.

One track is, how do people come together and do things similar to what, say, the church did; that is, try to come up with a remedy where they force these banks to pay attention? Because I can tell you, I live in the inner, inner, inner city of Baltimore, and there are no banks. I mean, to get to a bank, I have to go at least a mile, about 2 miles to get to a bank; and that's not unusual.

I'm trying to figure out—you know, I really want to believe in government, and I do to a degree. But government takes so long to get stuff done. And I'm trying to figure out, if I'm talking to my community people and they want to organize and figure out ways to make the whole purpose of CRA do what it is supposed to do, what do they do?

And then, on the other hand, what do we do in trying to tighten it up on this end? Anybody? Do you all understand the question?

Mr. BRADFORD. I'll give a couple stabs at it.

One of the things that's discouraging is, the regulators, in 1995, they took out some of the assessment factors that included the community. They essentially cut the community out of the CRA process, because they eliminated looking at how the lenders assessed credit needs. And so they made this a kind of a private deal between the regulators and the banks.

And then, in 1999, as part of Gramm-Leach-Bliley, you got the "sunshine"—what we refer to as the "sunstroke"—provision, which was really designed to intimidate community groups to say, if you participate in making any comments and then you make an agreement with the bank, we're going to hold all these sanctions against you; but we're not going to make the bank do anything or enforce anything, we don't even recognize the agreement as existing, but we could take the money away from you and prohibit you from the CRA stuff for 10 years.

I don't even know if that fits the equal protection clause in the Constitution, but—that provision of Gramm-Leach-Bliley.

And then the Federal Reserve expanded that in the regulations, and they said the definition of "agreement" is, if you go and talk to a bank and say, We want these four types of loans; and then, later on, without ever talking to you again, the bank has a press conference—and this is an example they actually used in the regulations—and they identify those four types of loans. Even though they are not going to do them the way you want it, the regulators and the banks can declare that an "agreement," and they can impose all these sanctions against you even though you not only didn't sign it, but you probably don't even like it.

I mean, this is sort of congressionally mandated harassment of the community people who are supposed to be involved, and it has scared a lot of people off. There are a lot of brave people on this panel and in Cleveland and Massachusetts who have stood up against it, but it is a threatening tactic.

It is embarrassing to have my government do that to the very people who have created the agreements. And these agreements have been the basis of the most creative forms of reinvestment in our country. That's where—outside something like South Shore Bank, that's where all the best programs came from, the most creative programs.

In Baltimore, you've got to have mixed-use stuff because you've got businesses and residential together. Banks didn't want to do that, so you had to create special programs. And neighborhoods did that. They wanted to have stuff for side-by-sides and duplexes because a lot of housing was that way, and banks only wanted to do single family; and so they had to create those programs themselves. I don't have to tell you about it, because Baltimore has one of the strongest histories of this kind of development activity that we ever had.

The first study that led to the HMDA Act was actually the study in 1973 in Baltimore. So I understand what you're coming to.

I think we've gotten to the point where you have to amend the Community Reinvestment Act, to tell the regulators some of the things that they have to do, because their discretion is never going to work. I think, as the chairman found out before, they can't pull the trigger. No matter what you do to violate the fair lending laws, they just can't bring themselves to pull the trigger and give you a failing grade.

So the law has to be changed to say, you have to include the assessment of whether there's a disparate minority impact; you have to decide, if people violate the law or do that, they fail. You have to include all the affiliates and what they are doing in your assessment. If any affiliate discriminates, then the entire bank fails at CRA, even if that affiliate is in California. We don't care where they are. You violate Federal laws in this country, you lose your banking privileges, period.

You've got to lay it all out to them because they just don't get it. And then that will give the community people the chance to do these things because I've been in it for almost 40 years.

Mr. CUMMINGS. How long?

Mr. BRADFORD. Almost 40 years, before there was a CRA working with these things.

And nobody has figured out how to serve community needs like the community. And I've evaluated these reinvestment agreements, and I know other people on the panel have looked at these too.

And this is the most creative kind of stuff. We intended, when we passed the CRA to create a development banking industry. And it was only going to happen if the community people came into it because the banks had no idea how to do it.

We've got the World Bank and everything else to help other countries. We had nothing for the United States.

And we had South Shore Bank, and we had pretty impressive agreements early on, but if the regulatory agencies just sort of abandon this thing, we are losing the strength, and it has all come from the community people.

Mr. CUMMINGS. Let me just ask you this. What part does the Federal Reserve play in all of this? If any, I mean.

Mr. BRADFORD. They are the key. They write the regulations.

Mr. CUMMINGS. And they have a lot of say?

Let me tell you why I'm asking this. When we—I also serve on the Joint Economic Committee, and when we were dealing with subprime—we are still dealing with the subprime market and the abuse. We wrote to Bernanke and asked him to lay out some guidelines with regard to avoiding making—we were trying to make sure that people were protected as best the Reserve could do with regard to these subprimes. And I am just wondering—you know, I am trying to think of all of the different kinds of methods that we can go at this thing.

Because you know what I am afraid of is that—I can almost fast forward—in 20 years a whole different set of people will be here. Some of us will be in rocking chairs. And it will be people who have been denied what the law said they should have gotten, and then it will also have hit another generation, and we will be going through the same stuff.

And I am just trying to figure out how do we—I hear you, but how do we put brakes on this—and, actually, you know—cause this gets kind of complicated, you know. And so, people—they lose their attention with regard to this kind of thing, because a lot of people don't have a clue of what CRA is.

So—but, you know, just—and I will turn it back over to you, Mr. Chairman. I am just trying to figure out how do we move from square one so that we can actually have some impact—I just want to finish this—so that we actually have kind of impact? Because I mean we can wrestle and wrestle and wrestle and the only thing we've done is, you know, messed up the wrestling mat a little bit and that's it. And the beat goes on. And I think people depend on the beat going on. They depend on people not paying attention while they get—while folk are getting rich.

And my last question is, you know, when I was a little boy, I remember specifically we would go downtown in Baltimore. There were two stores in all of downtown Baltimore that would sell clothes to black folks, and I was just a little kid about 5 years old, and I will never forget standing in the long lines. And I asked my mom, I said, "Mom, I don't understand this. All of those stores out

there and there is like 300 black people standing in line getting school clothes from the one store." I said, "Don't those others stores want to make some money?" I was just a little kid.

And so, I mean, and I am trying to figure out, do you all see this as just blatant discrimination? Do you think people just have a negative view of minorities? Do you think that they—there is some kind of grand scheme to keep certain neighborhoods in a certain state?

I mean, you know, going back to my example, there are people who have great credit, they so happen to be African American, they are whites, they are all kinds. But do you kind of just blanket out a whole group of people and say, OK, later for you. I mean, is it—are we that mean in this society? Do you think—you must have an opinion.

Mr. CARR. I was going to say, if you look at most distressed neighborhoods, you probably see a combination of things happening. One is financial vulnerability that predisposes people to being taken advantage of, and then compounding that is active discrimination in the markets.

And one of the things that is just interesting is to see how regulation is often upside down, where the people who are most financially vulnerable receive the least protection from financial services industry, from the regulatory agencies.

So, for example, if you look at the subprime lenders, the predatory lenders, in fact they were the least regulated entities. And so why does that happen? It shouldn't happen. And the reality of it is that, for all of the weaknesses of CRA, there were a lot of things that could have been done directly to better regulate the subprime market, and it wasn't. And so that is probably the greatest source of damage to African American wealth at least for this half century, maybe for the entire century. The African American home ownership rate is falling fast.

So to get to your question about what do you do, I think, first of all, independent of CRA, we need to put into law effective regulations for those entities that are nevertheless serving those communities. You know, pay-day lenders, rent-to-own title lenders, subprime lenders need better national regulations, specifically.

In our testimony, we say to some extent we bring those institutions under CRA umbrella, but that will only be good to the extent that CRA is actually enforced. Which leads me to a comment that I made at the opening of my statement which sometimes is considered or thought to be a throwaway line, but I don't mean it to be so at all.

I don't think that there is a good appreciation for the value of consumers who live in places like Baltimore and Philadelphia and Cleveland and other distressed communities across this country. I don't know that there is a real understanding about the money that flows through those neighborhoods and how in dysfunctional ways it doesn't, in fact, accrue to the national economic GDP the way that it could.

And as minority households grow as a share of the U.S. population, one thing that would be interesting, I think, for the Federal Reserve to do is take a look at the growing participation of minorities in the labor market and sort of ask, you know, sort of sce-

narios: How much better could the country be off if we were in fact empowering them economically?

And then maybe Congress might have to do some exceptional things like to empower and/or create financial institutions that aim at those markets that have been historically discriminated against for which there is enormous market failure and really experiment, do some financial experiment, do some financial engineering and bring those consumers into the 21st century of financial services access.

I will just conclude by saying my real belief in talking about these issues, just like the last panel, you can't understand the rationale. It is unconceivable, and I wouldn't have an answer as to why we don't just simply enforce the laws as effectively as we can. So I would conclude that the value of doing it does not outweigh all of the political challenges that are perceived to be faced by those who must enforce it. I don't know. Those are my own personal comments, not those of NCRC, but I share your frustration.

Mr. CUMMINGS. Just one last thing. As you were talking, I couldn't help but think about we used to—we just started getting these Targets, and it is interesting that when you go to the Target stores, they are packed with black people. I mean, before, Target wouldn't even come to these neighborhoods. But now they are packed.

You know, usually Target's claim to fame is that you don't have lines. Did you know that, Mr. Chairman? In other words, their claim to fame is they want to appeal to people and they have enough check-out counters. That is part of their scheme so that you feel comfortable coming in so you can get in and get out. I mean, they have all kinds of checkers in the black community, and they still got lines.

What my point is is that something—somebody woke up to what you just said and said, wait a minute, hold it. Oh, there are black people. They do need trash cans. They do need, you know, diapers. They do need—so let's go there.

What took them years to even get there? Which is to me incredible.

Mr. Chairman, I know I have gone longer than you, and you have been very kind.

Mr. BRADFORD. On the Target issue, it is interesting, because I used to work in Minneapolis, which is where they are located, where they are from. And in Minneapolis, nobody would build a store in the inner city, and the neighborhood people demanded they build a store, and they finally got K-Mart to open a store, and it was the largest-selling K-mart store in their entire network. And Target looked at that and realized that they had been avoiding these neighborhoods.

And Minneapolis is not a, inner city place, let me tell you. But then they began to realize there was market there.

It is like the community people have done the same thing. They like to take the bankers and people on tours and say come out to my neighborhood. You have never been to my neighborhood. You drive by it in your car to get to work, but you have never been in this neighborhood. And it has been like a conversion experience for a lot of the really good bankers we worked with who come out

there and realize what potential there was in those neighborhoods, who never had actually been there before.

And I probably shouldn't say this about a colleague, economic colleagues, but we need fewer economists making these decisions. I mean, economists don't even believe there could be discrimination because it violates the rational man theory. You gotta have people trying to make these decisions who have seen the world, who go out there and talk to people and realize the potential. Because you are right. It is there. And over and over again I have seen businesses find it, bankers find it, people go out in the neighborhoods. They have to get their feet on the ground in the neighborhoods and see what the potential is.

Mr. CUMMINGS. Thank you, Mr. Chairman.

Mr. KUCINICH. Mr. Cummings, this committee holds your participation in highest regard because, as you state, you come from the inner city, the "inner" inner city. I still live in the city and have for most have my life in the city of Cleveland; and I would imagine that this Congress has changed dramatically over the last hundred years, that there is probably not a lot of Members that live in the inner city. And so, you know, we might have an eye that is trained a little bit differently.

I represented the inner city in the city council. Mayor of Cleveland, State Senate, Congress, have an inner city district or district that includes the inner city.

When you get into issues like this that have a powerful economic underpinning, given the history of the United States, you cannot separate the economic realities from race. Of course, we understand that doesn't mean that poor white folks aren't dealing with the same problems, essentially, in terms of lack of access to credit. Matter of fact, the neighborhood that we looked at in Cleveland that had over 50 percent of failure of loans and, of course, a rapid rate of foreclosures, happened to be predominantly Caucasian. And so there was a lot of poor people and moderate income people in the same boat whether they were white or black. The point—and, you know, we understand that.

As Mr. Cummings is talking about Target, here is what I am thinking about. I am thinking about all of these people going to Target, because that is the only place that might be available, and I am thinking that all of these—most of these goods are made in China. Think about it. You know, buy a washing machine, a bicycle, textiles, plants closing in the United States. Not work here. Unemployment rises, particularly in inner city areas.

I mean, there is a cycle here. You can't—it is interesting how you can get into an issue like CRA and suddenly you can go back to where is the money and where is it going. Because what is happening, what is happening and what we are seeing here is the wealth being distributed to the top in this country.

Banks are engines for the redistribution of the wealth, and the wealth goes upwards. CRA is an engine for a more equitable distribution. That's what it's about at its inception. The CRA doesn't work that well, it still goes up, and not only that but it will accelerate upward if the cop is off the beat, which is what happened with the subprime loan and people were just—basically had their financial positions ransacked.

So this committee, which is a domestic policy oversight subcommittee, understands the linkages and—because there are.

I want to conclude with a question to Mr. Van Tol and then see if we can—if there is any final comments by any of the panelists. Mr. Van Tol, how has your participation in the CRA process decreased in the past 7 years?

Mr. VAN TOL. Well, I think what we see happening with a lot of community groups—we very actively work to keep involved in the process, but among many of our peer groups and particularly in smaller community development sort of groups, if they don't see that their efforts are having an effect with the regulators, they naturally drop off in their participation.

Mr. KUCINICH. So is the participation process different today than it was in 1997, 1987?

Mr. VAN TOL. Well, I think during the Clinton years there was—for a time, there was an increase in people who or banks who were referred to the Justice Department. There was a feeling that taking action at the local level had real effects and that you were doing something good for your community.

When you start feeling—not seeing that happen any more, if you are a busy person working for a community group, your natural inclination is to stop taking that action. If you—I mean, it is a counter—it's not a good thing to do, but it is just a natural thing for people to do.

Mr. KUCINICH. So if you had access to fair lending review of banks conducted by regulatory agencies, would that change participation?

Mr. VAN TOL. I think there is a whole series of ways. If Congress would look at how to make the Community Reinvestment Act more friendly to the consumer groups, more friendly to people in the neighborhoods, to make sure that it was mandated, that during mergers there had to be a public meeting—I mean, you could—the groups, you know, represented on this table and nationally could come up with a whole series of ways to make, to empower communities in the process. And, you know, that would be one.

You know, you could—right now, if there is a negative community reinvestment rating that a bank disagrees with, they have a right to appeal that within the process. We, as community groups, don't get to see positive ratings and have a right to appeal them downward. So the deck is stacked in a lot of ways in favor of the lending institutions and against the community groups.

So I think if Congress could look at all of the ways that happens and restack the deck so that there is a more level playing field, we would feel more empowered, we would get more involved in the process, and I think benefits would accrue to everyone.

Mr. KUCINICH. Each of the panelists has experience on this and some of you, in your written testimony, have outlined improvements that you would recommend be made in the Community Reinvestment Act; and in light of the Gramm-Leach-Bliley, it would be good to—and some of you have done that, but I think it is good to inspect the implications of that and what might be able to be done to strengthen the Community Investment Act or to change that law as well.

I would ask each of you if there is, based on what you have heard today from the regulators, if there is anything that you would like to submit for the record in terms of followup comment or analysis or recommendations for legislative initiatives or reforms or any area for further inquiry that this committee might look into. Because, again, this committee has a very broad reach, and there has not been any regulatory enforcement in broad areas of our economy for quite a while. This subcommittee intends to change that.

So you can be of continued assistance in our work, and we are open to hearing your suggestions about what we might be able to do with respect to the Community Reinvestment Act, to Gramm-Leach-Bliley, to any area that relates to your expertise in housing and access to credit or anything else that might touch on the areas that you have familiarity with.

So I would let each of you know I would invite you to continue to stay in touch with the subcommittee and to give us the opportunity of your expertise in this and to thank you for your commitment to community. This is—each of you have reflected a long-term commitment. When you—I am sure when you see the staggering toll that it has taken on families in the subprime mortgage failure and you see the lack of enforcement of the CRA, it can be very discouraging. But I think we can change that, and that is actually what the work of this committee is about, by bringing the truth to light and giving people a chance to, you know, look at what's happening.

Are there any—before I conclude the work of this committee for the day, do any of you have any final comments that you want to make and, you know, feel free to right now. Anything? Anybody want to say anything?

Mr. VAN TOL. I would just like to emphasize one point. I hope as you look at CRA reform, this whole issue of assessment areas desperately needs review. Because that system is currently broken. You know, you heard some of the statistics from Jim about lending. In terms of business lending, the same thing is happening. I look at the rural counties of upstate New York, and about 75 percent of the loans going into those rural counties now are credit card loans from the urban center credit card lenders with no assessment areas in those counties.

That same donut that you saw for Detroit, you could take—for many lenders, you could look at the cities across America and all of the rural areas in between that are left out of assessment areas because they get jumped over.

Mr. KUCINICH. So there you could take the amount of credit card loans that are going into rural areas and you could probably juxtapose it with bankruptcy statistics.

Mr. VAN TOL. I am sure you could. And it is just a problem of having assessment areas tied to deposit-taking branches rather than to where the institutions are actually doing it.

Mr. KUCINICH. So if the institutions aren't out there to loan, then what happens is that the next line of credit is a credit card, and you also have—the staff and I were talking earlier about the issue of marketing—you also have the extraordinary aggressive marketing of credit card companies, just extraordinary.

I cut up most of my credit cards years ago because I started to see the impact that it can quickly have on somebody's budget. But if that is the only way you can get access to money, you are stuck.

So that is an interesting area that the subcommittee could go into, and I would like—again, I would invite your comments on that and any guidance that you have on the issue of assessment, how might we strengthen that.

Anyone else on the panel before—and thank you.

Mr. MARSICO. Just one quick comment, which is I think that the Community Reinvestment Act works best when it empowers communities, and that has been most seen through community CRA challenges to bank merger applications, and that resulted in the most sort of innovative, affordable lending programs.

But, in recent years, the number of CRA challenges seems to have diminished dramatically; and I think there are two reasons for that. One is that rather than—the regulators actually during the 1990's used to push banks to reach these agreements with groups, and it would let negotiations proceed while the communities were negotiating with the banks, and agreements would emerge, and they were terrific. They included monitoring provisions and reporting requirements.

But banks then started to make these unilateral commitments, and the agencies accepted them. So, you know, they weren't negotiated, they don't have monitoring, they just sort of say this is what we will do, and then they report on their progress, and that really takes the steam out of CRA challenges.

And the second point is the national scope of banks. It is very hard to make a challenge when there are 150 metropolitan areas that the bank serves. It is overwhelming. And, actually, you heard before, you know, one of the comments was, well, if a bank is discriminating in one assessment area but not the others, well, what are we going to do about that? Well, you know, that is the same kind of attitude I find with CRA challenges. It might not be lending well in one area but, well, it has 150 areas, so what can we do?

So I think putting some power back in these CRA challenges, it would be a very important way to make the CRA work better.

Mr. CARR. I would just say very quickly the inclusion of nondepository affiliates of banks being covered under CRA is a mandatory necessity as well as reforming the assessment area. And then also requiring that there be a direct focus on lending to minority households and communities would go a long way toward, if not enforcing, certainly providing the kind of information that would make it very difficult to hide and run away from the reality of what is happening through major financial institutions as it respects disenfranchised communities and households.

Mr. BRADFORD. I would just add, I think you have to review the fair lending exam process itself. We do a lot of consulting with lenders, and we look at their own lending regulations and guidelines, and I can tell you if any lender showed me the Federal guidelines, they would be in a heap of trouble in terms of their ability to actually control discrimination. They are really kind of disgraceful.

Mr. KUCINICH. They are kind of?

Mr. BRADFORD. Disgraceful. They don't really cover marketing, which is the main way in which subprime lending deceives people. They don't cover underwriting practices. They just say look at underwriting, but they don't describe to people how they are supposed to look at that and what to do.

Their statistical analysis only works if you have a lot of actual minorities who applied. So if you are good enough to get no minorities to apply, you are exempt from their statistical analysis. It is an absurd system of target.

And, also, they only target one focal point, they call it, or two focal points. So even though they examine a bank, they will sort of pick, well, this year we will look at marketing, next year we will look at loans to single family homes, instead of looking at the entire package. There is no way in the world that a decent lender who was trying to do their own internal process would ever set up a set of guidelines like that.

Mr. KUCINICH. Well, this has been a very informative hearing of this Domestic Policy Subcommittee, and I want to thank the members of the panel for their participation.

I want to note, as I did at the beginning of the hearing, that the gentleman from California, the ranking member, Mr. Issa, was called to California because of the very serious matter of the fires in that State and in proximity to his district; and with his generous consent we were able to move forward. Because our rules, unless we have cooperative participation here, it doesn't work. But he made that possible, and I want to thank him and wish the people of California, his constituents, well as they contend with this outbreak of fires.

This is the Domestic Policy Subcommittee of the Oversight and Government Reform Committee. Our hearing today began at 2 o'clock—it is nearing 6 o'clock—on the issue of Upholding the Spirit of the Community Reinvestment Act: Do Community Reinvestment Act Ratings Accurately Reflect Bank Practices.

Our first panel had Ms. Sandra Thompson, who was the Director of the Division of Supervision and Consumer Protection of the Federal Deposit Insurance Corporation; Ms. Sandra Braunstein, who was the Director of the Division of Consumer and Community Affairs Board of Governors of the Federal Reserve System; Ms. Montrice Yakimov, Managing Director for Compliance and Consumer Protection, Office of Thrift Supervision; Ms. Ann Jaedicke, Deputy Comptroller for Compliance Policy, Comptroller of the Currency; and, of course, the distinguished gentlemen who are in front of us, panel II: Calvin Bradford, Board member, National Training and Information Center; Mr. James Carr, chief operating officer, National Community Reinvestment Coalition; Professor Richard Marsico, professor of law, New York Law School, director of the Justice Action Center; and Mr. Hubert Van Tol, director of Economic Justice, Rural Opportunities, Inc.

This has been a very meaningful hearing. I want to thank Congressman Davis and Congressman Cummings for their participation. This committee will continue to delve deeply into this issue and the economic implications for millions of families.

Again, thank you to members of the panel.

This committee is adjourned. And thank the staff, too, very much.

Thank you.

[Whereupon, at 5:52 p.m., the subcommittee was adjourned.

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