Testimony before the

HOUSE FINANCIAL SERVICES COMMITTEE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

"Rooting Out Discrimination in Mortgage Lending: Using HMDA as a Tool for Fair Housing Enforcement"

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I. Introduction

Good afternoon. Mr. Chairman and Members of the Subcommittee, thank you for this opportunity to discuss discrimination in mortgage lending and tools for fair lending enforcement. My name is Ginny Hamilton, and I am the Executive Director of the Fair Housing Center of Greater Boston. The Fair Housing Center works to eliminate housing discrimination and promote open communities throughout the greater Boston region. We serve the communities of Norfolk, Suffolk, Essex, Middlesex, and Plymouth counties in Eastern Massachusetts. The Fair Housing Center was founded in 1998 with funds from the Boston Foundation and more than 100 charter members. In 1999, we received a grant from the National Fair Housing Alliance (NFHA), which was in turn funded by HUD's Fair Housing Initiative Program (FHIP), to become a full service fair housing center offering: education and training, community outreach, case advocacy, testing, research, and policy advocacy. Today, we receive FHIP funding independently and remain an active member of the National Fair Housing Alliance.

I am here to speak with you today about the ways in which our organization uses Home Mortgage Disclosure Act (HMDA) data and paired testing to document and address housing discrimination in Boston and eastern Massachusetts. Discriminatory lending practices are of particular concern in a region characterized by ongoing segregation, exorbitant housing prices and below national average homeownership rates for African American and Latino families. Currently, HMDA data alone are not sufficient to identify discriminatory practices. We have effectively used data, however, to tell us where to look.

II. Residential Segregation and Mortgage Lending Disparities in Greater Boston

Home Mortgage Disclosure Act (HMDA) data have long shown significant racial/ethnic disparities in mortgage lending. Staff and Board members of the Fair Housing Center of Greater Boston have conducted numerous studies analyzing HMDA data, three of which I wish to highlight here. I have included all three reports as appendices to this written testimony.

Since the mid-1990s, the Massachusetts Community and Banking Council (MCBC), a coalition of banks and community groups, has published annual reports documenting disparities in the lending market. Based on HMDA data, the reports document differences by race in the proportion of loans received, denial rates, and lending to neighborhoods with high proportions of residents of color. [1]

The first series of MCBC reports, entitled *Changing Patterns*, has shown consistently lower rates of lending to borrowers of color both in the city of Boston and throughout Greater Boston. Although there have been improvements in some areas over the sixteen years documented by *Changing Patterns*, lending to borrowers of color continues to lag behind lending to whites. In recent years there has been an increase in the ratio of loans denied to borrowers of color compared with white borrowers.

[1] MCBC was founded by bankers and community groups "to increase the provision of credit and banking services to the low-income and minority communities within the city of Boston." The impetus for its founding was the widely publicized 1989 Federal Reserve study that found large disparities in lending to communities of color. Fair Housing Center Director Ginny Hamilton serves on the board of MCBC and its mortgage lending reports are written by Fair Housing Center Board member Jim Campen.

The most recent report in the series, *Changing Pattern XIII*, shows the following: within 101 municipalities in metro Boston[2], half of home purchase loans made to African American and Latino buyers between 2003 and 2005 were concentrated in just three cities (Boston, Lynn, and Revere.) In contrast, only a fifth of loans made to members of other racial/ethnic groups were made in those municipalities. In particular:

- **Lending to Black borrowers in the Boston metro region was highly concentrated in a small number of municipalities. Boston alone received nearly one-half (46.0%) of the total loans to Blacks, while Randolph and Lynn received another one-sixth (17.2%) of the total.** (Boston received 18.0% of total loans to all borrowers in the region, while Randolph and Lynn received just 4.8% of total loans.) Eight municipalities – Boston, Lynn, Malden, Milton, Medford, Randolph, Stoughton, and Everett – each received over 100 loans to Blacks during the three-year period; these eight municipalities accounted for 77.4% of loans to Blacks in the Boston metro region, while they received just 29.0% of total loans.
- **In eight municipalities – Carlisle, Gloucester, Hamilton, Manchester-by-the-Sea, Nahant, Sherborn, Stow, and Wenham – not a single home-purchase loan was made to a Black borrower during the three-year period.** In 54 of the 101 Boston Metro municipalities Blacks received 1.0% or less of total loans, and in 23 additional municipalities the Black loan shares were between 1.0% and 2.0%.
- **Lending to Latino borrowers in the Boston metro Region was highly concentrated in a small number of municipalities, although less concentrated than lending to Blacks. Just two cities – Boston and Lynn – received 37.7% of all loans to Latinos** (they received 21.5% of total loans to all borrowers). Six municipalities – Boston, Chelsea, Everett, Framingham, Lynn, and Revere – each received over 400 loans to Latinos during the three-year period; these six municipalities accounted for 63.0% of all loans to Latinos, while receiving just 27.6% of total loans.
- **In three municipalities – Essex, Hamilton, and Nahant – not a single home-purchase loan was made to a Latino borrower during the three-year period.** In 25 of the 101 municipalities in the Boston metro region Latinos received 1.0% or less of total loans, and in 29 additional municipalities the Latino loan shares were between 1.0% and 2.0%.

The second series of MCBC studies, *Borrowing Trouble (I-VII)*, looks specifically at the rapidly growing sub-prime lending market. Again, the studies document that a disproportionately large percentage of these High APR Loans (referred to as HALs) go to African Americans and Latinos, even to those with higher incomes. Moreover, the pattern spilled over into neighborhoods, with sub-prime lending rising in neighborhoods containing larger populations of color and the same trends occurring in suburban towns and satellite cities as in the city of Boston itself.

- Black and Latino borrowers in Boston, in Greater Boston, and statewide were much more likely to receive HALs than were their white or Asian counterparts. **In Greater Boston, the HAL share for Blacks was 3.8 times greater than the HAL share for whites in the case of *home-purchase* lending (57.1% vs. 14.9%), and 3.0 times greater for *refinance***

[2] In *Changing Patterns*, the Boston metro region is defined as the 101 municipalities in the Metropolitan Area Planning Council region.

lending (31.3% vs. 10.4%), while the corresponding Latino/white disparity ratios were 3.9 and 2.7.

- When borrowers are grouped by both race/ethnicity and income level, the HAL loan shares for Blacks and Latinos are always substantially higher than the HAL shares for white borrowers in the same income category. Furthermore, the disparities in HAL shares tend to increase as the income level increases. **In Boston in 2005, highest-income Blacks received 71.1% of their *home-purchase* loans in the form of HALs and the HAL share for highest-income Latinos was 56.2%, while the HAL loan share was 9.4% for highest-income whites.** That is, for *home-purchase* loans, the HAL shares for highest-income Blacks and Latinos were, respectively, 7.6 times and 6.0 times greater than the HAL share for highest-income whites. In Boston in 2005, highest-income borrowers were those with incomes of over $152,000.
- In the city of Boston, the concentration of high-APR lending is greatest in the predominantly-minority census tracts (all of these tracts are low- or moderate-income). **For *home-purchase* loans in Boston, the HAL shares for low-income and moderate-income predominantly-minority tracts were, respectively, 7.2 times and 9.2 times higher than the HAL share in upper-income predominantly white tracts.** For *refinance* loans, the HAL shares for low-income and moderate-income predominantly-minority tracts were 7.7 times and 6.5 times higher than the HAL share in upper-income predominantly-white tracts.
- The shares of total loans that were accounted for by high-APR loans varied dramatically among Boston's major neighborhoods. For *home-purchase* loans, the 58.0% HAL share in Mattapan was twelve times greater than the 4.7% share in Charlestown. For *refinance* loans, the 36.8% HAL share in Roxbury was thirteen times greater than the 2.8% HAL share in the Back Bay/Beacon Hill neighborhood. **The four Boston neighborhoods with the highest percentages of minority residents – Mattapan, Roxbury, Dorchester, and Hyde Park – also had the four highest HAL shares for both *home-purchase* and *refinance* lending, ranging from 27.2% to 58.0%; meanwhile, in the four neighborhoods with fewer than 25% minority residents – Back Bay/Beacon Hill, South Boston, West Roxbury, and Charlestown – the HAL shares were between 2.8% and 14.6%.**
- Among the 101 communities in Greater Boston, **the five communities with the highest shares of HALs in 2005 had an average of 21.5% Black plus Latino households and an average MFI of $47,022, while the five communities with the lowest HAL shares had an average of 2.5% Black plus Latino households and an average MFI of $135,194**. (The high HAL-share communities are Everett, Revere, Chelsea, Lynn, and Randolph; the low HAL-share communities are Carlisle, Needham, Dover, Weston, and Lincoln.)
- Considering the seven largest Massachusetts cities outside Greater Boston, t**he totals of the HAL shares for home-purchase and refinance loans in Lawrence (HAL shares of 67.5% for home-purchase loans and 39.0% for refinance loans), Springfield (54.0% and 39.7%), and Brockton (58.5% and 33.1%) were all higher than the total HAL shares in any community in Greater Boston.** Lawrence, Springfield, and Brockton rank first, third, and fifth among Massachusetts communities in percentage of Black plus Latino households (Chelsea and Boston rank second and fourth).
- **The three biggest overall lenders in Boston** (the only three lenders with over nine hundred total loans in the city) **each had substantial disparity ratios for their high-APR lending.**

> **The Black/white disparity ratios were 3.5 at Countrywide** (30.6% vs. 8.8%), **6.1 at Wells Fargo** (26.4% vs. 4.4%), **and 3.8 at Washington Mutual/Long Beach** (36.6% vs. 9.7%). **The Latino/white disparity ratios at these same three lenders were 1.2, 4.3, and 5.4, respectively.**

More than Money, the third study I want to highlight, shows that **racial disparities in mortgage lending cannot be explained by affordability alone.** In 2003, Fair Housing Center Director David Harris co-authored a study with Nancy McArdle of the Harvard Civil Rights Project to test the common explanation that people of color simply cannot afford to buy homes in our suburbs. The paper analyzed census data on homeownership and HMDA data on recent mortgages to determine the extent to which the region's ongoing segregation can be explained by a disparity in the values/prices of homes people of color own and those owned by whites. **In 80 percent of cities and towns, the number of African American and Latino homebuyers was less than half what would be predicted based on affordability alone.**

While there can be no denying that high housing costs are limiting options for many residents, this analysis of HMDA data shows that affordability alone does not explain these discrepancies. Most strikingly, African Americans and Latinos, who could afford to buy in a wide range of more outlying suburban communities, are concentrating in Boston, certain inner suburbs, and certain satellite cities, often the same places experiencing the largest declines in white homeowners. The study found that this simple notion of "affordability" does not explain the ongoing and frequently documented patterns of racial concentration and segregation.

The data presented in these studies are strongly suggestive of lending *discrimination*, but the information currently included in HMDA data is not sufficient to prove that discrimination contributes to the observed disparities. This is why the Fair Housing Center conducts targeted lending discrimination testing (described below) to root out actual discrimination. Lenders regularly call attention to the limited nature of the information included in HMDA data which lacks, for example, such relevant details as the credit history/score of the borrower, and the size of the loan in relationship to the price/value of the home (loan-to-value ratio or LTV). We agree with the industry on the value of including such additional information.

This leads to my <u>first set of recommendations</u>: enhanced HMDA data.

- HMDA data collection should be enhanced to include the identification of loans processed through mortgage brokers, as well as to defining separate high cost benchmarks for fixed rate and adjustable rate mortgages, loan-to-value ratio; factors used to measure borrower credit worthiness (such as credit score), and the total fees as a separate item.
- Federal regulators should work with civil rights and consumer organizations to determine new HMDA data classifications that reflect the complexity of brokered loans. These loans often involve counter-offers which are technically a rejection but which may, in some cases represent a better product or terms for the consumer.

III. Statistical Evidence of Lending Discrimination

These changes to HMDA data would aid efforts to identify potential instances of lending discrimination. However, it is not necessary to await such data in order to conclude that lending discrimination occurs. Indeed, a study published by the Federal Reserve Bank of Boston in 1992 showed that the serious disparities between the loan denial rates of borrowers of color and white borrowers in Greater Boston reflected racial discrimination by lenders as well as other factors.[3]

In May 2006, the Center for Responsible Lending released *Unfair Lending: The Effect of Race and Ethnicity on the Price of Sub-prime Mortgages*. The authors matched records from HMDA data with records from a large proprietary database of sub-prime loans to so that the info available for each borrower included race/ethnicity; credit score; loan-to-value ratio; existence of prepayment penalties; and whether the loan was fixed- or adjustable-rate. Both simple cross tabulation and more sophisticated multiple regression analysis showed that, other things equal, Black and Latino borrowers were substantially more likely to receive higher-cost loans than white borrowers.[4]

Also in 2006, then-NY Attorney General Eliot Spitzer's settlement with Countrywide Home Loans indicates the Attorney General found evidence of higher prime loan pricing for African Americans and Latinos than for white borrowers who were equally risky. This agreement is found on line at: www.oag.state.ny.us/press/2006/dec/Countrywide%20Assurance%20Final%20Signed%20PDF.pdf [The specific finding referenced here is paragraph #2.4 on page 3.]

IV. Testing for Discrimination

Findings from HMDA data, however strong and however suggestive, are regularly dismissed as not conclusive proof of racial/ethnic discrimination. More complex statistical evidence, however carefully found, is often based on statistical techniques too complicated to be readily understood by the average person, and the industry has never failed to find experts who will, for a fee, dispute the validity of any conclusion that it didn't like. Nevertheless, there is one type of evidence of discrimination that is clear and convincing – and that is paired testing.

Testing is a controlled method of measuring and documenting variations in the quality, quantity and content of information and services offered or given to various home seekers by housing providers. Quite simply, a test is designed to reveal differences in treatment and to isolate the causes of these differences by controlling for the desired factor. HUD's regulations to the federal Fair Housing Act read: "A person who receives the inaccurate or untrue information need not be an actual seeker of housing in order to be the victim of a discriminatory housing practice…." (24 CFR Part 14 et al. Implementation of the Fair Housing Amendments Act of 1988; Final Rule. Section 100.80.) The U.S. Supreme Court has also recognized testing as a tool to uncover housing discrimination. See *Havens Realty Corp v. Coleman*, 455 U.S. 363, 373-374 (1982).

A proven means for discovering the presence of discrimination, testing has become commonly accepted practice in several arenas. For fair housing enforcement purposes, the Department of Justice has its own testing program and the Department of Housing and Urban Development approves testing by fair housing organizations nationwide. Also, many corporations use "shopping services" to test a competitor's products as well as the performance of their own employees.

[3] Federal Reserve Bank of Boston *Mortgage Lending in Boston: Interpreting HMDA Data* originally published in 1992, revised version in American Economic Review in 1996

[4] Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages. Center for Responsible Lending. Debbie Gruenstien bocian, Keith S. Ernst, and Wei Li. May 31, 2006. www.responsiblelending.org

Testing is carried out by qualified fair housing organizations such as ours, both to provide systematic assessment of discrimination in the market and to investigate individual claims of discrimination. Fair housing organizations have a non-profit 501(c)3 status, so employees do not receive increases in salary or gifts as a result of any compensation that a victim of discrimination might receive after a settlement. Any claims or compensation for an occupant or applicant who has been the victim of discrimination goes to the complainant. Fair housing centers may also receive funds through a settlement or lawsuit, which is most often used to educate members of the community about their rights, or to put on a fair housing campaign.

V. Evidence of Lending Discrimination in Greater Boston

Since 2001, testing conducted by the Fair Housing Center of Greater Boston has shown that African Americans and Latinos experience discrimination in approximately half of their attempts to rent, purchase, or finance homes in the greater Boston region. Our testing data adds to a large body of evidence of housing discrimination from paired testing of providers of rental housing, from paired testing of real estate brokers who deal with potential home buyers, and from paired testing of mortgage lenders by seekers of home loans. (The amount of evidence is progressively smaller in each case because carrying out the tests is progressively more complex and expensive.)

Several national studies have presented evidence of racial and ethnic discrimination from paired testing of mortgage lenders. In the mid-1990s, NFHA conducted fair lending investigations that revealed discrimination based on race or national origin in two-thirds of almost 600 tests conducted in eight cities, including Boston. In two-thirds of the tests, whites were favored over African Americans and Latinos; in only 3 percent of the tests, African American and Latino testers were favored over white testers. In all cases, the African American and Latino testers were better qualified for the loans than their white counterparts.

Two more recent studies used testing to look at discriminatory treatment in the pre-application phase, and discriminatory behavior by mortgage brokers. The first was released in April 2002, the Urban Institute, *All Other Things Being Equal: A Paired Testing Study of Mortgage Lending Institutions*. The second, *Fair Lending Disparities: Stubborn and Persistent* was released in May 2006 by the National Community Reinvestment Coalition.

In May 2006, the Fair Housing Center of Greater Boston released our own mortgage testing audit report, *The Gap Persists: A Report on Racial and Ethnic Discrimination in the Greater Boston Home Mortgage Lending Market*. The rest of this section is a summary of that report.

During the four months from October 2005 to January 2006, the Fair Housing Center conducted an investigation to determine the extent and nature of discrimination by mortgage lenders in Greater Boston. The Fair Housing Center used trained volunteers to call and visit banks and mortgage offices and to report in detail on their experiences. Overall, the Fair Housing Center found differences in treatment which disadvantaged the homebuyer of color in nine of the twenty matched paired tests conducted, or 45 percent. In seven of these tests the differences in treatment were clearly large enough to form the basis for legal action, while the evidence in the remaining two tests may or may not have risen to that level. The chart below breaks down these test results by several different variables.

	Tests Conducted	Tests Showing Evidence of Discrimination	Percent of Tests that Show Evidence of Discrimination
All tests	20	9	45%
Good Credit	10	4	40%
Mediocre Credit	10	5	50%
African American/white pair	10	5	50%
Asian/white pair	4	2	50%
Latino/white pair	5	2	40%
Caribbean/white pair	1	0	0%

In all tests, the tester of color was better qualified than the white tester. Four of the tests with differences in treatment were conducted by pairs of testers with good credit scores, and five were done by pairs with mediocre credit scores. Of the ten tests pairing white and African American testers, there were five test pairs where the African American tester received disadvantageous treatment. Of the four Asian tests pairing with white tester, two showed evidence of discrimination. There were five tests pairing Latino and white testers, and in two the lender advantaged the white tester over the Latino tester. The one test pairing a Caribbean and white tester did not show evidence of discrimination. Summaries of each of the nine tests showing differences are provided in the full report.

Selection of Sites

Fair Housing Center staff worked with staff of the Massachusetts Affordable Housing Alliance (MAHA[5]) to discuss selection of sites and test methodology. MAHA provided the Fair Housing Center with the names of the 25 mortgage lenders that do the highest volume of lending in Boston. To this list, the Fair Housing Center added several companies who do a high volume of business in greater Boston and are reputed to have very low customer satisfaction rates. From this combined list, the Fair Housing Center tested ten banks and ten mortgage lending companies with offices located throughout Greater Boston.

Test Design

Fair Housing Center staff members provide all testers with HUD-approved standardized training that emphasizes the role of testers as objective fact finders. The Fair Housing Center paired testers and assigned both members of the pair near-identical incomes, credit ratings, and housing search locations, so that the major difference between the paired testers was the race or ethnicity of the loan seeker. Testers of color were assigned slightly higher credit scores and incomes, and

[5] The Massachusetts Affordable Housing Alliance (MAHA) is a statewide nonprofit group that works to encourage local and state government and businesses to invest more money in affordable housing. Known for their award winning homebuyer classes for consumers, MAHA also conducts research and organizes tenants and homeowners in support of affordable housing. www.mahahome.org

slightly lower debt compared to their white counterparts, such that in a discrimination-free environment, the tester of color would be slightly better qualified for the home loan.

From October 2005 to January 2006, the Fair Housing Center conducted twenty matched pair site visit tests for discrimination against African American, Latino, Asian, Caribbean loan seekers. The audit was designed for each tester to have similar experiences, with every effort to have testers contact the same person. During each test, the testers requested that the mortgage provider give them any information or quotes available but were instructed not to pursue the full application process. All testers inquired about a $475,000 mortgage with $25,000 down payment.

In MAHA's experience with first time homebuyers, homebuyers of color with mediocre credit are often turned away by mortgage providers, while the companies attempt to work with white homebuyers with similar credit to find ways to provide the loans. The Fair Housing Center sought to gather evidence as to whether such differences are occurring and therefore decided to include two levels of credit ratings. Ten pairs of testers had good credit, with assigned credit scores of approximately 750. Ten pairs of testers had mediocre credit, with assigned credit scores of approximately 650.

<u>Test Implications</u>

The results of this investigation are disturbing and reveal inconsistencies in the treatment of and services provided to testers of color when compared directly to white testers, including discouraging statements, higher quotes, or worse treatment of the tester of color or encouraging statements, lower quotes, or better treatment for the white tester. These differences serve to disadvantage loan seekers of color and advantage white loan seekers. The testing process directly reflects reality insofar as neither testers of color nor white testers were aware of their relative (dis)advantages. As in previous Fair Housing Center audits, no individuals were targets of outright hostility or subjected to overt discrimination.

A troubling finding of this investigation is that discriminatory behavior, often subtle, takes place from the beginning of the lending process. All the tests were pre-application phase, and loan seekers of color were still disadvantaged in 45 percent of the tests. There is reason to believe, from other sources, that discrimination also happens at later stages of securing a mortgage loan. Common reports of "bait and switch" tactics suggest that borrowers who initially receive good treatment and attractive terms from the lenders will receive different terms at or near their closing. According to MAHA, many of their clients, most of whom are African American, experience just such treatment toward the end of the loan process.

Our investigation shows that lenders frequently give white loan seekers more information than loan seekers of color, creating a gap between white people's financial literacy and that of people of color. **In seven of the twenty tests conducted in this investigation, the white loan seeker received substantially more information from the lender** about different types of loans, either verbally or in writing (and often both), than the loan seeker of color, and not once did the person of color receive more information than his or her white counterpart. When a lender takes the time to describe the advantages and disadvantages of different loans, the loan seeker becomes an educated consumer. That loan seeker is now equipped with knowledge that will allow him or her to choose the right loan type and negotiate with lenders in the future. In contrast, when a lender simply tells a loan seeker "this is the loan for you, and it costs this much," the loan seeker has not gained any insight into how to choose the right loan or get a good interest rate. **Our**

investigation shows that it is not just the lender's style that determines how much information a home seeker receives, in too many cases it is the color of the loan seeker's skin.

In four out of twenty tests, the lender contacted the white tester after their meeting to follow up, but did not contact the tester of color. Follow up comes in different forms, including additional information about loan products, a suggestion to pursue a loan with that lender, or a simple thank you card for the meeting. All of these sorts of contact send a message that the lender wants the loan seeker as a client. No lender in our study followed up with the tester of color and not with the white tester.

In five out of twenty tests, the white tester was offered a discount on closing costs which was not offered to the tester of color, or was quoted a substantially lower closing cost than the tester of color. The differences ranged from $500 to $3,600. We cannot assume that these preliminary numbers accurately reflect the final closing costs had our testers truly applied for a loan. However, at the first stages of shopping for a mortgage, quotes with high closing costs can discourage home seekers of color from pursuing home ownership at all. And lenders know that closing costs are a big factor in consumers' choice of lenders; that is why they offer specials like certificates for money off closing fees. If such specials are made available to white loan seekers but not loan seekers of color, the lender is pursuing white customers while allowing non-white potential customers to walk away.

One of the most consistent aspects of all these tests was that there was not one single instance in which a tester of color was subjected to overt discrimination. This simple fact underscores the need for and benefit of testing as a means of gauging discrimination in general, but particularly in a lending industry characterized by such large differences in outcomes.

My <u>second set of recommendations</u> concerns expanded sponsorship and use of paired testing in fair lending enforcement.

- Federal government agencies and bank regulators should make much more aggressive and extensive use of paired testing in their own enforcement activities and investigations by contracting and working directly with qualified fair housing enforcement organizations.
- Federal government agencies and bank regulators should also support qualified fair housing organizations in carrying out greatly expanded paired testing.
- Congress and federal agencies should provide an exemption to qualified fair housing organizations to allow mortgage lending testing beyond the pre-application phase of the mortgage lending process to enforce civil rights and anti-predatory lending laws. As mentioned above, discrimination occurs in every step of the loan process, but private groups are not currently able to test beyond pre-application because of form restrictions.

V. Federal Regulators Do Not Sufficiently Oversee and Enforce Fair Lending Laws

Private lawsuits have historically been important to the effort to eliminate lending discrimination. Currently, most fair lending cases are brought by private fair housing organizations and individual attorneys. While these private efforts are very important, the full engagement of the responsible federal government agencies is an essential component of any serious effort to combat lending discrimination in all of its many, evolving forms.

Private organizations do not have the resources needed to undertake investigation, analysis and litigation of fair lending violations on a routine basis. This requires review and analysis of a wide range of documents related to marketing practices, underwriting and loan servicing policies, confidential personal data from actual loan files, and a variety of other information that lenders deem proprietary. While fair housing organizations provide a vital service in conducting testing and research activities to uncover fair lending violations, for both policy and practical reasons, the federal government must be an integral partner in fair lending enforcement efforts.

Lending disparities occur not only between individuals, but between neighborhoods and communities divided along racial lines. African American and Latino that have traditionally not had access to main stream and prime lenders. One mechanism by which racially disparate outcomes are generated is by branch location and/or marketing efforts that lead a corporation's Black and Latino borrowers to obtain loans primarily from a high-cost sub-prime affiliate while its white borrowers obtain their loans primarily from a low-cost prime lending affiliate. Traditional fair lending exams might determine that each of the two affiliates treats all its applicants fairly, even though the overall corporation's lending is highly unfair.

From a fair lending perspective, when examining a lending institution that makes both prime and sub-prime loans, it is critical to review the institution's marketing and application procedures to ensure that all applicants have equal access to all reasonable products for which they qualify. It is also critical to look at the lenders distribution system. Does the lender have retail brick and mortar operations in predominately white, suburban communities while not having brick and mortar retail operations in predominately African American and Latino neighborhoods? Does the lender, when considering its entire books of business, rely on mortgage brokers as its primary originators in predominately African American and Latino neighborhoods?

If the government fails to pursue such cases or does not engage in a competent effort to uncover lending discrimination by the lenders under its authority, then most lending discrimination will go unchecked. Indeed for the entire history of our country, it has. Lack of forceful federal enforcement actually provides a form of safe harbor for those in the industry engaging in discriminatory practices.

The federal agencies that regulate insured depository institutions, particularly the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the Federal Reserve Board (Fed), have the authority to conduct an effective process for fair lending examinations; however, their record of enforcement falls short of the mark and has not been effective at eliminating discrimination in the mortgage market. Disclosure is a valuable tool for the evaluation of lending practices, but it cannot replace forceful and effective enforcement activities undertaken by federal agencies. Financial regulatory agencies have referred some lending discrimination cases to the Department of Justice for enforcement actions; however, they are few in number.

Currently, no federal agency regulates independent mortgage companies for fair lending compliance. Yet, as testing shows, discrimination is as at least as common in these institutions as in regulated banks. To help alleviate the problems in the subprime market, the Federal Reserve should exercise its discretion as the agency with rule-making authority under the Home Ownership and Equity Protection Act (HOEPA) to limit the use of subprime exploding ARM mortgages. HOEPA provides broad authority to prohibit unfair or deceptive mortgage lending practices and to address abusive refinancing practices on all mortgage loans, not only high-cost loans; [6] however, the Federal Reserve has never exercised this authority. By issuing a regulation under HOEPA, the Federal Reserve would ensure that all subprime mortgage loans in the country were subject to the same rules.

HUD, as the lead enforcement agency under the Fair Housing Act and the administrator of the Federal Housing Administration, has the authority to initiate investigations and enforcement actions. However, it has undertaken very little fair lending enforcement activity. Assistant Secretary Kim Kendrick has made a commitment to improving enforcement efforts at HUD and to reinvigorating the Secretary-initiated complaint process. HUD's recently established fair lending enforcement office is a step in the right direction. It is my understanding that the New England Regional office has been unofficially playing this role, handing fair lending cases from around the country. This new program should be appropriately resourced and compelled to proactively investigate fair lending violations.

During the 1990s, the Department of Justice was a leader among government agencies in fair lending enforcement. These DOJ investigations set in operation a process by which both HUD and the financial regulatory agencies could refer pattern and practice cases to DOJ for investigation and litigation. These cases set out legal strategies and formats for investigation and litigation in a wide range of lending issues from redlining to retail and wholesale pricing. Historically, the decade of the 1990s can be seen as the high point in federal enforcement efforts. There is little sign of enforcement activity in this decade.

The Federal Trade Commission has authority over non-regulated lenders under the Equal Credit Opportunity Act (ECOA), but it has pursued almost no lending discrimination cases, although the FTC had an enforcement plan as far back as 1978 (See Discrimination in Real Estate Finance: The Role of the FTC Enforcement – A Report to the Federal Trade Commission, Pottinger and Company, 1978).

It should be clear by now that racial/ethnic discrimination in mortgage lending exists and is a serious problem. If and when regulators make a serious attempt to find racial/ethnic discrimination in lending, they can and will find it, as at the Boston Fed more than a decade ago and at the New York Attorney General's office more recently. We at the Fair Housing Center, and my colleagues at the National Fair Housing Alliance, believe it is shameful that the four bank regulators (OCC, OTS, FDIC, and the Fed) and the other regulatory agencies charged with enforcing the nation's fair housing laws (HUD, DOJ, FTC) have made such minimal and half-hearted efforts to identify and reduce racial/ethnic discrimination in mortgage lending.

These leads to my <u>third set of recommendations: The federal agencies and regulators tasked with fair housing and fair lending oversight must expand their fair lending enforcement efforts.</u> These agencies need assistance from both Congress, in the form of appropriations to fund these initiatives such as HUD's newly mortgage discrimination investigation unit, and from the

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[6] (l) DISCRETIONARY REGULATORY AUTHORITY OF BOARD.--

(2) PROHIBITIONS.--The Board, by regulation or order, shall prohibit acts or practices in connection with--

(A) mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section; and

(B) refinancing of mortgage loans that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower." 15 USC Section 1639(l)(2).

Administration, in the form of political will. The following are additional recommendations that Congress should implement and/or oversee.

Fair Housing: Increased Appropriations and New Legislation

- Congress should allocate at least $26 million to HUD's Fair Housing Initiatives Program in order to facilitate increased education and enforcement efforts on the part of local fair housing organizations. Additional funding should be provided for for qualified fair housing organizations to conduct activities specifically addressing fair lending issues.
- Congress should support and pass the Housing Fairness Act of 2007 (H.R. 2926) that contains the following provisions: doubling the authorization level for HUD's Fair Housing Initiatives Program to $52 million; a commitment of at least $20 million annually for fair lending and fair housing enforcement testing and actions; a commitment of at least $5 million annually to fund studies of the effects of housing segregation on our nation's communities. Representative Al Green and 44 other members of Congress currently co-sponsor this bill. The companion bill S. 1733 has been proposed in the Senate.

Aggressive Fair Lending Oversight and Enforcement

- Congress should require federal government agencies, including HUD, DOJ, and the FTC, to undertake more aggressive, effective and expansive fair lending enforcement activities. These agencies should consult with experts in fair lending enforcement organizations so that the federal examination and enforcement programs reflect best practices and state of the art investigation techniques and litigation strategies.
- Congress should require that HUD improve the quality of its training programs to increase the capacity of its investigators and Fair Housing Assistance Program (FHAP) investigators to investigate lending complaints.
- Congress should require that federal agencies that regulate insured depository institutions, particularly the OCC, the FDIC, the OTS, and the Fed, use their authority to undertake stronger oversight and enforcement activities to eliminate discrimination from the mortgage market. They should also re-examine their use of HMDA data to assure maximum coverage of potential fair lending violations. Any cases that regulators resolve with lenders on behalf of a few consumers should also be referred to DOJ for a pattern and practice investigation.
- Congress should ask the Fed for a status report on the 270 institutions that it flagged in 2005 and 2006 for additional investigation because of their pricing data and other issues.
- Congress should move to regulate all financial institutions active in lending. To fill the vacuum of fair lending enforcement activity for non-depository institutions, the Fed should use its authority to ensure that these institutions are in compliance with the fair lending laws. If this authority is lacking, Congress should grant the needed authority.

Changes Regulators Must Implement

- Regulators need to examine lending corporations as a whole, reviewing data from retail and wholesale divisions as well as prime and sub-prime divisions together. Traditional fair lending exams might determine that each of the two affiliates treats all its applicants fairly, even though the overall corporation's lending is highly unfair.

- Regulators should contract with private, qualified fair housing organizations to conduct comprehensive testing programs.
- Regulators need to run regression analyses on lender portfolios looking at origination, pricing, point of origination, costs, pre-payment penalty, and yield spread premium issues stratified by key protected class characteristics. Regulators are in a unique position to do this as they have access to full records and data.

Enhance HMDA Data.

- HMDA data collection should be enhanced to include the identification of loans processed through mortgage brokers, as well as to defining separate high cost benchmarks for fixed rate and adjustable rate mortgages, loan-to-value ratio; factors used to measure borrower credit worthiness (such as credit score), and the total fees as a separate item.
- Federal regulators should work with civil rights and consumer organizations to determine new HMDA data classifications that reflect the complexity of brokered loans. These loans often involve counter-offers which are technically a rejection but which may, in some cases represent a better product or terms for the consumer.

Expand Sponsorship and Use of Paired Testing in Fair Lending Enforcement.

- Federal government agencies and bank regulators should make much more aggressive and extensive use of paired testing in their own enforcement activities and investigations by contracting and working directly with qualified fair housing enforcement organizations.
- Federal government agencies and bank regulators should also support qualified fair housing organizations in carrying out greatly expanded paired testing.
- Congress and federal agencies should provide an exemption to qualified fair housing organizations to allow mortgage lending testing beyond the pre-application phase of the mortgage lending process to enforce civil rights and anti-predatory lending laws. As mentioned above, discrimination occurs in every step of the loan process, but private groups are not currently able to test beyond pre-application because of form restrictions.

Thank you once again for the opportunity to testify before this Committee. I am available to answer any questions and assist in any way that we can to assure that this Committee, Congress and the government as a whole fulfill their duties to enforce fair lending nationwide.

Attachments to this testimony:

The Gap Persists: Racial and Ethnic Discrimination in the Greater Boston Home Mortgage Lending Market. The Fair Housing Center of Greater Boston, May 2006. www.bostonfairhousing.org/publications.htm

More than Money: The Spatial Mismatch Between Where Homeowners of Color in Metro Boston Can Afford to Live and Where They Actually Reside, by David J. Harris of the Fair Housing Center of Greater Boston and Nancy McArdle of the Civil Rights Project of Harvard University. January 2004. www.bostonfairhousing.org/publications.htm

Changing Patterns XVIII: Mortgage Lending to Traditionally Underserved Borrowers & Neighborhoods in Greater Boston, 1990 – 2005 by Jim Campen for the Massachusetts Community and Banking Council, November 2006. www.masscommunityandbanking.org

Borrowing Trouble VII: High-Cost Mortgage Lending in Greater Boston, 2005 by Jim Campen for the Massachusetts Community and Banking Council, January 2007. www.masscommunityandbanking.org

National Fair Housing Alliance, *The Crisis of Housing Segregation: 2007 Fair Housing Trends Report,* April 30, 2007