Written Testimony
of
Calvin Bradford, President
Calvin Bradford & Associates, Ltd.

on behalf of the National Fair Housing Alliance

Before the House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit

"Home Mortgage Disclosure Act: Newly Collected Data and What It Means"

June 13, 2006

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My name is Calvin Bradford. I am speaking here today on behalf of the National Fair Housing Alliance (NFHA). I want to thank the members of this Committee for inviting us to these important hearings. Professionally, I am President of Calvin Bradford & Associates, Ltd., a consulting firm that engages in research, policy evaluation, general consulting, and expert witness services in the fields of fair housing and community development. I am submitting this written statement to expand on and provide supporting details to my oral testimony.

Founded in 1988, the National Fair Housing Alliance is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. Headquartered in Washington, D.C., NFHA, through comprehensive education, advocacy and enforcement programs, provides equal access to apartments, houses, mortgage loans and insurance policies for all residents of the nation.

I have worked in the field of lending discrimination for thirty-five years. Since the National Fair Housing Alliance (NFHA) was founded, I have worked with the organization on many of its extensive educational, training, and enforcement programs in fair lending. I am also a member of the board of the National Training and Information Center (NTIC), which was founded in 1973 as a research and technical support provider to National People's Action and other community organizations that first initiated the movement against redlining and disinvestment. NTIC's newsletter, *Disclosure*, embodies both the initial organizing effort to seek lending disclosure and the fundamental democratic principle of ensuring that citizens have access to critical information about the forces that affect their lives and the vitality of their communities.

I am intimately familiar with the Home Mortgage Disclosure Act (HMDA). I worked with both the constituent organizations and the Congressional staff responsible for drafting the Home Mortgage Disclosure Act and the Community Reinvestment Act (CRA). I have produced two national studies of the uses of HMDA data for the U.S. Department of Housing and Urban Development (HUD) and made a survey of reinvestment programs linked to uses of HMDA for the Ford Foundation. Since they were first released, I have engaged in research and analysis using HMDA data. I have engaged in several studies of reinvestment lending programs that were developed from various forms of HMDA analyses. I have used HMDA data to develop the lending aspects of the HUD-mandated Analysis of Impediments to Fair Housing Choice for more than a dozen jurisdictions.

I have served as a consultant in fair lending enforcement on contracts with HUD and state and local enforcement agencies. I have served as an expert in at least fifty cases of lending discrimination and abusive lending practices. I am honored that I have been asked several times to come before Congressional committees holding oversight hearings on HMDA, CRA and fair lending enforcement.

Five Key Points

There are five key points that I want to make concerning HMDA and its role in fair lending enforcement.

I. Home Mortgage Disclosure Act Data Are Widely Used and Extremely Valuable In Fair Lending and Community Lending Activities.

HMDA has served extremely well the purposes for which it was intended. It has proven to be a dynamic law that has been expanded and improved to reflect the changes in the mortgage lending markets over time. However, it must be used properly in order to identify discrimination. In addition, we recommend additional steps to make the data more user-friendly, especially for the community-based organizations and others with limited resources.

II. Federal Fair Lending Enforcement Is Critical to Eliminate Housing Discrimination.

Even as a growing U.S. population becomes more diverse, our communities remain highly racially and ethnically segregated, and segregation continues to extract a high price in economic and societal terms. Segregation in our neighborhoods and communities weakens the overall infrastructure, results in a drain on the tax base and minimizes the capacity of local officials to provide essential services to their communities. The hazards of segregation illuminate the meaningful significance of ensuring equal treatment and promoting integrated neighborhoods.

III. Federal Regulatory Agencies Must Improve Their Fair Lending Oversight and Enforcement Activities.

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. In the experience of many of us directly involved in training, education, and litigation, their record of enforcement falls short of the mark and has not been effective at eliminating discrimination from the mortgage market.

IV. HUD, Justice and the FTC Must Increase Their Fair Lending Enforcement Efforts.

The U.S. Department of Housing and Urban Development (HUD), as the lead enforcement agency under the Fair Housing Act and the administrator of the Federal Housing Administration, has a critical role to play in fair lending enforcement. However, it has undertaken very little fair lending enforcement activity. We are encouraged by the announcement last week of HUD’s settlement of a lending discrimination case in Newport, Kentucky, on behalf of an African-

American complainant. At the U.S. Department of Justice (DOJ), which has brought several excellent and landmark fair lending cases in the past, fair lending enforcement activity since 2000 has not been as robust as that in the 1990s. 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.

V. No Agency Regulates Independent Mortgage Companies for Fair Lending Compliance.

Despite the utility of HMDA data for highlighting potential lending discrimination, analysis of the data has not led to effective enforcement of the fair lending laws for a growing segment of the mortgage lending industry, non-depository institutions. This is not a failure of the data, but a failure of the regulatory system. In our view, the Fed, which plays a lead role in this area, does not make effective use of its regulatory authority with respect to the non-depository institutions over which it has jurisdiction. These include some of the largest mortgage companies dealing in both prime and subprime lending. We believe that the Fed should take more aggressive action to ensure that these companies are in compliance with fair lending laws.

However, even if the Fed were to pursue aggressive supervision and enforcement with respect to bank holding company affiliates, that would still leave a significant segment of the market, namely unaffiliated non-depository institutions, without fair lending oversight. Although there are a few notable cases of state attorneys general who have used consumer protection statutes effectively to eliminate unfair and deceptive lending practices, on the whole, state regulation has not proven adequate to the task of fair lending enforcement. This is a gap that must be filled.

I. Home Mortgage Disclosure Act Data Are Widely Used and Extremely Valuable in Fair Lending and Community Lending Activities

HMDA generates one of the most commonly used government data sets, along with some routine economic indicators and Census data. HMDA data are used thousands of times each year by regulators, government agencies, lending institutions, community-based organizations, private fair housing and community development organizations, both independent and academic researchers, and parties engaged in fair lending education and enforcement.

A. HMDA Data Have Many Uses

HMDA was enacted to provide the public and public officials with data on mortgage lending patterns. These data were intended to: identify disparities in lending to focus attention on both individual lenders and neighborhoods with potential fair lending concerns; help regulatory agencies assess the performance of mortgage lenders; and help direct public sector investments in ways that would improve the environment for private investment. Since the first release of HMDA, community groups, civil rights organizations, and the media have used HMDA data to focus national attention on lending discrimination issues. HMDA has been a dynamic law with Congress responding to changing issues by making the original law permanent, expanding the range of lenders covered, and adding additional data to the disclosure requirements.

Over the past thirty years, HMDA has served society extraordinarily well. Its uses have undoubtedly exceeded the expectations of its authors. For example:

- HMDA has become the preeminent source of comprehensive data to track patterns and trends in the mortgage market. In recent years, academic researchers, government agencies, and scores of community groups have used HMDA data to document the emergence and dramatic expansion of the subprime mortgage market and its concentration in minority communities. I worked on one such study, "Risk or Race: Racial Disparities and the Subprime Refinance Market," published in 2002 by the Center for Community Change. That study analyzed subprime lending in every metropolitan area in the country and found considerable racial disparities in this segment of the mortgage market.

- The data are used to identify underserved markets and develop programs to address local needs in those markets. HMDA data have become an integral part of the Community Reinvestment Act (CRA) examinations conducted by the federal banking regulatory agencies. They are also widely used by community-based organizations to identify gaps in their local mortgage markets. Based on these analyses, local groups have built partnerships with lending institutions and local government agencies to develop and monitor reinvestment programs that have directed billions of dollars to underserved communities through targeted loan programs in both the primary and secondary markets.

- Individual lenders use HMDA data as part of their own analysis of their role in the larger markets and in assessing whether there are patterns in their lending that might be seen as possible indicators of discrimination. Thus, data have served to focus the industry on fair lending compliance more intensely than had been the case before the creation of the HMDA resource.

- HMDA data are also used extensively in fair lending enforcement to identify patterns that may indicate unfair lending practices. The data have been widely used for this purpose by a variety of government agencies, fair housing groups, and individuals, as described in more detail below.

The list of ways that HMDA data have been used is much longer, but these examples serve to underscore its utility.

We recommend that the Federal Reserve take two steps to enhance the public's ability to access and utilize HMDA data:

1. *Maintain a consistent record layout from year to year.* From time to time, the Federal Reserve switches the location of particular fields within the database, requiring users to retool the systems they have devised to analyze the data. This is a burden for individuals and organizations with limited resources and does not appear to serve a public purpose;

2. *After obtaining public input, provide the data in a format more readily compatible with current PC capabilities and widely-used software packages.* In an effort to assist community-based organizations and others with limited access to mainframe computers, the Federal Reserve developed a proprietary program for extracting subsets of HMDA data for more detailed analysis. While this may have been useful in the early 1990's, given today's technology, this program is a hindrance. There are several related issues whose resolution would make the data considerably more user-friendly. We urge you to encourage the Federal Reserve to reach out to the public to seek input on ways to accomplish this goal.

3. *Eliminate the mismatch between the resources and access to data that exists between government agencies and the public.* In a larger research sense, there is a lack of real openness which should characterize objective investigation of lending patterns. Present and past Federal Reserve economists (sometimes working with a small inner circle of other academics), as well as Fannie Mae and Freddie Mac, typically release studies based on HMDA data in conjunction with other data. This is the case with the Fed's use of the Georgetown Credit Research Center's data. We have what amounts to a private group controlling sets of unknown proprietary data that allegedly enhance the raw HMDA data. Organizations outside the private group are put in a compromised position. The members of the private group often criticize others using the HMDA data (or other occasional limited data sources) for not including the proprietary data sets that belong to this private group.

   These data sets, as well as regular samples of the loan data for Fannie Mae, Freddie Mac, the VA and FHA, should all be made public so that a wide range of researchers can work with common sets of data. Researchers commonly work with confidential data; there is no reason to believe that sharing the data with researchers subject to non-disclosure agreements would compromise either personal privacy protections or corporate proprietary rights. After other researchers have had ample time to work with these data sets themselves, there should be open forums in which different methods of analysis and differing results are presented and discussed.

B. HMDA Data Have Changed with the Market

Over the years, the mortgage market has changed dramatically. These changes are evident in the institutional structure of the mortgage lending industry; the role, size and structure of the secondary market; and the types of mortgage products available. One of the beauties of HMDA is that it has been adapted to reflect significant market changes, thus maintaining its utility as a tool for monitoring both market trends and individual lender performance, including fair lending compliance. Originally, HMDA required disclosure of loans made by depository institutions. Subsequently, its scope was expanded to require disclosure by non-depository institutions and to provide information on borrower characteristics and the disposition of individual loan applications. Most recently, the HMDA regulations were amended to provide information on loan pricing for "high cost" loans and to flag loans whose terms fall within the definition of the Home Ownership Equity Protection Act (HOEPA).

There are two additional changes that we believe would enhance the utility of the HMDA data. Both of these could be accomplished through regulatory action.

1. *Identify loans originated by brokers.* This is important because brokered loans now represent more than forty percent of mortgage originations, which is an enormous shift from just a few years ago. Further, many fair lending and consumer compliance concerns arise with respect to brokered loans, making it particularly useful to be able to identify these in the HMDA data.

2. *Modify triggers used for reporting loan pricing to reflect better the realities of the market.* Current regulations require lenders to report, for loans subject to Regulation Z (Truth in Lending Act), the difference between the annual percentage rate (APR) and the yield of Treasury securities with a comparable term when that spread is three points or more for first liens and five points or more for subordinate liens. This works fairly well for fixed-rate loans, which are typically tied to such long-term Treasury notes.

   However, for adjustable rate mortgages (ARMs), a shorter benchmark is typically used. The interest rate on ARMS is usually pegged either to a short-term "swap" rate or to the two-year LIBOR (London Inter-Bank Offering Rate). ARM rates are systematically lower than the interest on fixed rate loans. Thus, linking the rate spread trigger to the higher Treasury rate artificially suppresses the level of "high-cost" loans reported in the HMDA data. ARMs are one of the primary products in both the refinance and subprime markets, areas in which there are significant fair lending concerns. Therefore, we believe that it is important to establish a separate benchmark for reporting pricing data on these loans.

C. HMDA Data Are the Cornerstone of Fair Lending Enforcement

The data disclosed under HMDA have formed the cornerstone of both private and public fair lending enforcement efforts. Because of the private nature of the mortgage transaction, few borrowers have an opportunity to compare the terms and conditions of the mortgage they receive with those made available to similarly situated borrowers. Thus, it is very difficult, if not impossible, for individual borrowers to identify discrimination, even when they are its victims. Further, given the increasing complexity of mortgage instruments, the forms that lending discrimination may take are also increasingly complex. This makes data analysis a critical component of fair lending oversight and enforcement.

The data have been widely used by private individuals and organizations to further fair lending compliance.

- In the mid-1990s, for example, the National Fair Housing Alliance (NFHA) engaged in the first national lender testing project. NFHA analyzed HMDA data in eight metropolitan areas to determine the overall market patterns and identify lenders whose deviations from the market norms might indicate some form of racial discrimination. Using this analysis, NFHA tested selected lenders and found differential treatment in sixty-eight percent of the tests.

- This year, the Fair Housing Center of Greater Boston built on HMDA analyses to uncover differences in treatment for homebuyers of color in nine of twenty matched pair tests. At least seven of these tests showed differences clear enough to merit enforcement action.

- Analysis of subprime lending patterns has provided background information important in lawsuits brought by private attorneys that have set major legal precedents against the practice of reverse redlining and the targeting and exploitation of minority markets. These include the well-known cases of *Hargraves, et al. v. Capital City*, here in the District of Columbia, and the case of *Honorable, et al. v. Easy Life, et al.*, in Chicago.

HMDA data are also widely used by the various public agencies that have responsibility for fair lending oversight and enforcement.

- The federal banking regulatory agencies use HMDA data extensively in fair lending exams, as detailed in the FFIEC Fair Lending Examination Procedures manual. The Federal Reserve, FDIC, OCC and OTS also use the data in their CRA compliance.

- The Department of Justice (DOJ) has used HMDA data analysis in many of the fair lending cases it has brought. DOJ has used HMDA data to identify lending patterns and to map lending patterns geographically based on race. These cases were not "proven" with HMDA data, but they lent additional weight to evidence from other sources, including loan files. The maps show a compelling story for many lenders DOJ has sued as they show a paucity of branches and loans in minority neighborhoods.

- HMDA data are commonly used in the Analysis of Impediments to Fair Housing Choice, which HUD requires jurisdictions receiving Community Development Block Grant funds to conduct. Once lending barriers to fair housing are identified, jurisdictions are required to develop plans to overcome these barriers. HMDA data can not only be used to define the barriers, but they can be used by both the jurisdictions and the public to monitor progress toward the elimination of these barriers.

D. Important Issues of HMDA Data Analysis in Fair Lending Enforcement

There is considerable debate about the best techniques to use in HMDA data analysis. I would like to comment on a few of the issues that are most pertinent in the context of fair lending enforcement.

Too Much Emphasis Is Placed on Statistical Significance as a Benchmark for Measuring Discrimination

Although much of the academic research conducted with HMDA data strives to achieve high levels of statistical significance, this benchmark does not necessarily apply in the fair lending context. This would mean that, unless disparities along racial, ethnic, gender or similar lines were found at a statistically significant level, researchers would assert that discrimination is not a factor in the marketplace. The problem with this approach is that statistical significance requires large numbers. Most lenders have a limited number of loans or applications in any given metropolitan area.

The use of statistical significance is likely one of the reasons the Fed's recent analysis of the 2004 data found so few disparities among "comparable" applicant types within specific loan products of individual lenders. A lender may engage in extremely discriminatory activity, but because of the relatively small number of records for analysis, this extreme activity might not produce "statistical significance" – especially at the required level for statistical significance used by the Fed in its analysis. Other types of measures and analysis need to be used if we are to use the HMDA data successfully to identify possible patterns of discrimination.

One approach to achieving statistical significance has been to combine different racial and ethnic groups into a single "minority" category. This may increase the number of "comparable" applicants or borrowers for statistical purposes, but it will mask differences between these racial and ethnic groups. For example, some Asian-American groups often have better access to mortgages than comparable white applicants in the same markets (though there are clearly regional and local markets where this is not the case). Hispanics tend to have lower levels of subprime or high cost loans than do African-Americans. Combining all of these groups into a single category tends to diminish the real disparities in the market.

Another approach has been to aggregate and analyze data for particular lenders at the national (rather than MSA) level. While this maximizes the number of applications and loans for analysis and may provide some useful profile data for that lender, it may also mask real differences in the lender's performance within particular MSAs. No lending study, including the analysis provided by the Fed each year, should focus exclusively on national patterns.

Rejection Rates as a Benchmark Do Not Necessarily Apply to Subprime Loans

In the prime mortgage market, much fair lending analysis has focused on rejection rates (along with other transactions where the loans were not completed, such as loans withdrawn, etc.). In the subprime market, however, where the question confronting a lender is less often whether or not to make a loan than how much to charge, the conclusions that one may draw from rejection rates are less clear.

On the other hand, to the extent that subprime lending plays a valuable role in access to credit, then rejection rates are just as important as they are in prime lending. The issue is to determine when denial is a good indicator of discrimination and when the infusion of subprime lending into minority markets is a good indicator of discrimination. In this complex situation, rejection rate analysis may have to be combined with particular patterns of market penetration and interest rate disparities or spreads.

Loans Originated by Brokers Make It Difficult to Measure Discrimination

With the growing dominance of the broker channel for delivering loans, rejection rates are even less helpful. This is because brokers tend to shop loans to several lenders. The lender that closes the loan reports an origination, while any of the other lenders that approved the loan report a loan approved but not accepted. In other cases, a lender may provide a counter offer that may be as good or better than the loan that the broker decided to give the borrower. In such cases, the lender making the counter offer may have to report a rejection – which, in fact, represents a better deal that may not have been communicated to the borrower or that was received by the broker after another lender had made the deal. In these cases, the origination and rejection data are unclear and may even be misleading.

Analysis of Disparities by Gender Need More Attention

Historically, the analysis of differences by gender has been rare. With the growth of the subprime markets, however, there has been an increased focus the pattern of litigation on lending schemes that take advantage of women, either directly or as the result of targeting older homeowners who tend to be disproportionately female. Thus, more attention needs to be paid to examining differences in lending by gender.

II. Federal Fair Lending Enforcement Is Critical to Eliminate Housing Discrimination

Even as a growing U.S. population becomes more diverse, our communities remain highly racially and ethnically segregated, and segregation continues to extract a high price in economic and societal terms. Segregation in our neighborhoods and communities weakens the overall infrastructure, results in a drain on the tax base and minimizes the capacity of local officials to provide essential services to their community. The hazards of segregation illuminate the meaningful significance of ensuring equal treatment and promoting integrated neighborhoods. Not only do integrated neighborhoods create a more diverse community and reduce the concentration of poverty in a city, they also sustain better schools, more amenities, a healthier infrastructure, a stronger tax base and a broader mix of businesses. Fair lending is a key part of ensuring equal housing opportunity in our communities.

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 and critical component of any serious effort to combat lending discrimination in all of its many, evolving forms.

Typically, in order to show that a member of a protected class was treated illegally in a mortgage transaction, one needs to know how other applicants where treated. This requires access to information that is not in the public domain. Most victims of lending discrimination are unlikely to know that they have been discriminated against. Indeed, where misleading, deceptive, or fraudulent practices are involved in the discrimination, the intent of the lending agents is to ensure that the person is not aware of these practices.

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. For both policy and practical reasons, the federal government is best situated to undertake this effort.

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. Lack of forceful federal enforcement actually provides a form of safe harbor for those in the industry engaging in discriminatory practices.

III. Federal Regulatory Agencies Must Improve Their Fair Lending Oversight and Enforcement Activities

Disclosure is a valuable tool for the evaluation of lending pratices, but it cannot replace forceful and effective enforcement activities undertaken by federal agencies. Historically, public awareness of fair lending problems has been influenced by the actions of citizen organizations, private enforcement efforts, and the media. Many of these actions have been based upon HMDA data analysis, and these analyses have evolved as the mortgage market and the forms discrimination takes have evolved. If, however, we are to eliminate discrimination, the responsible federal government agencies must undertake aggressive, effective fair lending enforcement activities. Financial regulatory agencies have referred some lending discrimination cases to the Department of Justice for enforcement actions; however, they are few in number.

Fair lending examination reports are strictly confidential, so it is impossible for the public to review and evaluate them directly. However, the procedures used by examiners are public (see the FFIEC Interagency Examination Procedures), and these give us some sense of the agencies' approach. We can compare this to our own knowledge of the mortgage market and the points in the lending process that are susceptible to illegal discrimination.

A. Current Methods for Examining Prime and Subprime Affiliates Will Not Necessarily Identify Discrimination

One pivotal issue is the way the exam procedures handle the question of prime vs. subprime loans. From a fair lending perspective, when examining a lending institution that makes both prime and subprime 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.

The examination procedures indicate that the "subsidiaries" of a lending institution should all be examined (page 3 of the FFIEC Interagency Examination Procedures) and that the examination should assess whether a lender with both prime and subprime affiliates has concentrated its subprime subsidiaries in minority neighborhoods and its prime subsidiaries in white neighborhoods (page 8). These are good procedures.

However, while the procedures consider racially segregated channels for different loan products as a potential indicator of differential treatment, they specifically state that affiliates (separate companies within a holding company) should not be included in the examination and should not even be contacted (page 3). This allows institutions to use their corporate structure to evade fair lending review. It puts the onus on the Federal Reserve Board, as the umbrella regulator for bank holding companies, to make full use of its authority under the Bank Holding Company Act to ensure that no bank holding company affiliate is engaged in illegal discriminatory practices. It is not clear that the Fed is currently doing so.

There are a number of bank holding companies with prime and subprime affiliates. One such example is Citigroup, which has a prime lender (CitiMortgage) that operates both through retail offices and brokers, and a subprime affiliate (CitiFinancial) that operates through several thousand retail offices in local neighborhoods across the country. When Citigroup acquired The Associates, a major subprime lender, and merged it with CitiFinancial, many community groups raised concerns about how applicants that qualified for prime loans would have access to those loans if they entered through the subprime CitiFinancial channel.

One way that Citigroup could ensure that all applicants to any of its mortgage affiliates would have access to the full range of its mortgage loan products is for it to license its own CitiFinancial offices as brokers for CitiMortgage products. Certainly, Citigroup has more control over the quality and training of its own employees at the CitiFinancal offices than it has over independent brokers who are licensed to process CitiMortgage loans.

Based on the information on CitiFinancial's website, one might think this is what Citigroup has done. Indeed, under the link to "Products and Services" it states: "We have **a solution for every need and budget**". It adds, "**No matter What Your Situation, We Have a Solution!** At CitiFinancial, we don't just make you a loan – we become your partner in finding a solution."

However, this is not the case, as I determined last week by calling several CitiFinancial offices near where I live. When I asked if they could make me a loan from CitiMortgage, I was told, "no, if you want a loan from them, you have to go through their offices." I said, "So, you only make CitiFinancial loans and not CitiMortgage loans?" Staff in another office reported that, "even though we are all under the same umbrella, we have nothing to do with them (CitiMortgage)." I should note that there are no CitiMortgage offices in my area, making it difficult for potential applicants to gain access to prime mortgage products from Citigroup.

Thus, CitiGroup segregates its prime and subprime channels in a way that gives rise to fair lending concerns. It is not alone. Bank holding companies using this structure have an effective safe harbor under the agencies' fair lending examination procedures. In such a situation, it is critical for the Federal Reserve to conduct regular, comprehensive and aggressive fair lending compliance exams for non-depository bank holding company affiliates engaged in mortgage lending.

B. Current Methods of Examination Will Not Reveal Whether Everyone Is Receiving the Best Loan Product

For some time now, lenders have been grappling with how to set up an effective system to ensure that applicants get the best loan product for which they qualify, regardless of the channel (prime or subprime) through which they enter the institution. Another concern for fair housing advocates is that all loan applicants have access to all of a lender's products through a single application process. The fair lending exam procedures list situations in which "a single loan processor could simultaneously attempt to qualify any applicant, whether to the bank or the mortgage company, under either the bank's prime criteria or the mortgage company's sub-prime criteria" as potential indications of steering (page 8).

Thus, for the regulatory agencies, the very structure that community lending advocates and fair housing organizations advocate to maximize fair lending sends up a red flag for potential discrimination. Of course, if the examination procedures are correct in flagging this structure as a possible sign of discrimination, then the entire wholesale market that operates through brokers that shop loans for the best deal should be held suspect simply by its very existence. In our view, brokers are a special case, because of the fact that their interest is not necessarily consistent with the best interest of their clients. To the extent that brokers provide borrowers with loans based on the compensation the broker receives, rather than the terms that best meet the borrowers' needs, the potential for abuse and illegal discrimination exists and may flourish. Currently, it is not possible for the public to identify which loans are originated through brokers. **We believe that the regulations should be revised to require lenders to identify loan applications originated by brokers.**

However extensive or comprehensive the examination procedures may appear to be, they may be suspended in cases where the supervisory agencies decide to use "regression analysis or other statistical methods of identifying potential discrimination with respect to one or more loan products" (page 1).

C. "Statistical Significance" Should Not Be the Prime Measure of Uncovering Discrimination

As described earlier, while statistical methods can be used in appropriate ways, they are not a wholesale substitute for other forms of analysis and, in fact, often serve to mask discrimination. Tests of statistical significance between groups are heavily dependent upon the number of cases (applicants or borrowers) in each group. The supervisory agencies use statistics to compare groups of applicants or borrowers who are "similarly situated" or "similarly qualified" except for race or some other protected class characteristic. In doing this, one needs to be careful that the definition of "similarly qualified" or "similarly situated" does not result in groups that are so small that even large differences in actual treatment or pricing do not meet the statistical tests of significance.

This is illustrated by a case I worked on in which we had access to detailed characteristics for over 16,000 loan applicants. Even with this pool, we were unable to identify borrowers who were precisely the same on all qualifying characteristics except for race. In this situation it was more reasonable to determine whether, for various minority applicants who had been rejected, white applicants who were clearly less qualified had been approved, especially with regard to the factors identified in the Adverse Action Notice as the basis for rejecting the minority applicants.

The need for alternative analytical approaches is critical. Each time an applicant from a protected class is denied a loan or offered one on terms and conditions inferior to those offered to an equally or less qualified control applicant, there is evidence of possible discrimination. This makes it critical for those charged with enforcing the fair lending laws to employ both statistical and non-statistical analysis in the oversight and enforcement process.

D. Even Overt Discrimination Sometimes Escapes Notice by Federal Regulators

Because there are no public documents about the results of fair lending exams, it is difficult to assess the quality of the fair lending examination process. Community Reinvestment Act (CRA) evaluations are supposed to contain comments on whether the regulator found any evidence of discriminatory lending practices. However, my litigation experience shows that the statements in these public disclosures do not always contain accurate information of the findings of the fair lending exams.

The recent case of Flagstar Bank, FSB, represents that rare exception where we actually have proof of fair lending violations that we can compare to the public comments of the institution's regulator and to the CRA ratings given to the bank before and after the violations occurred. This case illustrates the disconnect between some lending institution behavior and the fair lending examination process by the federal financial institution regulatory agencies.

- Between February of 1994 and November of 2005, during which time the OTS gave Flagstar Bank "Satisfactory" and "Outstanding" CRA ratings, this lender was sued numerous times in federal court for issues related to discrimination in lending. Most lending cases are either dismissed by the courts or settled. Flagstar, in contrast, was found liable for discrimination at trial or by the court in at least two of these cases.

- In 1999, a jury in Detroit found Flagstar liable for discrimination against minority borrowers, and plaintiffs were awarded damages. In 2003, in a national class action suit, a federal court in Indianapolis found a written pricing policy developed by Flagstar management in 2001 so overtly discriminatory that the court ruled against Flagstar on summary judgment. The policy explicitly stated that pricing would be different for minority and non-minority borrowers. It appears that <u>the discriminatory pricing policy was developed and implemented by Flagstar *while* the OTS was conducting its consumer compliance examination.</u>

- The OTS conducted five CRA examinations and never found Flagstar in violation of discrimination laws. During this time period, Flagstar was given a "Satisfactory" CRA rating four times and was elevated to an "Outstanding" rating <u>after</u> the summary judgment finding in 2003.

This took place despite the seemingly extensive fair lending examination procedures (see the Interagency Fair Lending Examination Procedures). These procedures call for the review of "lending policies, marketing plans, underwriting, appraisal and pricing guidelines" (page 6) and for the review of "complaints alleging discrimination in residential loan pricing" (page 8). The procedures call for the review of possible indicators of overt discrimination, "including explicit prohibited basis identifiers in underwriting or pricing" (page 7). Clearly, these core examination factors were either ignored or the examiners for the OTS who were assigned to review one of the largest mortgage lenders in the nation did not understand the most basic tenants of fair lending.

Flagstar was one of the nation's twenty largest mortgage lenders during the period covered by this litigation. It sold loans to both Fannie Mae and Freddie Mac and was one of the largest underwriters of FHA loans through certification granted by HUD. After the judicial findings of lending discrimination, <u>no sanctions were applied by the OTS, HUD, Fannie Mae, or Freddie Mac.</u>

In fact, Flagstar was allowed to expand significantly during this time period by opening numerous branches, expanding into a new state, and expanding to additional metropolitan areas in these states. The approval of its applications to expand was based, in part, on its CRA ratings. As a result, during the period from 1994 through 2005, Flagstar grew from just over $500 million in assets to nearly $13 billion in assets.

The Flagstar case raises serious concerns about the adequacy and effectiveness of the regulatory agencies' fair lending enforcement efforts.

IV. HUD, Justice and the FTC Must Increase Their Fair Lending Enforcement Efforts

While the federal banking regulatory agencies have a key role to play in fair lending enforcement, other agencies also have important parts to play. As insured depository institutions lose market share to uninsured, largely unregulated mortgage lenders, the roles played by HUD, the Department of Justice (DOJ) and the Federal Trade Commission take on greater importance.

During the 1990s, the Department of Justice was a leader among government agencies in fair lending enforcement. Its activity was triggered by a Pulitzer Prize-winning series in the Atlanta Constitution-Journal, "The Color of Money," written by Bill Dedman. The series used HMDA data, along with additional data collected from thrifts by the Federal Home Loan Banks, and documented redlining and racial discrimination in Atlanta.

This series provided the Department of Justice with background for its first major investigation of lending discrimination in the case brought against Decatur Federal Savings & Loan. The attention given to these news stories also added impetus to legislation that eventually amended the HMDA and resulted in disclosure of data on borrower characteristics and the disposition of loan applications.

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. In many of the pattern and practice cases filed by DOJ, HMDA data are used to illustrate racial disparities consistent with the charges made in the cases. These cases have 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. As listed on its website, DOJ has filed twenty-three lending discrimination cases since the early 1990s, two of which are in the form of amicus briefs. Three of those cases allege discrimination in non-mortgage consumer credit transactions. Of the remaining eighteen cases, three have been filed since 2000. About half the DOJ cases have been referrals from OTS, OCC, or the Fed. DOJ cases filed since 2000 appear to be based on analysis of HMDA data from the late 1990s and early 2000s. We are not aware of what efforts or analysis DOJ may currently have in process. There may be a number of lending institutions currently under investigation. And, although

Aside from the recent settlement between HUD and Fifth Third Bank, the level of fair lending enforcement activity by the Department of Housing and Urban Development has been negligible. Assistant Secretary Kim Kendrick has made a commitment to improving enforcement efforts at HUD and to reinvigorating the Secretary-initiated complaint process. We look forward to working in partnership with the Assistant Secretary and her staff to achieve these goals and urge Congress to provide sufficient funding to HUD to allow it to enforce the many facets of the Fair Housing Act.

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).

V. No Agency Regulates Independent Mortgage Companies for Fair Lending Compliance

The most glaring abyss in the federal enforcement effort, however, is in the large segment of the market outside of the normal regulatory environment. With the move in the mortgage market away from depository lenders and toward wholesale lending through brokers, the lack of enforcement activity in this area becomes a black hole within which many of the most abusive lending practices reside.

HUD has the authority as the lead agency in fair housing enforcement to initiate investigations and enforcement activities in this area, but, aside from some minimal cases of closing cost violations of RESPA, it has not brought any fair lending enforcement actions against independent mortgage companies.

The Fed has the authority to regulate the activities of bank holding company affiliates, which often account for the majority of the lending done by the holding company overall. However, to our knowledge, the Fed has never taken any fair lending enforcement action against any bank holding company mortgage affiliate, nor has it referred to the Department of Justice any cases involving these companies.

Conclusion and Final Recommendations

In summary, HMDA has been an invaluable tool used by community organizations, industry groups, and governmental agencies to educate the nation about lending practices and to identify potential signs of fair lending discrimination. That said, there are some changes that should be made to the HMDA data to make it a stronger tool. HMDA has been expanded and improved over the years to reflect changes in the marketplace; now is the time to make more of those changes to ensure public access to the data and to regulate non-depository institutions, a rapidly growing share of the marketplace. In addition, Congress, the Administration, and federal agencies must use their authority to undertake much stronger fair lending activities including investigations and enforcement.

The following are the recommendations we believe that Congress should oversee in response to the five key issues outlined at the beginning of this testimony:

- HMDA data should be more user-friendly, especially for community-based organizations and others with limited resources. The FFIEC needs to establish a funded advisory board, composed of a broad range of HMDA users and civil rights enforcement agencies and attorneys with successful experience in the lending enforcement area. Its role would be to provide assistance on how to make HMDA data more user-friendly and accessible and advice on how to restructure the federal examination and enforcement programs. This group could also serve to provide discussion and review of proposed changes to HMDA.

- Consideration should be given to enhancing HMDA disclosure data 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, and to recording the total fees as a separate item.

- Federal regulators and consumer organizations should work together 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/terms for the consumer.

- Congress should allocate additional resources to HUD's Fair Housing Initiatives Program in order to facilitate increased education and enforcement efforts on the part of local fair housing organizations.

- Federal government agencies in general must undertake more aggressive, effective fair lending enforcement activities. These agencies should consult with experts in fair lending enforcement organizations so that the federal examination and enforcement programs reflect the best practices of the state of the art in investigation techniques and litigation strategies.

- Federal agencies that regulate insured depository institutions, particularly the OCC, the FDIC, the OTS, and the Fed, should 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.

- The Fed announced publicly that it flagged 200 institutions for additional investigation because of their pricing data and other issues. This is a classic intersection between HMDA data and fair lending enforcement. Congress should ask the Fed for a status report on these investigations;

- The federal agencies tasked with enforcing the federal Fair Housing Act must expand their fair lending enforcement activities. These agencies need assistance from both Congress, in the form of appropriations to fund these initiatives, and from the Administration, in the form of political will. Congress should provide funding for a special mortgage lending unit at HUD, particularly in light of the predatory lending problems in the United States.

- The FTC must use its authority to undertake fair lending cases;

- All financial institutions active in lending must be regulated. 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.

Thank you once again for the opportunity to testify before this Committee. The National Fair Housing Alliance and I are 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 fulfills its duty to enforce fair lending nationwide.