NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

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

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Introduction and Executive Summary

Good afternoon, Chairman Watt and Ranking Minority Member Miller, I thank you for the honor and opportunity to present testimony today on behalf of the National Community Reinvestment Coalition (NCRC) on this important topic. NCRC is the nation's economic justice trade association of 600 member organizations dedicated to increasing access to capital and credit for working class and minority communities.

Over the years, the federal regulatory agencies have succeeded in preserving the profitability and vitality of one of the world's most enviable banking systems. Their oversight in this regard is to be commended. The regulatory agencies, however, have not devoted an equal amount of effort to protect financially vulnerable consumers and homebuyers.

The objective of regulatory oversight must be to create or promote healthy and competitive markets for all consumers, regardless of color, income, age, or gender. We have a saying at NCRC that we strive to make "capitalism" work in all communities. In line with this saying, we believe the nation's regulators must ensure that responsible lenders are competing vigorously and offering a high degree of product choice in all communities.

Unfortunately, the reality in our country remains one of a dual lending marketplace in which white and affluent communities enjoy a wide range of product choice while minority and working class communities are stuck with the high-cost home mortgage lenders, the check cashers, the payday outlets, and the car title lenders. It is unfortunate that the nation's most financially vulnerable and fragile consumers receive starkly inferior access to mainstream financial services and regulatory protection that could help them better leverage their limited resources and improve their financial wellbeing.

HMDA data has been a vital tool over the years not only for enforcement activities of the federal agencies but also the fair lending enforcement carried out by nonprofit community-based organizations. Markets work best when they are transparent; when information on prices and treatment of consumers is clear and publicly available. By removing the veil of secrecy and shinning a public spotlight on financial institutions' lending activities, HMDA data has reduced the amount of discrimination and abuse in the marketplace. Yet, as powerful as HMDA data has been in the efforts to stop discrimination, the full potential of HMDA has not been realized because key data elements remain missing from HMDA data.

NCRC's testimony will describe in detail how fair lending and consumer protection regulation has failed adequately to protect consumers. The federal agencies have taken some important and initial steps this year, but the fair lending and consumer protection regulatory infrastructure remains incomplete. In the face of unprecedented regulatory failure, resulting in potentially more than two million foreclosures and the loss of more than a hundred billion dollars of consumer housing wealth, only modest additional enforcement efforts are even beginning to take shape.

Last year, the House Financial Services Committee had a hearing on HMDA and regulatory oversight. We are pleased that you are holding this important hearing again this year and hope that these hearings lead to concerted action since we are facing a predatory lending crisis. In 2006, there were more than 1 million families in foreclosure and this year, there are already more than 925,000 families in foreclosure.

The Dual Lending Marketplace

A looming foreclosure crisis confronts America as lending institutions have engaged in new forms of dangerous high-cost lending. As this committee knows, most of the high-cost or subprime lending made in recent years feature adjustable rate mortgages (ARMs) with low “teaser” rates for the first few years followed by rapidly rising rates. Incredibly, many lenders assessed borrowers’ abilities to repay only at the low teaser rates. These loose underwriting standards have created the conditions for a perfect storm as almost 2 million of the ARM loans will re-set or start adjusting upward from their initial rates in 2007 and 2008.[1]

A particularly disturbing aspect of this lending is the fact that a disproporationate share of it has fallen on the backs of many of the most financially vulnerable households: modest income and minority families. NCRC released a report this month entitled *Income is No Shield Against Racial Differences in Lending.* Using HMDA data from 2005 (the most recent year available for industry-wide data), NCRC observes striking racial disparities in high-cost lending. If a consumer is a minority, particularly an African-American or a Hispanic, the consumer is most at risk of receiving a poorly underwritten high-cost loan.

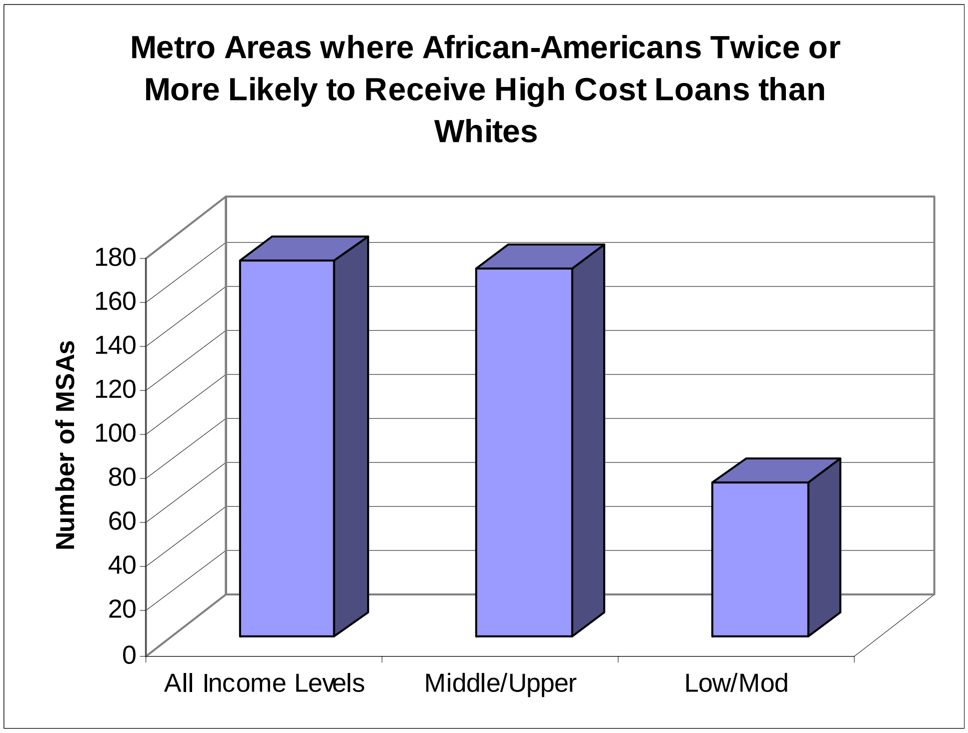
Middle-class or upper-class status does not shield minorities from receiving dangerous high-cost loans. In fact, NCRC observes that racial differences in lending increase as income levels increase. In other words, middle- and upper-income (MUI) minorities are more likely relative to their MUI white counterparts to receive high-cost loans than low- and moderate-income (LMI) minorities are relative to LMI whites. Mainstream media has carried hundreds of articles on the predatory lending debacle facing the country – some of which have focused on the disproportionate impact of the crisis on middle-income minority consumers. The Wall Street Journal, for example, recently wrote a poignant and detailed article describing widespread foreclosures due to predatory lending in Detroit’s middle-income African-American communities.[2]

[1] “Regulators are Pressed to Take Tougher Stand on Mortgages,” by Gregg Hitt and James R. Hagerty, Wall Street Journal, March 23, 2007

[2] Mark Whitehouse, “A Day of Reckoning Subprime Aftermath: Losing the Family Home – Mortgages Bolstered Detroit’s Middle Class Until Money Ran Out,” Wall Street Journal, May 30, 2007, page A1.

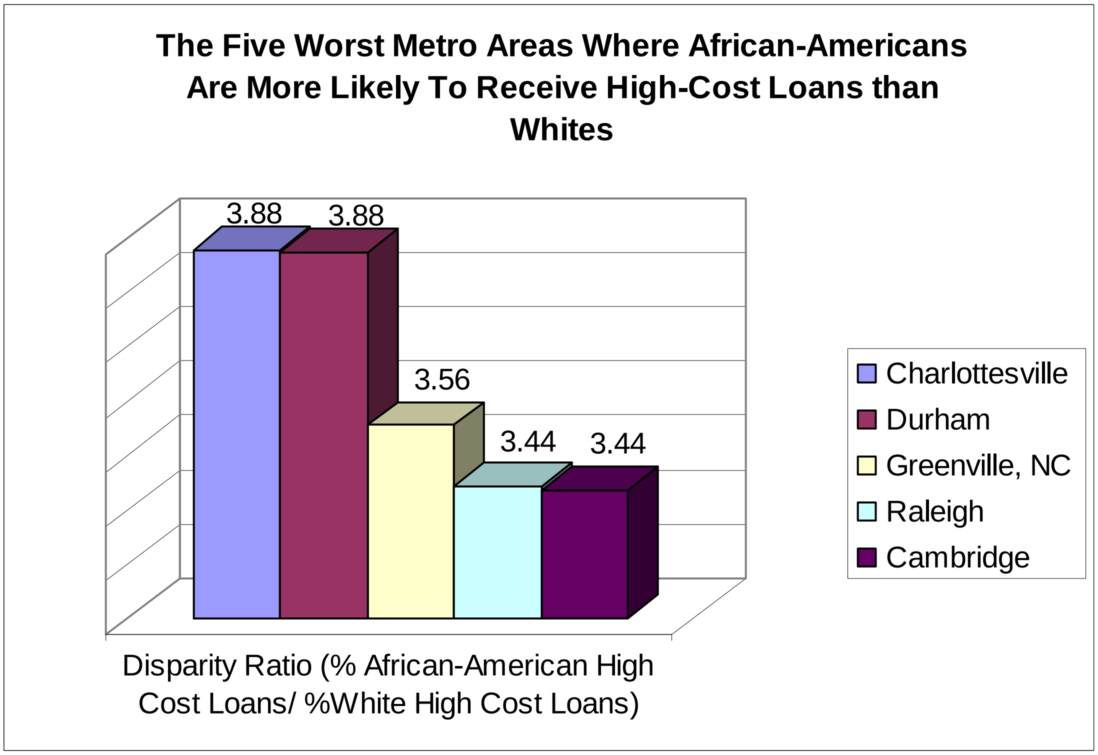
NCRC has consistently maintained the position that responsible high-cost lending serves legitimate credit needs.   Higher-cost loans compensate lenders for the added risk of lending to borrowers with credit imperfections.   However, wide differences in lending by race, even when accounting for income levels and credit quality, suggests that more minorities are receiving high-cost loans than is justified based on financial criteria. Previous studies by NCRC and others suggest that minorities are, in fact, receiving a disproportionately large amount of high-cost loans, after controlling for creditworthiness and other housing market factors. When minorities receive a disproportionate amount of high-cost loans, they lose substantial amounts of equity through higher payments to their lenders. In addition, they are more exposed to irresponsibly underwritten ARM loans.

The lending disparities for African-Americans were large and increased significantly as income levels increased. In the *Income is No Shield* report, we found that African-Americans of all income levels were twice as likely or more than twice as likely to receive high-cost loans as whites in 171 metropolitan statistical areas (MSAs) during 2005.   MUI African-Americans were twice as likely or more than twice as likely to receive high-cost loans as MUI whites in 167 MSAs. In contrast, LMI African-Americans were twice as likely or more than twice as likely to receive high-cost loans as LMI whites in 70 MSAs. Moreover, MUI African-Americans receive a large percentage of high-cost loans. In 159 metropolitan areas, more than 40% of the loans received by MUI African-American were high-cost loans**.**


Metro Areas where African-Americans Twice or More Likely to Receive High Cost Loans than Whites

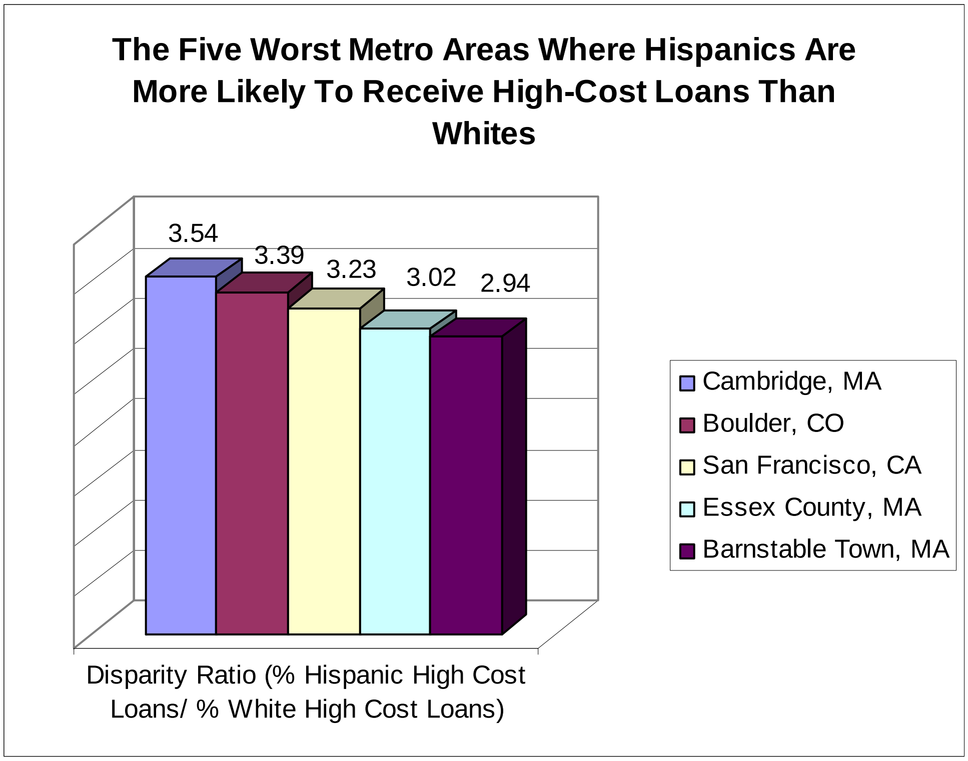
Considering all the metropolitan areas across the country, NCRC's report found that Charlottesville, VA; Durham, NC; Greenville, NC; Raleigh, NC; and Cambridge, MA had the largest overall lending disparities for African-Americans. In each of these MSAs, African-Americans were 3.4 times or more likely than whites to receive high-cost loans.

Mr. Chairman, North Carolina metropolitan areas were three of the five worst metropolitan areas in terms of African-American/white disparities. Moreover, in Charlotte, which is in your district, MUI African-Americans were 2.91 times more likely than MUI whites to receive high-cost loans.


The Five Worst Metro Areas Where African-Americans Are More Likely To Receive High-Cost Loans than Whites

Hispanics also experienced greater disparities in high-cost lending compared to whites as income levels rose. LMI Hispanics were twice or more likely to receive high-cost loans than LMI whites in 10 MSAs. MUI Hispanics were twice or more likely to receive high-cost loans than MUI whites in 75 MSAs. In addition, the percentage of high-cost loans received by MUI Hispanics was high. For MUI Hispanics, more than 40% of the loans received were high-cost in 71 MSAs and more than 30% of the loans received were high-cost in 137 MSAs.

The five worst metropolitan areas for overall Hispanic/white lending disparities are Cambridge, MA; Boulder, CO; San Francisco, CA; Essex County, MA; and Barnstable Town, MA. In each of these areas, Hispanics are 2.9 times or more likely than whites to receive high-cost loans. Three of the worst metropolitan areas are in the home state of the Chairman of the House Financial Services Committee.


The Five Worst Metro Areas Where Hispanics Are More Likely To Receive High-Cost Loans Than Whites

Some financial trade associations, particularly the Mortgage Bankers Association, were quick to criticize NCRC's *Income is No Shield Study* as a simplistic study that failed to control for creditworthiness and other important underwriting variables. The technical validity of their criticism is to some extent, accurate. But the point is nevertheless meaningless to public policy. The financial trade associations have repeatedly and continue adamantly to oppose enhancing HMDA data with additional critical variables that would enable the Federal Reserve and other agencies to immediately identify potentially illegal disparities.

Actions to preclude our ability to understand more clearly where illegal actions are occurring should not be rewarded by dismissing studies that reach compelling and insightful findings with the limited data available. Rather than dismissing our findings, Congress should address the concern raised by the Mortgage Bankers Association by adding variables to the HMDA database that will allow all participants in the housing markets to understand better what is actually occurring. That way, important Hearings, such as this one, can focus on addressing the obvious and significant problems that exist rather than debating the existence of real and legitimate concerns.

On a one-time basis, NCRC was able to obtain creditworthiness data and combine it with HMDA data in our *Broken Credit System* study released in early 2004. NCRC selected ten large metropolitan areas for the analysis: Atlanta, Baltimore, Cleveland, Detroit, Houston, Los Angeles, Milwaukee, New York, St. Louis, and Washington DC. As expected, the number of subprime loans increased as the amount of neighborhood residents in higher credit risk categories increased. After controlling for risk and housing market conditions, however, the race and age composition of the neighborhood had an independent and strong effect, increasing the amount of high cost subprime lending. In particular:

- The level of refinance subprime lending increased as the portion of African-Americans in a neighborhood increased in nine of the ten metropolitan areas. In the case of home purchase subprime lending, the African-American composition of a neighborhood boosted lending in six metropolitan areas.

- The impact of the age of borrowers was strong in refinance lending. In seven metropolitan areas, the portion of subprime refinance lending increased solely when the number of residents over 65 increased in a neighborhood.

In addition to the NCRC report, two studies conducted by Federal Reserve economists found that subprime lending increases in minority neighborhoods after controlling for creditworthiness and housing market conditions.[3] The Center for Responsible Lending also recently used HMDA data with pricing information to reach the same troubling conclusions that racial disparities remain after controlling for creditworthiness.[4]

NCRC strongly believes that additional underwriting variables such as creditworthiness need to be added to the HMDA data. But until this data becomes regularly available, the existing evidence and research suggests that the burden lies upon skeptics to disprove that market barriers including discrimination have impeded equal access to fairly priced loans for minorities and other protected classes.

Mystery Shopping Corroborates HMDA Disparity Findings

Non-HMDA data evidence provides strong support to the NCRC HMDA data findings. NCRC has a civil rights enforcement division that engages in mystery shopping, which has consistently uncovered disparate pricing and treatment for minorities with the same or better qualifications than whites. NCRC has reached these findings regardless of whether the financial institutions tested are brokers, mortgage companies, or other types of financial institutions.

[3] Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. See also Paul S. Calem, Jonathan E. Hershaff, and Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, in Fannie Mae Foundation's Housing Policy Debate, Volume 15, Issue 3, 2004 pp. 603-622.

[4] Center for Responsible Lending, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages,* see http://www.responsiblelending.org/issues/mortgage/reports/page.jsp?itemID=29371010

From 2004 to 2006, NCRC conducted mystery shopping of mortgage brokers, both large and small. Posing as loan seekers, both White testers (the control group) and Black or Hispanic testers (the protected group) met with and called local brokers to inquire about their loan options. The protected-class testers were actually given more attractive profiles in terms of their amount of equity, credit standing and employment tenure, and should have logically received better treatment. Instead, NCRC's fair lending testing of mortgage brokers uncovered a 46% rate of disparate treatment based on race and national origin.

NCRC's broker testing yielded 106 total complete, matched-pair tests. Individuals located in the metropolitan areas of Atlanta, Baltimore, Chicago, the District of Columbia, Houston, Los Angeles and Saint Louis tested brokers that were local, established businesses. In conducting the broker testing, NCRC found several companies with particularly egregious initial results. In these cases, testers were again dispatched for follow up testing to confirm and further investigate the practices of these companies. Of the 106 total tests, 84 separate companies were tested, the difference being as a result of 22 follow up tests.

A portion of the follow up tests were directed at Allied Home Mortgage Capital Corporation, against whom NCRC has filed a fair housing complaint. Additional complaints may also be filed, pending further investigation.

Our results documented the following disturbing patterns:

- African Americans and Latinos were discouraged 25% of the time concerning their efforts to meet with a broker, while white testers were discouraged only 12% of the time in their efforts to obtain credit.

- African Americans and Latinos were questioned about their credit over 32% of the time. White shoppers were only questioned about credit 13% of the time.

- White mortgage seekers had specific products discussed with them 91% of the time, while African Americans and Latinos had specific products discussed with them 76% of the time. Further, White testers received two rate quotes for every one quoted to African American and Latino testers.

- NCRC documented pricing discrimination in 25% of the fair lending tests, and noted that fees were discussed 62% of the time with white testers but only 35% of the time with "protected testers."

- Fixed rate loans were discussed 77% of the time with white testers but only 50% of the time with African American and Latino testers.

These results are very troubling and document the fact, controlling for credit and individual applicant qualification factors, African Americans and Latinos are being discriminated against in the marketplace and being forced to pay a "race tax" due to unequal access to credit.

Fair Lending and Consumer Protection Regulatory Enforcement

Despite the strong evidence suggesting that the lending market is not working in an efficient or equitable manner for working class and minority populations, the state of fair lending and consumer protection regulatory infrastructure is not at the point where it can effectively combat the enormous barriers in the marketplace for traditionally underserved populations.

Current federal fair lending efforts are inadequate to protect the interests of working class and minority consumers. In September of 2005, the Federal Reserve Board stated that it referred about 200 lending institutions to their primary federal regulatory agency for further investigations based upon the Federal Reserve's identification of significant pricing disparities in HMDA data.[5] An industry publication subsequently quoted a Federal Reserve official as stating that these lenders accounted for almost 50 percent of the HMDA-reportable loans issued in 2004.[6] In September of 2006, the Federal Reserve Board referred a larger number of lenders, 270, to their primary regulatory agencies for further investigations.[7]

Unbelievably and inconceivably, not a single case of discrimination or civil rights violations have arisen from the roughly 470 Federal Reserve referrals. While the HMDA data analysis by itself cannot conclude which financial institutions were discriminating, it is beyond the point of credulity to conclude that Federal Reserve investigators could be so consistently inaccurate in their assessments about possible violations of fair lending laws. When the HMDA data was not as detailed, the Department of Justice in the 1990's settled about a dozen cases alleging discrimination with major lenders including Long Beach Mortgage and Huntington.[8] These settlements had industry-wide impacts as

[5] Robert B. Avery, Glenn B. Canner, and Robert E. Cook, *New Information Reported under HMDA and Its Application in Fair Lending Enforcement*, Federal Reserve Bulletin, Summer 2005, http://www.federalreserve.gov/pubs/bulletin/2005/05summerbulletin.htm

[6] Inside Regulatory Strategies, November 14, 2005, p.2.

[7] Joe Adler, *Big Increase in Lenders with Suspect HMDA Data*, American Banker, September 11, 2006.

[8] There were a couple of cases in 2002 and 2004, but these cases were before the new HMDA pricing information was available. The cases involved the Department of Justice versus Decatur Federal Savings and Loan, September 1992; Shawmut Mortgage Company, December 1993; BlackPipe State Bank, December 1993; Chevy Chase, FSB, August 1994; Huntington Mortgage Company, October 1995; Security State Bank of Pecos, October 1995; Northern Trust Company, 1995; First National Bank of Gordon, April 1996; Long Beach Mortgage Company, September 1996; First National Bank of Dona Ana

lending institutions knew that the Department of Justice was serious about enforcing the nation's civil rights laws. A resumption of these settlements by the Department of Justice would send a clear signal to the bad actors in the lending industry.

Another overlooked component of fair lending enforcement consists of fair lending reviews accompanying Community Reinvestment Act (CRA) exams and bank merger applications. Evidence of discriminatory and illegal lending can result in downgrades of CRA ratings for banks if the discrimination and illegal lending was widespread and the lender had not taken 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 discriminatory lending and that no such lending was found.[9] There is no discussion of what precisely had been done to reach this conclusion. Meanwhile, excessive high-cost lending continues to destroy the wealth of vulnerable protected class households and the communities in which they live – creating increasing challenges and problems for those consumers ever to become part of America's mainstream financial system.

Community groups and the general public would have much more assurance that fair lending reviews were rigorous if the federal agencies described what types of fair lending reviews they conducted. For example, based on risk factors identified in HMDA and CRA data screening, did the agencies probe for race or gender discrimination, did they scrutinize loans for evidence of flipping or steering? A detailed description of the types of fair lending tests conducted and the results of those tests would provide a level of public confidence in fair lending enforcement that is currently lacking. The agencies used to provide detailed descriptions in the fair lending section of CRA exams in the mid- to late-1990's.

The bank merger application process has also become woefully lax in the last few years. Large bank mergers present numerous and complex fair lending and CRA issues that are receiving cursory attention. This has occurred in a time when minority households are growing as a share of America's total population. Rather than ensuring this fast growing population has access to financial services that will enable them to build wealth and contribute to the economy, CRA and fair lending enforcement is waning.

One example of this is that the federal agencies have chosen to conduct very few public hearings on mergers in the last few years. Public hearings provide an important

County, January 1997; Albank, August 1997; Deposit Guaranty National Bank, September 1999; Mid America Bank, FSB, 2002; Fidelity Federal Bank, FSB, July 2002; First American Bank, July 2004.

[9] 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.

opportunity for community organizations, elected officials, and bank representatives to more fully explore the range of issues in merger applications than can be possibly done through written comments alone on merger applications. Public hearings also provide opportunities for regulatory officials to ask questions of stakeholders and engage in a dialogue over the range of issues. Information collected and digested at these hearings enable all stakeholders to build in fair lending safeguards if and when the banks eventually merger.

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 back 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 profound 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 in the wake of the Katrina and Rita disaster, 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.[10]

The federal bank regulatory agencies are not the only agencies that have failed effectively to utilize the available tools and fair lending processes at their disposal. The Department of Housing and Urban Development (HUD) has a complaint process whereby a nonprofit organization can file a fair lending complaint alleging redlining, steering, and other actions that violate the Fair Housing Act and/or Equal Credit Opportunity Act. Unfortunately, in the fair lending complaints NCRC has filed, we have found a lack of expertise and capacity for processing the complaints among the HUD staff in the field offices.

Recent Moves by the Regulatory Agencies to Bolster their Fair Lending and Consumer Protection Enforcement – A Start but Not Enough

Cleary, NCRC advocates strongly that the federal agencies use their existing authority much more effectively. Yet, the existing authority would not be enough to keep pace with market developments as the regulatory agencies themselves have recognized. While NCRC appreciates the recent regulatory moves, they still remain inadequate by themselves to create fair and competitive markets in working class and minority communities.

Over the last year, the federal agencies have adopted guidance on non-traditional and subprime lending. Among other provisions, the guidance requires an ability to repay

[10] 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.

analysis for adjustable rate mortgages (ARMs) that is designed to eliminate the dangerous practice of assessing ability to repay on the initial low teaser rate. The subprime guidance also encourages lenders to terminate prepayment penalties 60 days before the expiration of teaser rates so that borrowers can refinance if the upward adjustment of interest rates creates unaffordable loans. Pursuing the standards in these guidance, the Federal Deposit Insurance Corporation (FDIC) and Office of Thrift Supervision (OTS) recently announced settlements with Fremont Investment and Loan and AIG, requiring these lenders to end abusive practices. While the guidance and settlements are consumer protections matters instead of explicit civil rights enforcement, they will nevertheless benefit minorities and other protected classes that have been receiving a disproportionate amount of abusive loans.

Even assuming that federal regulatory oversight was vigorous and consistent (which it is not), the federal regulatory agencies would have difficulties covering lending that originated with mortgage brokers. It is estimated that mortgage brokers process about 70 percent of the loans in the industry. While the federal agencies have advised lenders in various guidance that the must conduct due diligence regarding brokers with whom they do business, little evidence exists that the federal agencies have been able to effectively deter banks and thrifts from engaging with unscrupulous brokers.

Since federal agencies have had difficulties indirectly policing brokers, it is encouraging that the Federal Reserve Board, the Office of Thrift Supervision, and state regulatory agencies announced a pilot program on July 17 that would conduct coordinated examinations of banks, their non-depository subsidiaries, and brokers with whom they do business. Independent state-licensed lenders would also be entities examined under this program, which would scrutinize compliance with anti-discrimination laws and consumer protection statutes. Lest we get too excited about this program, we must remember that the media reports that about twelve lending institutions will be examined during the initial phase of the program. The initial and tentative nature of this program makes it clear that current fair lending and consumer protection oversight has only reached a segment of the lenders in the industry and that enormous strides need to be made in order to ensure a fair and competitive market for traditionally underserved populations.

While some federal agencies have embarked on a program to cooperate with their state counterparts, media accounts reveal that the Office of Thrift Supervision is working on proposed rules to define and prohibit unfair and deceptive practices on the part of thrift institutions. Congress has likewise applied considerable pressure on the Federal Reserve Board to prohibit unfair and deceptive practices for all lending institutions in the industry through their authority under the Homeownership and Equity Protection Act and the Federal Trace Commission Act. Federal Reserve Chairman Bernanke indicated last week that the Federal Reserve will be proposing rules regarding unfair and deceptive practices.

Steering a borrower qualified for a prime or market rate loan into a high-cost loan is one insidious practice that needs to be defined as unfair and deceptive under OTS and Federal Reserve rulemaking. FDIC Chairman Sheila Bair in testimony earlier this year suggested that many of the borrowers in ARM loans with rapidly rising rates could have qualified for lower cost fixed-rate loans.

Need for a Strong National Anti-Predatory Lending Bill

Even if the federal agencies rigorously implemented their recently adopted rules and their proposed rules (and rules rumored to be proposed soon), a strong national anti-predatory bill is essential. Simply, put the federal banking agencies cannot write rules under existing authority that will cover all parts of the lending industry. Moreover, it is unlikely the new federal-state pilot program will be expanded sufficiently to effectively police the business relationships of the thousands of brokers and state-regulated non-depository institutions with banks and thrifts. In addition, appraisers, servicers, and secondary market investors are not held accountable by federal bank regulation and are not covered sufficiently by existing federal law.

Abuses by an array of actors in the financial industry are too commonplace and new civil rights and consumer protection issues are constantly emerging. For example, since minorities and protected classes have been disproportionately targeted by predatory lenders, servicers and secondary market investors themselves risk engaging in discriminatory acts if they selectively foreclose upon minorities and protected classes. It is not clear which regulatory agency would apply the Fair Housing Act and the Equal Credit Opportunity Act to servicers and secondary market investors, suggesting a gap in existing enforcement that would allow discrimination to be practiced by other segments of the financial industry.

NCRC reiterates our position stated in previous Congressional testimony that S. 1299, the Borrowers Protection Act of 2007, represents a starting point for a comprehensive national anti-predatory bill. Rep. Ellison’s bill, H.R. 3018, or the Fairness for Homeowners Act of 2007, also contains a number of strong provisions. Provisions from S. 1299 and H.R. 3081 need to be combined with the best provisions from state anti-predatory law and provisions from bills introduced in previous Congressional sessions (such as anti-predatory bills introduced by former Senator Sarbanes and Representatives Miller, Watt, and Frank) in order to produce a comprehensive bill that prevents abuse from all segments of the industry. Finally, in our recommendations below we also describe how modernizing CRA will decrease disparities in lending and improve the equity and efficiency of lending markets for traditionally underserved communities.

A comprehensive anti-predatory bill would preserve and expand the private right of action. When regulatory oversight fails, the individual must have the right to sue in a court of law. While mandatory arbitration is on its way out as an industry practice, it is time to eliminate these unfair and lopsided non-judicial procedures through a national anti-predatory law that applies to all actors in the financial industry.

Conclusion

NCRC has asserted in this testimony that strenuous regulatory oversight and transparency is needed in order to create equitable and efficient markets that offer full product choice in minority and working class communities. HMDA data has been a powerful tool promoting transparent markets and removing a veil of secrecy that had allowed lenders to engage in blatant acts of discrimination. Yet, discriminatory practices have shifted to more subtle forms. Instead of widespread redlining and outright rejections of applicants due to their protected status, a more subtle form of discrimination involves charging higher interest rates and fees than is warranted based on creditworthiness. The new pricing data assists in uncovering discriminatory pricing, but the new pricing data by itself remains incomplete. Because HMDA data do not allow for the observation of fee gouging or dangerous risk layering involving high loan-to-value ratios and reduced documentation lending, unscrupulous lenders can continue to exploit financially vulnerable consumers. Until HMDA data includes more key underwriting variables and loan terms and conditions, the abusive parts of the industry will be one step ahead of the general public in inventing new methods for deceptive and usurious lending.

A more complete publicly available database would empower regulatory agencies and nonprofit agencies acting as private attorney generals to engage in fair lending and consumer protection enforcement. Regulatory agencies, on their part, need to be much more aggressive in using their existing tools such as fair lending reviews, discrimination settlements, CRA, and merger application reviews. They also need to augment their regulations beyond the non-traditional and subprime guidance issued this year. The pilot program involving the federal and state regulatory agencies is an infant version of the type of regulatory enforcement that is needed to adequately police the nation’s mortgage brokers and their relationships with lenders.

Some have suggested that Congress create a new regulatory agency whose mission is devoted to enforcing anti-discrimination, community reinvestment, and consumer protection laws designed to create viable and healthy markets for minorities, women, the elderly and working class Americans. Congress should consider seriously this option if the rights of millions of the nation’s most vulnerable families to fair treatment in the financial markets continue to be overlooked.

Specific Recommendations

Comprehensive Anti-Predatory Lending Legislation

Since NCRC’s data analyses revealed a disproportionate amount of high-cost lending targeted to vulnerable borrowers and communities, Congress must respond by enacting comprehensive anti-predatory lending legislation along the lines of bills introduced by Representatives Watt, Miller, Frank, Ellison and Senator Schumer. Only a national bill can apply to the entire range of institutions in the industry from mortgage brokers, mortgage companies, banks, appraisers to servicers and secondary market investors including Government Sponsored Enterprises.

Senator Schumer has recently introduced S. 1299, or the Borrower's Protection Act of 2007, that would require lenders to assess a borrower's ability to pay a loan at the maximum possible rate during the first seven years of the loan.   This procedure eliminates the dangerous practice of qualifying a borrower based on a low "teaser" rate in place during the first two or three years of the loan.   The bill would also prohibit steering or price discrimination by making it illegal for lenders to refer borrowers to loans that are not reasonably advantageous for them, based on the loan terms for which borrowers qualify. Rep. Ellison's bill, H.R. 3081 or the Fairness for Homeowners Act of 2007, also has a number of solid provisions. In order to form the basis for a comprehensive anti-predatory law, S. 1299 and H.R. 3081 need to be augmented to include provisions from the Miller-Watt-Frank bill and the strongest state anti-predatory laws. A private right of action needs to be preserved and expanded upon by national anti-predatory law.

Enhance the Quality of HMDA Data

NCRC believes that Congress and the Federal Reserve Board (which implements the HMDA regulations) must enhance HMDA data so that regular and comprehensive studies can scrutinize fairness in lending. Specifically, are minorities, the elderly, women, and low- and moderate-income borrowers and communities able to receive loans that are fairly priced? More information in HMDA data is critical to fully explore the intersection of price, race, gender, and income.

The first area in which HMDA data must be enhanced is fee and pricing information for all loans, not just high-cost loans. In order to detect fee gouging, HMDA must contain information on the total amount of fees that must be reported on the good faith estimate and the HUD-1 form provided to the borrower one day before closing. The interest rate movements in 2005 demonstrate the confusion associated with classifying the loans that currently have price information reported. Economists as well as the general public do not know whether to call the loans with price reporting, "subprime," "high-cost," or some other name. If price was reported for all loans, the classification problems would be lessened. All stakeholders could review the number and percentages of loans in all the price spread categories. The most significant areas of pricing disparities could be identified with more precision. Moreover, loan terms such as whether the loan was fixed and/or adjustable rate (with information on the length of time in which the initial rate was in effect) is needed to more fully understand the price of the loans.

Since NCRC's previous work found significant lending disparities for neighborhoods with large concentrations of senior citizens after controlling for creditworthiness, we believe that it is important to include the age of the borrower in the HMDA data. More refined analysis can then be conducted, which would be critical for fair lending enforcement. Also, a data field indicating if the loan started with a broker, mortgage company, or depository institution would enable federal agencies and the general public to assess the fair lending performance of different parts of the industry with much more precision.

HMDA data must contain credit score information similar to the data used in NCRC's *Broken Credit System* report released in the winter of 2003. For each HMDA reportable loan, a financial institution must indicate whether it used a credit score system and if the system was their own or one of the widely used systems such as FICO (a new data field in HMDA could contain 3 to 5 categories with the names of widely-used systems). The HMDA data also would contain one more field indicating which quintile of risk the credit score system placed the borrower. Another option is to attach credit score information in the form of quintiles to each census tract in the nation. That way, enhanced analyses can be done on a census tract level to see if pricing disparities still remain after controlling for creditworthiness. This was the approach adopted in NCRC's *Broken Credit System* and in studies conducted by Federal Reserve economists.

HMDA data must contain information on other key underwriting variables including the loan-to-value and debt-to-income ratios. In addition, Senator Reed's bill, S. 1386, would create a database on foreclosures and delinquencies that would be linked with HMDA. This would be an important data enhancement that would help policymakers understand which loan terms and conditions (such as loan-to-value ratios and fixed or ARM) are more likely to be associated with delinquencies and foreclosures.

Fair Lending Enforcement Must be More Transparent

Above, we discuss how many referrals the Federal Reserve has made each year to the primary regulatory agencies of lending institutions exhibiting significant lending disparities based on their HMDA data. In order to make this process more transparent and thereby increase public confidence in the process, the federal agencies should annually report to Congress how many fair lending investigations they conducted, the types of fair lending investigations, and the outcomes of these investigations. This annual reporting should also include information on fair lending compliance exams conducted in conjunction with CRA exams and HUD's processing of fair lending complaints.

The pilot program announced by the federal agencies and state regulators is a start to conducting compliance reviews for all parts of bank holding companies and the brokers with whom they do business, but the pilot program is a very small start. It needs to be expanded exponentially. Congress should receive annual reports on this federal and state coordinated effort regarding fair lending and consumer compliance reviews.

Additional Support for Fair Housing Agencies

HUD's Fair Housing Assistance Program (FHAP) and the Fair Housing Initiatives Program (FHIP) provides funds for state agencies and nonprofit organizations, respectively, to engage in anti-discrimination enforcement, complaint processing, education and outreach activities. For Fiscal Year 2008, HUD is requesting $55 million for the programs. NCRC believes that the annual appropriation should be at least double that amount, given the significant fair lending disparities revealed by HMDA data.

Public Hearings for Mergers

Fair lending enforcement would be heightened significantly if the federal agencies regularly conduct public hearings, especially for the largest mergers in the country. Public hearings provide vital opportunities for all stakeholders to dialogue concerning fair lending and CRA issues and how to reduce lending disparities. As noted above, the federal agencies have shied away from conducting hearings in the last few years. A few years ago, the Office of Thrift Supervision had a regulatory requirement that a meeting involving the merging lenders and community groups be conducted by the agency if a member of the public requests the meeting in its comment letter. A regulatory or statutory requirement similar to the OTS procedure needs to be adopted for merger applications. When a significant number of members of the general public indicate that the merger will have significant fair lending and CRA impacts, the federal agency should hold a hearing to seriously consider and resolve these issues.

Strengthen CRA by Applying It to Minority Neighborhoods and All Geographical Areas Lenders Serve

In order to increase prime lending for minority borrowers and reduce lending disparities, CRA exams must evaluate the banks' records of lending to minority borrowers and neighborhoods as well as scrutinizing banks' performance in reaching low- and moderate-income borrowers and neighborhoods. If CRA exams covered minority neighborhoods, pricing disparities in these neighborhoods would be reduced. The Federal Reserve Board, in its review of HMDA data, found that bank lending exhibited fewer disparities in geographical areas covered by their CRA exams than in areas not covered by their exams.[12] CRA's mandate of affirmatively meeting credit needs is currently incomplete as it is now applied only to low- and moderate-income neighborhoods, not minority communities.

CRA must also be strengthened so that depository institutions undergo CRA examinations in all geographical areas in which they make a significant number of loans. Currently, CRA exams assess lending primarily in geographical areas in which banks have their branches. But the overlap between branching and lending is eroding with each

[12] Avery, Robert B., Glenn B. Canner, and Robert E. Cook, "New Information Reported under HMDA and Its Application in Fair Lending Enforcement." *Federal Reserve Bulletin*, Summer 2005. Avery, Robert B., Kenneth P. Brevoot, and Glenn B. Canner, "Higher-Priced Home Lending and the 2005 HMDA Data," *Federal Reserve Bulletin*, September 2006.

passing year as lending via brokers and correspondents continues to increase. NCRC strongly endorses HR 1289 or the CRA Modernization Act of 2007. HR 1289 mandates that banks undergo CRA exams in geographical areas in which their market share of loans exceeds one half of one percent in addition to areas in which their branches are located.

Short of statutory changes to CRA, NCRC believes that the regulatory agencies have the authority to extend CRA examinations and scrutiny to geographical areas beyond narrow "assessment" areas in which branches are located. Currently, the federal banking agencies will consider lending activity beyond assessment areas if the activity will enhance CRA performance. Likewise, the CRA rating must be downgraded if the lending performance in reaching low- and moderate-income borrowers is worse outside than inside the assessment areas.

CRA Must be Expanded to Non-Bank Lending Institutions

Large credit unions and independent mortgage companies do not abide by CRA requirements. NCRC and Government Accountability Office (GAO) research concludes that large credit unions lag CRA-covered banks in their lending and service to minorities and low- and moderate-income borrowers and communities.[13] Unlike their counterparts, credit unions in Massachusetts are covered by a state CRA law. NCRC has also found that CRA-covered credit unions in Massachusetts issue a higher percentage of their loans to LMI and minority borrowers and communities than credit unions not covered by CRA. Therefore, NCRC believes that applying CRA to both large credit unions and independent mortgage companies will increase their market-rate lending to LMI and minority borrowers.

[13] NCRC, *Credit Unions: True to their Mission?*, 2005, http://www.ncrc.org; and Government Accountability Office, *Credit Unions: Greater Transparency Needed on Who Credit Unions Serve and on Senior Executive Compensation Arrangements,* November, 2006