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OTS 98-80 - OTS to Use New Exam Procedures to Detect Fair Lending Violations

Office of Thrift Supervision

NEWS

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OTS To Use New Exam Procedures To Detect Fair Lending Violations

CLEVELAND, OHIO, Nov. 4, 1998 - Federal examiners of thrift institutions early next year will begin using new procedures to ferret out violations of the nation's fair lending laws. The Office of Thrift Supervision (OTS) and other federal banking agencies are currently finalizing the procedures.

The agencies "have spent the past 24 months revamping our fair lending examination procedures to improve our ability to detect evidence of lending discrimination, including redlining," said OTS Director Ellen Seidman in a speech in Cleveland today to the second fair lending conference of the Cuyahoga Countywide Financial Institutions Advisory Committee (C-FIAC).

Previewing the new procedures, she said they are "more detailed and comprehensive than those currently in place and were designed to enhance our ability to determine whether or not an institution is discriminating. The inclusion of specific techniques to analyze redlining should prove useful in our continued efforts to uncover and eradicate this offensive, illegal practice."

She said that examiners and institutions involved in the testing phase of the new procedures "found them to be thorough, and expressed confidence in the conclusions reached by the process." Implementing the new procedures will require that OTS devote more resources to this portion of the examination process, "but we believe that the effort is clearly worthwhile.

"While our procedures for identifying violations of fair lending laws and regulations have been strengthened, the serious negative consequences of finding such violations remain the same," Ms. Seidman asserted. "We will continue to vigorously employ all remedies at our disposal, including enforcement actions and referrals to the Department of Justice or Department of Housing and Urban Development to firmly and expeditiously address discriminatory practices, as warranted."

Since 1993, OTS has made 12 referrals to Justice where the agency believes an institution has engaged in a pattern or practice of discrimination or discouragement contrary to applicable laws.

Ms. Seidman also said an interagency review of the regulations under the Community Reinvestment Act (CRA) should begin now because the "financial services landscape is changing before our eyes. Every day, more institutions are using product delivery systems outside the traditional brick and mortar branch structure." Among these systems are mail, telephone, loan production offices, agent relationships and the Internet, and their reach "challenges the geographically focused evaluation criteria that underpin the CRA regulation."

She said that smaller institutions being challenged by "mega-banks" need to find creative ways to support their neighborhoods, possibly through different types of loan products better matched to community credit needs or through deposit or other financial services, or community-based investments. Although OTS examiners consider factors such as extreme price competition from very large institutions in their CRA evaluations, the CRA regulation "can encourage and reward the creativity of institutions challenged by such factors better than it does now."

Lending may be too heavily weighted for some small institutions, and they may be able to do more good for their community through qualified community development investments and services. Making the strategic plan option within CRA a more attractive alternative may also help, she said.

Referencing the fact that the overall homeownership rate, as well as rates for minorities, have hit all-time highs in the third quarter of 1998, Ms. Seidman reviewed the Home Mortgage Disclosure Act (HMDA) data for 1997. She pointed out that over the past five years minority groups have made some impressive gains in home purchase originations, including increases of 62 percent for Blacks, 58 percent for Hispanics, 29 percent for Asians and 25 percent for Native Americans compared with 16 percent for Whites. She expressed concern, however, that a gap still exists between the rate for Whites and minorities and that the rate of increase for minorities has slowed in the past two years.

Another concern is that HMDA data do not differentiate between the more traditional types of loans and those for manufactured housing. That lack of distinction between categories can "skew the aggregate numbers in a way that does not tell the whole story," she said. The data show that denial rates in lending for both Blacks and Whites in the last two years have increased, and the higher denial rates in minority lending, in particular, relate in a large way to the higher application rates by minorities to lenders specializing in manufactured housing and subprime lenders.

To help gain a better understanding and perspective on the data, OTS joined with several other federal agencies last May in requesting the Federal Reserve Board, which is responsible for implementing the HMDA regulations, to require the identification of manufactured home transactions which have significantly different underwriting standards, denial rates and other features from traditional home loans.

HMDA data also show that minorities increasingly rely on government-backed mortgages, such as FHA and VA. Although these loans offer lower down payment requirements and other advantages, there is concern the increase may result from illegal steering, whereby a lender assumes the applicant won't qualify for a conventional loan because of his or her race and steers the person to a government-backed loan.

Ms. Seidman said the HMDA reports "are an invaluable tool" in giving regulators information about lending patterns, but "there are many gaps and limitations in the data." It is important to carefully analyze and understand relevant data, but also "to continue to look at the lending activities of individual institutions and to assist with their efforts to better reach minorities communities and individuals." She said OTS' own community outreach program is geared to helping do that.

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View Director Seidman's Remarks