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Statement of

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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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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 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, 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 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, 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.