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Large Bank Mergers Fair Lending Review (GAO)

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Report to the Honorable Maxine Waters and the Honorable Bernard Sanders House of Representatives

November 1999

LARGE BANK MERGERS

Fair Lending Review Could be Enhanced With Better Coordination

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The Honorable Maxine Waters
United States House of Representatives

Honorable Bernard Sanders
United States House of Representatives

As you requested, this report discusses large bank holding company mergers and regulatory enforcement of the Fair Housing Act (FHAct) and the Equal Credit Opportunity Act (ECOA), known collectively as the fair lending laws.[1] The fair lending laws prohibit discrimination in lending based on an applicant's race, color, religion, gender, national origin, or certain other protected characteristics. During the past few years, mergers between several of the largest U.S. banking institutions have prompted consumer and community groups to raise a number of fair lending concerns.

The objectives of this report are to (1) describe the fair lending issues raised by consumer and community groups during the application process for six large bank holding company mergers[2] and (2) assess the Federal Reserve Board's (FRB) consideration of those issues.[3] Appendix I provides information that you requested regarding actions that regulators have taken in response to recommendations made in our 1996 report on fair lending.[4] Appendix II contains information about emerging fair lending issues related to credit scoring, automated loan underwriting, and mortgage brokers.

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[1]The requesters also asked us to assess the impact of large bank mergers on community lending to low- and moderate-income neighborhoods and the Federal Reserve Board's process for assessing the Community Reinvestment Act performance of merger applicants. We conducted a separate assignment to address these issues. See Federal Reserve Board: Merger Process Needs Guidelines for Community Reinvestment Issues, GAO/GGD-99-180 (Sept. 25, 1999).

[2]The six bank holding company mergers that we looked at ultimately resulted in four holding companies.

[3]The regulatory role of FRB includes scrutiny of proposed transactions that involve bank holding companies and member banks of the Federal Reserve System. FRB administers the Bank Holding Company Act, which requires FRB approval of the acquisition of banks, bank holding companies, and nonbank affiliates by bank holding companies. Under the Bank Merger Act, FRB must approve mergers involving state member banks and may deny acquisition of a state member bank under the Change in Bank Control Act.

[4]Fair Lending: Federal Oversight and Enforcement Improved but Some Challenges Remain, GAO/GGD-96-145 (Aug. 13, 1996).

Results in Brief

In each of the six mergers, consumer and community groups raised the issue of perceived high loan denial and low lending rates to minorities by banks, bank subsidiaries, and nonbank mortgage subsidiaries involved in the mergers. In four merger cases, community and consumer groups were concerned about alleged potential discriminatory practices of the holding companies' nonbank mortgage subsidiaries. Unlike bank subsidiaries, nonbank mortgage subsidiaries are not subject to routine examinations by federal regulators for compliance with fair lending and other consumer protection laws and regulations. The fair lending laws generally confer enforcement authority for nonbanking companies with the Federal Trade Commission (FTC), Department of Housing and Urban Development (HUD), or Department of Justice (DOJ) and do not specifically authorize any federal agency to conduct examinations of nonbanking companies for compliance with these laws. The consumer and community groups were concerned that (1) sub-prime[5] lending activities of the nonbank mortgage subsidiaries had resulted or could result in minorities being charged disproportionately higher rates and fees, and (2) minority loan applicants were being "steered" between the affiliated banking or nonbank subsidiaries of the holding company to the lender that charged the highest rates or offered the least amount of services. Other fair lending issues, which involved the banks, included alleged discriminatory prescreening and marketing[6] (four mergers), low lending rates to minority-owned small businesses (two mergers), discriminatory treatment of applicants (two mergers), and redlining[7] (one merger).

FRB considered these fair lending issues in the six merger cases by collecting, reviewing, and analyzing information from various sources, including the bank holding companies involved in the mergers and other federal and state agencies. Specifically, FRB staff analyzed Home Mortgage Disclosure Act (HMDA) data provided annually by the banks and nonbank mortgage subsidiaries involved in the mergers. In addition, FRB staff stated that they placed heavy emphasis on prior and on-going compliance examinations performed by the appropriate primary banking regulators for the banks involved in the merger. However, examinations for nonbank mortgage subsidiaries were generally not available because these entities are not routinely examined by any federal agency. In two of the six

[5]Sub-prime lending refers to the extension of credit to higher risk borrowers, a practice also referred to as "B/C" or "nonconforming credit."

[6]Discriminatory prescreening and marketing refer to practices that selectively discourage or encourage applicants with respect to inquiries about or applications for credit at the preapplication stage.

[7]Redlining is the refusal of lenders to make mortgage loans in certain geographic areas, typically minority or low-income neighborhoods, regardless of the creditworthiness of the loan applicant.

mergers in our review, FRB had previously performed compliance investigations of nonbank mortgage subsidiaries involved in the mergers. According to FRB staff, FRB had used its general examination and supervisory authority for bank holding companies to conduct these particular investigations.

FRB did not routinely contact FTC or HUD concerning the six mergers despite their fair lending enforcement responsibilities. Specifically, FTC has primary law enforcement responsibilities under ECOA for the nonbank mortgage subsidiaries of bank holding companies, and HUD is responsible for the enforcement of the Fair Housing Act for all institutions. In addition, FRB shared some, but not all, of the fair lending-related comment letters it received during the application process with the appropriate primary banking regulators, FTC, and HUD. Allegations of fair lending problems expressed in the letters could be useful to these other agencies in their ongoing enforcement activities. Finally, FRB did not provide or direct the public or enforcement agencies to sources for structural information about the bank holding companies involved in the mergers. This could have limited the information these sources provided to FRB. This letter contains recommendations that address these concerns.

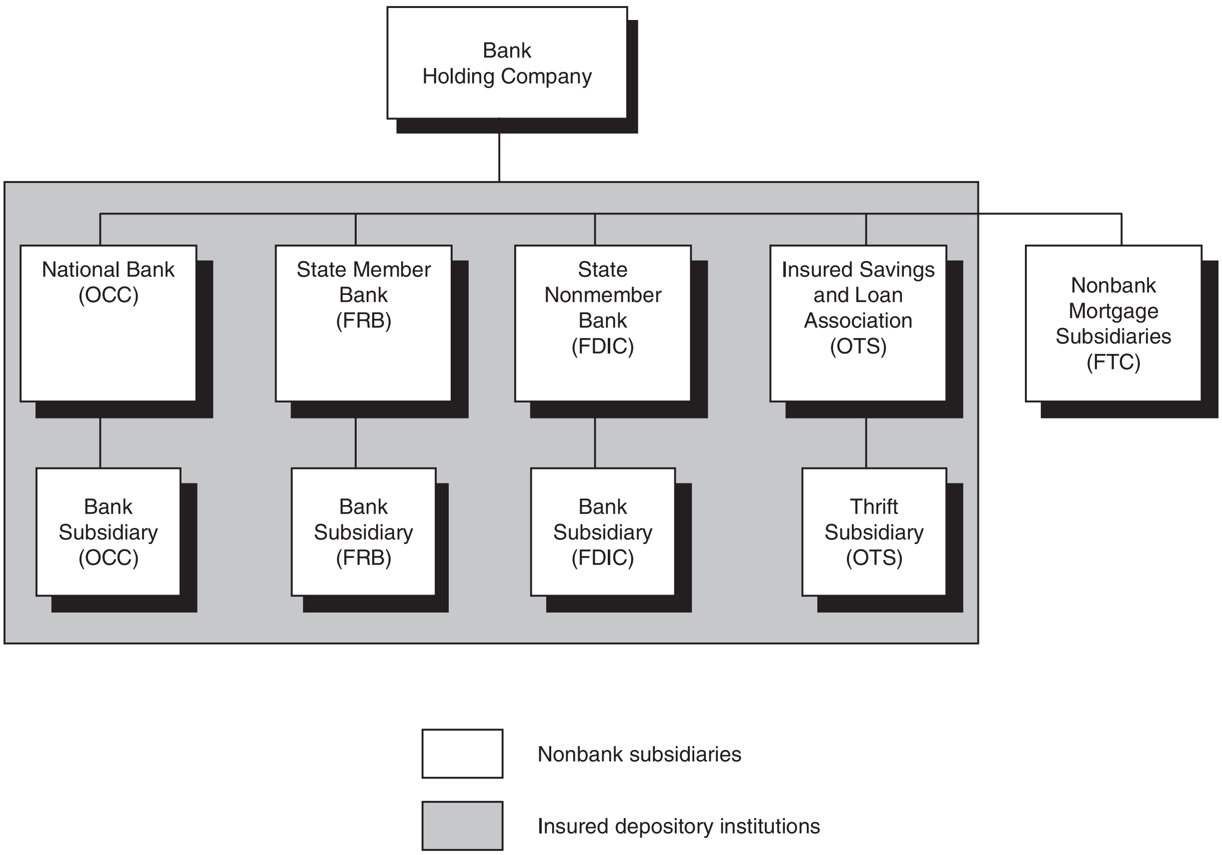
Background

Although not specifically required to do so by statute, FRB considers the fair lending compliance of the entities under the holding companies involved in the merger and any substantive public comments about such compliance. FRB must act on a merger request within 90 days of receiving a complete application or the transaction will be deemed to have been approved. FRB also seeks comments from appropriate state and federal banking regulatory agencies, which have 30 days to respond. While the application is pending, public comment on the proposed merger is to be solicited through notices in newspapers and the Federal Register. The public is allowed 30 days to provide written comments. FRB is required to consider several factors when reviewing a merger application, including (1) the financial condition and managerial resources of the applicant, (2) the competitive effects of the merger, and (3) the convenience and needs of the community to be served.

Fair lending oversight and enforcement responsibilities for entities within a bank holding company vary according to entity type (see fig. 1). Federal banking regulators are responsible for performing regularly scheduled examinations of insured depository institutions and their subsidiaries to assess compliance with fair lending laws.[8] In contrast, nonbank subsidiaries of bank holding companies are not subject to regularly scheduled compliance examinations by any agency. However, the fair lending laws provide primary enforcement authority over nonbank mortgage subsidiaries to HUD and FTC. HUD has enforcement authority with respect to FHAct violations for all institutions, and FTC has ECOA enforcement responsibility with respect to all lenders that are not under the supervision of another federal agency. For example, FTC is responsible for the enforcement of ECOA with respect to nonbank mortgage subsidiaries of bank holding companies. FRB has general legal authority under the Bank Holding Company Act and other statutes to examine nonbank mortgage subsidiaries of bank holding companies. Appendix III contains information regarding the extent of mortgage lending performed by banks, thrifts, and independent mortgage companies, another major component of the mortgage lending market, which are not addressed in this study. It also provides data specific to the banking sector.

[8]In the context of this report, the term "federal banking regulators" refers to FRB, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS).

Figure 1: Fair Lending Enforcement Responsibility for Components of a Hypothetical Bank Holding Company



Note 1: The primary federal agency for fair lending enforcement is shown in the parentheses. With respect to nonbank mortgage subsidiaries, FTC's authority is limited to enforcement of ECOA.

Note 2: HUD has primary enforcement responsibility for FHAct compliance of all institutions, including all components of a bank holding company.

Source: GAO.

Federal banking regulatory agencies are authorized under ECOA to use their full range of enforcement authority to address discriminatory lending practices by financial institutions under their jurisdictions. This includes the authority to seek prospective and retrospective relief and to impose civil money penalties. HUD, on the other hand, has enforcement authority with respect to FHAct violations for all institutions and HMDA compliance responsibilities for independent mortgage companies. Both ECOA and FHAct provide for civil suits by DOJ and private parties. Whenever the banking regulatory agencies or HUD have reason to believe that an institution has engaged in a "pattern or practice" of illegal discrimination, they must refer these cases to DOJ for possible civil action. Such cases include repeated, regular, or institutionalized discriminatory practices. Other types of cases also may be referred to DOJ.

From 1996 through 1998, DOJ entered into four settlements and one consent decree involving fair lending compliance. In the same period, FTC entered into three consent decrees and issued one complaint that were based at least in part on ECOA compliance issues. FRB and OCC, respectively, took two and nine enforcement actions against regulated institutions for violations of the fair lending laws and regulations in this same time period. During this time period FRB, OCC, and FTC also conducted various investigations of consumer complaints they received regarding alleged fair lending violations by institutions under their jurisdiction. For example, FRB conducted 32 investigations of consumer complaints it received in 1998 that alleged fair lending violations by state member banks.

HUD can investigate fair lending complaints against various types of institutions, including bank holding companies, national banks, finance companies, mortgage companies, thrifts, real estate companies, and others. In processing fair lending complaints, HUD is to conduct an investigation and, if evidence suggests a violation of the law, issue a charge. HUD is required by law to attempt to conciliate such cases. From 1996 through 1998, HUD entered into 296 conciliation agreements. Of the 296, at least 108 involved banks, mortgage companies, or other entities related to bank holding companies. If conciliation is not achieved, HUD may pursue the case before an Administrative Law Judge. However, a complainant, respondent, or aggrieved person may elect to have the claims asserted in a federal district court instead of a hearing by an Administrative Law Judge. The Secretary of HUD may review any order issued by the Administrative Law Judge. Decisions of the Administrative Law Judge may be appealed to the federal court of appeals.

Regulatory enforcement of ECOA and FHAct, enacted in 1974 and 1968, respectively, is supported by the HMDA. As amended in 1989, HMDA requires lenders to collect and report data annually on the race, gender, and income characteristics of mortgage applicants and borrowers. Lenders who meet minimum reporting requirements submit HMDA data to their primary banking regulator or HUD in the case of independent mortgage companies.[9] HMDA data are then processed and made available to the

[9]For data collection in 1998, depository institutions with a home or branch office in a metropolitan statistical area (MSA) had to report HMDA data if they had more than $29 million in assets as of December 31, 1997. Nondepository lenders were required to report HMDA data if they had assets of more than $10 million and had an office or loan activity in an MSA. They were also required to report,

public through the reporting lenders, the Federal Financial Institutions Examination Council,[10] and other sources. Such information is intended to be useful for identifying possible discriminatory lending patterns.

As we noted in our 1996 report on fair lending, federal agencies with fair lending enforcement responsibilities face a difficult and time-consuming task in the detection of lending discrimination.[11] Statistical analysis of loan data used by some federal agencies can aid in the search for possible discriminatory lending patterns or practices, but these methods have various limitations. For example, these statistical models cannot be used to detect illegal prescreening or other forms of discrimination that occur prior to the submission of an application. For these forms of discrimination, consumer complaints may be the best indicator of potential problems. We noted in the report that it is critical that the agencies continue to research and develop better detection methodologies in order to increase the likelihood of detecting illegal practices. In addition, we encouraged the agencies' efforts to broaden their knowledge and understanding of the credit search and lending processes in general because such knowledge is prerequisite to improving detection and prevention of discriminatory lending practices.

Scope and Methodology

To describe the fair lending issues raised by consumer and community groups during the application process for large bank holding company mergers, we looked at FRB's internal summaries of comments made by consumer and community groups for six selected large bank holding company mergers that occurred from 1995 to 1998. For each of those years, we selected the mergers with the largest asset values for the acquired bank holding company. The six large bank holding company mergers that we reviewed were

regardless of asset size, if they originated 100 or more home purchase loans (including refinancings) during the calendar year.

Depository institutions are exempt from reporting HMDA data if they made no first-lien home purchase loans (including refinancings of home purchase loans) on one-to-four family dwellings in the preceding calendar year. Nondepository institutions are exempt if their home purchase loan originations (including refinancing of home purchase loans) in the preceding calendar year came to less than 10 percent of all their total loan originations (measured in dollars).

[10]FFIEC was established in 1979 as a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions and to make recommendations to promote uniformity in the supervision of these institutions. The Council's membership is composed of FRB, OCC, FDIC, OTS, and the National Credit Union Administration.

[11]GAO/GGD-96-145, p. 66.

- NBD's acquisition of First Chicago in 1995,
- Fleet's acquisition of Shawmut in 1995,
- Chemical's acquisition of Chase in 1996,
- NationsBank's acquisition of Boatmen's in 1997,
- NationsBank's acquisition of BankAmerica in 1998, and
- BancOne's acquisition of First Chicago NBD in 1998.

To verify the completeness of FRB's summaries of the comment letters, we developed a data collection instrument, reviewed a sample of comment letters submitted for two of the mergers, and compared our data with the FRB summaries. From our sampling of comment letters, we determined that FRB's internal summaries of the comment letters were accurate and that we could rely upon the other FRB summaries as accurate reflections of the public comments submitted.

To assess FRB's consideration of the types of fair lending issues raised during the merger process for large bank holding companies, we reviewed FRB's internal memorandums and supporting documentation for the six selected mergers and FRB's orders approving the mergers in question. We also interviewed FRB staff involved in assessing the comments made by consumer and community groups for the six selected mergers. In addition, we obtained and analyzed fair lending enforcement actions taken by FRB, OCC, DOJ, FTC, and HUD to determine if they involved institutions that were part of the six selected mergers. We also conducted interviews with representatives of these agencies to discuss coordination policies and procedures related to the merger process for these large bank holding companies.

We held discussions with representatives of the four bank holding companies that resulted from the six mergers, representatives of bank industry trade groups, and various consumer and community groups that commented on the six mergers to obtain their views regarding the federal regulatory response to fair lending issues raised during the merger process. We conducted our review from November 1998 to July 1999, in accordance with generally accepted government auditing standards.

We requested comments on a draft of this report from FRB, OCC, FTC, DOJ, and HUD. FRB, OCC, and HUD provided written comments that are included in appendixes IV through VI. A summary of the agencies' comments and our responses are presented at the end of this letter.

Fair Lending Concerns Were Raised in Each Merger

Consumer and community groups submitted comment letters raising fair lending issues in each of the six mergers. The number of comment letters that FRB received on the mergers—which included letters supporting or opposing the merger—ranged from 17 to approximately 1,650. Table 1 lists the primary fair lending issues raised and the number of mergers in which each issue was raised.

Table 1: Fair Lending Issues Raised in Six Selected Merger Cases

Fair lending issue	Number of mergers
Denial of credit/low lending to minorities	6
Abusive sub-prime lending	5
Discriminatory prescreening/marketing	4
Steering	3
Low lending to minority-owned small businesses	2
Discriminatory treatment of applicants	2
Redlining	1

Source: GAO analysis of FRB data.

Issue of High Denial and Low Lending Rates for Minorities Was Raised in All Six Mergers

As shown in table 1, consumer and community groups raised the issue of perceived high denial and low lending rates to minorities in all six cases. The groups typically based these concerns on their analysis of HMDA data. For example, one of the community groups commenting on a proposed merger cited denial rates for minorities that were twice the rate for Whites in a particular geographic area. In other cases, consumer and community groups cited HMDA data indicating that the number of loans made to minority groups by the institutions involved in the merger was not consistent with the demographics of a particular market. The groups claimed that the HMDA data provided evidence of a disparate impact in lending to minorities.[12]

The consumer and community groups were most often concerned about the lending record of the subsidiaries of the holding company that was the acquirer. However, a number of these groups raised issues with the lending records of both holding companies involved in the proposed merger. In a few cases, the lending record of the subsidiaries of the holding company that was to be acquired was identified as an issue. The consumer and community groups often did not identify the specific institution under the

[12]According to the 1994 Policy Statement issued by the Interagency Task Force on Fair Lending, the courts have recognized three methods of proof of lending discrimination under ECOA and FHAct: overt evidence of discrimination, disparate treatment, and disparate impact. Overt evidence of discrimination exists when a lender blatantly discriminates on a prohibited basis. Disparate treatment occurs when a lender treats applicants differently on the basis of one of the prohibited factors. Disparate impact occurs when a lender applies a policy or practice uniformly to all applicants but the policy or practice has a discriminatory effect on a prohibited basis and is not justified by business necessity.

holding company in question but, instead, focused on the overall lending in specific geographic markets.

Nonbank Mortgage Subsidiary Concerns Were Raised On Five Mergers

Consumer and community groups raised fair lending concerns in five of the six mergers regarding the activities of nonbank mortgage subsidiaries. In four of the mergers, the concerns involved the nonbank mortgage subsidiaries of the holding companies. Nonbank mortgage subsidiaries of holding companies accounted for approximately one-fifth of the total mortgage lending of the bank sector, and they experienced steady growth in both the number and dollar value of mortgage loans originated from 1995 through 1997. Their growth in lending activity out-paced other bank sector entities in 1997. (See app. III, figs. III.2 to III.5.) The nonbank mortgage company in the fifth merger was a subsidiary of one of the lead banks involved in the merger.

Groups Were Concerned About Abusive Sub-Prime Lending Practices

In five merger cases, consumer and community groups cited abusive or what they characterized as "predatory" sub-prime lending as a fair lending issue. Sub-prime lending itself is not illegal and is generally acknowledged as a means of widening consumer access to credit markets. However, as stated in a recent interagency document, the "higher fees and interest rates [associated with sub-prime lending] combined with compensation incentives can foster predatory pricing or discriminatory steering of borrowers to sub-prime products for reasons other than the borrower's underlying creditworthiness."[13]

The alleged abusive sub-prime lending activities cited by the consumer and community groups included such practices as undisclosed fees and aggressive collection practices that were more likely to affect the elderly, minorities, and low- to moderate-income individuals. Other concerns identified with sub-prime lending included the alleged targeting of minorities for the higher priced sub-prime loans even if they would qualify for loans at lower rates. The groups typically relied on anecdotal rather than statistical evidence to support their concerns. HMDA data cannot be used to analyze sub-prime lending because HMDA does not require lenders to identify which loans are sub-prime or report loan characteristics that can be used to identify sub-prime lending, such as the pricing and fees, and does not require the reporting of borrowers' credit information.

Concerns About Steering Raised in Three Mergers

In three of the merger cases, consumer and community groups alleged that minorities were being directed or steered disproportionately to the holding

[13] Interagency Guidance on Subprime Lending, as adopted by FRB, OCC, FDIC, and OTS on March 1, 1999.

company lender that offered the highest-priced loans or the least amount of service. In two of the mergers, the allegations focused on steering between the banks and the holding companies' nonbank mortgage companies engaged in sub-prime lending. The steering issue raised in the third merger involved referral practices between a bank and its subsidiaries that allegedly resulted in minorities typically receiving a lower level of service.

One of the consumer and community groups alleged that a holding company established the nonbank mortgage company as a bank holding company subsidiary rather than as a bank subsidiary to escape regulatory scrutiny. As noted earlier, nonbank subsidiaries of bank holding companies are not subject to regularly scheduled compliance examinations. The group stated that this created a "regulatory blindspot."

Other Fair Lending Issues Were Raised on Some of the Mergers

Consumer and community groups raised prescreening and marketing issues in four mergers. In two of the four, the consumer and community groups were concerned about prescreening of applicants that resulted in the referral of only those applicants deemed qualified. The groups alleged that the prescreening programs violated the ECOA provision that requires lenders to provide applicants with written notification of a loan application denial stating the reason or basis for the denial. The community groups also raised issues with bank fee or marketing practices. According to these groups, some practices were intended to discourage minorities from applying for credit, and other practices disproportionately targeted minorities for loans with higher interest rates.

In two of the merger cases, consumer and community groups raised issues related to lending to small businesses owned by minorities or located in minority communities. The primary support for these issues appeared to be analysis of HMDA data and Community Reinvestment Act (CRA) data.[14] The consumer and community groups alleged that the holding companies involved in the two mergers were discriminating against or providing an inadequate level of funding to minority-owned small businesses or small businesses located in minority communities.

Concerns about the discriminatory treatment of minority applicants were raised in two of the mergers. The basis for the complaint on one merger

[14]The Community Reinvestment Act requires the federal banking regulators to encourage depository institutions to help meet credit needs in all areas of the communities they serve, including low- and moderate-income neighborhoods, consistent with safe and sound operations. CRA regulations issued by the banking regulators require nonexempt depository institutions to annually report data on small business loans they originated or purchased.

was the results of an independent testing program that used matched-pair testing.[15] According to the complainant, Black applicants were kept waiting longer, were quoted higher closing costs and overall processing times, and overall were discouraged from applying for credit in comparison to White applicants. In another merger, FRB received several comment letters that objected to the acquiring bank holding company's customer call center's handling of fair lending complaints. Specifically, they asserted that the center's staff did not inform callers of their right to file a complaint and lacked expertise in fair lending and investigative techniques.

Redlining of predominantly minority neighborhoods was alleged in one merger. A consumer/community group said that the acquiring bank holding company had redlined many of the low- and moderate-income, predominantly minority communities in a particular city. The group based its allegation on the lack of bank branches and minimal marketing of credit products in those communities.

FRB Analyzed HMDA Data and Relied Heavily on Prior Exams to Assess Fair Lending Concerns

FRB analyzed HMDA data to help assess the validity of the fair lending concerns raised by the groups. FRB also obtained and reviewed additional information from the bank holding companies involved in the proposed merger. FRB staff stated that in assessing fair lending concerns, they relied primarily on current and past fair lending compliance examinations performed by the primary banking regulator(s).

In each of the six mergers, FRB staff obtained and reviewed additional information provided by the bank holding companies to assess the fair lending issues raised by consumer and community groups. According to FRB officials, they forwarded the comments received from the consumer and community groups during the public comment period to the bank holding companies involved in the mergers. They explained that the bank holding companies were encouraged, but not required, to provide information or a response to the issues raised in the comment letters. In addition, FRB sometimes requested specific information from the bank holding companies in response to issues raised by the consumer and community groups. For example, FRB staff requested and assessed information from one holding company about the settlement of lawsuits involving consumer complaints. This request was made in response to a group's concerns about the compliance of a nonbank mortgage subsidiary with fair lending and consumer protection laws.

[15]Matched-pair testing consists of having similarly qualified "testers" (e.g., one minority and the other nonminority) pose as prospective loan applicants. After discussing loan possibilities on an individual basis with an institution, the testers document their treatment and the completeness of the information given to them by the institution's personnel.

FRB Performed HMDA Analyses in All Six Mergers

In response to consumer and community groups' concerns about overall lending to minorities by the entities involved in the proposed holding company mergers, FRB staff obtained and analyzed HMDA data. Using these data, FRB compared the lending performance of the bank holding company subsidiary in question to the performance of other lenders in the aggregate for a particular community or geographic area. In addition, they looked at the holding company's record of lending to minorities over the last several years to determine if there were any discernible patterns that could indicate discriminatory lending.

In conducting their analysis, FRB staff identified lending rate disparities in some areas/markets that indicated that the holding company subsidiary was lagging behind the aggregate or not doing as well as could be expected. However, FRB staff noted that although HMDA data may indicate a need for further analysis or targeted reviews through examinations, HMDA data alone cannot provide conclusive evidence of illegal discrimination because of known limitations in the HMDA data.

Bank regulators, bank officials we contacted, and some academics and community group representatives agreed that HMDA data are limited in their potential to demonstrate discrimination. Principal among the limitations associated with HMDA data is the lack of information on important variables used in the credit underwriting process. For example, HMDA data do not include information on the creditworthiness of the applicant, the appraised value of the home, or the credit terms of the loan. This information typically is maintained only in the lender's loan files and is accessible to regulators conducting compliance examinations or investigations.

FRB Relied Heavily on Results of Bank Regulators' Compliance Examinations

FRB staff stated that they relied heavily on the primary regulator's compliance examinations because on-site comprehensive reviews of actual bank practices and records are the best means to assess compliance with the fair lending laws. Moreover, time, access, and authority constraints limit the analysis of fair lending issues that FRB staff can perform during the application process for bank holding company mergers. FRB officials stated that the merger application review process is not a substitute for the fair lending examination process. Therefore, FRB relied on the past and current fair lending examination results of the primary banking regulator.

In response to the fair lending concerns raised by the consumer and community groups, FRB staff said they obtained information on the scope of and conclusions reached on prior and on-going fair lending compliance examinations performed by the primary banking regulator. The age of the examinations relied on by FRB ranged from over 3 years old to having been recently completed or still on-going. These examinations covered the fair lending compliance of the banks and their subsidiaries with the fair lending laws and regulations. The fair lending examination reports typically did not address all of the fair lending issues raised by the consumer and community groups during the merger process, such as abusive sub-prime lending, discriminatory prescreening/marketing, and steering.[16]

Moreover, nonbank mortgage subsidiaries of bank holding companies are not routinely examined for fair lending compliance by any federal regulatory or enforcement agency. On a case-by-case basis, FRB officials told us they have exercised their general authority granted under the Bank Holding Company Act and other statutes to conduct fair lending compliance investigations of a bank holding company's nonbank mortgage subsidiaries. In two cases, FRB had conducted prior investigations of nonbank mortgage subsidiaries involved in proposed mergers we studied.

According to FRB officials, a long-standing FRB policy of not routinely conducting consumer compliance examinations of nonbank subsidiaries was formally adopted in January 1998. The policy is based on three primary considerations. First, ECOA and other major laws enforced under FRB's compliance program give primary enforcement responsibility for nonbank subsidiaries of bank holding companies to FTC. Second, routine examinations of the nonbank subsidiaries would be costly. Third, such examinations would, in the FRB officials' opinion, raise questions about "evenhandedness" given that similar entities, such as independent mortgage companies, that are not part of bank holding companies would not be subjected to examinations. FRB does not have specific criteria as to when it will conduct on-site investigations of these nonbank mortgage subsidiaries. According to FRB, on-site inspections of a holding company nonbank mortgage subsidiary are conducted when factors present suggest that discriminatory practices are occurring and when it seems appropriate to do so because the matter may relate to relevant managerial factors. In contrast, FRB's policy is to conduct full, on-site examinations of the subsidiaries of the banks it regulates. Banks still account for a greater amount of lending than the other bank sector entities—bank subsidiaries and nonbank mortgage subsidiaries of holding companies. However, the

[16]Representatives of one of the primary banking regulators explained that examiners did not have examination procedures for such fair lending issues as redlining and steering prior to the adoption of Interagency Fair Lending Examination Procedures in January 1999.

growth in lending by nonbank mortgage subsidiaries has steadily increased since 1995 and outpaced other bank sector entities in 1997 (see app. III).

In discussions with FTC officials, we confirmed that they do not examine or routinely investigate nonbank mortgage subsidiaries of holding companies. They emphasized that FTC is a law enforcement agency, not a regulator. FTC, they said, does not conduct compliance examinations but does investigations targeted at specific entities, most of which are agency-initiated. However, investigations can result from consumer complaints that indicate a pattern or practice or public interest problem to be explored. The officials noted that FTC's jurisdiction is broad—generally covering any lending entity that is not a bank, thrift, or their holding companies—but FTC resources are limited. They said FTC's current ECOA enforcement efforts have focused on independent mortgage or finance companies and discriminatory pricing issues. During the period of the six mergers that we reviewed, 1996 through 1998, FTC achieved three settlements and issued one complaint in ECOA enforcement actions; none involved bank holding company entities.

In all six mergers, FRB noted that the primary banking regulator had found no evidence of illegal credit discrimination in its most recent fair lending compliance examinations. Of the two prior FRB investigations of nonbank mortgage subsidiaries, FRB found no evidence of illegal discrimination in one case. As discussed further in the next section, FRB made a referral to DOJ on the other case on the basis of the nonbank mortgage subsidiary's use of discretionary loan pricing practices that resulted in disparate treatment based on race.

FRB Imposed Conditions on One Merger on the Basis of Fair Lending Issues

FRB approved all six of the mergers, but one was approved with a condition related to a fair lending compliance issue. At the time of the merger application in question, DOJ was pursuing an investigation—on the basis of a FRB referral—of the holding company's nonbank mortgage subsidiary. The focus of the investigation was on the nonbank mortgage subsidiary's use of discretionary loan pricing—known as overaging—which allegedly resulted in minorities disproportionately paying higher loan prices than nonminorities. The nonbank mortgage subsidiary was under a commitment with FRB not to engage in overage practices. FRB approved the merger with the condition that the holding company not resume the overage practice without FRB's approval. DOJ subsequently entered into a settlement agreement with the nonbank mortgage subsidiary in which it agreed to change its overage policies and pay $4 million into a settlement fund.[17]

FRB's Processes Had Weaknesses That Could Limit Government Agencies' Access to Relevant Information

In our review of the six merger cases, we found weaknesses in some of FRB's practices that could limit the access of various government agencies to information about the fair lending compliance performance of bank holding company entities. Two weaknesses could limit FRB's access to such information during consideration of bank holding company merger applications. Specifically, FRB did not routinely contact FTC or HUD to obtain information about any fair lending complaints or concerns related to the entities involved in the mergers. Moreover, FRB did not ensure that information about the structural organization of the bank holding companies was available to the public or DOJ, which could have limited the information provided to FRB by these sources. A third weakness could limit the access of other agencies with fair lending compliance responsibilities to information FRB obtained during consideration of merger applications. Specifically, FRB did not routinely provide the primary banking regulators, FTC, and HUD with the comment letters it received during the merger applications process regarding the fair lending compliance of the banks and nonbank mortgage subsidiaries of the holding companies involved in the six mergers.

FRB Did Not Routinely Seek Information From FTC or HUD

As discussed previously, the enforcement of fair lending laws is shared by a number of federal agencies. For example, there are four agencies (FRB, FTC, HUD, and DOJ) that have roles in fair lending enforcement with regard to nonbank mortgage subsidiaries of bank holding companies. Federal agencies involved in fair lending oversight and enforcement—including FRB, FTC, HUD, and DOJ and other federal banking regulators—recognize the need for effective coordination in their Interagency Policy Statement on Discrimination in Lending. This policy states that they will seek to coordinate their actions to ensure that each agency's action is consistent and complementary.

In keeping with the spirit of this policy, FRB routinely solicited input from the primary federal regulator for the banking subsidiaries of the holding

[17]According to FRB, one bank holding company merger or acquisition application has been denied on the basis of fair lending compliance issues. In 1993, FRB denied the application by Shawmut National Corporation to acquire the New Dartmouth Bank on the basis of fair lending concerns. In denying the application, FRB cited DOJ's and FTC's ongoing joint investigation of the lending practices of Shawmut Mortgage Company, a holding company affiliate. The statement also emphasized inaccuracies in HMDA data reported by Shawmut. The investigation was prompted by a 1992 FRB referral reflecting its concern that Shawmut, through the mortgage affiliate, may have engaged in discriminatory treatment of minorities in mortgage lending in Boston. At the time of the application, DOJ and FTC had not yet completed their joint investigation.

companies involved in the merger.[18] In addition, FRB and DOJ staff told us that they coordinated informally with each other during the merger application process regarding the fair lending compliance of the holding company subsidiaries involved in the mergers. However, FRB did not typically contact FTC or HUD to determine if they had ongoing investigations involving any of the bank holding company subsidiaries or other data, including consumer complaints, that could be useful in assessing the fair lending concerns raised by consumer and community groups during the merger process. In the five merger cases in which fair lending concerns about the nonbank mortgage subsidiaries were raised, FRB contacted FTC with regard to only one of the merger applications; FRB did not contact HUD in any of the cases. Without coordination with FTC and HUD, FRB cannot ensure that it has access to all relevant information about fair lending issues that may arise in its consideration of bank holding company merger applications.

In three of the six merger cases, HUD had fair lending complaint investigations in process at the same time that FRB was considering the merger applications. There was one merger in which HUD had three ongoing investigations arising out of consumer complaints (complaint investigations) at the time of the merger application. For example, one of the cases that HUD was investigating during a merger involved alleged discrimination at the preapplication interview, such as minority applicants receiving less information about the bank's mortgage products and being quoted less favorable terms than similarly qualified White applicants. All six of the complaint investigations that were in process at the time of the mergers were the result of complaints by individuals. In five of the six cases, HUD entered into conciliation agreements that involved monetary payments to the complainants ranging from $350 to $46,000.

Public and Enforcement Agencies Need Holding Company Structure Information

In soliciting input on the proposed merger, FRB did not provide or direct federal enforcement agencies or the public to structural information about bank holding companies that would identify an affiliated bank and nonbank lenders involved in the merger. As a result, federal enforcement agencies and the public may not have been able to provide all relevant information. For this reason, FRB may not have had current and complete fair lending information on bank holding companies to properly assess the fair lending activities of these companies during the merger application process.

[18]FRB also solicited information from the relevant state regulator of the banking subsidiaries of the holding companies involved in the merger.

Ensuring knowledge of and access to structural information on bank holding companies, including the names and addresses of bank and nonbank lenders under the applicant, could enable the enforcement agencies to better complement FRB's efforts to assess the fair lending activities of bank holding company entities for the merger application process. A HUD official we interviewed stated that without information from FRB regarding the structural organization of a bank holding company, HUD may not be able to identify the entities within the holding company structure that were subject to ongoing or past complaint investigations. Officials from DOJ and FTC also indicated the need for such information.

Access to information about the structural organization of the holding companies involved in proposed mergers could also help improve the quality of public comments that FRB receives during the merger process. FRB staff stated that the comments that they receive from consumer and community groups often exhibit a lack of understanding of the often complex structural organization of the holding companies involved in a proposed merger—particularly as it relates to mortgage lending activity.

Outlines of the hierarchical structure of bank holding companies have been available since January 1997 through the FRB's National Information Center (NIC) on the Internet.[19] However, not all the government agencies and consumer and community groups may be aware of the NIC source or have access to it. In addition, the structural information provided by NIC could be viewed as somewhat overwhelming and, in that sense, difficult to use. As noted on the NIC Web site itself, the information for large institutions "can be quite lengthy and complex." The structural information on the NIC Web site is also limited in that geographical information is provided for some, but not all, lenders within holding companies. Although the site offers the names and addresses of banking institutions' branch offices, it does not offer such information for nonbank lenders within a holding company. To determine the affiliation of a local lender's branch office, consumers are likely to find names and addresses necessary—especially in light of the many consolidations that are occurring in today's financial marketplace and the similarities that can exist in lenders' names.

FRB Did Not Routinely Forward Comment Letters

Because the enforcement of fair lending laws is shared by a number of federal agencies and fair lending problems may involve the interaction of entities overseen by differing federal agencies, coordinated information-sharing among the agencies can contribute to effective federal oversight.

[19]The NIC data can be accessed at http://www.ffiec.gov/nic.

FRB staff told us they do not typically forward the fair lending-related comment letters received during the merger process to the appropriate primary banking regulator, FTC, or HUD for consideration in subsequent fair lending oversight activities. FRB staff stated that they do refer some of the fair lending-related comment letters if they identify problems or practices that give rise to supervisory concerns. They explained that their internal policies and, in the case of HUD, a Memorandum of Agreement between HUD and the banking regulators require FRB to forward consumer complaints by individuals to the appropriate federal agency. [20] However, FRB staff stated that comment letters that raised general fair lending issues regarding lending patterns or policies would not have been routinely forwarded to other agencies. For example, FTC did not receive the comment letters from consumer and community groups that raised fair lending issues with the nonbank mortgage subsidiaries of the holding companies involved in four of the mergers. We believe that by forwarding the fair lending-related comment letters, FRB will provide the other agencies the opportunity to detect problems that arise from the interactions of entities under the holding company structure that may otherwise go undetected.

Conclusions

The historical division of fair lending oversight responsibility and enforcement authority presents challenges and opportunities to agencies that have jurisdiction over the entities in large bank holding companies. Although large bank holding companies typically include entities overseen by different federal regulators, some types of fair lending abuses could involve operating relationships between such entities. An adequate federal awareness during the merger application process of fair lending compliance performance and federal response to any alleged fair lending abuses may well depend upon effective information-sharing among the various agencies and the ready availability to these agencies and the public of information identifying lenders under the holding company. Although the merger application process is not intended to substitute for fair lending examination or enforcement processes of individual agencies, it presents an opportunity to enhance the effectiveness of those processes. To take advantage of this opportunity, the FRB's merger application process for large bank holding companies should provide that relevant information, including consumer complaints or consumer complaint data, be obtained from all agencies with responsibility for compliance with fair lending laws. Further, the process should ensure that this information, as well as comment letters received from consumer and community groups, is shared

[20] Executive branch agencies are required to notify HUD of FHAct violations and complaints under Executive Order 12892. Exec. Order No. 12892, 59 Fed. Reg. 2, 939 (1994).

among those agencies to assist in their continuing efforts to identify and oversee developments in mortgage lending that can affect lender compliance with fair lending laws.

FRB, as regulator of bank holding companies, is uniquely situated to monitor developments in operating relationships among holding company entities that could affect fair lending. Its role could be especially valuable in monitoring the lending activity of nonbank mortgage subsidiaries. The FRB policy of not routinely examining nonbank mortgage subsidiaries for fair lending compliance and the FTC role as an enforcement agency rather than a regulator result in a lack of regulatory oversight of the fair lending performance of nonbank mortgage subsidiaries whose growth in lending out-paced other bank sector entities in 1997.

Recommendations

To enhance the consideration of fair lending issues during the bank holding company merger approval process, we recommend that the Board of Governors of the Federal Reserve System develop a policy statement and procedures to help ensure that

- all parties asked to provide information or views about the fair lending performance of entities within the bank holding companies are given or directed to sources for structural information about the holding companies, and
- all federal agencies responsible for helping to ensure the fair lending compliance of entities involved in the proposed merger are asked for consumer complaints and any other available data bearing on the fair lending performance of those entities.

To aid in ongoing federal oversight efforts, we recommend that FRB develop a policy and procedures to ensure that it provides federal agencies relevant comment letters and any other information arising from the merger application process that pertains to lenders for which they have fair lending enforcement authority. For example, the other agencies may be interested in receiving FRB's HMDA analysis as well as the other data obtained and analyzed by FRB in response to the fair lending allegations raised in the comment letters.

In addition, we recommend that FRB monitor the lending activity of nonbank mortgage subsidiaries and consider examining these entities if patterns in lending performance, growth, or operating relationships with other holding company entities indicate the need to do so.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from the Chairman of the Federal Reserve Board, the Comptroller of the Currency, the Secretary of Housing and Urban Development, the General Counsel of the Federal Trade Commission, and the Assistant Attorney General for Administration of the Department of Justice. Each agency provided technical comments, which we incorporated into the report where appropriate. In addition, we received other written comments from FRB, OCC, and HUD; these are reprinted in appendixes IV through VI of this report.

With respect to the draft report's recommendations, FRB sought clarification regarding the first recommendation, generally agreed with the next two recommendations, and disagreed with the last recommendation. OCC and HUD did not disagree with our recommendations and expressed their support for efficient and effective enforcement of the fair lending laws. Further, HUD suggested that a more formal arrangement be created for obtaining and considering agency input during FRB's merger approval process.

FRB sought clarification of our intent in the first recommendation—that, when soliciting comments on proposed bank holding company mergers, FRB provide structural information about those holding companies. FRB said that information about holding company structure is available to the public and federal agencies on the Internet at the Federal Reserve's National Information Center (NIC) site and, upon request, from the Board and the Reserve Banks. FRB also said that the information is often in the application filed by the applicant bank holding company, for those who elect to review the application in full; and the information is widely available from publications and from other federal agencies.

We added information to the text to clarify our intent. Our intent in recommending that FRB provide the structural information or a source or sources of such information is to enhance consideration of fair lending issues during the merger approval process. We believe that the provision of structural information, including names and addresses of branch offices of lenders, or directions about how to obtain that information, can help ensure that FRB receives from interested parties timely and complete fair lending information on lenders involved in the merger. Without being able to identify the bank and nonbank lenders in the holding companies involved in a merger, interested parties could be unable to determine if lenders whose actions have raised fair lending concerns are affiliated with those holding companies. We do not disagree that this information is sometimes available from a variety of sources. However, ready public access to that information depends upon public awareness of the availability of the information. We note that none of the Federal Register notices requesting public comment on bank holding company mergers in our sample that occurred after 1997, when NIC was created, mentioned the NIC Internet site or any other source of information about the structure of the applicant bank holding companies.

Responding to the report's statement that information provided on NIC can be quite lengthy and complex, FRB said that it believed the complexity is largely a reflection and a function of the size and scope of these large organizations. FRB also said it was not clear just how the information could be made simpler for the public. We agree that the complexity of the information about the largest bank holding companies on NIC is a function of the size and scope of these organizations. However, we also believe that the information could be narrowed, and in that way simplified, by a mechanism that could help interested parties focus on the relevant details of the holding company's structure. A variety of entities are often affiliated with large holding companies, including, for example, investment, leasing, and real estate development companies. A NIC search mechanism to narrow the structural information to bank and nonbank lenders affiliated with a holding company would aid federal agencies and consumer organizations that may need such information to collect or sort through fair lending concerns about such institutions from field offices or member organizations nationwide.[21] More focused information, including names and addresses of branch offices, would also benefit consumers attempting to determine the affiliation of a local lender's office.

As mentioned in the report, NIC provides a mechanism for obtaining lists of the names and addresses of banking institutions' branch offices; however, it does not provide the addresses of nonbank lenders' branch offices or list such branch offices. We believe that this is an important weakness in NIC as a tool to be used in the merger application process by agencies, consumer groups, and individuals, considering the prevalence of concerns about nonbanks' fair lending performance in the merger cases we analyzed.

FRB said that persons generally start out with the identity of the organization about which they have concerns, and it should be relatively simple to confirm whether that organization is affiliated with an applicant bank holding company. We agree that persons would generally use NIC to

[21]Nonbank subsidiaries of large holding companies include firms engaged in a wide variety of activities. For example, lenders that are nonbank subsidiaries of holding companies could include mortgage companies and finance companies.

determine if an identified organization is affiliated with an applicant bank holding company. However, the ease of determining this through NIC could vary, depending upon whether the organization of concern is a banking institution or a nonbank subsidiary of the holding company. As of October 10, 1999, NIC users could determine the holding company affiliation of a banking institution (but not a nonbank holding company subsidiary) by entering the legal name of a banking institution (or even part of that name) and the city and state in which the institution is located. NIC also offered a function enabling users to obtain a listing of addresses of all branch offices of banking institutions (but not addresses of franchises or branch offices of lenders that are nonbank holding company subsidiaries). To confirm a nonbank lenders' affiliation with an applicant bank holding company, the interested party's only option is to search for the nonbank lender's legal name while reading through the multipage listings of entities that describe the entire hierarchial structure, starting with the parent holding company. The only geographical information provided for a nonbank holding company subsidiary in the listing is the city and state domicile of the head office—that is, no branch offices or franchises are identified in the listing.

Referring to our mention of the absence of geographic information on NIC, FRB notes that a person's concerns about a particular entity will likely relate to the geographic area in which the person resides, or to which the person has some link. We agree with this statement. We also believe that a person concerned about a particular local lender is likely to need to see the names and addresses of lenders affiliated with holding companies involved in a proposed merger to determine if his concern about the local lender is relevant for FRB's consideration.

With regard to our recommendation for greater information sharing between FRB, the other banking regulators, HUD, and FTC during the merger application process, FRB generally agreed and said it would explore ways to enhance the systematic exchange of relevant information. However, FRB did not agree that it should seek information about other agencies' consumer complaints as part of the merger application review process. The reasons for this were:

- A 1992 Memorandum of Understanding between HUD and the banking regulators' calls for HUD to refer allegations of fair lending violations to the appropriate banking regulator, which is to take these into account in examinations and supervisory activity.
- HUD cases involving individual or isolated grievances—and not a finding of a pattern or practice—would not likely represent the type of

information that is particularly useful in FRB's review of managerial resources for purposes of the Bank Holding Company Act.

Although the 1992 Memorandum of Understanding between HUD and the banking regulators calls for the referral of allegations of fair lending violations to the appropriate banking regulator, it does not address the referral of these fair lending allegations to FRB for consideration during the bank holding company merger application process. The fair lending allegations received by HUD, FTC, and the other banking regulators could be useful to FRB in its consideration of the managerial resources factor during the merger process. We acknowledge that not all consumer complaints received by other agencies would be relevant for FRB to consider during the bank holding company merger process. However, an otherwise unobserved pattern or practice bearing on the managerial resources of a large and complex holding company could emerge from a review of widely collected consumer complaints. Moreover, consumer complaint letters can be a useful indicator of certain types of illegal credit discrimination, such as discriminatory treatment of applicants and illegal prescreening and marketing. FRB stated that the exchange of information between agencies should (1) ensure that the information is provided in a timely manner and (2) maximize the benefits of the exchange while minimizing the burden to all parties. We concur with FRB's expectations regarding the exchange of information and acknowledge FRB's initiative in planning to consult with the other federal agencies to identify possible ways to enhance the systematic exchange of relevant information.

FRB stated that it planned to take action in response to our recommendation that it provide copies of relevant comment letters received during the merger application process to the other federal agencies involved with fair lending enforcement. Specifically, FRB indicated that it would consult with the other agencies and was prepared to establish whatever mechanism deemed appropriate to ensure that the agencies receive public comments that they would find helpful to ongoing supervisory oversight. FRB's plans are a positive first step in responding to our recommendation.

FRB disagreed with our recommendation as stated in the draft report that it monitor the lending activities of nonbank mortgage subsidiaries and consider reevaluating its policy of not routinely examining these entities if circumstances warranted. FRB stated that it had recently studied this issue at length and concluded that although it had the general legal authority to examine nonbank mortgage subsidiaries of bank holding companies, it lacked the clear enforcement jurisdiction and legal responsibility for engaging in routine examinations. We revised the wording of our recommendation to clarify that we were not necessarily recommending that FRB consider performing routine examinations of nonbank mortgage subsidiaries. We recognize that FTC has the primary fair lending enforcement authority for the fair lending compliance of nonbank mortgage subsidiaries. However, FRB is uniquely situated to monitor the activities of these nonbank mortgage subsidiaries by virtue of its role as the regulator of bank holding companies and its corresponding access to data that are not readily available to the public or other agencies, such as FTC. If patterns in growth, lending performance, or operating relationships with other holding company entities do not change dramatically, then there may be no reason to examine these entities. Monitoring the lending activities of the nonbank mortgage subsidiaries would help FRB determine when it would be beneficial to conduct targeted examinations of specific nonbank mortgage subsidiaries using size, extent of lending in predominately minority communities, involvement in sub-prime lending, or other factors as the basis for selection. In other cases, FRB may determine that the results of its monitoring efforts should be referred to those agencies responsible for enforcement of nonbank mortgage subsidiaries' compliance with fair lending laws.

OCC and HUD did not disagree with our recommendations. OCC stated that it was committed to working with all the agencies that have a role in providing efficient and effective oversight of compliance with fair lending laws. HUD stated that it stands committed to enhancing coordination among federal agencies to achieve fair lending. HUD noted its support for efforts to ensure greater compliance among nondepository lenders with the FHAct and other consumer protection laws. HUD suggested that a memorandum of understanding that would govern interagency coordination during the merger application process might be appropriate. Such a memorandum could be a useful tool to document each agency's responsibility regarding information sharing and coordination during the merger application process for bank holding companies.

As agreed with your offices, we are sending copies of this report to Representative Rick Lazio, Chairman, and Representative Barney Frank, Ranking Minority Member, of the House Subcommittee on Housing and Community Opportunities; Representative James Leach, Chairman, and Representative John LaFalce, Ranking Minority Member, of the House Committee on Banking and Financial Services; and Senator Phil Gramm, Chairman, and Senator Paul Sarbanes, Ranking Minority Member, of the Senate Committee on Banking, Housing, and Urban Affairs. We are also sending copies of the report to the Honorable Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System; the Honorable John D. Hawke, Jr., Comptroller of the Currency; the Honorable Andrew Cuomo, Secretary, Department of Housing and Urban Development; the Honorable Stephen R. Colgate, Assistant Attorney General for Administration, Department of Justice; and the Honorable Deborah A. Valentine, General Counsel, Federal Trade Commission. Copies will also be made available to others on request.

If you or your staff have any questions regarding this letter, please contact me or Kay Harris at (202) 512-8678. Key contributors to this report are acknowledged in appendix VII.

Thomas J. McCool

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Director, Financial Institutions
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Contents

Abbreviations

CRA	Community Reinvestment Act
DOJ	Department of Justice
ECOA	Equal Credit Opportunity Act
FDIC	Federal Deposit Insurance Corporation
FHA	Fair Housing Act
FRB	Federal Reserve Board
FTC	Federal Trade Commission
HMDA	Home Mortgage Disclosure Act
HUD	Department of Housing and Urban Development
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
FRS	Federal Reserve System

Status of Actions on Recommendations Made in Our 1996 Report

GAO recommendation	Responsible agency(ies)	Action taken by agency(ies)
Remove the disincentives associated with self-testing.	Federal Reserve Board (FRB) and Department of Housing and Urban Development (HUD)	Congress enacted legislation in September 1996. FRB and HUD issued implementing regulations in December 1997.[a]
Develop and adopt uniform fair lending examination procedures.	FRB, Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), Office of Thrift Supervision (OTS), and National Credit Union Administration (NCUA)	The Federal Financial Institutions Examination Council approved Interagency Fair Lending Examination Procedures in December 1998.[b]
Adopt guidelines and procedures for the use of preapplication discrimination testing.	FRB, OCC, FDIC, OTS, and NCUA	FRB - yes[c] OCC - yes FDIC - no[d] OTS - no[e] NCUA - no
Use full range of enforcement authority, including civil money penalties, to ensure timely and accurate HMDA data.	FRB, OCC, FDIC, OTS, and NCUA	FRB - yes OCC - yes FDIC - yes OTS - yes NCUA - no[g]
Update guidance on the characteristics of referable pattern or practice cases under ECOA and FHA.	Department of Justice (DOJ)	DOJ issued updated guidance on pattern and practice of discrimination to the banking regulators and HUD in November 1996.[h]

[a]Economic Growth and Regulatory Paperwork Reduction Act of 1996, sec. 2302 (a)(1) & (b)(1), 15 U.S.C. 1691c-1(1996); Regulation B, 12 C.F.R. sec. 202.15(1998)(FRB's implementing regulation on self-testing); and 12 C.F.R. parts 100 and 103 (1998) (HUD's implementing regulation on self-testing).

[b]FRB, FDIC, and OTS have implemented the procedures. OCC and NCUA indicated they are in the process of developing additional guidance to use in conjunction with the Interagency Fair Lending Examination Procedures.

[c]FRB stated it has authorized the use of preapplication testing in its reserve banks. However, none of the reserve banks have conducted any tests to date.

[d]In a letter dated September 4, 1998, FDIC stated it does not engage in the use of testers in fair lending examinations. Instead, FDIC encourages banks to implement their own testing programs, and FDIC examiners are to undergo training relative to a bank's self-testing program.

[e]OTS has initiated a project to determine the feasibility of conducting a preapplication testing program.

[f]NCUA is in the process of developing guidance to address preapplication testing.

[g]NCUA indicated that timely and accurate HMDA data has not been identified as a problem; therefore, it has not assessed civil money penalties.

[h]Department of Justice Memorandum, "Identifying lender practices that may form the basis of a pattern or practice referral to the Department of Justice," November 1996.

Source: Data provided by FRB, OCC, FDIC, OTS, NCUA, DOJ, and HUD.

Emerging Fair Lending Issues Not Raised in the Six Mergers

In addition to the issues raised by consumer and community groups in the six mergers that we looked at, representatives of the regulatory and enforcement agencies and the bank holding companies we contacted identified various emerging fair lending issues. These issues involved (1) credit scoring, (2) automated loan underwriting, and (3) mortgage brokers. The fair lending concerns associated with these three issues are discussed below. We do not attempt to address all of the various and complex enforcement, compliance, and consumer protection issues associated with each of the three topics. Instead, we highlight some of the fair lending concerns that have been associated with each topic.

Credit-Scoring Issues

The Federal Reserve Board (FRB) and the Department of Justice (DOJ) raised the issue of potential discrimination in credit scoring as an emerging fair lending concern. The Office of the Comptroller of the Currency (OCC) expressed the concern that some lenders may view credit scoring as a safe harbor from fair lending issues. This would ignore the possibility that differential treatment may occur in segmenting the applicant population during the development or input of the data, or in judgmental overrides of the credit-scoring system.

According to credit reporting companies (credit bureaus), credit scoring is intended to be an objective method for predicting the future credit performance of borrowers. Credit scoring has gained wide usage among lenders who use it to make lending decisions on various types of loans, such as installment; personal finance; bankcard; and, most recently, mortgages. To develop a credit-scoring system, lenders generally use a risk-scoring process that examines consumer credit reports, assigns numerical values to specific pieces of information, puts those values through a series of mathematical calculations, and produces a single number called a risk score or credit score. Lenders generally offer credit to borrowers with the higher scores. The premise is that the higher scores indicate a better likelihood that the borrower will repay the loan.

According to FRB, discrimination in credit scoring could be revealed in two ways, either through disparate treatment or disparate impact. Disparate treatment and disparate impact are methods of analyzing whether discrimination exists. The disparate treatment analysis determines whether a borrower is treated less favorably than his/her peers due to race, sex, or other characteristics protected by the Equal Credit Opportunity Act (ECOA) or the Fair Housing Act (FHAct). The disparate impact analysis determines whether a lender's seemingly neutral lending policy has a disproportionately adverse impact against a protected group, the policy is justified by business necessity, and a less adverse alternative to such policy or practice exists.

OCC, DOJ, and the Federal Trade Commission (FTC) agree that fair lending concerns in credit scoring most often arise when lenders ignore the credit score (i.e., override the score) and use subjective judgment to make a lending decision. Fair lending concerns associated with credit scoring were not raised as an issue in any of the six bank holding company mergers in our study. Officials from all four of the bank holding companies we interviewed stated they used credit-scoring systems. However, they indicated that their credit-scoring systems were applied with safeguards designed to ensure compliance with fair lending laws and regulations.

From 1990 through 1998, the regulators and enforcement agencies had few cases of discrimination in credit scoring. OCC referred a case in 1995 and another in 1998 to DOJ that dealt with alleged discrimination in credit scoring. An agreement was reached with OCC in the 1995 case, and the 1998 referral resulted in DOJ filing a lawsuit. In this particular case, DOJ alleged that the bank required a higher credit score for Hispanic applicants to be approved for loans/credit. FTC cited one case of credit discrimination in 1994, which resulted in a consent decree. In this case, the lender had used overrides of the credit-scoring system that discriminated against applicants on the basis of marital status.

Automated Loan Underwriting Issues

The fair lending issues that were raised regarding credit scoring are closely associated with the issues associated with automated loan underwriting. According to the Federal National Mortgage Association (Fannie Mae), automated loan underwriting is a computer-based method that is intended to enable lenders to process loan applications in a quicker, more efficient, objective, and less costly manner. The lender enters information from the borrower's application into its own computer system. This information is communicated to an automated loan underwriting system, such as those developed by Fannie Mae and the Federal Home Loan Mortgage Corporation (Freddie Mac). The lender then requests a credit report and credit score from a credit bureau. The automated loan underwriting system then evaluates the credit bureau data and other information to arrive at a recommendation about whether or not the loan meets the criteria for approval.

The following is an excerpt from a recent report by the Department of Housing and Urban Development (HUD) on the single-family underwriting and appraisal guidelines of Fannie Mae and Freddie Mac that summarizes some of the fair lending concerns associated with automated loan underwriting systems:

> "Currently, there is little known about the effects of automated underwriting systems on low- and moderate-income or minority applicants. Some informants believe these systems may prevent underwriters [lenders] from taking full advantage of the increased levels of underwriting flexibility allowed by the GSEs [government-sponsored enterprises]. Lower income applicants are more likely to be required to produce documentation supporting their loan application, such as letters explaining past credit problems or statements from employers about expected salary increases. Automated systems may not have the ability to assess all of these kinds of data, and so may place lower income borrowers at a disadvantage. Informants also raised concerns that these systems may allow lenders to reduce their underwriting staff because automated systems increase the productivity of individual underwriters. Lenders, informants pointed out, could reduce staff and only process applications identified by automated systems as requiring minimal further review. As a result, automated systems may make it harder for marginal applicants to receive personalized attention from an underwriter."[1] "

Representatives of the four holding companies that resulted from the mergers included in our study stated that they all used automated loan underwriting and credit-scoring systems to some degree. Three of the four holding companies said they have adopted a program in which loans that are not initially approved by their automated loan underwriting systems are subject to a secondary review by an experienced loan underwriter. Although the secondary review programs added additional costs and time to the process, the holding companies stated that it was necessary to guard against potential disparate impacts with respect to lending to minorities.

Mortgage Broker Issues

Another concern that was raised by bank holding company officials that we met with involved a lender's liability for the fair lending activities of mortgage brokers who are affiliated in some fashion with the lender. Although no standard definition of a mortgage broker exists, mortgage brokers are generally entities that provide mortgage origination or retail services and bring a borrower and a creditor together to obtain a loan from the lender (or funded by the lender).[2] Typically, the lender decides whether to underwrite or fund the loan. HUD defines two categories of mortgage brokers. HUD's narrowly defined category consists of entities that may have an agency relationship with the borrower in shopping for a loan and

[1] A Study of the GSEs' Single Family Underwriting Guidelines, Final Report, April 1999, Department of Housing and Urban Development.

[2] According to HUD, mortgage brokers initiate an estimated half of all home mortgages made each year in the United States. This estimate covers loans originated by all lender types, including independent finance companies that are not affiliated with insured depository institutions or their holding companies. (See app. III for data regarding the number of loans originated from 1995 through 1997 by lender type.)

therefore have a responsibility to the borrower because of this agency representation. HUD's broadly defined category consists of entities who do not represent the borrower but who may originate loans with borrowers utilizing funding sources in which the entity has a business relationship. The banking industry is concerned that lenders could be held liable for a fair lending violation resulting from the activity of a mortgage broker that provides origination or retail services for a lender. When lenders use mortgage brokers in providing mortgage credit, it is not always clear whether the lender, the mortgage broker, or both are responsible for the credit approval decision. FRB officials noted differences between the federal enforcement agencies and FRB with respect to the criteria used to determine when lenders are responsible for lending transactions involving brokers.

Of the four holding companies resulting from the mergers in our study, three indicated that they use mortgage brokers. Officials of one of the holding companies we contacted said they wanted additional clarification from bank regulators regarding the bank's liability for its lending decisions in transactions involving brokers because it used mortgage brokers extensively in making loans for manufactured housing and automobile loans.

ECOA, as implemented by FRB's Regulation B, defines a creditor as someone who "regularly participates" in credit-making decisions. Regulation B includes in the definition of creditor "a creditor's assignee, transferee, or subrgee who so participates." For purposes of determining if there is discrimination, the term creditor also includes "a person who, in the ordinary course of business, regularly refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made." Regulation B states that "a person is not a creditor regarding any violation of ECOA or regulation B committed by another creditor unless the person knew or had reasonable notice of the act, policy, or practice that constituted the violation before becoming involved in the credit transaction." This is referred to as the "reasonable notice" standard. On the basis of the definition of creditor contained in Regulation B and the specific facts, a mortgage broker can be considered a creditor and a lender can also be considered a creditor even if the transaction involves a mortgage broker.

FRB noted that lenders have increasingly asked for guidance regarding the definition of a creditor as they expand their products and services. In March 1998, FRB issued an Advance Notice of Proposed Rulemaking that solicited comments related to the definition of "creditor" and other issues as part of its review of Regulation B. Specifically, FRB solicited comments on whether (1) it was feasible for the regulation to provide more specific guidance on the definition of a creditor; (2) the reasonable notice standard regarding a creditor's liability should be modified; and (3) the regulation should address under what circumstances a creditor must monitor the pricing or other credit terms when another creditor (e.g., a loan broker) participates in the transactions and sets the terms.

On August 4, 1999, FRB published proposed revisions to Regulation B that expand the definition of creditor to include a person who regularly participates in making credit decisions, including setting credit terms. In the Discussion of Proposed Revisions to the Official Staff Commentary (the Discussion), FRB stated that it believes that it is not possible to specify by regulation with any particularity the circumstances under which a creditor may or may not be liable for a violation committed by another creditor. Thus, FRB decided that Regulation B would retain the "reasonable notice" standard for when a creditor may be responsible for the discriminatory acts of other creditors. In the Discussion, FRB further stated that it believes that the reasonable notice standard may carry with it the need for a creditor to exercise some degree of diligence with respect to third parties' involvement in credit transactions, such as brokers or the originators of loans. However, FRB believes that is not feasible to specify by regulatory interpretation the degree of care that a court may find required in specific cases.

Opinions vary among regulatory agencies in terms of a lender's liability in transactions that involve mortgage brokers. OCC and FRB share the view that a broker must be an agent of the lender, or the lender must have actual or imputed knowledge of a broker's discriminatory actions, for a lender to share liability for discrimination by a broker. DOJ has taken the position that lenders are liable for all of their lending decisions, including those transactions involving mortgage brokers. In 1996, DOJ took one enforcement action involving a mortgage broker. The case involved mortgage company employees and brokers charging African-American, Hispanic, female, and older borrowers higher fees than were charged to younger, White males. HUD officials told us their agency has not taken a position on this issue. FTC officials told us that FTC has not taken any action that reflects a position on this issue.

Data on Loans Originated by Institution Type From 1995 Through 1997

From 1995 through 1997, Federal Reserve Board (FRB) data indicated that home mortgage lending activity[1] by institution type within the financial sector generally increased as measured by the total number of loans originated. Figure III.1 provides an overview of mortgage lending activity by financial sector.[2] It shows that the bank sector originated more loans than the thrift sector or independent finance companies over this period when the large bank holding company mergers we studied occurred. As discussed previously, banking regulators (FRB, Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision) have the primary oversight responsibility for the bank and thrift sectors. The Federal Trade Commission (FTC) and the Department of Housing and Urban Development (HUD) are responsible for fair lending enforcement of independent finance companies, which are not addressed in this study.

Figures III.2 and III.3 provide overviews of lending by components of the bank sector: banks, bank subsidiaries, and nonbank mortgage subsidiaries of bank holding companies. The home mortgage lending activity of the three components has remained relatively stable from 1995 to 1997. Figure III.2 shows that banks originated the most home mortgage loans in this period followed by bank subsidiaries and then nonbank mortgage subsidiaries of bank holding companies. Figure III.3 reveals the same pattern when dollar value of loans is considered. However, the data reveal larger percentages in the dollar value of home mortgage loan originations for both bank subsidiaries and bank holding company mortgage subsidiaries in comparison to the share of mortgage loan originations. The banking regulators are responsible for the fair lending oversight of the banks and bank subsidiaries; FTC and HUD are responsible for fair lending enforcement of the nonbank mortgage subsidiaries of bank holding companies.

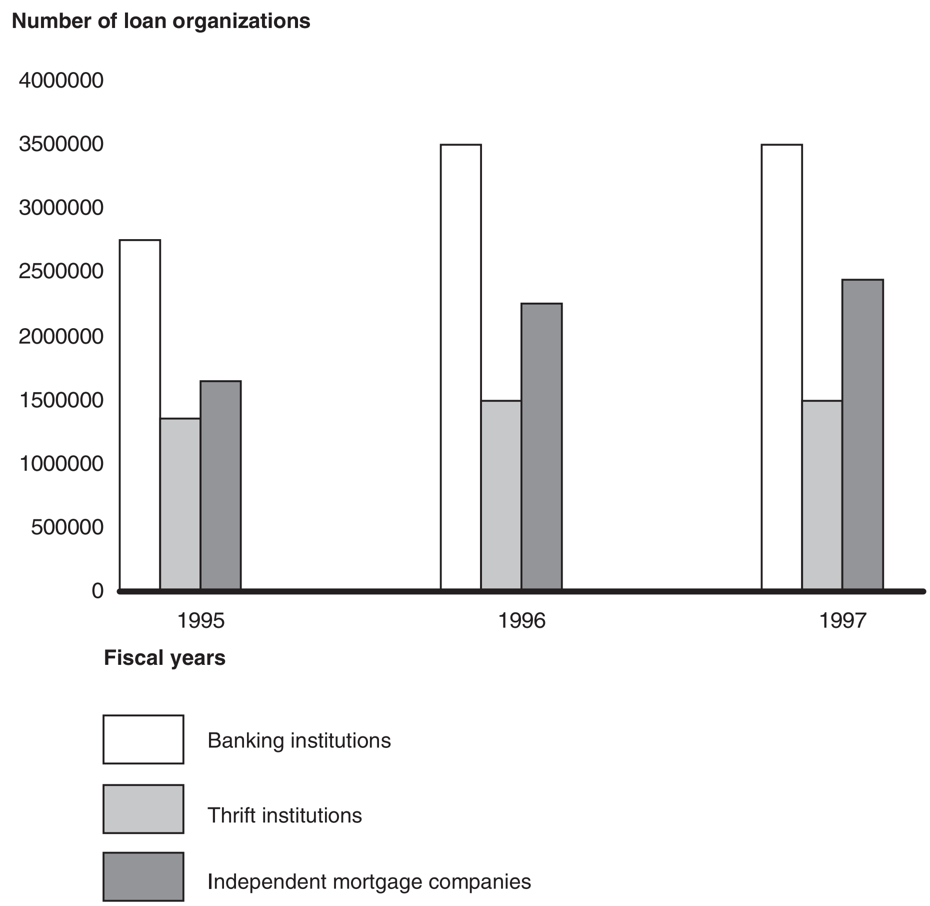
Because the nonbank mortgage subsidiaries of bank holding companies are not routinely examined for fair lending compliance by any federal regulatory or enforcement agencies, we analyzed their rate of growth compared to other bank sector lenders. Figure III.4 shows that in 1997, the percent change in loan originations by nonbank mortgage subsidiaries of bank holding companies was large in comparison to loan originations by

[1] The Home Mortgage Disclosure Act Data (HMDA) on lending activity includes: (1) purchasing loans for single and multifamily dwellings, manufactured homes, and mobile homes; (2) home equity loans; and (3) mortgage refinances.

[2] Credit Union data were not included in the figures due to the relatively small volume of mortgage loans they originated versus the other types of lenders.

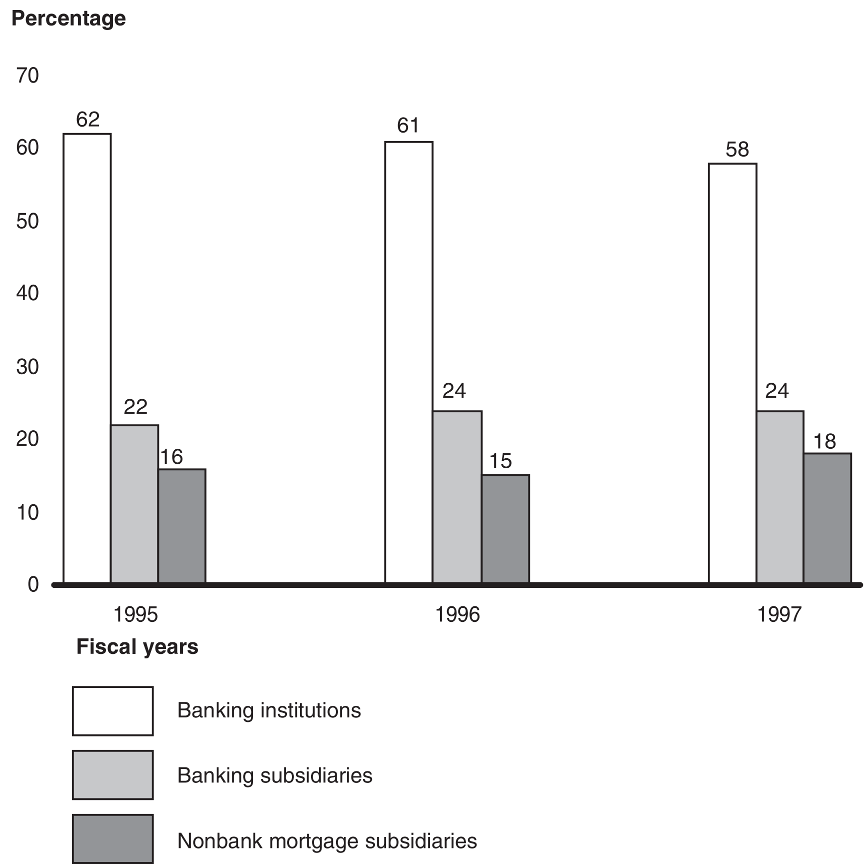
banks and banking subsidiaries. Figure III.5 shows that the dollar value of mortgage loan originations has a pattern similar to the percentage change in loan originations. Figure III.4 and III.5 combined show an increasing presence in home mortgage lending by nonbank mortgage subsidiaries of bank holding companies.

Figure III.1: Loans Originated by Financial Sector From 1995 to 1997



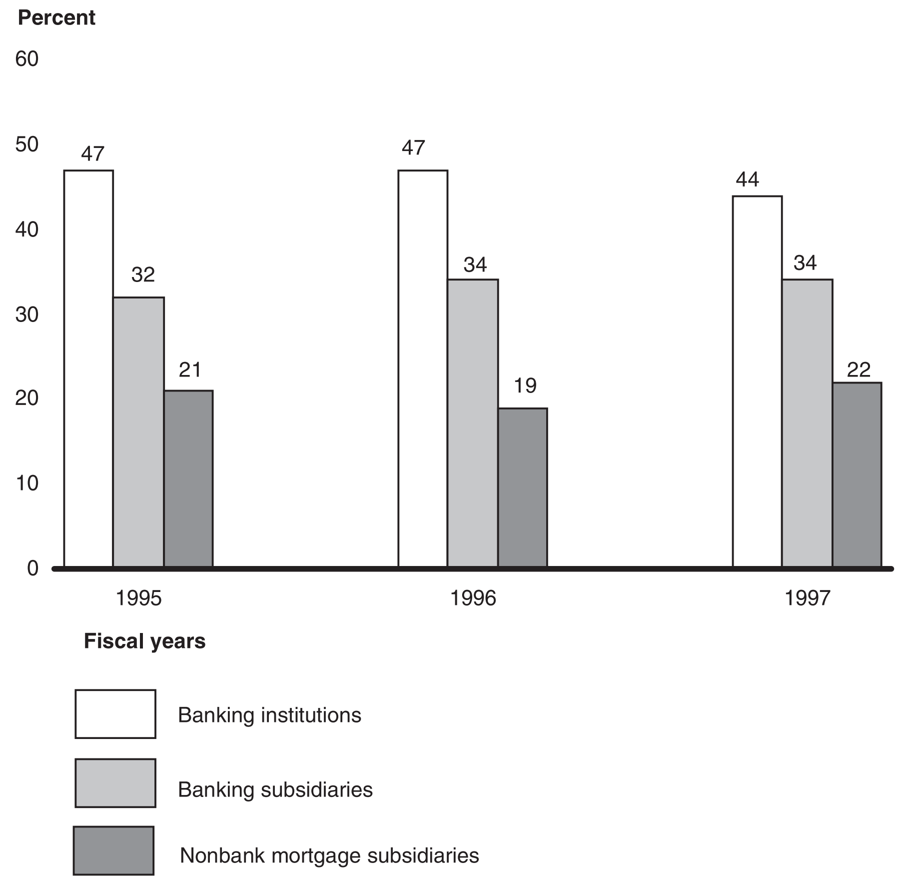
Source: HMDA data provided by Division of Research and Statistics, FRB.

Figure III.2: Proportion of the Number of Loans Originated by Bank Sector Component From 1995 to 1997



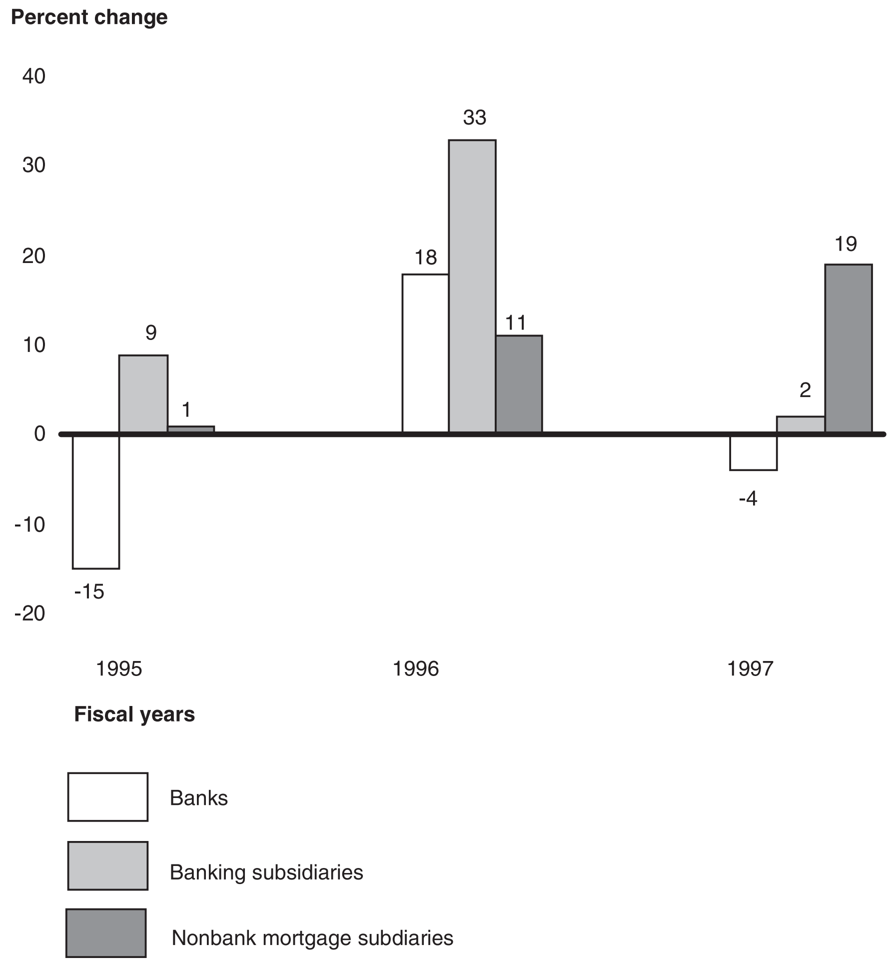
Source: HMDA data provided by Division of Research and Statistics, FRB.

Figure III.3: Proportion of the Dollars of Loans Originated by Bank Sector Component From 1995 to 1997



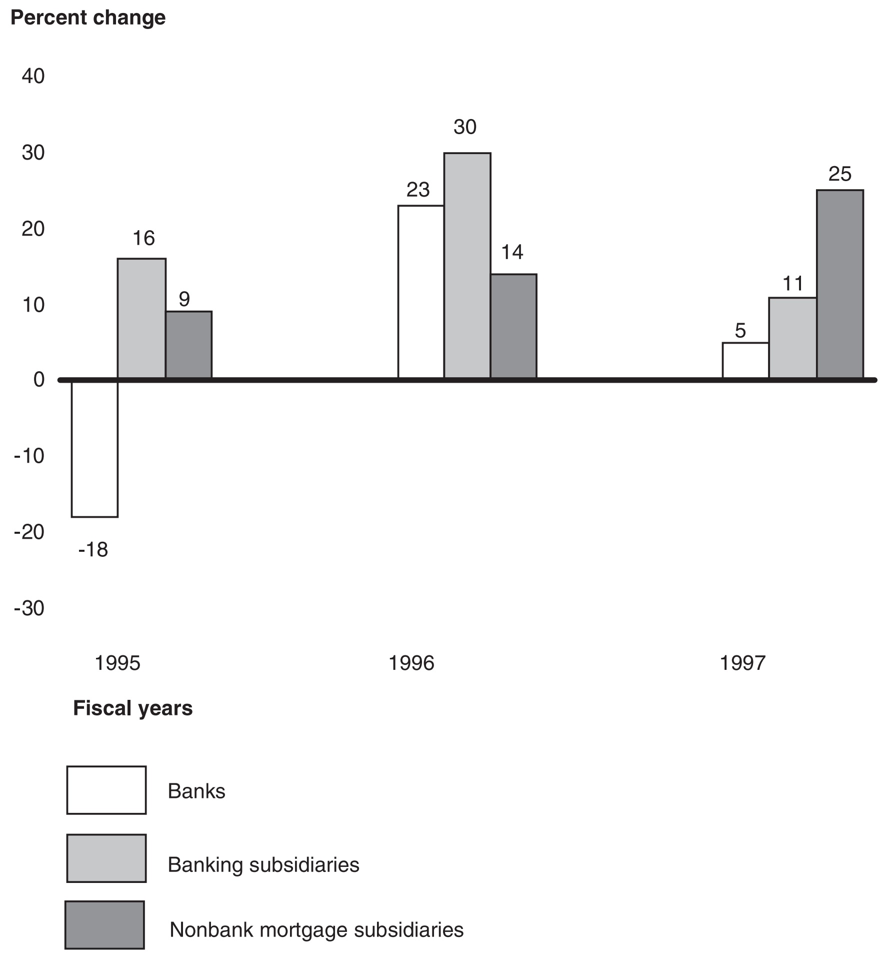
Source: HMDA data provided by Division of Research and Statistics, FRB.

Figure III.4: Percent Change in the Number of Loan Originations for Each Bank Sector Component From 1995 to 1997



Source: GAO analysis of HMDA data provided by Division of Research and Statistics, FRB.

Figure III.5: Percent Change in the Dollar Value of Loan Originations for Each Bank Sector Component From 1995 to 1997



Source: GAO analysis of HMDA data provided by Division of Research and Statistics, FRB.

Comments From the Federal Reserve Board

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

September 20, 1999

Mr. Thomas J. McCool
Director
Financial Institutions and Markets Issues
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. McCool:

We appreciate the opportunity to comment on your agency's draft report entitled Large Bank Mergers: Fair Lending Review Could be Enhanced With Better Coordination.

The report discusses the Board's processing of large bank merger applications in regard to enforcement of the Fair Housing Act and the Equal Credit Opportunity Act. It offers recommendations for ways in which the Board could enhance the fair lending aspects of its reviews of these applications, and aid the other agencies in ongoing federal oversight regarding fair lending. The report recommends (1) that the Board ask other federal agencies for consumer complaints and other available data bearing on fair lending performance (and direct them to structural information about the bank holding company); (2) that the Board provide public comments that raise fair lending concerns to the supervisory agency charged with enforcing the fair lending laws with respect to the entities involved; and (3) that the Board monitor the lending activity of nonbank mortgage subsidiaries of bank holding companies, and possibly consider once again whether to routinely examine these entities for fair lending compliance.

We will discuss these recommendations in turn. But first, it is important to explain the context in which the Board addresses fair lending matters in bank merger cases. When the Federal Reserve considers a bank holding company application, it looks at a number of factors that are determined by statute. These are the competitive effects of the transaction, the financial resources and future prospects of the organization, the managerial resources of the organization, and the convenience and needs of the communities affected.

The Board considers compliance with the fair lending laws as part of its review of the managerial resources of an organization. It is important to understand, however, that the Board is limited to determining whether an organization's record of compliance with these laws, as determined by the agencies responsible for their enforcement (or by the courts), reflects adversely on the managerial resources of the organization or other statutory factors.

Mr. Thomas J. McCool
September 20, 1999
Page 2

Enforcement of the fair lending laws, including the authority to determine compliance, has been specifically granted by statute to various agencies other than the Board, except with respect to state member banks of the Federal Reserve System. (The Board is in the same position regarding most federal laws, including the securities and equal employment laws, as well as various state statutes.) For example, Congress specifically granted the Federal Trade Commission, and not the Board, jurisdiction over the enforcement of the fair lending laws as they apply to nonbank companies; this includes all nonbank subsidiaries of a bank holding company. This is in direct contrast to the treatment of state member banks, where the Board expressly has been granted authority to enforce the fair lending and other federal laws.

The GAO report correctly notes that in the Board's review of fair lending concerns, the Board relies heavily on the relevant supervisory agency's examination reports when the entity is subject to agency examination. This practice is appropriate given that examination reports of banks reflect a comprehensive assessment of compliance with the fair lending laws by the agency charged with enforcement of those laws. This assessment is made in the examination process after an on-site and in-depth review of loan files, consideration of written policies and procedures, interviews with lending officers responsible for making credit decisions, and, in the case of fair lending compliance, a review of complaints and their resolution by the institution.

In considering the report's first recommendation, we agree with the concept that the Board should consider relevant information in the course of acting on a bank holding company application. But given the context in which we deal with fair lending concerns, we do not agree with that part of the recommendation that urges the Board to seek information about consumer complaints—from the other banking agencies, the Department of Housing and Urban Development, and the Federal Trade Commission—during the application process.

The report lays heavy stress on a finding that over the three-year period covered by the GAO in its study of large bank mergers, the Department of Housing and Urban Development handled more than 108 cases from 1996 through 1998 involving allegations of unlawful discrimination against banks, their mortgage subsidiaries, or other entities related to bank holding companies. The report presents this finding as support for the recommendation that the Board should seek information about complaints from the other agencies. (It presents the finding as support also for the recommendation, discussed below, that the Board should reconsider its policy of not routinely examining the lending subsidiaries of bank holding companies.)

This finding needs to be placed into context. First, to the extent that the 108-plus cases for the three-year period cited by the report involve depository institutions and their subsidiaries, there already is in place a mechanism for the systematic exchange of information. A Memorandum of Understanding among the agencies, dating back to 1992, calls for the Department to inform the appropriate regulatory agencies of cases involving depository institutions or their subsidiaries (which likely constitute the vast majority of the cases cited). For any such case referred by the Department, the complaint and its resolution are taken into account in the banking regulator's examination of the institution involved, or in other appropriate supervisory measures. We believe, frankly, that this is where these matters should be, and can

Mr. Thomas J. McCool
September 20, 1999
Page 3

best be, handled. Second, to the extent that a Department case involves the resolution or conciliation of an individual or isolated grievance—and not a finding of a pattern or practice—the matter probably would not represent the type of information that is particularly useful to the Board in its review of managerial resources for purposes of the Bank Holding Company Act.

We would, on the other hand, welcome any relevant information that these agencies might be able to provide the Board on investigations that document a pattern or practice of unlawful discrimination in lending by entities affiliated with the applicant bank holding company. In response to the report's recommendation, we will explore—with the financial regulators, the Department of Housing and Urban Development, and the Federal Trade Commission, as well with the Department of Justice—establishing possible mechanisms by which to enhance the systematic exchange of relevant information. We will seek to ensure that they convey relevant information to us in connection with bank holding company applications in a timely manner and in ways that maximize the benefits of the exchange and minimize burden to all parties.

In a related matter, the report recommends that the Board provide enforcement agencies and members of the public, or direct them to sources for, structural information about the bank holding companies involved in an application. As the report notes, this information is, and has been, made generally available on the Internet by way of the Federal Reserve's National Information Center (NIC). In addition, the information is always provided on request to any party seeking it from the Board and the Reserve Banks; often is contained in the application filed by the applicant bank holding company, for those members of the public who elect to review the application in full; and is widely available from publications and from other federal agencies.

The report makes the point that information provided on NIC can be quite lengthy and complex. We believe the complexity is largely a reflection and a function of the size and scope of these large organizations. Given that NIC can provide the entire organizational hierarchy of a bank holding company, it is not clear just how the information could be made simpler for the public. Moreover, persons generally start out with the identity of the organization about which they have concerns, and it should be relatively simple to confirm whether that entity is affiliated with an applicant bank holding company. The report also refers to the absence of geographic information on NIC; but again, a person's concerns about a particular entity will likely relate to the geographic area in which the person resides, or to which the person has some link. These are points where the final report could perhaps clarify GAO's intent with respect to this recommendation.

The report's second recommendation is that the Board develop a policy and procedures to ensure that we provide the appropriate federal agencies relevant comment letters received during the application process and any other information arising from the application process that raise fair lending concerns. As the report notes, we do already refer to the responsible agency any comment letters that raise specific complaints of fair lending discrimination—as distinct from public comments that express more general fair lending concerns not related to any particular customer or transaction. The latter comments we currently refer on a selective basis, in instances

Mr. Thomas J. McCool
September 20, 1999
Page 4

where strong evidence exists of a pattern or practice of unlawful discrimination. We also provide public comments whenever the agency asks to receive them, as occurs on occasion.

In our experience, the public comments raising fair lending concerns during the application process often deal with the perception of disproportionate lending to minorities and areas populated by minority residents; often, too, these comments rely on statistical analyses using HMDA data to support allegations of discriminatory lending. But it is a generally recognized fact that while the HMDA data serve useful purposes in regulatory oversight, the data do not provide a basis for arriving at findings of unlawful discrimination. Thus, benefits to the receiving agency could be somewhat limited. Nonetheless, in response to the recommendation we will consult with the other agencies (and are prepared to establish whatever mechanism seems appropriate) to ensure that they receive public comments from the application process that they would find helpful to their ongoing supervisory oversight.

The report's third recommendation is that the Board monitor the lending activities of nonbank mortgage subsidiaries of bank holding companies and reconsider our policy with respect to routine examinations. We do not agree with this recommendation. The matter is one that we recently studied at length. As the report notes, in January 1998 the Board concluded that while we have the general legal authority to examine these entities, we have neither the clear enforcement jurisdiction nor the legal responsibility for engaging in such activities, as the Congress has directly charged the Federal Trade Commission with these duties. But we did not then, and do not now, rule out making a decision to investigate further a particular case in connection with an application, as we have done in the past, when factors present suggest that discriminatory practices are occurring—and when it seems appropriate for the Board to do so because the matter may relate to relevant managerial factors. Even in this situation, however, the Board's authority seems limited to referring our examination results to the appropriate agency for enforcement.

Thank you for the opportunity to comment on your draft report. We anticipate that the recommendations will generate constructive conversations among the agencies in order to seek out further opportunities to improve upon systems for identifying and remedying discriminatory practices in lending.

Sincerely,

Comments From the Office of the Comptroller of the Currency

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

September 15, 1999

Mr. Thomas J. McCool
Director, Financial Institutions and Markets Issues
General Government Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. McCool:

We have received and reviewed your draft report entitled Large Bank Mergers: Fair Lending Review Could be Enhanced With Better Coordination. The report was prepared at congressional request to describe the fair lending issues raised by consumer and community groups during the application process for six large bank holding company mergers and to assess the Federal Reserve Board's consideration of those issues. The report concludes that fair lending concerns were raised in each merger and that the Federal Reserve analyzed HMDA data but relied mostly on prior examinations to assess fair lending concerns. The report makes recommendations to the Federal Reserve to correct process weaknesses that could limit other government agencies' access to relevant information.

We appreciate your providing the OCC with an opportunity to comment on the report. The OCC is committed to working with all of the agencies that have a role in providing efficient and effective oversight of compliance with fair lending laws. Editorial suggestions and technical comments have been provided to your evaluators separately. We do not have any additional comments at this time.

Sincerely,

Edward J. Hanley
Senior Deputy Comptroller for Administration
and Chief Financial Officer

Comments From the Department of Housing and Urban Development

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-2000

September 13, 1999

OFFICE OF THE ASSISTANT SECRETARY
FOR FAIR HOUSING AND EQUAL OPPORTUNITY

Mr. Thomas J. McCool
Director, Financial Institutions
and Markets Issues
General Accounting Office
441 G Street, NW
Washington, DC 20548

Dear Mr. McCool:

Thank you for the opportunity to comment on the draft General Accounting Office report "Large Bank Mergers -- Fair Lending Review Could be Enhanced with Better Coordination."

As you know, Congress charged HUD with enforcing the Fair Housing Act, which prohibits discrimination in residential real estate-related transactions. This includes discrimination in the provision or servicing of mortgage loans.

HUD stands committed to enhancing coordination among federal agencies to achieve fair lending. In this spirit, we propose that your final report recommend that the Federal Reserve Board (FRB), the Federal Trade Commission (FTC), the Department of Justice (DOJ), and HUD execute a memorandum of understanding governing interagency work on bank mergers. In addition to specifying procedures for exchanging information, it should also provide for DOJ, the FTC, and HUD to make appropriate recommendations on the proposed merger.

HUD also supports efforts to ensure greater compliance with the Fair Housing Act and consumer protection laws such as the Real Estate Settlement Practices Act among non-depository lenders supervised by the FRB.

2

We look forward to further collaboration with the FRB and the other banking supervisory and enforcement agencies to eliminate all obstacles to fair lending.

Sincerely,

Eva M. Plaza
Assistant Secretary

GAO Contacts and Staff Acknowledgments

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Acknowledgments

In addition to those named above, Harry Medina, Janet Fong, Christopher Henderson, Elizabeth Olivarez, and Desiree Whipple made key contributions to this report.

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