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Report to Congressional Requesters

July 2009

FAIR LENDING

Data Limitations and the Fragmented U.S. Financial Regulatory Structure Challenge Federal Oversight and Enforcement Efforts

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Highlights

Highlights of GAO-09-704, a report to congressional requesters

FAIR LENDING

Data Limitations and the Fragmented U.S. Financial Regulatory Structure Challenge Federal Oversight and Enforcement Efforts

Why GAO Did This Study

The Fair Housing Act (FHA) and the Equal Credit Opportunity Act (ECOA)—the "fair lending laws"—prohibit discrimination in lending. Responsibility for their oversight is shared among three enforcement agencies—the Department of Housing and Urban Development (HUD), Federal Trade Commission (FTC), and Department of Justice (DOJ)—and five depository institution regulators—the Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System (Federal Reserve), National Credit Union Administration (NCUA), Office of the Comptroller of the Currency (OCC), and Office of Thrift Supervision (OTS). This report examines (1) data used by agencies and the public to detect potential violations and options to enhance the data, (2) federal oversight of lenders that are identified as at heightened risk of violating the fair lending laws, and (3) recent cases involving fair lending laws and associated enforcement challenges.

GAO analyzed fair lending laws, relevant research, and interviewed agency officials, lenders, and consumer groups. GAO also reviewed 152 depository institution fair lending examination files. Depending upon file availability by regulator, GAO reviewed all relevant files or a random sample as appropriate.

What GAO Recommends

Congress should consider options, such as requiring larger lenders to report additional data, to enhance the data available to detect potential fair lending violations. Further, as part of ongoing discussions on revising the regulatory structure, Congress should consider how to best ensure consistent and effective federal oversight of the fair lending laws. In comments, agencies and regulators generally agreed with the report's analysis.

View GAO-09-704 or key components.
For more information, contact Orice Williams Brown at (202) 512-8678 or williamso@gao.gov.

What GAO Found

The Home Mortgage Disclosure Act (HMDA) requires certain lenders to collect and publicly report data on the race, national origin, and sex of mortgage loan borrowers. Enforcement agencies and depository institution regulators use HMDA data to identify outliers—lenders that may have violated fair lending laws—and focus their investigations and examinations accordingly. But, HMDA data also have limitations; they do not include information on the credit risks of mortgage borrowers, which may limit regulators' and the public's capacity to identify lenders most likely to be engaged in discriminatory practices without first conducting labor-intensive reviews. Another data limitation is that lenders are not required to report data on the race, ethnicity, and sex of nonmortgage loan borrowers—such as small businesses, which limits oversight of such lending. While requiring lenders to report additional data would impose costs on them, particularly smaller institutions, options exist to mitigate such costs to some degree, such as limiting the reporting requirements to larger institutions. Without additional data, agencies' and regulators' capacity to identify potential lending discrimination is limited.

GAO identified the following limitations in the consistency and effectiveness of fair lending oversight that are largely attributable to the fragmented U.S. financial regulatory system:

- Federal oversight of lenders that may represent heightened risks of fair lending law violations is limited. For example, the enforcement agencies are responsible for monitoring independent mortgage lenders' compliance with the fair lending laws. Such lenders have been large originators of subprime mortgage loans in recent years and have more frequently been identified through analysis of HMDA data as outliers than depository institutions, such as banks. Depository institution regulators are more likely to assess the activities of outliers and, unlike enforcement agencies, they routinely assess the compliance of lenders that are not outliers. As a result, many fair lending violations at independent lenders may go undetected, and efforts to deter potential violations may be ineffective.

- Although depository institution regulators' fair lending oversight efforts may be more comprehensive, the division of responsibility among multiple agencies raises questions about the consistency and effectiveness of their efforts. For example, each regulator uses a different approach to analyze HMDA data to identify outliers and examination documentation varies. Moreover, since 2005, OTS, the Federal Reserve, and FDIC have referred more than 100 lenders to DOJ for further investigations of potential fair lending violations, as required by ECOA, while OCC made one referral and NCUA none.

Enforcement agencies have settled relatively few (eight) fair lending cases since 2005. Agencies identified several enforcement challenges, including the complexity of fair lending cases, difficulties in recruiting and retaining staff, and the constraints of ECOA's 2-year statute of limitations.

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Abbreviations

APR	annual percentage rate
CRA	Community Reinvestment Act
DFP	Division of Financial Practices
DOJ	Department of Justice
DTI	debt-to-income
ECOA	Equal Credit Opportunity Act
FDIC	Federal Deposit Insurance Corporation
FHA	Fair Housing Act
FHEO	Office of Fair Housing and Equal Opportunity
FTC	Federal Trade Commission
HMDA	Home Mortgage Disclosure Act of 1975
HUD	Department of Housing and Urban Development
LTV	loan-to-value
MSA	metropolitan statistical area
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency
OSI	Office of Systemic Investigations
OTS	Office of Thrift Supervision

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United States Government Accountability Office
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Congressional Requesters

The Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA) (collectively, fair lending laws) prohibit discrimination in making credit decisions.[1] Specifically, ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age, because an applicant receives income from a public assistance program, or because an applicant has in good faith exercised any right under the Consumer Credit Protection Act.[2] FHA prohibits discrimination by direct providers of housing, as well as other entities whose discriminatory practices, among other things, make housing unavailable to persons because of race or color, religion, sex, national origin, familial status, or disability. Under one or both of the fair lending laws, a lender may not, because of a prohibited basis:

- fail to provide information or services or provide different information or services regarding any aspect of the lending process, including credit availability, application procedures, or lending standards;
- discourage or selectively encourage applicants with respect to inquiries about or applications for credit;
- refuse to extend credit or use different standards in determining whether to extend credit;
- vary the terms of credit offered, including the amount, interest rate, duration, or type of loan;
- use different standards to evaluate collateral;
- treat a borrower differently in servicing a loan or invoking default remedies; or

[1]Respectively, Pub. L. No. 90-321, title VII, as added Pub. L. No. 93-495, title V, 88 Stat. 1521 (1974), *codified at* 15 U.S.C. §§ 1691–1691f; and Pub. L. No. 90-284, title VIII, 82 Stat. 81 (1968), *codified at* 42 U.S.C. §§ 3601-3619.

[2]Pub. L. No. 90-321, 82 Stat. 146 (1968), *codified at* 15 U.S.C. §§ 1601-1667e, 1671-1693r; 18 U.S.C. §§ 891-896.

- use different standards for pooling or packaging a loan in the secondary market or for purchasing loans.

Eight federal agencies—the Department of Housing and Urban Development (HUD); the Federal Trade Commission (FTC); the Department of Justice (DOJ)—and the regulators of insured depository institutions—the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System (Federal Reserve), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS)—principally share oversight and enforcement responsibility for the fair lending laws. The enforcement agencies, HUD, FTC, and DOJ, generally have jurisdiction over nondepository mortgage lenders, including independent mortgage lenders that are not affiliated with federally insured depository institutions or owned by federally regulated lenders.[3] The depository institution regulators oversee federally insured banks, thrifts, and credit unions and, as appropriate, certain subsidiaries, affiliates, and service providers of these institutions. While the enforcement agencies can pursue investigations, file complaints, and participate in litigation against lenders in administrative or federal district courts for potential fair lending violations under their independent investigative and enforcement authorities, depository institution regulators are required to refer lenders under their supervision to DOJ for further investigation whenever one has reason to believe a lender has engaged in a pattern or practice of discouraging or denying applications for credit in violations of ECOA.[4] Furthermore, the depository institution regulators must provide notice to HUD and the alleged injured parties whenever they have reason to believe that an FHA violation occurred that did not also constitute a pattern or practice violation of ECOA and thus did not trigger a referral to DOJ. The depository institution regulators also have authority to enforce the FHA and ECOA through administrative proceedings.

Over the years, some members of Congress, researchers, consumer groups, and others have raised questions about lenders' compliance with

[3]DOJ has enforcement authority over all lenders under both the FHA and ECOA.

[4]15 U.S.C. § 1691e(g). According to DOJ, the courts have found a "pattern or practice" when the evidence establishes that the discriminatory actions were the defendant's regular practice, rather than an isolated instance. A "pattern or practice" also exists when the defendant has a policy of discriminating, even if the policy is not always followed.

fair lending laws and the depository institution regulators' and agencies' enforcement of these laws. These concerns have been heightened in recent years because of the availability of mortgage pricing data published by the Federal Reserve, which many lenders are required to submit under the Home Mortgage Disclosure Act of 1975, as amended (HMDA).[5] According to the Federal Reserve, researchers, and others, their analyses of HMDA data indicate that on average, African-American and Hispanic mortgage borrowers may pay substantially higher interest rates and fees than similarly situated non-Hispanic white borrowers. Since 2005, the Federal Reserve annually has used HMDA data to identify approximately 200 lenders with statistically significant pricing disparities based on ethnicity or race and distributed this screening or outlier list to other enforcement agencies, depository institution regulators, and state regulators for their review and potential follow-up.[6] Many of these entities were independent lenders that specialized in subprime loans, which appear to have been disproportionately offered to minority borrowers. Critics argue that enforcement agencies and depository institution regulators have not adequately pursued potential fair lending violations; for example, in recent years few enforcement actions have been brought against lenders alleging discrimination.

Federal enforcement agencies and depository institution regulators have stated that they have processes to ensure effective oversight and enforcement of the fair lending laws. In particular, enforcement agencies and depository institution regulators said that they use the lists of institutions that have statistically significant pricing disparities provided by the Federal Reserve and/or develop their own screening or outlier lists through independent analysis of HMDA data or consumer complaints and

[5]Pub. L. No. 94-200, title III, 89 Stat. 1125, *codified at* 12 U.S.C. §§ 2801–2810. HMDA requires lending institutions to collect and publicly disclose information about housing loans and applications for such loans, including the loan type and amount, property type, income level and borrower characteristics (such as ethnicity, race, and sex). All federally insured or regulated banks, credit unions, and savings associations with total assets exceeding $39 million, as of December 31, 2008, with a home or branch office in a metropolitan statistical area (MSA) that originated any secured home purchase loans or refinancing are required to file HMDA data. Regulation C, 12 C.F.R. §§ 203.3(e)(1), 203.4 (2009); *see also* Home Mortgage Disclosure, 73 *Fed. Reg.* 78616 (Dec. 23, 2008) (establishing an adjustment from $37 million to $39 million). Further, most mortgage lending institutions located in a MSA must file HMDA data. 12 C.F.R. §§ 203.3(e)(2), 204.4.

[6]Not all depository institution regulators may use the term "outlier" to describe lenders that are identified as potentially having heightened risk for fair lending law violations through their annual analysis of HMDA data and other information. However, we use the term "outlier" to describe such lenders for purposes of consistency in this report.

focus investigative and examination resources on those institutions.[7] Federal agency and depository institution regulatory officials also stated that limitations in HMDA data, particularly the lack of underwriting information such as borrowers' credit scores, explain why many investigations and examinations are a result of false positives and thus do not result in enforcement actions.[8] In addition, as discussed in this report, FTC officials said that HMDA data do not allow for assessing mortgage pricing discrimination at all lenders. However, federal officials also stated that they vigorously pursue cases where the inclusion of underwriting data does not explain differences in denials and mortgage interest rates between borrowers who fall into different protected groups based on national origin, race, or sex and initiate enforcement actions where appropriate.[9]

This report responds to your request that we provide an overview of federal oversight and enforcement of the fair lending laws and addresses a range of relevant issues. Specifically, this report (1) assesses the strengths and limitations of data sources that enforcement agencies and depository institution regulators use to screen for lenders that have potentially heightened risk for fair lending law violations and discusses options for enhancing the data, (2) assesses federal oversight of lenders that may represent relatively high risks of fair lending violations as evidenced by analysis of HMDA data and other information, (3) examines differences in depository institution regulators' fair lending oversight programs, and (4) discusses enforcement agencies' recent litigation involving potential fair lending law violations and challenges that federal officials have identified in fulfilling their enforcement responsibilities.

To meet our objectives, we reviewed and analyzed fair lending examination and investigation guidance, policies, and procedures,

[7]For the purposes of this report, we refer to enforcement agencies' (HUD, FTC, and DOJ) assessments of individual lender's compliance with the fair lending laws (including analysis of HMDA data and other information, on-site interviews, and file reviews) as "investigations" and depository institution regulators' (FDIC, Federal Reserve, NCUA, OCC, and OTS) assessments as "examinations."

[8]We use the term "underwriting" in this report to describe data or information that lenders may use to make credit decisions, such as whether to approve or deny a loan application or the terms of approved loans, such as their interest rates or fees. These underwriting data or variables include borrower credit scores, debt-to-income (DTI) ratios, or loan-to-value (LTV) ratios.

[9]*See* 12 C.F.R. pt. 203, app. B.

agencies' Inspectors General reports, testimonies, agency documents, academic studies, and past GAO work, in particular our 1996 report on federal oversight of fair lending laws.[10] In addition, we assessed agencies' compliance with fair lending examination procedures by selecting a sample of 152 fair lending examination files and summaries derived from each depository institution regulator's annual list of lenders at potentially heightened risk for fair lending violations (that is, outlier lists).[11] For the Federal Reserve, FDIC, and OTS, we reviewed summary documentation of completed examinations for each lender based on their 2005 and 2006 HMDA data outlier lists. For OCC and NCUA, we reviewed randomly selected samples of their outlier examination reports, largely due to the time that it took these agencies to provide requested documentation.[12] We generally limited the scope of our examination file review to compliance (that is, if such examinations were initiated on schedule and if they contained key elements for which the depository institution regulators' *Interagency Fair Lending Examination Procedures* call for, such as a review of HMDA and underwriting and pricing data, reviews of loan policies and files, and interviews with lending officials).[13] Making judgments on how well the depository institution regulators conducted examinations (for example, if they selected a sufficient sample of loan files to review or if they used an appropriate examination methodology) was beyond the scope of this review. However, we did compare the depository institution regulators' overall outlier examination findings and assessed the extent to which the interagency examination procedures allowed for assessments of all phases of the mortgage loan application process. We also reviewed agency referrals to DOJ since 2005, reviewed DOJ's investigative activities and settlements, and consulted with all agencies on some of the challenges they encountered in enforcing fair lending laws.

[10]See GAO, *Fair Lending: Federal Oversight and Enforcement Improved but Some Challenges Remain* GAO/GGD-96-145 (Washington, D.C.: Aug. 13, 1996).

[11]Depository institution regulators may use the Federal Reserve's annual HMDA screening list to target examinations or they may develop their own outlier lists through independent reviews of HMDA data and other sources, such as complaints. Our reviews were based on outlier lists that the depository institution regulators developed from 2005 and 2006 HMDA data.

[12]Our review consisted of a random sample of 20 outlier examinations that OCC conducted based on 2005 HMDA data and seven based on 2006 HMDA data. We also reviewed a random sample of 10 of the 25 fair lending examinations that NCUA conducted in calendar year 2007.

[13]Federal Financial Institutions Examination Council(FFIEC), "Interagency Fair Lending Procedures," http://www.ffiec.gov/PDF/FairLend.pdf.

Finally, we interviewed officials from each federal enforcement and depository institution regulator—including senior officials, policy analysts, economists, statisticians, attorneys, examiners, and compliance specialists—state financial regulatory entities, lenders, and researchers.[14] We asked these officials to describe and comment on regulatory efforts to enforce fair lending laws, which included screening lenders for potentially heightened risk of violations, conducting examinations, and enforcing the laws through referrals, investigations and examinations, or other means. (See app. I for more information on our objectives, scope, and methodology).

We conducted this performance audit from October 2008 to July 2009, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

During the late 1960s and 1970s, Congress enacted several laws that were intended to help ensure fair and equitable access to credit for both individuals and communities. These laws included FHA in 1968, ECOA in 1974, and HMDA in 1975.[15] ECOA and FHA constitute the federal antidiscrimination statutes applicable to lending practices and commonly are referred to as the "fair lending laws." Although both statutes prohibit discrimination in lending, FHA antidiscrimination provisions also apply more generally to housing, such as prohibiting discrimination in the sale or rental of housing. Unlike ECOA and FHA, HMDA does not prohibit any specific activity of lenders, but it establishes data collection, reporting, and disclosure obligations for particular institutions, which are discussed below. The Federal Reserve has general rulemaking authority for ECOA and HMDA, and HUD has similar rulemaking authority for FHA.

[14]We did not interview NCUA economists or attorneys, and NCUA does not have statisticians.

[15]This also includes the Community Reinvestment Act (CRA) of 1977, Pub. L. No. 95-128, title VIII, 91 Stat. 1147. CRA seeks to affirmatively encourage institutions to help meet the credit needs of the entire community served by each institution, and CRA ratings take into account lending discrimination by those lenders. For example, see 12 C.F.R. §§ 25.28(c), 228.28(c) (2009). This report focused solely on enforcement of ECOA and FHA.

Federal Oversight and Enforcement of Fair Lending Laws Are Shared among Multiple Agencies and Depository Institution Regulators

Responsibility for federal oversight and enforcement of the fair lending laws is principally shared among three enforcement agencies and five depository institution regulators (see app. II for more details). In general, with respect to the relevant fair lending law, HUD and DOJ have jurisdiction over all depository institutions and nondepository lenders, including "independent" mortgage lenders, such as mortgage finance companies, which are not affiliated with, or owned by, federally insured depository institutions such as banks, thrifts, or credit unions or owned by a federally regulated bank or savings and loan holding company.[16] FTC has jurisdiction pursuant to ECOA over all nondepository lenders, including independent mortgage lenders, subsidiaries and affiliates of depository institutions, and nondepository subsidiaries of bank holding companies. Unlike HUD and DOJ, FTC does not have enforcement authority over federally regulated depository institutions.[17]

The following describes the fair lending enforcement responsibilities of HUD, FTC, and DOJ in more detail:

- Under FHA, HUD investigates all complaints filed with it alleging violations of FHA and may initiate investigations and file its own complaints, referred to as Secretary-initiated complaints, against independent mortgage lenders, or any other lender, including depository institutions that HUD believes may have violated the act. FHA requires HUD to seek conciliation between the parties to any complaint. If conciliation discussions are unsuccessful, and HUD determines after an investigation that reasonable cause exists to believe that a discriminatory housing practice has occurred, or is about to occur, HUD must issue a Charge of Discrimination against those responsible for the violation and prosecute the claim before an administrative law judge. However, after a charge has been issued, any party may elect to litigate the case instead in federal district court, in which case DOJ assumes responsibility from HUD for pursuing litigation. A HUD administrative law judge or federal judge

[16]*See* 42 U.S.C. §§ 3610, 3612, 3614; 15 U.S.C. § 1691e(g), (h). According to HUD, a memorandum of understanding between HUD and the federal depository institution regulators provides for intra-governmental cooperation in the investigation of fair housing complaints against depository institutions. DOJ indicated that DOJ, but not HUD, has authority to enforce ECOA as well as the FHA with respect to all lenders.

[17]15 U.S.C. § 1691c(a)(c).

may order lenders to change their policies, compensate borrowers affected by the violation, and take steps to prevent future violations, in addition to imposing civil penalties.[18]

- FTC also may conduct investigations and file ECOA complaints against nonbank mortgage lenders or brokers—including but not limited to nonbank subsidiaries of banks and bank holding companies—that may be violating ECOA. If FTC concludes that it has reason to believe ECOA is being violated, the agency may file a lawsuit against the lender in federal court to obtain an injunction and consumer redress. If FTC deems civil penalties are appropriate, the agency may refer the case to DOJ. Alternatively, FTC may bring an administrative proceeding against the lender before the agency's administrative law judges to obtain an order similar in effect to an injunction.

- DOJ, which has both ECOA and FHA authority, may initiate its own investigations of any creditor—whether a depository or nondepository lender—under its independent authority or based on referrals from other agencies as described below. DOJ may file pattern or practice and other fair lending complaints in federal courts.

  The types of remedies that may be obtained in fair lending litigation include monetary settlements for consumer redress or civil fines, agreements by lenders to change or revise policies, and the establishment of lender fair lending training programs, and other injunctive relief.

The five depository institution regulators generally have fair lending oversight responsibilities for the insured depository institutions that they directly regulate, as well as certain subsidiaries and affiliates (see table 1). Along with the enforcement agencies, the Federal Reserve and OTS also have general authority over lenders that may be owned by federally regulated holding companies but are not federally insured depository institutions. Many federally regulated bank holding companies that have insured depository subsidiaries, such as national or state-chartered banks, also may have nonbank subsidiaries, such as mortgage finance companies. Under the Bank Holding Company Act of 1956, as amended, the Federal Reserve has jurisdiction over such bank holding companies and their

[18]HUD also refers fair lending complaints filed by aggrieved persons to state and local government agencies that enforce fair housing laws that are substantially equivalent to FHA. See 42 U.S.C. § 3610(f). However, such complaints are then processed under the state or locality's substantially equivalent law, not FHA.

nonbank subsidiaries.[19] OTS has jurisdiction over the subsidiaries of savings and loan-holding companies, which can include federally insured thrifts as well as noninsured lenders.

Table 1: Federal Depository Institution Regulators of Federally Insured Depository Institutions

Type of depository institution	Federal depository institution regulator
Commercial banks	
National banks	OCC
State banks – Federal Reserve System members	Federal Reserve
State banks – Federal Reserve System nonmembers	FDIC
Savings associations	OTS
Credit unions	NCUA

Source: GAO.

Depository institution regulators conduct examinations of institutions they oversee to assess their fair lending compliance, including determining whether there is evidence that lenders have violated ECOA or the FHA. Under ECOA, depository institution regulators are required to refer lenders that may have violated the fair lending laws to DOJ if there is reason to believe that a lender has engaged in a pattern or practice of discouraging or denying applications for credit in violation of ECOA.[20] The depository institution regulators are required to notify HUD of any instance where there is reason to believe that a FHA and ECOA violation has occurred which has not been referred to DOJ as a potential ECOA pattern and practice violation.[21] Under the FHA, HUD must provide information to DOJ regarding any complaint in which there is reason to believe that a pattern or practice of violations occurred or that a group of

[19]Ch. 240, 70 Stat. 133, *codified at* 12 U.S.C. 1841-1850.

[20]A depository institution regulator also may refer an ECOA case to DOJ when it has reason to believe that one or more creditors has violated the nondiscrimination provisions of ECOA. 15 U.S.C. § 1691e(g).

[21]15 U.S.C. § 1691e(k). FDIC also noted that, as a practical matter in mortgage lending, most ECOA violations also will constitute violations of FHA. DOJ noted that this is the case if they involve one or more factors prohibited by both statutes, such as race, color, national origin, sex or religion. Marital status is not a prohibited basis under FHA.

persons has been denied rights under FHA and the matter raises an issue of general public importance.[22]

In addition, ECOA granted the depository institution regulators enforcement authority to seek compliance under section 8 of the Federal Deposit Insurance Act and the Federal Credit Union Act.[23] Depository institution regulators have parallel jurisdiction over such matters, even when the matter is referred to the DOJ, because there is a reason to believe that a pattern or practice violation has occurred and DOJ does not defer for administrative enforcement.[24] The agencies must work together to assure there is no duplication of their efforts. The Federal Reserve, OCC, FDIC, and OTS generally may take an administrative enforcement action against an insured depository institution or an institution-affiliated party that is violating, or has violated a law, rule, or regulation.[25] NCUA may take administrative enforcement action against an insured credit union or its affiliated party that is violating or has violated a law, rule or

[22]42 U.S.C. §§ 3610(e)(2) 3614(a).

[23]Ch. 967, §§ 1,2, 64 Stat. 873 (1950) *codified at* 12 U.S.C. § 1818; ch. 750, 48 Stat. 1216 (1934), *codified at* 12 U.S.C. §§ 1751 et. seq.

[24]*See* 15 U.S.C. §§ 1691c(a) and 1691e(g).

[25]12 U.S.C. § 1818(b). An institution-affiliated party is (1) any director, officer, employee, or controlling stockholder (other than a bank holding company) of, or agent for, an insured depository institution; (2) any other person who has filed or is required to file a change-in-control notice with the appropriate federal banking agency under [12 U.S.C. § 1817(j)]; (3) any shareholder (other than a bank holding company), consultant, joint venture partner, and any other person as determined by the appropriate federal banking agency (by regulation or case-by-case) who participates in the conduct of the affairs of an insured depository institution; and (4) any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in any violation of any law or regulation; any breach of fiduciary duty; or any unsafe or unsound practice, which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution, which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution. 12 U.S.C. § 1813(u).

regulation.[26] Depository institution regulators also have cease and desist authority, can order restitution for the victims of discrimination, and issue orders to change or revise lending policies or institute a compliance program or require external audits and compliance with these orders can be enforced in federal court.[27] Moreover, they can impose civil money penalties for each day that a violation continues.[28]

HMDA Data Provide Information on the Race, Sex, and Other Personal Characteristics of Mortgage Loan Borrowers and Applicants

HMDA, as amended, requires certain lenders to collect, disclose, and report data on the personal characteristics of mortgage borrowers and loan applicants (for example, their ethnicity, race, and sex), the type of loan or application (for example, if the loan is insured or guaranteed by a federal agency such as the Federal Housing Administration), and certain financial data such as the loan amount and borrowers' incomes.[29] HMDA's purposes are to provide the public with loan data that can assist in identifying potential risks for discriminatory patterns and enforcing antidiscrimination laws, help the public determine if lending institutions are meeting the housing credit needs of their communities, and help public officials target community development investment. In 2002, the Federal Reserve, pursuant to its regulatory authority under HMDA, required financial institutions to collect certain mortgage loan pricing data for higher priced loans in response to the growth of subprime lending and to address concerns that minority and other targeted groups were being charged excessively high interest rates for mortgage loans. This

[26]12 U.S.C. § 1786(e)(1). ("If, in the opinion of the Board, any insured credit union, credit union which has insured accounts, or any institution-affiliated party is engaging or has engaged, or the Board has reasonable cause to believe that the credit union or any institution-affiliated party is about to engage, in an unsafe or unsound practice in conducting the business of such credit union, or is violating or has violated, or the Board has reasonable cause to believe that the credit union or any institution-affiliated party is about to violate, a law, rule, or regulation, or any condition imposed in writing by the Board in connection with the granting of any application or other request by the credit union or any written agreement entered into with the Board, the Board may issue and serve upon the credit union or such party notice of charges in respect thereof.")

[27]12 U.S.C. § 1818.

[28]12 U.S.C. § 1818(i)(2); 12 U.S.C. § 1786(k)(2) for NCUA. In addition, while DOJ has 2 years to file a civil action for an ECOA violation, depository institution regulators have 5 years to take enforcement action to impose civil money penalties for violations of the fair lending statutes.

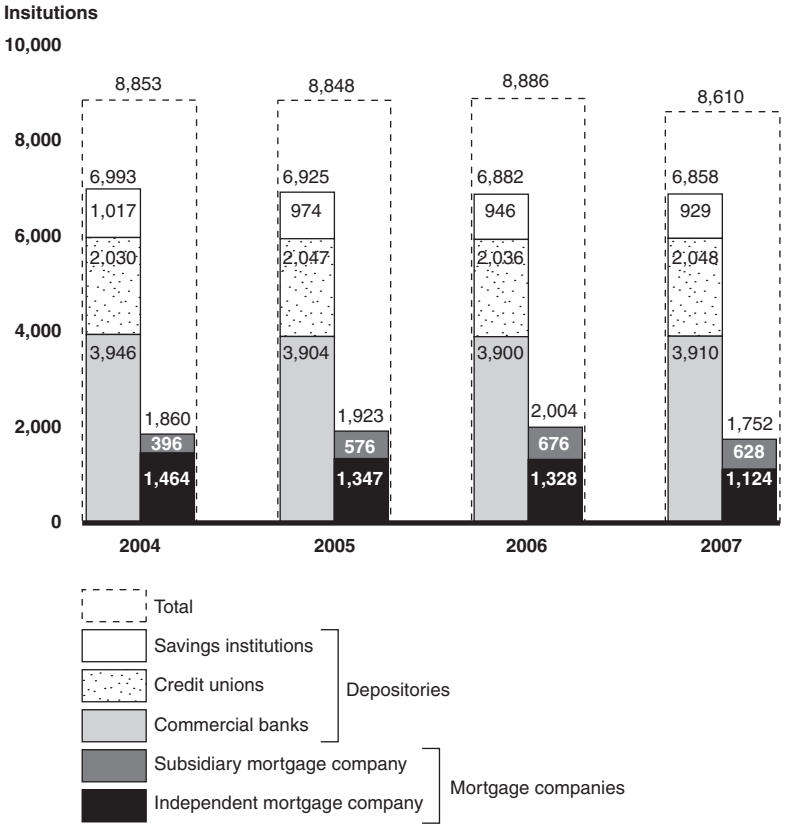
[29]Regulation C, 12 C.F.R § 203.2(e) (2009) addresses which financial institutions must submit HMDA data.

requirement was effective on January 1, 2004.[30] Specifically, lenders were required to collect and publicly disclose information about mortgages with annual percentage rates above certain designated thresholds. This 2004 revision to HMDA also was intended to provide depository institution regulators and the public with more information about mortgage lending practices and the potentially heightened risk for discrimination. The data were first reported and publicly disclosed in 2005.

HMDA's data collection and reporting requirements generally apply to certain independent mortgage lenders and federally insured depository institutions as set forth in Regulation C. As shown in figure 1, many more depository institutions than independent mortgage lenders are required to collect and report HMDA data (nearly 80 percent are depository institutions, and 20 percent are independent lenders). Lenders subject to HMDA's requirements must submit the data by March 1 for the previous calendar year. For example, lenders submitted calendar year 2004 data—the first year in which lenders were required to collect and report mortgage pricing data—to the Federal Reserve by March 1, 2005. Through individual contracts with the other depository institution regulators and HUD, the Federal Reserve collects the HMDA data from all filers, performs limited data validity and quality reviews, checks with lenders as appropriate to clear up discrepancies, and publishes the data in September of each year.

[30]According to the Federal Reserve, one of the purposes of Regulation C is to require reporting of price data for subprime loans. Originally, a "higher price" loan under Regulation C was defined as a loan with an annual percentage rate (APR) of 3 or more percentage points (5 or more percentage points for subordinate-lien loans) higher than the yield for a comparable term Department of the Treasury security as of a date within approximately 1 month before the date the interest rate for the loan was set. On October 24, 2008, the Federal Reserve announced the adoption of a final rule amending Regulation C, effective October 1, 2009, that changes the definition of a "higher price" mortgage loan under Regulation C to correspond to the definition of a "higher price" loan under Regulation Z. Under the new rule, a "higher price" loan is one with an APR that is 1.5 or more percentage points (3.5 or more percentage points for subordinate-lien loans) higher than a rate published by the Federal Reserve Board (based on the Freddie Mac Primary Mortgage Market Survey average rate) as of a date within approximately 1 week before the date the interest rate for the loan was set. The new rule is intended to more effectively and consistently capture the subprime market and is not intended to lower the threshold and capture more loans overall. *See* Home Mortgage Disclosure, 73 *Fed. Reg.* 63329 (Oct. 24, 2008) (*to be codified at* 12 C.F.R. pt. 203).

Figure 1: HMDA-Filing Institutions by Type, 2004-2007



Source: GAO analysis of Federal Reserve data.

Note: All federally insured or regulated banks, credit unions, and savings associations with total assets exceeding $39 million (in 2009) with a home or branch office in an MSA and that originated, during the preceding calendar year, at least one home purchase loan or refinancing secured by a first lien on a one- to four-family dwelling are required to file HMDA data.

The threshold for 2004 is $33 million; 2005 is $34 million; 2006 is $35 million; 2007 is 26 million; 2008 is 38 million, and 2009 is $39 million.

Data Available to Detect Potentially Heightened Risk for Fair Lending Violations Have Limitations, and Options to Enhance the Data Involve Trade-offs

Federal enforcement agencies and depository institution regulators use analysis of HMDA data and other information to identify lenders that potentially are at heightened risk of having violated the fair lending laws and target their investigations and examinations accordingly. However, there are several critical limitations in available HMDA data and other data that limit federal fair lending oversight and enforcement efforts. First, HMDA data lack key underwriting data or information, such as borrowers' credit scores or loan-to-value ratios, which may help explain why lenders may charge relatively higher interest rates or higher fees to some borrowers compared with others. Second, limited data are available on the premortgage loan application process to help determine if loan officers engage in discriminatory practices, such as steering minority applicants to high-cost loans, before a loan application is filed. Third, Regulation B, the regulation that implements the ECOA, generally prohibits lenders from collecting personal characteristic data, such as applicants' race, ethnicity and sex, for nonmortgage loans, such as small business and credit card loans, which also impedes federal oversight efforts. Requiring lenders to collect and publicly report additional data could benefit federal oversight efforts as well as independent research into potential discrimination in lending, but also would impose additional costs, particularly on smaller institutions with limited recordkeeping systems. Several options, such as limiting additional data collection and reporting requirements to larger lenders, could help mitigate such costs while better ensuring that enforcement agencies and depository institution regulators have critical data necessary to help carry out their fair lending responsibilities.

Federal Enforcement Agencies and Depository Institution Regulators Use HMDA Data to Detect Lenders at Potentially Heightened Risk of Having Violated the Fair Lending Laws

Since 2005, when HMDA mortgage pricing data became available, the Federal Reserve annually has screened the data to identify lenders with statistically significant pricing disparities, based on ethnicity or race, and voluntarily has shared the screening results with other federal and state agencies.[31] First, the Federal Reserve systematically checks the data for errors (such as values that are outside the allowable ranges) or omissions, which may include contacting individual institutions for verification purposes. Second, using statistical analysis, the Federal Reserve matches loans made to minorities with loans made to non-Hispanic whites for each HMDA reporting lender, based on the limited information available in

[31]The Federal Reserve begins this process in March when HMDA data is filed for the preceding calendar year and the lists are generally shared with the other depository institution regulators by September.

HMDA (such as property type, loan purpose, loan amount, location, date, and borrower income). Third, the Federal Reserve calculates disparities by race and ethnicity for rate spreads (among those loans for which rate spreads were reported) and the proportion of loans that are higher priced (the incidence of higher priced lending). Finally, it identifies those lenders with statistically significant disparities in either the amount of rate spread or the incidence of higher priced lending and develops a list it shares with the other agencies.[32]

As shown in table 2, which breaks out the Federal Reserve screening list for 2006 HMDA data, independent lenders that are under the jurisdiction of enforcement agencies accounted for almost half of lenders on the list, although they account for only about 20 percent of all HMDA data reporters. Federally insured and regulated depository institutions such as banks, thrifts, and credit unions, which comprise nearly 80 percent of all HMDA data reporters, accounted for the other half of the outlier list.

Table 2: Number of Outliers on Federal Reserve Screening List Based on HMDA Year 2006 Data, by Type of Federal Agency That Oversees Them

Type of federal agency	Number of HMDA outliers	Percentage of total outlier list	Number of regulated institutions that are HMDA filers
Enforcement agencies	128	49	2,004
Depository institution regulators	132	51	6,882
Total	**260**	**100**	**8,886**

Source: GAO.

Note: All federally insured or regulated banks, credit unions, and savings associations with total assets exceeding $39 million (in 2009) with a home or branch office in an MSA and that originated, during the preceding calendar year, at least one home purchase loan or refinancing secured by a first lien on a one- to four-family dwelling are required to file HMDA data.

Federal enforcement agencies generally use the Federal Reserve's annual screening list, but also conduct independent analyses of HMDA data and other information to develop their own list of outliers, according to agency officials. For example, all of the enforcement agencies said that they incorporate the Federal Reserve's annual screening list into their own

[32]Currently, the rate spread is the difference between the annual percentage rate on the loan and the yield on Department of the Treasury securities with a comparable maturity.

ongoing screening process to identify targets for fair lending investigations. In addition, HUD and FTC officials said they also use other information to identify outliers, including consumer complaint data.

Like enforcement agencies, depository institution regulators generally use the Federal Reserve screening list, independent analysis of HMDA data, and other information sources to identify potential outliers and other risk factors. The approaches that the depository institution regulators use may vary significantly. For example, OCC and OTS consider a range of potential risk factors in developing its annual outlier list including, the Federal Reserve's annual pricing outlier list, independent analysis of mortgage pricing disparities, approval and denial rate disparities, and indications of potential redlining and marketing issues, among others.[33] Other depository regulators, such as the FDIC and the Federal Reserve generally focus on independent analysis of HMDA data and other information to develop outlier lists that are based on statistically significant pricing disparities, although they also may assess other risk factors, including approval and denial decisions and redlining, in assessing fair lending compliance at other lenders under their jurisdiction. FDIC and the Federal Reserve use this analysis to plan and scope their routine fair lending compliance examinations.[34] As shown in table 3, OCC, due to the range of risks that it assesses, identified the largest number of outliers on the basis of its analysis of 2006 HMDA data. We discuss the agencies' differing approaches in more detail and the potential implications of such differences later in this report.

[33]Redlining is the practice by which lenders may not make loans in areas that have large minority populations.

[34]As described in this report, depository institution regulators conduct routine fair lending and other consumer compliance examinations in addition to the targeted examinations associated with their outlier programs.

Table 3: Number of All Outliers Identified by Depository Institution Regulators, Based on HMDA Year 2006 Data

Depository institution regulator	Number of outliers identified by depository institution regulators based on HMDA year 2006 data	Number of HMDA filers	Percentage of outliers to HMDA filers
OCC	113	1,169	10
FDIC	47	2,854	2
OTS	26	588	4
Federal Reserve	47	680	7
NCUA	24	2,048	1
Total	**257**	**7,339**	**4**

Sources: GAO analysis of data from FDIC, Federal Reserve, NCUA, OCC, and OTS.

Notes: All federally insured or regulated banks, credit unions, and savings associations with total assets exceeding $39 million (in 2009) with a home or branch office in an MSA and that originated, during the preceding calendar year, at least one home purchase loan or refinancing secured by a first lien on a one- to four-family dwelling are required to file HMDA data.

The number of filers is as of 2007 for the Federal Reserve and NCUA and as of 2008 for FDIC, OCC, and OTS.

Without HMDA data, enforcement agencies' and depository institution regulators' ability to identify outliers and target their investigations and examinations would be limited. According to the depository institution regulators, analysis of HMDA data allows them to focus examination resources on lenders that may have potentially heightened risk of violating fair lending laws. In the absence of HMDA data, enforcement agencies and depository institution regulators would have to cull through loan files or request electronic data to assess a lender's relative risk of having violated the fair lending laws, which could be a complex and time-consuming process.

Lack of Key Underwriting Information Can Limit Regulatory Screening and Independent Research on Discrimination in Mortgage Lending; Collecting That Information Entails Additional Costs, Which May Be Outweighed by the Benefits under Certain Options

Although the development of outlier lists on the basis of HMDA data may allow enforcement agencies and depository institution regulators to prioritize fair lending law investigations and examinations, the lack of key information necessary to gauge a borrower's credit risk, such as underwriting variables, limits the data's effectiveness. Agency and depository institution regulatory officials have told us that the lack of key mortgage loan underwriting variables, such as borrowers' credit scores, borrowers' debt-to-income, or the loan-to-value ratios of the mortgages, is a critical limitation of HMDA data.[35] Underwriting variables are important because they may help explain mortgage lending disparities among what otherwise appear to be similarly situated loan applicants and borrowers of different ethnicity, race, or sex and may help to uncover additional disparities that may not be evident without the underwriting variables. The lack of underwriting data may result in enforcement agencies and depository institution regulators initiating investigations or examinations of lenders that may charge relatively higher interest rates to certain borrowers due to business necessities, such as risk-based pricing that reflects borrower's creditworthiness.

FTC officials also said that the information HMDA data has provided on potential mortgage pricing disparities limits its usefulness for the agency's enforcement activities. In particular, FTC officials said that reported HMDA data are geared toward assessing mortgage pricing disparities among subprime lenders rather than lenders that may offer prime, conventional mortgages or government-guaranteed (or –insured) mortgages. The FTC officials said that lenders that originate such mortgages generally do so at levels below the thresholds established in HMDA data reporting requirements.[36] Thus, the FTC officials said that Federal Reserve's annual outlier list is disproportionately represented by independent and other lenders that have specialized in subprime mortgage loans and that the agency's capacity to assess the potential for

[35]The credit score indicates the applicants' past credit history and potential default risk, the DTI indicates the potential financial burden of a mortgage on a borrower, and the LTV indicates the amount of borrower equity in a property.

[36]A loan's rate spread—the difference between the annual percentage rate on a loan and the rate on the Department of the Treasury securities of comparable maturity—determines whether pricing data are required for HMDA reporting. Only loans with spreads above designated thresholds set by Regulation C must be reported. For example, for first-lien loans, the threshold is 3 percentage points above the Department of the Treasury security of comparable maturity. 12 C.F.R. §203.4(a)(12). The Federal Reserve chose the thresholds in the belief that they would exclude the vast majority of prime-rate loans and include the vast majority of subprime-rate loans. *See* 67 Fed. Reg. 7222, 7229 (Feb. 15, 2002).

discrimination in the prime and government-guaranteed and -insured mortgage markets is limited.

Agencies, Regulators, and Researchers Typically Supplement HMDA Data with Underwriting Information to Help Assess Potentially Risk for Fair Lending Law Violations

To compensate for the lack of key underwriting information included in HMDA data, officials from enforcement agencies and depository institution regulators said that they typically request additional data once an outlier investigation or examination has been initiated. Some officials said that while it generally is easier for larger lenders to provide the data on a timely basis because most of them store it electronically, smaller lenders with paper-based loan documentation may face greater challenges in doing so or may not maintain requested data. When the underwriting data are received, enforcement agency and depository institution regulatory officials said that they use them to determine if statistically significant pricing and denial disparities between mortgage loan applicants and borrowers of different ethnicity, race, or sex still exist. Officials we contacted generally agreed that the annual screening process would be more efficient if they had access to additional underwriting data at the time they screened the HMDA data to identify potential outliers. To try to address the timing issue, in 2009, OCC began a pilot program to obtain this information earlier in the screening process. Specifically, OCC has requested that six large national banks separately provide certain specified underwriting information to the agency at the same time they report HMDA data.

The lack of key underwriting information in HMDA data also limits independent research, advocacy, and private plaintiff case development regarding potential discrimination in mortgage lending.[37] Because HMDA data are publicly available, researchers, community groups, and others use them to assess the potential risk for discrimination in the mortgage lending industry and at particular lenders. However, researchers, community groups, and others have stated that the absence of sufficient underwriting data makes determining if lenders had a reasonable basis for mortgage pricing and other disparities—as identified through analysis of HMDA data alone—difficult. As a result, researchers have obtained aggregated mortgage underwriting data from other sources and matched them with HMDA data to assess potential risk for discrimination in mortgage lending. While this approach may help identify the potential risk for discrimination, the underwriting data obtained may not be as accurate

[37]See GAO, *Fair Lending: Race and Gender Data Are Limited for Nonmortgage Lending*, GAO-08-698 (Washington, D.C.: June 27, 2008).

as if reported directly by the lenders as part of HMDA. Additionally, FDIC noted that although the data from other sources may reflect commonly accepted standards for underwriting, they may or may not reflect a particular lender's actual policy.[38]

Additional Costs to Lenders from Making Underwriting Data Available to Federal Agencies and Researchers Could Be Offset to Some Degree

Requiring lenders to collect and publicly report key underwriting data as part of their annual HMDA data submissions would benefit regulatory and independent research efforts to identify discrimination in mortgage lending.[39] With underwriting data included in HMDA data, enforcement agencies and depository institution regulators may be better able to identify lenders that may have disparities in mortgage lending, enabling them to better target investigations and examinations toward the lenders most at risk of having violated the fair lending laws. Moreover, this could help minimize burdens on lenders that do not represent significant risks but are flagged as outliers without the additional data. Similarly, such data might help researchers and others better assess the risk for potential risk for discrimination and independently assess the enforcement of fair lending laws and enhance transparency. For example, researchers, advocacy groups, and potential plaintiffs could use independent analysis of the data to more efficiently monitor discrimination by particular lenders and in the mortgage lending industry generally, which could help inform Congress and the public about compliance with the fair lending laws.

Although expanding HMDA data to include certain underwriting data could facilitate regulatory and independent research efforts to assess the potential risk for mortgage discrimination, it would result in additional costs to lenders. As we have reported previously, quantifying such costs in a meaningful way can be difficult for a variety of reasons, such as challenges associated with obtaining reliable data from potentially thousands of lenders that have different cost accounting systems and underwriting policies.[40] According to representatives from a banking trade group and a large lender, the additional costs likely would include

[38]FDIC also indicated that when conducting pricing analyses, they aim to understand and analyze the pricing factors actually used by the particular lender being reviewed.

[39]Under HMDA, the Federal Reserve has broad authority to carry out the purposes of the act, including requiring lenders to collect and report data as deemed necessary. Our work did not involve a review of the Federal Reserve's basis for not requiring lenders to report certain underwriting data. Congress also has the option of amending HMDA, as it has in the past to require additional data collection and reporting.

[40]GAO-08-698.

expenses associated with (1) establishing information systems or upgrades to collect the data in the proper format, (2) training costs for staff who would be responsible for collecting and reporting the data, and (3) legal and auditing costs to help ensure that the data were accurate and in compliance with established standards. The representative from the large lender said that costs also would be associated with electronically storing and securing additional types of sensitive data that eventually would be made public. Additionally, the official said thousands of employees, who currently look at underwriting, but are not associated with reporting HMDA data, would have to receive fair lending compliance training. Additionally, the official said ensuring compliance with additional public reporting requirements would require additional legal support to certify the accuracy of the additional data. Finally, the costs may be relatively higher for smaller institutions because they may be less likely than larger lenders to collect and store underwriting and pricing data electronically or may not currently retain any pricing data.

While certain key underwriting data, such as borrower credit scores, DTI ratios, and LTV ratios, generally would benefit regulatory screening efforts and independent research, advocacy, and private enforcement, they may not be sufficient to resolve questions about potential heightened risk for discrimination by individual lenders or in the industry generally. As part of fair lending investigations and examinations, enforcement agencies and depository institution regulators may request a range of additional underwriting data from lenders, such as detailed product information, mortgage-rate lock dates, overages, additional fees paid, and counteroffer information to help assess the basis for mortgage rate disparities identified through initial analysis of HMDA data.[41] However, according to representatives from a banking trade group and a large lender, requiring them to collect and publicly report such additional underwriting data as part of their annual HMDA data submissions likely would involve additional training, software, compliance, and other associated costs. In addition, according to FTC, overage data may be closely guarded proprietary information, which lenders likely would object to reporting

[41]Overages occur when lenders allow loan originators to exercise discretion when determining the fees and interest rates charged to borrowers over and above the risk-based price of the loan. This overage is not related to the default risk of a particular borrower. Therefore, two borrowers with similar underwriting characteristics may pay different prices for the same loan product due to the added discretionary price. According to FTC, although many lenders collect overage data to determine loan officer compensation, not all lenders maintain this information so that it can be readily provided in response to requests from enforcement agencies and depository institution regulators.

publicly on the grounds that they would represent disclosures to their competitors.

Several options could reduce the potential costs associated with requiring lenders to collect and report certain underwriting variables as part of their HMDA data submissions. For example, these options include

- *Large lender requirement—requiring only the largest lenders to provide expanded reporting*. According to officials, many of these lenders already collect and store such information electronically. According to published reports, the top 25 mortgage originators accounted for 92 percent of total mortgage loan volume in 2008. Thus, such a requirement would focus on lenders that constitute the vast majority of mortgage lending and minimize costs on smaller lenders, which may not record underwriting in electronic form as most larger lenders reportedly do;[42]

- *Regulatory (nonpublic) reporting of expanded data—requiring all HMDA filers to routinely report underwriting data only to the depository institution regulators* in conjunction with HMDA data (as OCC is requiring six large lenders in its pilot study). In so doing, lenders may facilitate depository institution regulators' efforts to identify potential outliers while minimizing concerns about potential public reporting and compliance costs; and

- *Nonpublic reporting limited to large lenders—requiring only the largest* lenders to report expanded data to the depository institution regulators in conjunction with their HMDA data filings.

While all of these options would help mitigate additional costs to some degree compared with a general requirement that lenders collect and report publicly underwriting data, each would result in limited or no additional information available to researchers and the public—one of the purposes of the act. In addition, according to DOJ, it is not clear whether the enforcement agencies would have access to the expanded data under the second or third options described above. Nevertheless, any of these options could help enhance depository institution regulators' ability to oversee and enforce fair lending laws. Without additional routinely provided underwriting data, agencies and depository institution regulators

[42]Inside Mortgage Finance Publications, *The 2009 Mortgage Market Statistical Annual* (Bethesda, Md.: 2009).

will continue to expend limited resources collecting such information on a per institution basis as they initiate investigations and examinations.

Lack of Data during the Preapplication Phase of Mortgage Lending May Result in a Gap in Fair Lending Oversight, and Addressing This Gap Has Been Challenging

Another data limitation that might affect federal efforts to enforce the fair lending laws is the lack of information about the preapplication process for mortgage loans. HMDA data only capture information after a mortgage loan application has been filed and a loan approved or denied. However, fair lending laws apply to the entire loan process. The preapplication process involves lenders' treatment of potential borrowers before an application is filed, which could affect whether the potential borrower applies for a loan and the type of loan.[43] In a 1996 report on federal enforcement of fair lending laws, we reported that discrimination could occur in the treatment of customers before they actually applied for a mortgage loan.[44] This type of discrimination, which also would be a violation under ECOA, could include spending less time with minority customers when explaining the application process, giving them different information on the variety of products available, or quoting different rates.

Subsequent studies by researchers and fair housing organizations have continued to raise concerns about the potential risk for discrimination in mortgage lending during the preapplication phase.[45] The methodology used in these studies often included a technique known as matched pair testing. In matched pair testing, individuals or couples of different ethnicity, race, or sex pose as mortgage loan applicants, visit lenders at different times, and meet with loan officers. The testers, or mystery shoppers, usually present comparable financial backgrounds in terms of assets, income, debt, and credit history, and are asked to request information about similar loan products. For example, in a 2006 study that utilized testers who posed as low-income, first-time home buyers in approximately 250 matched pair tests, researchers found evidence of adverse treatment during the preapplication phase of African-Americans

[43]Some information is collected concerning preapproval requests made by loan applicants. *See* Regulation C, 12 C.F.R. pt. 203, app. A (2009).

[44]See GAO/GGD-96-145.

[45]Stephen Ross, et. al. "Mortgage Lending in Chicago and Los Angeles: A Paired Testing Study of the Preapplication Process," *Journal of Urban Economics* 63, no. 3 (Aug. 3, 2006). Margery Austin Turner and Felicity Skidmore, eds., The Urban Institute, "Mortgage Lending Discrimination: A Review of Existing Evidence" (Washington, D.C.: June 1999).

and Hispanics in the Chicago metropolitan area.[46] Specifically, the study found that African-American and Hispanic testers were less likely than their white counterparts to be given detailed information about requested or additional loan products and received less coaching and follow-up communication. However, the authors of the study found that in Los Angeles the treatment of white, African-American, and Hispanic testers generally was similar.

Agency officials we contacted said that the use of testers may have certain advantages in terms of identifying potential risks for discrimination by loan officers and other lending officials, but it also has a number of challenges and limitations. For example, officials from FTC, NCUA, and OTS said that testers require specialized skills and training, which results in additional costs. In the early 1990s, FTC officials said that they used testers as a part of their fair lending oversight activities and found the effort not only to be costly but also inconclusive because matching similarly situated borrowers and training the testers was difficult. OCC indicated that it conducted a pilot testing program from 1994 through 1995 and found that indications of differing treatment were weak and involved primarily unverifiable subjective perceptions, such as how friendly the loan officer was to the tester.[47] FTC officials said that current technological advances have made the use of testers even more difficult because loan officers can check a potential loan applicant's credit scores during the initial meeting. Therefore, these officials said that loan officers may suspect testers are not who they claim to be, thereby raising questions about potential fraud that could affect the loan officer's interactions with the testers and make any results unreliable. FTC officials also noted that it also was difficult to script identical scenarios because testers often would ask questions, react, and respond differently, which can make test results unreliable. DOJ officials said that they only occasionally used testers in the context of fair lending enforcement due to the difficulties described above and the complexities involved in analyzing lender treatment of testers during the mortgage preapplication process. However, FDIC officials said they were in the early stages of analyzing the costs of using testers and considering whether it would be beneficial to use them in conjunction with their fair lending reviews.

[46]Ross, et al.

[47]The results of OCC's pilot testing program were summarized in Advisory Letter 96-3 (Apr. 18, 1996).

While the agencies and depository institution regulators' generally do not use testers to assess the potential risk for discrimination during the preapplication phase, the alternative strategies that are used have limitations. In general, officials said that they encourage lenders to voluntarily test for fair lending compliance, which may include the use of testers. Officials said that they would review any available analysis when conducting fair lending examinations. However, according to Federal Reserve and OCC officials, this information provided by the use of in-house testers may be protected by the ECOA self-testing privilege, which limits their ability to use it for examination purposes.[48] Federal Reserve officials also noted that few lenders conduct such testing. Depository institution regulators also said that they review customer complaint data; compare the number of applications filed by mortgage loan applicants of different ethnicity, race, or sex and investigate any potential disparities; and review HMDA and additional data to help determine the extent to which minority mortgage loan applicants may have been steered into relatively high-cost loans although they might have qualified for less-expensive alternatives. However, these alternative sources share the same limitations as the use of testers, including the information may provide only an inferential basis for determining if discrimination occurred during the preapplication process and may not be reliable. The depository institution regulators have yet to identify robust data or means of assessing potential discrimination during this critical phase of the mortgage lending process. In a recent report on the financial regulatory system, the Department of the Treasury suggested that surveys of borrowers and loan applicants may be an alternative means of assessing compliance with consumer protection laws, such as the fair lending laws.[49] Without adequate data from the preapplication phase such as through the use of testers, surveys, or alternative means, any fair lending oversight and enforcement will be incomplete because it will include only information on the borrowers that apply for credit and not the larger universe of potential borrowers who sought it.

[48]*See* 15 U.S.C. § 1691c-1, which provides that the results of a self-test conducted by a lender of a credit transaction to determine the lender's compliance with ECOA, when corrective action is taken for any possible violation identified in the self-test is privileged and may not be obtained or used in a court action, examination, or investigation related to the lender's compliance with ECOA. *See also* 42 U.S.C. § 3614-1 (FHA self-testing privilege).

[49]See Department of the Treasury, *Financial Regulatory Reform: A New Foundation: Rebuilding Financial Supervision and Regulation* (June 2009).

Lack of Personal Characteristic Data for Nonmortgage Lending Limits Effectiveness of Efforts to Detect Potential Risk for Fair Lending Law Violations

A final data limitation is that depository institution regulators generally do not have access to personal characteristic data (for example, race, ethnicity, and sex) for nonmortgage loans, such as business, credit card, and automobile loans. In a 2008 report, we reported that Federal Reserve Regulation B generally prohibits lenders from requesting and collecting such personal characteristic data from applicants for nonmortgage loans.[50] The Federal Reserve concluded in 2003 that lifting Regulation B's general prohibition and permitting voluntary collection of data on personal characteristic data for nonmortgage loan applicants, without any limitations or standards, could create some risk that the information would be used for discriminatory purposes. The Federal Reserve also argued that amending Regulation B and permitting lenders to collect such data on a voluntary basis would result in inconsistent and noncomparable data. In the absence of personal characteristic data for nonmortgage loans, we found that agencies tended to focus their oversight activities more on mortgage lending rather than on areas such as automobile, credit card, and business lending that are also subject to fair lending laws.[51]

While the interagency procedures that depository institution regulators use to conduct fair lending examinations provide for assessing the potential risk for discrimination in nonmortgage lending, our 2008 report concluded that such procedures had a high potential for error and were time-consuming and costly. Under the interagency procedures, examiners may make use of established "surrogates" to deduce nonmortgage loan applicants' race, ethnicity, or sex. For example, after consulting with their agency's supervisory staff, the procedures allow examiners to assume that an applicant is Hispanic based on the last name, female based on the first name, or likely to be an African-American based on the census tract of the address. However, there is the potential for error in the use of such surrogates (for example, certain first names are gender neutral, and not all residents of particular census tract may be African-American). Furthermore, using such surrogates may require examiners to cull through individual nonmortgage loan files. In contrast, HMDA data allow enforcement agencies and depository institution regulators to identify potential outliers through statistical analysis.

[50]See GAO-08-698.

[51]Regulation B also establishes procedures that lenders are to follow in providing notice to loan applicants that their applications for credit have been denied. *See* 12 C.F.R. § 202.9 (2009).

As we reported, requiring lenders to collect personal characteristic data for nonmortgage loans to facilitate the regulatory supervision and independent research into the potential risk for discrimination would involve additional costs for lenders.[52] These potential costs included information system integration, employee training, and compliance costs. A requirement that lenders collect and publicly report such personal characteristic data likely would need to be accompanied by a requirement that they provide underwriting data to better inform assessments of their lending practices. However, because certain types of nonmortgage lending, such as small business lending, generally are more complicated than mortgage lending, the amount of underwriting data that would need to be reported to allow for informed assessments likely would be comparatively higher as would the associated reporting costs. Similar to the options for expanding HMDA data, several options could facilitate depository institution regulators' efforts to assess the potential risk for discrimination in nonmortgage lending while mitigating potential lender costs. In particular, lenders could be required to collect such data for certain types of loans, such as small business loans, and make the data available to depository institution regulators rather than publicly report it.

[52]A Federal Reserve official said that it has the authority under ECOA to require lenders to collect personal characteristic data for nonmortgage loans but may not have the authority to require the public reporting of such information.

Lenders That May Pose Relatively Greater Risks of Violating Fair Lending Laws Generally Are Subject to Less Comprehensive Federal Oversight Due to the Fragmented Regulatory Structure and Other Factors

Lenders that may represent heightened risks of fair lending violations are subject to relatively less comprehensive federal review of their activities than other lenders. Specifically, the Federal Reserve's annual analysis of HMDA pricing data and other information suggest that independent lenders and nonbank subsidiaries of holding companies are more likely than depository institutions to engage in mortgage pricing discrimination. While depository institutions may represent relatively less risk of fair lending violations, they generally are subject to a comprehensive oversight program. Specifically, depository institution regulators conduct oversight examinations of most depository institutions that are identified as outliers (more than an estimated 400 such examinations were initiated and largely completed based on the 2005 and 2006 HMDA data analysis) and have established varying policies to conduct routine fair lending compliance oversight of many other depository institutions as well. In contrast, enforcement agencies, which have jurisdiction over independent lenders have conducted relatively few investigations of such lenders that have been identified as outliers over the past several years (for example, HUD and FTC have initiated 22 such investigations since 2005). HUD and FTC also generally do not conduct fair lending investigations of independent lenders that are not viewed as outliers. While the Federal Reserve can conduct outlier examinations of nonbank subsidiaries as it does for state-chartered depository institutions under its jurisdiction, it lacks clear authority to conduct routine consumer compliance, including fair lending, examinations of such nonbank lenders as it does for state member banks. To some degree, these differences reflect differences between the missions of enforcement agencies and depository institution regulators, as well as resource considerations. They also illustrate critical deficiencies in the fragmented U.S. financial regulatory structure, which is divided among multiple federal and state agencies.[53] In particular, the current regulatory structure does not ensure that independent lenders and nonbank subsidiaries receive the same level of oversight as other financial institutions. As we have stated previously, congressional action to reform the financial regulatory system is needed and could, among a range of benefits, help to ensure more comprehensive and consistent fair lending oversight.

[53]The U.S. Supreme Court recently upheld the states' right to enforce state fair-lending laws against National Banks, which are under the supervision of the OCC. *Cuomo v. Clearing House Ass'n, L.L.C.*, 557 U.S.___, No. 08-453, 2009 WL 1835148 (June 29, 2009).

Federal Reserve's Annual HMDA Analysis and Other Information Suggest That Independent Mortgage Lenders and Nonbank Subsidiaries of Holding Companies Pose Relatively Heightened Risks of Potential Fair Lending Law Violations

Based on the Federal Reserve's annual screening lists, independent mortgage lenders represent relatively heightened risks of fair lending law violations than federally insured depository institutions (see table 4). On the basis of 2004–2007 HMDA data, the Federal Reserve annually identified on average 116 independent mortgage lenders through its pricing screens, which represent about 6 percent of all independent mortgage lenders that file HMDA data. In contrast, the Federal Reserve identified on average 118 depository institutions as outliers during the same period, which represented less than 2 percent of depository institutions that file HMDA data.

Table 4: Annual Numbers of HMDA Filers Identified by the Federal Reserve Screens as a Percentage of Total HMDA-filing Lenders, by Lender Type, 2004-2007

	2004	2005	2006	2007
Independent mortgage lenders (HUD, FTC, and DOJ)				
Number of HMDA-filing lenders	1,860	1,923	2,004	1,752
Number of filers identified by Federal Reserve screens (outliers)	104	138	128	94
Percentage of lenders identified as outliers	5.6	7.2	6.4	5.4
Depository lenders (FDIC, Federal Reserve, NCUA, OCC, and OTS)				
Number of HMDA-filing lenders	6,993	6,925	6,882	6,858
Number of filers identified by Federal Reserve screens (outliers)	90	130	132	121
Percentage of lenders identified as outliers	1.3	1.9	1.9	1.8

Source: *Federal Reserve Bulletin*.

Notes: All federally insured or regulated banks, credit unions, and savings associations with total assets exceeding $39 million (in 2009) with a home or branch office in an MSA and that originated, during the preceding calendar year, at least one home purchase loan or refinancing secured by a first lien on a one- to four-family dwelling are required to file HMDA data.

The number of lenders represents only those institutions that were required to file HMDA reports. The number of lenders identified through the Federal Reserve screens is not totaled for 2004–2007, as some lenders may appear on multiple lists and summing outliers would involve double counting. In addition, the Federal Reserve sends the same list of independent mortgage lenders to HUD, FTC, and DOJ because they are the agencies with jurisdiction over these lenders.

Independent mortgage lenders and nonbank subsidiaries of holding companies have been a source of significant concern and controversy for fair lending advocates in recent years. As we reported in 2007, 14 of the top 25 originators of subprime and Alt-A mortgages were independent mortgage lenders, and they accounted for 44 percent of such

originations.[54] Similarly, we found that 7 of the 25 largest originators of subprime and Alt-A mortgages in 2007 (accounting for 37 percent of originations) were nonbank subsidiaries of bank and savings and loan holding companies. The remaining four originators were depository institution lenders. We also reported that many such high-cost, and potentially heightened-risk mortgages, appear to have been made to borrowers with limited or poor credit histories and subsequently resulted in significant foreclosure rates for such borrowers. In a 2007 report, we found that the market share of subprime lending had grown dramatically among minority and other borrowers and at the expense of the market for mortgage loans insured by the Federal Housing Administration.[55]

Depository Institution Regulators Conduct Targeted Fair Lending Examinations of Most Institutions Identified as Outliers as Well as Other Lenders through the Routine Examination Process

Depository institution regulators oversee fair lending compliance through targeted examinations of institutions that are identified as outliers through screening HMDA data or routine examinations of the institutions under compliance or safety and soundness examination programs. A key objective of the depository institution regulators' fair lending outlier examinations, which generally are to take place within 12–18 months of a lender being placed on such a list, is to determine if initial indications of heightened fair lending risk warrant further review and potential administrative or enforcement action, which can serve to punish violators and deter violations by other lenders. To assess lender compliance, each of the depository institution regulators is to follow the *Interagency Fair Lending Examination Procedures*, which were established jointly by the depository institution regulators in 1999.[56] While the interagency fair lending procedures are intended to be flexible to meet the specific requirements of each depository institution regulator, they contain general

[54]GAO-08-78R. Alt-A mortgages generally serve borrowers whose credit histories are close to prime, but the loans often have one or more higher-risk features such as limited documentation of income or assets.

[55]See GAO, *Federal Housing Administration: Decline in the Agency's Market Share Was Associated with Product and Process Developments of Other Market Participants*, GAO-07-645 (Washington, D.C.: June 29, 2007).

[56]The *Interagency Fair Lending Examination Procedures* are currently being updated.

procedures to be included in examinations, according to officials.[57] Specifically, under the guidelines, examiners are to request information from each lender about its underwriting and pricing policies and procedures, the types of loan products offered, and the degree of loan officer discretion in making underwriting and pricing decisions. The depository institution regulators also assess the accuracy of the lender's HMDA data and request loan underwriting and pricing data. The depository institution regulators also interview lending officials to ensure they properly understand the policies and procedures and discuss any remaining discrepancies that have been identified between mortgage applicants and borrowers of different ethnicity, race, or sex. The examiners also generally review lender files to assess potential discrepancies, particularly when disparities in the data persist after accounting for underwriting variables. Finally, examiners may review the lender's marketing efforts to check for fair lending violations and assess the lender's fair lending compliance monitoring procedures and training programs to ensure that efforts are sufficient for ensuring compliance with fair lending laws.

Our reviews of completed fair lending outlier examinations indicated general agency compliance with established policies and procedures. Based on our file review, we estimate that the depository institution regulators initiated and largely completed more than 400 examinations of lenders that were identified as outliers on the basis of their analysis of 2005 and 2006 HMDA data. The combined outlier lists for each HMDA data

[57]The examination procedures generally include guidelines to set the scope and intensity of an examination by identifying all potential focal points or risk factors that appear worthwhile to examine. Activities include understanding credit operations and evaluating the potential for discriminatory conduct, and examination procedures, which assess the institution's fair lending performance by applying the appropriate procedures that follow each of the examination focal points already selected during scoping. The appropriate procedures include (1) documenting overt evidence of disparate treatment, such as written policy, oral statements, or unwritten practice; (2) analyzing transactional underwriting for residential, consumer, and commercial loans to test for disparities in loan approvals and denials; (3) analyzing potential disparities in terms and conditions, such as rates, fees, maturity variations, LTVs, and collateral requirements to test for pricing disparities; (4) analyzing the potential for steering, redlining, and discriminatory marketing practices; (5) analyzing the lender's credit scoring model, if used; (6) and analyzing the potential for disparate impact, which is the potential that a seemingly neutral business or lending policy has a disproportionate and adverse effect on targeted groups.

year contained more than 200 lenders.[58] Furthermore, our analysis of examination files generally identified documentation that showed that depository institution regulators followed key procedures in the interagency fair lending guidance, including reviewing underwriting policies, incorporating underwriting data into analysis, and conducting interviews with the lending institution officials. While we identified documentation of these key elements, our review did not include an analysis of the depository institution regulators' effectiveness in identifying potentially heightened risks for fair lending law violations. However, our review identified certain differences and, in some cases, limitations in the depository institution regulators' fair lending examination programs, which are discussed in the next section.

Depository institution regulators also have established varying policies to help ensure that many lenders not identified through HMDA screening routinely undergo compliance examinations, which may include fair lending components. Such routine examinations may be critical because HMDA data analysis may not detect all potentially heightened risks for violations, and many smaller lenders are not required to file HMDA data. For example, FDIC, Federal Reserve, and OTS officials said they have policies to conduct on-site examinations of lenders for consumer compliance, including fair lending examinations, generally every 12–36 months, primarily depending on the size of the lender and the lender's previous examination results. Moreover, FDIC, Federal Reserve, and OTS officials said they conduct a fair lending examination in conjunction with every scheduled compliance examination. OCC selects a sample of all lenders—including those that are not required to file HMDA data—for targeted fair lending examinations. OCC officials said its examiners then conduct a more in-depth fair lending examination on these randomly selected institutions, which averages about 30 institutions per year. NCUA generally conducts fair lending examinations on a risk basis, as described later in this report, and generally does not conduct routine fair lending examinations of credit unions that are not viewed as representing potentially heightened risks.

[58]This estimation of more than 400 outlier examinations is based on the fact that FDIC, OTS, and the Federal Reserve generally were able to provide the requested documentation for all institutions identified on their 2005 and 2006 outlier lists. As previously mentioned, we reviewed a sample of examinations from OCC and NCUA. Both OCC and NCUA generally were able to provide documentation of examinations for institutions selected in our sample; however, we faced certain challenges in assessing OCC's documentation, which are explained in the following section.

Limited Mission Focus and Resource Levels May Help Explain Breadth of Depository Institution Regulators Fair Lending Oversight Programs

While depository institution regulators may identify potentially heightened risks for fair lending violations through their outlier and routine examinations, ECOA requires that they refer all cases for which they have a reason to believe that a pattern or practice of discrimination has occurred to DOJ for further investigation and potential enforcement. Moreover, depository institution regulators must provide notice to HUD whenever they have a reason to believe that a FHA and ECOA violation has occurred and the matter has not been referred to DOJ as a potential pattern or practice violation of ECOA.[59] Therefore, depository institution regulators generally do not have to devote the time and resources necessary to determine whether the federal government should pursue litigation against depository institutions and, if so, conduct such litigation as this is the responsibility of the enforcement agencies. However, depository institution regulators may pursue other actions against lenders for fair lending violations through their administrative authorities including monetary penalties, cease and desist orders to remedy the institution's systems, policies and procedures, restitution to obtain reimbursement and remedies for harmed consumers and order additional ameliorative measures including creating community or financial literacy programs to assist consumers.

Depository institution regulators also may have large examination staffs and other personnel to carry out fair lending oversight. At the depository institution regulators, fair lending oversight generally is housed in offices that are responsible for oversight of a variety of consumer compliance laws and regulations, and the CRA, in addition to the fair lending laws. While ensuring compliance with these laws is challenging as there may be thousands of depository institutions under the jurisdiction of each depository institution regulator, regulators typically have hundreds of examiners to carry out these responsibilities. Moreover, the Federal Reserve, FDIC, OCC, and OTS also employ economists and statisticians to assist in fair lending oversight. NCUA officials said that the agency does not employ statisticians. However, all of the depository institution regulators have attorneys who are involved in supporting fair lending oversight and other consumer law compliance activities.

[59]The depository institution regulator also must inform the loan applicant of its notice to HUD and of the remedies available under FHA. In addition, pursuant to a memorandum of understanding between HUD and the depository institution regulators, the regulators provide HUD a copy of any complaint they receive that appears to allege a violation of FHA against an institution within their respective jurisdictions.

Federal Reviews of Independent Lenders and Nonbank Subsidiaries of Holding Companies Are Limited

While independent lenders and nonbank subsidiaries of holding companies may represent higher fair lending risks than depository institutions, federal reviews of their activities are limited. According to HUD and FTC officials, since 2005, the agencies have initiated a combined 22 investigations of independent mortgage lenders for potentially heightened risks for fair lending violations.[60] FTC opened more than half, 13, of these investigations in 2009, and these investigations currently are in the initial stages. DOJ has also opened several such investigations, as well as conducting investigations of nonbank subsidiaries of bank holding companies and savings and loan holding companies based on referrals from the depository regulators. Therefore, the enforcement agencies have not conducted investigations, in many cases, where the Federal Reserve's initial analysis of HMDA data suggests statistically significant mortgage pricing disparities between minority and nonminority borrowers. As discussed previously, the Federal Reserve has identified on average 116 independent lenders annually for mortgage pricing disparities based on its analysis of HMDA data since 2005. While DOJ, HUD and FTC may independently analyze HMDA data to identify lenders that they view as representing the highest risks, and targeting their investigations accordingly, as discussed previously, in the absence of underwriting data the agencies cannot be assured that other lenders with statistically significant differences in mortgage pricing for minority and nonminority borrowers are in compliance with the fair lending laws. HUD and FTC also generally do not initiate investigations of independent lenders that are not viewed as outliers. According to FTC officials, such investigations are not initiated largely due to resource limitations, which are discussed below. Therefore, unlike most depository institution regulators, enforcement agencies do not assess the fair lending compliance of independent lenders through routine oversight.

Once DOJ, HUD or FTC identify a particular lender as potentially having violated fair lending laws, their initial investigative efforts generally resemble those of depository institution regulators' outlier examinations. For example, DOJ, HUD and FTC officials said they request that such lenders provide loan underwriting policies and procedures, information on the types of loan products offered, and information on the extent to which

[60]For HUD, this number includes six investigations opened since 2005. HUD also initiated a fair lending investigation of a regulated depository institution, but this is not included in the group of 22 because the case did not involve an independent mortgage lender. For FTC, this number includes 16 investigations, 3 of which were closed, settled, or had a complaint filed since December 2008, and 13 of which were opened in 2009.

loan officers have discretion over loan approvals and denials or the pricing terms (interest rates or fees) at which an approved loan will be offered.[61] According to agency officials, if loan officers have substantial discretion under lender policies, the risk of discriminatory lending decisions is higher.[62] DOJ, HUD and FTC officials also may request raw HMDA data from lenders and test their accuracy and request loan underwriting or overage data. With this information, DOJ, HUD and FTC officials said they conduct additional statistical analysis to help determine if initial disparities based on ethnicity, race, or sex can be explained by underwriting information. DOJ, HUD and FTC officials also may determine if the lender internally monitors fair lending compliance and interview representatives of the lending institution.[63] Finally, DOJ, HUD and FTC may review loan files. In such reviews, investigators generally try to identify, frequently through statistical analysis, similarly situated applicants and borrowers of different ethnicity, race, or sex to determine if there was any discrimination in the lending process. On the basis of their investigations, HUD DOJ, and FTC determine if sufficient evidence exists to file complaints against the lenders, subject to such investigations, and pursue such litigation where deemed appropriate.

Enforcement agencies also have established efforts to coordinate their activities and prioritize investigations of independent lenders and other institutions, as necessary. For example, enforcement agency officials said that they meet periodically to discuss investigations and have shared information derived from investigations. According to DOJ, the agency, FTC and HUD also have a working group that meets on a bimonthly basis to discuss HMDA pricing investigations on nonbank lenders and to discuss

[61]As discussed later, many lenders may allow their loan originators discretion in setting the price of a mortgage, which has been the basis of nearly all DOJ, HUD, and FTC fair lending enforcement actions relating to the pricing of mortgages.

[62]According to FTC, there are two ways to separate the discretionary price of a mortgage from the risk-based price of a mortgage: (1) by obtaining underwriting data and then using statistical or analytic techniques to compare the total price of the loan (such as the annual percentage rate data reported under HMDA) across borrowers with similar underwriting characteristics or (2) by directly evaluating the discretionary price of the loan—a data point that, as discussed later, agency officials report that many but not all lenders maintain.

[63]See prepared statement of FTC, *Home Mortgage Disclosure Act Data and FTC Lending Enforcement*, before the House Committee on Financial Services Subcommittee on Oversight and Investigations (Washington, D.C.: Jul. 25, 2007). See also, prepared statement of DOJ, *Rooting Out Discrimination in Mortgage Lending: Using HMDA as a Tool for Fair Lending Enforcement*, before the House Committee on Financial Services, Subcommittee on Oversight and Investigations, (Washington, D.C.: Jul. 25, 2007).

issues common to the three enforcement agencies in their shared oversight of nonbank lenders.

Resource Considerations May Limit Enforcement Agencies Fair Lending Oversight Activities

The differences in the enforcement agencies' capacity to pursue potential risks for violating the fair lending laws, relative to the depository institution regulators, results in part from resource considerations. For example, in a 2004 report, we assessed federal and state efforts to combat predatory lending (practices including deception, fraud, or manipulation that a mortgage broker or lender may use to make a loan with terms that are disadvantageous to the borrower), which can have negative effects similar to fair lending violations.[64] We questioned the extent to which FTC, as a federal enforcer of consumer protection laws for nonbank subsidiaries, had the capacity to do so. We stated that FTC's mission and resource allocations were focused on conducting investigations in response to consumer complaints and other information rather than on routine monitoring and examination responsibilities.

Our current work also indicates that resource considerations may affect the relative capacity of enforcement agencies to conduct fair lending oversight. For example, at HUD, responsibility for conducting such investigations lies with the Fair Lending Division in the Office of Systemic Investigations (OSI) in its Office of Fair Housing and Equal Opportunity that was established in 2007. OSI currently has eight staff—including four equal opportunity specialists and two economists. At FTC and DOJ, the units responsible for fair lending oversight each have fewer than 50 staff, and have a range of additional consumer protection law responsibilities. FTC's Division of Financial Practices (DFP) has 39 staff, including 27 line attorneys, and is responsible for fair lending enforcement as well as the many other consumer protection laws in the financial services arena, such as the Fair Debt Collection Practices Act and Section 5 of the FTC Act, which generally prohibits unfair or deceptive acts or practices.[65] In addition, economists and research analysts from FTC's Bureau of Economics assist in DFP investigations, particularly with data analysis. At DOJ, the unit responsible for fair lending investigations, the Housing and Civil Enforcement Section, includes 38 staff attorneys with a range of

[64]GAO, *Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending*, GAO-04-280 (Washington, D.C., Jan. 30, 2004).

[65]Pub. L. No. 90-321, title VIII, as added Pub. L. No. 95-109, 91 Stat. 874 (1977), *codified at* 15 U.S.C. §§ 1692-1692p; Pub. L. No. 63-203, ch. 311, 38 Stat. 717(1914), *codified at* 15 U.S.C. §§ 41-58.

enforcement responsibilities, including enforcing laws against discrimination in rental housing, insurance, land use, and zoning, as well as two economists and one mathematical statistician.

In the President's proposed budget for fiscal year 2010, he requested additional resources for fair lending oversight. For example, HUD's proposed budget includes $4 million for additional staff to address abusive and fraudulent mortgage practices and increase enforcement of mortgage and home purchase settlement requirements. This budget request would increase staffing for HUD's Office of Fair Housing and Equal Opportunity to expand fair lending efforts and for the Office of General Counsel to handle increased fair lending and mortgage fraud enforcement among other initiatives. Further, the budget request includes an additional $1.3 million to fund increases for DOJ's Housing and Civil Enforcement Section's fair housing and fair lending enforcement, including five additional attorney positions. In its fiscal year 2010 budget request, FTC requested nine additional full-time equivalent staff for financial services consumer protection law enforcement, which officials noted include fair lending.

The Federal Reserve's Oversight Authority for the Nonbank Subsidiaries of Bank Holding Companies is Limited

While the nonbank subsidiaries of bank holding companies also may pose heightened risks of fair lending violations, the Federal Reserve has interpreted its authority under the Bank Holding Company Act, as amended by the Gramm-Leach Bliley Act, as limiting its examination authority of such entities compared with the examination authority that it and other depository institution regulators conduct oversight of depository institutions.[66] The Federal Reserve interprets its authority as

[66]Ch. 240, 70 Stat. 133, as amended by Pub.L. No. 106-102 Stat.1338 (1999), codified at 12 U.S.C. §§ 1841–1850. Under 12 U.S.C. § 1844(c)(2)(A)(i)-(ii), the Federal Reserve may examine bank holding companies and subsidiaries (including nonbank subsidiaries) to determine the nature of their operations, their financial condition, risks that may pose a threat to the safety and soundness of a depository institution subsidiary and the systems of monitoring and controlling such risks. In addition, the Federal Reserve may examine a bank holding company or subsidiary (including a nonbank subsidiary) to monitor compliance with any federal law that the Federal Reserve has specific jurisdiction to enforce against the bank holding company or subsidiary and those laws governing transactions and relationships between any depository institution subsidiary and its affiliates. *See* 12 U.S.C. § 1844(c)(2)(A)(iii). ECOA provides the Federal Reserve with specific enforcement authority against bank holding companies and their nonbank subsidiaries. *See* 15 U.S.C. § 1691c(b). However, FHA does not have a similar enforcement provision. The Federal Reserve interprets the language in section 1844 about monitoring compliance with federal law as providing it with limited examination authority of nonbank subsidiaries because it generally must have specific authority to enforce a consumer protection law in order to examine a nonbank subsidiary for compliance with the law.

permitting it to conduct consumer compliance oversight of nonbank subsidiaries when there is evidence of potentially heightened risks for violations, such as through annual analysis of HMDA data or other sources of information such as previous examinations or consumer complaints. However, pursuant to a 1998 policy, Federal Reserve examiners are prohibited from conducting routine consumer compliance examinations of nonbank subsidiaries. According to FTC, while the agency also has authority over nonbank subsidiaries, its capacity to oversee them is limited due to resource limitations as discussed earlier. Due to the risks associated with nonbank subsidiaries, in 2004, we suggested that Congress consider (1) providing the Federal Reserve with the authority to routinely monitor and, as necessary, examine nonbank subsidiaries of bank holding companies to ensure compliance with federal consumer protection laws and (2) giving the Federal Reserve specific authority to initiate enforcement actions under those laws against these nonbank subsidiaries.[67]

While Congress has not yet acted on our 2004 suggestion, Federal Reserve officials said that they have implemented a variety of steps within their authority to strengthen consumer compliance supervision, including fair lending supervision of nonbank subsidiaries since our 2004 report. In particular, they said the Federal Reserve created a unit in 2006 dedicated to consumer compliance issues associated with large, complex banking organizations, including their nonbank subsidiaries. In addition, Federal Reserve officials said examiners are to conduct consumer compliance risk assessments of nonbank subsidiaries in addition to their supervisory responsibilities for bank holding companies. Based on these risk assessments, the officials said examiners may conduct a targeted examination on a case-by-case basis. Furthermore, when a nonbank subsidiary has been identified as a potential outlier, Federal Reserve officials said similar to oversight practices for state member banks, they assess the entity for risk of pricing discrimination and may conduct additional statistical pricing reviews through the use of HMDA data and other information to better understand its potential risks. During such reviews, Federal Reserve officials said that examiners closely review the lender's policies and procedures and with the approval of the Director of Consumer Compliance also may conduct loan file reviews if there is potential evidence of a fair lending violation. Federal Reserve officials said

[67] GAO-04-280.

that they have referred one nonbank subsidiary for pricing discrimination to DOJ in recent years.

We also note that in 2007 the Federal Reserve began a pilot program with OTS, FTC, and state banking agencies to monitor the activities of nonbank subsidiaries of bank and savings and loan holding companies. OTS has jurisdiction over savings and loan holding companies and any of their nonbank subsidiaries.[68] During the pilot program, agency officials said that they conducted coordinated consumer compliance reviews of several nonbank subsidiaries and related entities, such as mortgage brokers that may be regulated at the state level, to assess their compliance with various federal and state consumer protection laws, including fair lending laws. According to the Federal Reserve, OTS, and FTC officials, they recently completed their reviews of the pilot study and are evaluating how the results might be used to better ensure consumer compliance, including fair lending oversight, of nonbank subsidiaries.

While the Federal Reserve's process for reviewing nonbank subsidiaries identified as potentially posing fair lending risks and the pilot study are important steps, its lack of clear authority to conduct routine examinations of nonbank subsidiaries for compliance with all consumer protection laws appears to be significant. Given the limitations in HMDA data described in this report, agency screening programs may have limited success in detecting fair lending violations. According to a Federal Reserve official, many potential violations of the fair lending laws and subsequent referrals of state-chartered banks are identified through routine examinations rather than the outlier examination process. Without clear authority to conduct similar routine examinations of nonbank subsidiaries for their fair lending compliance, the Federal Reserve may not be in a position to identify as many potential risks for fair lending

[68]OTS conducts routine risk-focused examinations on each consolidated holding company structure. 12 U.S.C. § 1467a(b)(4) states in pertinent part that "[e]ach savings and loan holding company and each subsidiary thereof (other than a bank) shall be subject to such examinations as the Director [of OTS] may prescribe." This appears to be broad examination authority as compared with the Federal Reserve's limited authority to examine bank holding company subsidiaries. According to OTS, the level of review of a nonthrift subsidiary is determined on a case-by-case basis depending on a variety of factors, including the type of activities, the size or materiality of the subsidiary in relation to the consolidated structure, the role of functional depository institution regulators, and financial performance. OTS does not routinely conduct stand-alone examinations of nonthrift subsidiaries as it does of thrift institutions, which are examined every 12–18 months.

violations at such entities as it does through the routine examinations of state member banks.

Limitations in Fair Lending Oversight of Independent Lenders and Nonbank Subsidiaries Also Reflect the Fragmented Regulatory Structure

The relatively limited fair lending oversight of independent lenders and nonbank subsidiaries reflect the fragmented and outdated U.S. financial regulatory system.[69] As described in our previous work, the U.S. financial regulatory structure, which is divided among multiple federal and state agencies, evolved over 150 years largely in response to crises, rather than through deliberative legislative decision-making processes. The resulting fragmented financial regulatory system has resulted in significant gaps in federal oversight of financial institutions that represent significant risks. In particular and consistent with our discussion about fair lending oversight, federal depository institution regulators lacked clear and sufficient authority to oversee independent and nonbank lenders. Congress and the administration currently are considering a range of proposals to revise the current fragmented financial regulatory system.

In our January 2009 report, we stated that reforms urgently were needed and identified a framework for crafting and evaluating regulatory reform proposals that consisted of characteristics that should be reflected in any new regulatory system.[70] These characteristics include

- clearly defined and relevant regulatory goals— to ensure that depository institution regulators effectively can carry out their missions and be held accountable;
- a systemwide focus—for identifying, monitoring, and managing risks to the financial system regardless of the source of the risk;
- consistent consumer and investor protection—to ensure that market participants receive consistent, useful information, as well as legal protections; and

[69]GAO, *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*, GAO-09-216 (Washington, D.C.: Jan. 8, 2009) and GAO, *Large Bank Mergers: Fair Lending Review Could be Enhanced with Better Coordination*, GAO/GGD-00-16 (Washington, D.C.: Nov. 3, 1999).

[70]GAO-09-216.

- consistent financial oversight—so that similar institutions, products, risks, and services are subject to consistent regulation, oversight, and enforcement.

Any regulatory reform efforts, consistent with these characteristics, should include an evaluation of ways in which to ensure that all lenders, including independent lenders and nonbank subsidiaries, will be subject to similar regulatory and oversight treatment for safety and soundness and consumer protection, including fair lending laws. In the absence of such reforms, oversight and enforcement of fair lending laws will continue to be inconsistent.

Differences in the Depository Institution Regulators' Fair Lending Oversight Programs Also Highlight Challenges Associated with a Fragmented Regulatory System

Although depository institution regulators' initial activities to assess evidence of potentially heightened risks for fair lending violations generally have been more comprehensive than those of enforcement agencies, their oversight programs also face challenges that are in part linked to the fragmented regulatory structure. While depository institution regulators have taken several steps to coordinate their fair lending oversight activities where appropriate, the effects of these efforts have been unclear. Each depository institution regulator uses a different approach to screen HMDA data and other information to identify outliers, and the management of their outlier examination programs and the documentation of such examinations varied. For example, FDIC, Federal Reserve, and OTS described centralized approaches to managing their outlier programs while NCUA's and OCC's management approaches were more decentralized. In contrast to other depository institution regulators, OCC's outlier examination documentation standards and practices were limited, although the agency recently has taken steps to improve such documentation. Finally, depository institutions under the jurisdiction of FDIC, Federal Reserve, and OTS were far more likely to be subject to referrals to DOJ for potentially being at heightened risk for fair lending violations than those under the jurisdiction of NCUA and OCC. These differing approaches raise questions about the consistency and effectiveness of the depository institution regulators' collective fair lending oversight efforts, which are likely to persist so long as the fragmented regulatory structure remains in place.

Depository Institution Regulators Have Coordinated Fair Lending Examination Procedures and Used an Interagency Task Force and Other Forums to Discuss Oversight Programs

Given the current fragmented structure of the federal regulatory system, we have stated that collaboration among agencies that share common responsibilities is essential to ensuring consistent and effective supervisory practices.[71] Such collaboration can take place through various means including developing clear and common outcomes for relevant programs, establishing common policies and procedures, and developing mechanisms to monitor and evaluate collaborative efforts. In keeping with the need for effective collaboration, depository institution regulators as well as enforcement agencies have taken several steps to establish common policies and procedures and share information about their fair lending oversight programs. These steps include the following:

- Since 1994, depository institution regulators and enforcement agency officials have participated in an Interagency Fair Lending Task Force. The task force was established to develop a coordinated approach to address discrimination in lending and adopted a policy statement in 1994 on how federal regulatory and enforcement agencies were to conduct oversight and enforce the fair lending laws. Federal officials said that the task force, which currently meets on a bimonthly basis, continues to allow depository institution regulators and enforcement agencies to exchange information on a range of common issues, informally discuss fair lending policy, and confer about current trends or challenges in fair lending oversight and enforcement. For example, officials said that depository institution regulators and enforcement agencies may discuss how they generally approach fair lending issues, such as outlier screening processes. According to depository institution regulators, because the task force is viewed as an informal information-sharing body, it has not produced any reports on federal fair lending oversight and no meeting minutes are kept. Moreover, officials said that economists from the depository institution regulators contact each other separately from the task force to discuss issues including their screening processes for high-risk lenders and emerging risks. According to FDIC, attorneys from different agencies also contact each other about specific legal issues and share relevant research. DOJ officials indicated that they regularly discuss with attorneys from the depository institution regulators, HUD and FTC specific legal issues.

- As discussed previously, in 1999, the depository institution regulators jointly developed interagency fair lending procedures. According to

[71]GAO, *Financial Market Regulation: Agencies Engaged in Consolidated Supervision Can Strengthen Performance Measurement and Collaboration*, GAO-07-154 (Washington, D.C.: Mar. 15, 2007).

depository institution regulatory officials, they are in the process of revising and updating the procedures through the Federal Financial Institutions Examination Council Consumer Compliance Task Force.[72] They expect the updated examination guidelines to be finalized and adopted in 2009 with potential enhancements to pricing, applicant steering, mortgage broker, and redlining sections of the guidance.

Differences in Depository Institution Regulators' Fair Lending Oversight Programs include Screening Approaches, Examination Management and Documentation, and Referral Practices

While depository institution regulators have taken a number of actions to collaborate on their fair lending oversight efforts, challenges remain in ensuring consistent application of oversight and treatment of lenders. In the Department of the Treasury's recent report on the financial regulatory structure, it stated that the fragmented regulatory structure for fair lending oversight and other consumer protection laws creates several critical challenges.[73] In particular, the report stated that the fragmented structure makes coordination of supervisory policies difficult and slows responses to emerging consumer protection threats. In our work, we also identified key differences in the depository institution regulators' fair lending oversight approaches, which indicate that the division of responsibility among multiple depository institution regulators results in inconsistent oversight processes as described below:

Approaches to Screening HMDA Data and Other Information to Identify Fair Lending Outliers Varied among the Depository Institution Regulators

While the Federal Reserve annually reviews HMDA data to identify lenders at potentially heightened risk for fair lending violations related to mortgage pricing disparities, each depository institution regulator uses its own approach to identify potential outliers. Specifically,

- FDIC and Federal Reserve examination officials generally develop their own outlier lists on the basis of statistically significant pricing disparities. FDIC and the Federal Reserve's approaches differ from one another and from the Federal Reserve's annual mortgage pricing outlier list that is distributed to all agencies. FDIC officials said that the agency's approach to developing its pricing outlier list is geared toward the smaller state-chartered banks that primarily are under its jurisdiction. Federal Reserve officials said they supplement the annual mortgage pricing outlier list for lenders under their jurisdiction with additional information. For example,

[72]The council is an interagency body charged with promoting uniformity in examination procedures and processes in the supervision of financial institutions. See 12 U.S.C. §§ 3301 to 3311.

[73]See Department of the Treasury, *Financial Regulatory Reform: A New Foundation: Rebuilding Financial Supervision and Regulation* (June 2009).

the officials said this information includes assessments of the discretion and financial incentives that loan officers have to make mortgage pricing decisions, the lenders' business models, and past supervisory findings. As we discussed earlier, both FDIC and the Federal Reserve noted that they also screen HMDA data and other information to assess other risk factors, such as redlining. However, such screening is done in conjunction with their routine examination processes rather than their outlier examination processes.

- In contrast, OCC and OTS generally consider a broader range of potential risk factors beyond pricing disparities in developing their annual outlier lists. According to OCC officials, in addition to the Federal Reserve's outlier list and OCC's independent analysis of mortgage pricing disparities, it also conducts screening relating to approval and denial decisions, terms and conditions, redlining and marketing. Similarly, OTS officials said they use other risk factors, such as mortgage loan approval and denial decisions, redlining and steering, beyond mortgage pricing disparities, in developing their outlier lists.

- NCUA does not currently conduct independent assessments of HMDA data as it does not have any statisticians to do so, according to an agency official. Instead, NCUA officials said that the agency prioritizes fair lending examinations based on several factors, which include the Federal Reserve's annual pricing screening list, complaint data, safety and soundness examination findings, discussion with regional officials, and budget factors. Over the past several years, NCUA has conducted approximately 25 fair lending examinations each year, and these examinations are generally divided equally among its five regional offices. NCUA's Inspector General reported in 2008 that analytical efforts for identifying discrimination in lending were limited, but the agency was developing analyses to screen for potential discriminatory lending patterns, which were expected to be operational in 2009.[74]

There may be a basis for depository institution regulators to develop fair lending outlier screening processes that are suited towards the specific types of lenders under their jurisdiction. Nevertheless, the use of six different approaches among the five depository institution regulators (the Federal Reserve's annual analysis plus the unique approach at each regulator) to assess the same basic data source raises questions about

[74]See National Credit Union Administration, Office of the Inspector General, *Home Mortgage Disclosure Act Data Analysis Review*, OIG-08-09 (Washington, D.C.: Nov. 7, 2008).

duplication of effort and the inefficient use of limited oversight resources. In this regard, we note that OCC's independent analysis of HMDA data in 2007 identified twice as many national banks and other lenders under its jurisdiction with mortgage pricing disparities as the Federal Reserve did in its mortgage pricing analysis of lenders under OCC's jurisdiction. With a continued division of fair lending oversight responsibility among multiple depository institution regulators, opportunities to develop a coordinated approach to defining and identifying outliers and better prioritize oversight resources may not be realized.

Management of the Fair Lending Examination Processes and Documentation Quality Varied

The depository institution regulators differed in the extent to which they centrally manage examination processes, documentation, and reporting. FDIC, the Federal Reserve, and OTS officials described a more centralized (headquarters-driven) approach to ensuring that outlier examinations are initiated and necessary activities carried out. Headquarters officials from these agencies described approaches they used to ensure that fair lending examiners and other staff in regional and district offices conduct outlier examinations, document examination findings and recommendations, and follow up on recommendations. In addition to running the HMDA data outlier screening programs, FDIC, the Federal Reserve and OTS officials said that they held ongoing meetings with headquarters and district staff to discuss outlier examinations and their findings. FDIC officials said that the agency has developed a process for conducting reviews of completed outlier and routine examinations to assess if the agency is consistently complying with the interagency fair lending examination procedures. Officials from FDIC, the Federal Reserve, and OTS also said that headquarters staffs were involved in conducting legal and other analyses needed to determine if a referral should be made to DOJ for a potential pattern or practice violation.

FDIC, OTS, and the Federal Reserve have developed fair lending examination documentation and reporting standards and practices designed to facilitate the centralized management of their outlier programs. Such examination documentation and reporting standards generally are consistent with federal internal control policies that require that agencies ensure that relevant, reliable, and timely information be

readily available for management decision-making and external reporting purposes.[75] For example,

- FDIC staff generally prepare summary memorandums that describe critical aspects of outlier examinations. These memorandums discuss when examinations were initiated and conducted; the initial focal point (such as mortgage interest rate disparities in conventional loans between African-American and non-Hispanic white borrowers) identified through HMDA data analysis; the methodologies used to assess if additional evidence of potential lending discrimination existed for each focal point(s); and any findings or recommendations. According to an FDIC headquarters official, FDIC headquarters manage the outlier reviews in collaboration with regional and field office staff. In addition to the outlier reviews, summary documents are reviewed on an ongoing basis to monitor the nationwide implementation of the fair lending examination program and allow the agency to assess the extent to which lenders are implementing examination recommendations. Additionally, in 2007, FDIC required that examiners complete a standardized fair lending scope and summary memorandum to help ensure implementation of a consistent approach to documenting fair lending reviews.

- OTS also generally requires its examiners to prepare similar summary documentation of outlier examinations, which agency officials said are used to help manage the nationwide implementation of their outlier examination programs.

- The Federal Reserve has developed management reports, which track major findings of outlier examinations and potentially heightened risks for violations of the fair lending laws and referrals to DOJ, to ensure that fair lending laws are consistently enforced and examiners receive appropriate legal and statistical guidance.[76] Federal Reserve officials said that the Reserve Banks generally maintain documentation of the outlier examinations in paper or electronic form; however, electronic versions of examination reports generally are available at the headquarters level.

[75]In November 1999, we issued an overall framework for establishing and maintaining internal control in the federal government, and identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement. See GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

[76]The Federal Reserve System consists of the Board of Governors and 12 districts, each with a Federal Reserve Bank that is responsible for day-to-day examination activities of banks and bank holding companies.

While NCUA and OCC officials also indicated that headquarters staff performed critical functions, such as HMDA data screening or developing policies for conducting fair lending examinations, they generally described more decentralized approaches to managing their outlier examination programs. For example, OCC officials said that the agency's supervisory offices are responsible for ensuring that examinations are initiated on time, key findings are documented, and recommendations are implemented.[77] Among other responsibilities, OCC headquarters staff provide overall policy and supervisory direction, develop appropriate responses to emerging fair lending issues, and provide ongoing assistance to field examiners as needed, and assist in determining whether referrals or notifications to other agencies are necessary or appropriate. OCC also conducts quality assurance reviews, which included an audit of fair lending examinations at large banks, which was completed in 2007. NCUA officials said that headquarters staff are involved in managing the selection of the approximately 25 fair lending examinations that are conducted each year, but regional staff play a significant role in selecting credit unions for examination on a risk basis. NCUA officials said that they do not routinely monitor regional compliance with the interagency fair lending examination procedures as this is largely the responsibility of regional officials. However, NCUA's staff at their central office would randomly review a select number of the fair lending examinations that are sent from the regional offices to ensure compliance with established procedures. NCUA's examination files generally included a single summary document that described scope, key findings, and recommendations made, if any, which facilitated our review.

However, due to OCC's approach to documenting outlier examinations, we faced certain challenges in assessing the agency's compliance with its examination schedules and procedures for the period we reviewed. For example, OCC was unable to verify when outlier examinations were

[77]Starting with the screening lists for the 2006 HMDA data, mid-size community bank examiners have been advised that they should complete fair lending examinations within approximately 1 year of receiving the screening lists from headquarters, although OCC acknowledges that some examinations presenting complex issues may not be completed within this time frame. For large banks, the screening lists are incorporated into ongoing fair lending supervision activities. Because of the continuous nature of supervisory activities for large banks, examinations may be completed even before the screening lists are issued by headquarters staff. In some instances involving highly complex examinations, the examination may take more than a year to complete.

started for most of their large banks.[78] OCC officials told us that part of the reason for this was because OCC conducts continuous supervision of large banks, and the database for large banks does not contain a field for examination start and end dates. Also, the documentation of outlier examination methodologies and findings and recommendations was not readily available or necessarily summarized in memorandums for management's review. Rather, a variety of examination materials contained critical items and retrieving such documentation from relevant information systems was time consuming. In 8 of the 27 OCC outlier examinations we reviewed, the documentation did not identify examination activities undertaken to assess lenders' fair lending compliance as being part of the outlier examination program.

In 2007, an OCC internal evaluation of its large bank fair lending program found that key aspects of the agency's risk-assessment process, such as its methodology, data analysis, and meetings with bank management were not well documented. However, the report also found that OCC fair lending examinations of large banks generally followed key interagency examination procedures and that adequate documentation supported the conclusions reached. The evaluation recommended that OCC develop a common methodology to assess fair lending risk and better documentation standards, which the agency is in the process of implemeting. In May 2009, OCC officials told us that they recently had taken steps to improve the ability to retrieve data from their documentation system. For example, for their database for midsize and community banks, OCC added a keyword search function to identify key information, such as the HMDA outlier year on which the examination was based. However, it is too soon to tell what effects these changes will have on OCC's fair lending examination documentation standards and practices. Unless these changes begin to address documentation limitations that we and OCC's internal evaluation identified, OCC management's capacity to monitor the implementation, consistency and reporting of the agency's fair lending examination program will be limited.

Depository Institution Regulators Referral Practices Vary

There are significant differences in the practices that the depository institution regulators employ to make referrals to DOJ and in the number of referrals they made. In response to a previous GAO recommendation,

[78]OCC took approximately 10 weeks to provide us examination start dates for its midsize and community banks before they implemented the keyword search function for its database at the time of our request.

DOJ provided guidance to the federal depository institution regulators on pattern or practice referrals in 1996.[79] The DOJ memorandum identified criteria for determining if an ECOA violation identified in a depository institution regulatory referral is appropriate for DOJ's further investigation for potential legal action or returned to the referring agency for administrative resolution. These criteria include the potential for harm to members of a protected class, the likelihood that the practice will continue, if the practice identified was a technical violation, if the harmed members can be fully compensated without court action, and the potential impact of federal court action, including the payment of damages to deter other lenders engaged in similar practices. Moreover, DOJ officials told us that they encourage depository institution regulators to consult with them on potential referrals.

While DOJ has issued long-standing guidance on referrals, depository institution regulatory officials indicated that different approaches may be used to determine if initial indications of potential risks for fair lending violations identified through HMDA screening warranted further investigation or referral to DOJ. For example, OCC and OTS officials said that they considered a range of data and information and conducted analyses before making a referral to DOJ. According to agency officials, this information might include statistical analysis of HMDA and loan underwriting data, reviews of policies and procedures, and on-site loan file reviews. OCC and OTS officials said that staff routinely conduct such file reviews as one of several approaches to assessing a lender's fair lending compliance and likely would not refer a case without conducting such reviews. In contrast, while FDIC and the Federal Reserve may also conduct file reviews to extract data and/or confirm an institution's electronic data, officials said that statistical analyses of HMDA and underwriting and pricing data could and have served as the primary basis for concluding that lenders may have engaged in a pattern or practice violation of ECOA and as the basis for making referrals to DOJ. NCUA generally relies on on-site examinations and loan file reviews to reach conclusions about lender compliance with the fair lending laws and, as mentioned earlier, does not conduct independent statistical reviews of credit unions' HMDA data. OCC officials said referrals for potential fair lending violations are not insignificant matters, either for the lender or DOJ, and they have established processes to ensure that any such referrals are warranted.

[79] GAO/GGD-96-145.

As shown in figure 2, the number of referrals varied by depository institution regulator. FDIC accounted for 91 of the 118 referrals (77 percent) that depository institution regulators made to DOJ from 2005 through 2008. In contrast, OCC made one referral during this period and NCUA none. OCC officials said that since 2005 their examiners have identified technical violations of the fair lending laws and weaknesses in controls that warranted attention of bank management, but that the identification of potential pattern or practice violations was "infrequent." NCUA officials said their examiners had reported technical violations but had not identified any pattern or practice violations, and thus made no referrals to DOJ.

Figure 2: Fair Lending Referrals to DOJ, by Depository Institution Regulator, 2005–2008

	Referrals by agency					
	FDIC	Federal Reserve	NCUA	OCC	OTS	All regulators
2005	35	2	0	0	0	**37**
2006	29	5	0	0	0	**34**
2007	15	9	0	0	3	**27**
2008	12	3	0	1	4	**20**
Total	**91**	**19**	0	**1**	**7**	**118**

Number of regulated entities (as of date)				
5,068 (12/31/08)	878 (12/31/07)	7,809 (12/31/08)	1,641 (3/31/09)	1,308 (6/30/08)

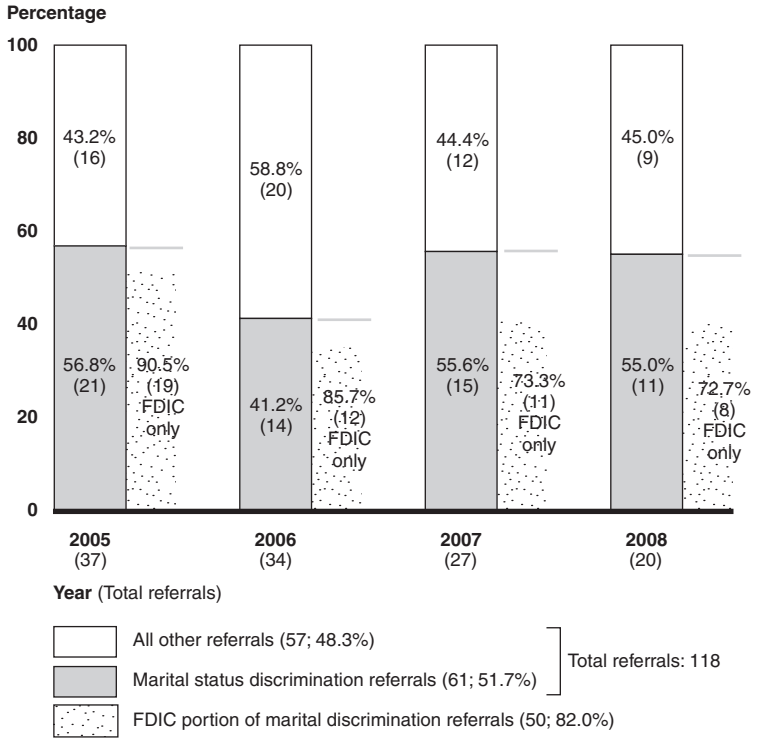
Source: GAO analysis of DOJ data.

Note: The numbers of referrals in the table include not only those based on outlier examinations but also those based on deficiencies that depository institution regulators identified through routine consumer compliance examinations during calendar years 2005–2008.

From 2005 to 2008, we found that about half of the referrals that the depository institution regulators made resulted from marital status-related violations of ECOA—such violations can include lender policies that require spousal guarantees on loan applications. FDIC accounted for about 82 percent of such referrals (see fig. 3). DOJ officials said they generally returned such referrals to the depository institution regulators

for administrative or other resolution.[80] The one institution that OCC referred to DOJ in 2008 involved a marital status violation, which DOJ subsequently returned to OCC for administrative resolution.

Figure 3: Percentage of Referrals to DOJ for Marital Status Discrimination in Violation of ECOA versus Other Fair Lending Referrals, 2005–2008



Source: GAO analysis of DOJ data.

Note: Referrals to DOJ for marital discrimination in violation of ECOA includes all referrals that relate to marital status concerns, such as spousal guarantee, and all violations pertaining to marital status.

While marital status referrals accounted for a significant percentage of all referrals, FDIC, OTS, and the Federal Reserve, through outlier and routine examinations, have identified potential pattern or practice violations in

[80]FDIC noted that DOJ does not opine on a matter when a matter is deferred to the depository institution regulator for administrative enforcement. Specifically, DOJ does not make its own determination of whether there was discrimination or whether there was a pattern or practice warranting the referral. The deferral of a matter is simply an agreement that the depository institution regulator is in a better position to resolve the violation through administrative measures.

other key areas (see table 5). Specifically, in the 110 outlier examinations that we reviewed that were conducted by these three depository institution regulators, the regulators identified potential pattern or practice violations based on statistically significant pricing disparities in 11 cases, or 10 percent of the examinations, and referred the cases to DOJ.[81] DOJ indicated that several of these referrals had been returned to the depository institution regulators for administrative enforcement, while the remaining referrals are still in DOJ's investigative process.

Table 5: Number and Percentage of Pattern or Practice Referrals to DOJ Related to Mortgage Pricing Disparities Identified by Selected depository institution Regulators in the Outlier Examinations GAO Reviewed, Based on HDMA Years 2005 and 2006 Data

	Number of outlier examinations reviewed	Number of examinations reviewed in which potential pattern or practice violations related to mortgage pricing were identified and referred to DOJ[a]	Percentage of reviewed examinations in which potential pattern or practice violation related to mortgage pricing were identified and referred to DOJ
FDIC	38	4	11
Federal Reserve	32	3[b]	9
OTS	40	4[c]	10
Total	**110**	**11**	**10**

Source: GAO.

Note: The numbers in this table are based on HMDA year, not calendar year.

[a]The number of pattern or practice referrals related to mortgage pricing disparities in this table is solely based on the number of fair lending outlier examinations and associated documentation that GAO reviewed. These numbers reflect referrals that GAO identified as of June 2009. The actual number of referrals to DOJ may be higher since some fair lending examinations are ongoing and may result in more referrals.

[b]DOJ considered two of the Federal Reserve referrals as one because the two referrals were sent to DOJ in one referral document.

[c]In addition, OTS referred one lender to HUD, and not to DOJ because a pattern or practice of discriminatory lending could not be established. As the institution's lending practices violated OTS nondiscrimination regulations and FHA as well as ECOA, OTS referred the institution to HUD.

While it is difficult to fully assess the reasons for the differences in referrals and outlier examination findings across the depository institution regulators without additional analysis, they raise important questions

[81]In our review of fair lending outlier examination files, we also identified cases in which depository institution regulators referred institutions to DOJ on the basis of other factors not related to mortgage pricing disparities, such as steering or policies of discrimination in automobile lending.

about the consistency of fair lending oversight. In particular, depository institutions under the jurisdiction of OTS, FDIC, and the Federal Reserve appear to be far more likely to be the subject of fair lending referrals to DOJ and potential investigations and litigation than those under the jurisdiction of OCC and NCUA. Under the fragmented regulatory structure, differences across the depository institution regulators in terms of their determination of what constitutes an appropriate referral as well as fair lending examination findings are likely to persist.

Enforcement Agencies Have Filed and Settled a Limited Number of Fair Lending Cases in Recent Years; Certain Challenges May Affect Enforcement Efforts

Enforcement agency litigation involving the fair lending laws has been limited in comparison with the number of lenders identified through analyses of HMDA data and other information. For example, since 2005, DOJ and FTC have reached settlements in eight cases involving alleged fair lending violations while HUD has not yet reached any settlements. Among other factors, resource considerations may account for the limited amount of litigation involving potential fair lending violations. Federal officials also identified other challenges to fair lending oversight and enforcement, including a complex and time-consuming investigative process, difficulties in recruiting legal and economic staff with fair lending expertise, and ECOA's 2-year statute of limitations for civil actions initiated by DOJ under its own authority or on the basis of referrals from depository institution regulators.

Overview of HUD and FTC Fair Lending Law Enforcement Activities

According to HUD officials, the department has filed two Secretary-initiated complaints against lenders alleging discrimination in their lending practices. The officials said that HUD is currently considering whether, pursuant to FHA, to issue Charges of Discrimination in administrative court in these two matters. If HUD decides to issue such charges in administrative court, any party may elect to litigate the case instead in federal district court, in which case DOJ assumes responsibility from HUD for pursuing litigation.

Since 2005, FTC under its statutory authority has filed complaints against two mortgage lenders in federal district court for potential discriminatory practices and has settled one of these complaints while the other one is

pending.[82] FTC's settlement dated December 17, 2008, with Gateway Funding Diversified Mortgage Services, L.P. (Gateway) and related entities provides an example of potential fair lending law violations and insights into federal enforcement activities. FTC filed a complaint against Gateway on the basis of an alleged ECOA pricing violation that originated in prime, subprime, and government loans such as FHA-insured mortgage loans. According to FTC, Gateway's policy and practice of allowing loan officers to charge discretionary overages that included higher interest rates and higher up-front charges resulted in African-Americans and Hispanics being charged higher prices because of their race or ethnicity. FTC alleged that the price disparities were substantial, statistically significant, and could not be explained by factors related to underwriting risk or credit characteristics of the mortgage applicants. Under the terms of the settlement, Gateway agreed to pay $2.9 million in equitable monetary relief for consumer redress ($2.7 million of which was suspended due to the company's inability to pay); establish a fair lending monitoring program specifically designed to detect and remedy fair lending issues; and establish, implement, operate, and maintain a fair lending training program for employees.[83]

The limited litigation involving potential fair lending violations reflects the limited number of investigations these agencies have initiated since 2005. From 2005 through 2009, HUD and FTC, as discussed previously, initiated 22 investigations of independent lenders at potentially heightened risk for fair lending law violations. Resource constraints may affect their capacity to file and settle fair lending related complaints. For example, FTC officials said that most of their staff who work on fair lending issues were dedicated to pursing the litigation associated with the three investigations that the agency opened from 2005 through 2008.[84] As two of these three investigations have now been settled or concluded, additional staff

[82] FTC Press Release, "Mortgage Lender Agrees to Settle FTC Charges That It Charged African-Americans and Hispanics Higher Prices for Loans" (December 16, 2008). http://www.ftc.gov/opa/2008/12/gateway.shtm. FTC Press Release, "FTC Alleges That Mortgage Lender Charged Hispanics Higher Prices for Loans" (May 11, 2009). http://www.ftc.gov/opa/2009/05/gem.shtm.

[83] *FTC v. Gateway Funding Diversified Mortgage Services, L.P.*, No. 08-5805 (E.D. Pa., 2008). The defendants in this case did not admit liability for any of the matters alleged in the complaint.

[84] As discussed previously, FTC reached a settlement in one of these investigations and filed a suit in federal court against another lender in May 2009. According to FTC, it concluded an investigation against another lender due to its deteriorated financial condition.

resources are available to pursue evidence of potential violations at other lenders under the agency's jurisdiction.

Overview of DOJ Fair Lending Enforcement Activities

Since 2005, DOJ has filed complaints and settled complaints in seven cases involving potential violations of the fair lending laws (see table 6). These cases involved allegations of racial and national origin discrimination, sexual harassment against female borrowers, and discrimination based on marital status in the areas of loan pricing and underwriting, and redlining. One of these settlements—United States. v. First Lowndes Bank, Inc—involved an allegation that a lender had engaged in mortgage pricing discrimination, which has been the basis of several depository institution regulators' referrals in recent years.[85]

Table 6: DOJ Settled Enforcement Cases Involving Fair Lending Violations, from 2005 through May 2009

Year settled	Name of case	Basis of complaint	Source of case	Outcome
2008	United States v. First Lowndes Bank, Inc., No. 2:08-cv-798-WKW-CSC (M.D. Al., 2008). (residential lending)	Race and pricing: The complaint alleged that the bank engaged in a pattern or practice of discriminating against African-American customers by charging them higher interest rates on manufactured housing loans than similarly situated white customers, in violation of FHA and ECOA.	Referral from FDIC based on 2004 HMDA pricing data	Settlement reached. The defendant agreed to pay up to $185,000, plus interest, to compensate African-American borrowers who may have been charged higher interest rates. The bank denied the allegations in the settlement documents and there was no factual finding or adjudication for any matter alleged.
2008	United States v. Nationwide Nevada, LLC, No. 2:08-cv-01309 (D. Nev., 2008). (automobile lending)	Redlining: The complaint alleged that Nationwide Nevada and its general partner NAC Management, Inc., engaged in a pattern or practice of discrimination by refusing to purchase contracts from automobile dealers when they believed that the applicant or co-applicant lived on an Indian reservation, in violation of ECOA.	Independent authority	Settlement reached. The defendant agreed to pay $170,000 plus interest to compensate loan applicants who may have suffered as a result of the defendants alleged failure to comply with the ECOA. The defendants denied that they engaged in any discrimination and specifically denied that they violated ECOA or Regulation B.

[85]No. 2:08-cv-798-WKW-CSC (M.D. Al., 2008).

Year settled	Name of case	Basis of complaint	Source of case	Outcome
2007	United States v. First Nat'l Bank of Pontotoc, No. 3:06cv061-M-D (N.D. Miss., 2007) (residential and consumer lending)[a]	Sexual harassment: The lawsuit alleged that a former bank vice president engaged in a pattern or practice of sexual harassment against female borrowers and applicants for credit in violation (consumer or residential lending) of FHA and ECOA.	Independent authority	Settlement reached. The defendants agreed to pay $250,000 to 15 identified victims, and $50,000 to the United States as a civil penalty. The defendants also agreed to pay up to $50,000 to any additional victims. Bank employees are required to receive training on the prohibition of sexual harassment under federal fair lending laws. The agreement also requires the bank to implement both a sexual harassment policy and a procedure by which an individual may file a sexual harassment complaint against any employee or agent of the First National Bank of Pontotoc. Defendants denied that they violated FHA or ECOA.
2007	United States v. Pacifico Ford, Inc., (E.D. Pa. 2007) (automobile lending)	Race and pricing: Alleges that the car dealership violated ECOA by engaging in a pattern or practice of discriminating against African-American customers by charging them higher dealer markups on car loan interest rates than similarly situated non-African-American customers.	Independent authority/ initiated jointly with Pennsylvania Attorney General	Settlement reached. Defendant agreed to pay up to $363,166, plus interest, to African-American customers who were charged higher interest rates. In addition, the dealership will implement changes in the way it sets markups, including guidelines to ensure that the dealership follows the same procedures for setting markups for all customers, and that only good faith, competitive factors consistent with ECOA influence that process. The dealership also will provide enhanced equal credit opportunity training to officers and employees who set rates for automobile loans. Defendants denied violating the ECOA or engaging in any discriminatory practices against African-Americans or any other consumers.

Year settled	Name of case	Basis of complaint	Source of case	Outcome
2007	United States v. Springfield Ford, Inc., (E.D. Pa. 2007) (automobile lending)	Race and pricing: Complaint alleges that the car dealership violated ECOA by engaging in a pattern or practice of discriminating against African-American customers by charging them higher dealer markups on car loan interest rates than similarly situated non-African-American customers	Independent authority/ initiated jointly with Pennsylvania Attorney General	Settlement reached. Defendant agreed to pay up to $94,564, plus interest, to African American customers who were charged higher interest rates. In addition, the dealership will implement changes in the way it sets markups, including guidelines to ensure that the dealership follows the same procedures for setting markups for all customers, and that only good faith, competitive factors consistent with ECOA influence that process. The dealership also will provide enhanced equal credit opportunity training to officers and employees who set rates for automobile loans. Defendants denied violating the ECOA or engaging in any discriminatory practices against African-Americans or any other consumers.
2007	United States v. Compass Bank, No. 07-H-0102-S (N.D. Al., 2007) (automobile lending)	Marital status: Complaint alleges that Compass Bank violated ECOA by engaging in a pattern or practice of discrimination on the basis of marital status in thousands of automobile loans that it made through hundreds of different car dealerships in the South and Southwest between May 2001 and May 2003.	Referral from the Federal Reserve	Settlement reached. Defendant agreed to pay up to $75 million to persons who may have suffered as a result of the alleged violations. The consent order also requires the bank to ensure that its underwriting guidelines and procedures do not discriminate on the basis of marital status and to implement fair lending training programs for its employees. The defendant denied the allegations.
2006	United States v. Centier Bank, No. 2:06-CV-344 (N.D. Ind. 2006) (business and residential lending)	Redlining: Complaint alleges that Centier Bank violated FHA and ECOA by unlawfully avoiding and refusing to provide its business and residential lending products and services to predominately African-American and Hispanic neighborhoods while making services available to white areas.	Independent authority	Settlement reached. Defendant agreed to open two new full-service branch offices in majority-minority census tracts; expand an existing supermarket office in a majority Hispanic census tract into a full-service branch; invest $3.5 million in a special financing program for residents and small businesses in the minority communities of the Gary, Indiana, area; invest at least $500,000 for consumer education and credit counseling programs; and spend at least $375,000 to advertise its products in media targeted to minority communities. The bank denied it engaged in discrimination or that it violated FHA or ECOA.

Source: GAO summary of DOJ data.

Note: This list includes only cases that were settled by DOJ from January 2005 through May 2009. It does not include cases referred by depository institution regulators during their reviews based on 2005 and 2006 HMDA data that remain open or were returned to the depository institution regulators for administrative action.

[a]See *also In the Matter of William W. Anderson, Jr.*, OCC No. AA-EC-09-22 (2009).

According to DOJ officials, the enforcement actions for mortgage lending result both from investigations that were initiated under the department's independent authority and from referrals from depository institution regulators. As shown in table 6, five of the seven fair lending cases settled were initiated under DOJ's independent investigative authority; one was based on a referral from FDIC, and one from the Federal Reserve. However, DOJ officials said that there are investigations based on other referrals from depository institution regulators that are ongoing, including one case in pre-suit negotiations based on a referral from the Federal Reserve and another case that arose from a FDIC referral.

Officials Cited Several Challenges in Conducting Fair Lending Investigations and Initiating Enforcement Actions

According to officials from federal enforcement agencies, investigations involving allegations of fair lending violations can be complex and time-consuming. For example, DOJ officials said that if the department decided to pursue an investigation based on a referral from a depository institution regulator, such an investigation may be broader than the information contained in a typical referral. DOJ officials said that referrals typically were based on a single examination, which may cover a limited period (such as potential discrimination based on an analysis of HMDA data for a particular year). They also pointed out that the standard for referral to DOJ for the depository institution regulators is "reason to believe" that a discriminatory practice is occurring.[86] DOJ officials said that to determine if a referred pattern or practice of discrimination warrants federal court litigation, they may request additional HMDA and underwriting data for additional years and analyze them. Furthermore, they said that lenders often hire law firms that specialize in fair lending to assist the lender in its response to the department's investigation. DOJ officials said that these firms may conduct their own analysis of the HMDA and underwriting and pricing data and, as part of the investigation process, offer their views about why any apparent disparities may be explained. Depending on the circumstances, this process can be lengthy. According to a 2008 report by

[86]As previously stated, ECOA requires these agencies to refer matters to DOJ when there is "reason to believe that 1 or more creditors has engaged in a pattern or practice of discouraging or denying applications for credit in violation of ECOA" 15 U.S.C. § 1691e(g).

FDIC's Inspector General, fair lending referrals that are not sent back to the referring agency for further review may be at DOJ for years before they are resolved.[87] Additionally, HUD officials said that their initial investigations into evidence of potential fair lending violations may detect additional evidence of discrimination that also must be collected and reviewed.

According to officials from an enforcement agency and available research, another challenge that complicates fair lending investigations involves lending discrimination based on disparate impact, which we also raised as an enforcement challenge in our 1996 report.[88] As discussed in the Interagency Policy Statement on Discrimination in Lending, issued in 1994, fair lending violations may include allegations of disparate treatment or disparate impact.[89] It is illegal for a lender to treat borrowers from protected classes differently, such as intentionally charging disproportionately higher interest rates based on race, sex, or national origin that are not related to creditworthiness or other legitimate considerations. It also is illegal for a lender to maintain a facially neutral policy or practice that has a disproportionately adverse effect on members of a protected group for which there is no business necessity that could not be met by a less discriminatory alternative. For example, a lender might have a blanket prohibition on originating loans below a certain dollar threshold because smaller loans might be more appealing to borrowers with limited financial resources and therefore represent higher default risks. While such a policy might help protect a lender against credit losses, it also could affect minority borrowers disproportionately. Furthermore, alternatives other than a blanket prohibition might mitigate potential losses, such as reviewing applicant credit data. It may be difficult for enforcement agencies or depository institution regulators to evaluate lender claims that they have a business necessity for particular policies and identify viable alternatives that would not have a disparate impact on targeted groups. However, an official from the Federal Reserve told us that

[87]Federal Deposit Insurance Corporation, Office of the Inspector General, , *Enforcement Actions for Compliance Violations at FDIC-Supervised Institutions* (Washington, D.C.: December 2008).

[88]GAO/GGD-96-145. See Stephen Ross and John Yinger, "Uncovering Discrimination: A Comparison of the Methods Used by Scholars and Civil Rights Enforcement Officials," *American Law and Economics Review* 8, no. 3 (Fall 2006).

[89]Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,266, 18,268 (Apr. 15, 1994).

the potential for disparate impact can be assessed through its examination and other oversight processes. The official said the Federal Reserve has evaluated lenders' policies to assess the potential disparate impact and has referred at least one lender to DOJ based on the disparate impact theory.

DOJ and FTC officials also said that recruiting and retaining staff with specialized expertise in fair lending laws can be challenging. Both DOJ and FTC officials said that recruiting attorneys with expertise in fair lending investigations and litigation was difficult, and employees who develop such expertise may leave for other positions, including at other federal depository institution regulators or quasi-governmental agencies that offer higher compensation. Additionally, DOJ and FTC officials said that recruiting and retaining economists who have expertise in analyzing HMDA data and underwriting data to detect potential disparities in mortgage lending can be difficult. FTC officials said that due to the recent departure of economists to depository institution regulators, the agency increasingly relies on outside vendors to provide such economic and statistical expertise.

ECOA's Statute of Limitations May Limit Enforcement Activities

Finally, some federal enforcement agency and depository institution regulators cited ECOA's statute of limitations as potentially challenging for enforcement activities. Currently, ECOA's statute of limitations for referrals to DOJ from the depository institution regulators and for actions brought on DOJ's own authority requires that no legal actions in federal court be initiated more than 2 years after the alleged violation occurred.[90] According to federal officials, the ECOA statute of limitations may limit their activities because HMDA data generally are not available for a year or more after a potential lending violation has occurred. Consequently, federal agencies and regulators may have less than a year to schedule an investigation or examination, collect and review additional HMDA and underwriting and pricing data, and pursue other approaches to determine if a referral to DOJ would be warranted. According to OTS officials, an extension of the statue of limitations beyond its current 2-year period would provide valuable additional time to conduct the detailed analyses that is necessary in fair lending cases. Accordingly, FDIC has recommended that Congress extend ECOA's statute of limitations to 5

[90]According to FTC, its investigations and enforcement actions are not subject to a statue of limitations when enforcing ECOA for equitable injunctive and monetary relief. When seeking civil penalties for ECOA violations, FTC is subject to a 5-year statute of limitations for those penalties. 28 U.S.C. § 2462.

years. DOJ officials noted that they would not be averse to the statute of limitations being extended.

While federal officials said that there are options to manage the challenges associated with the ECOA statutes of limitations, these options have limitations. For example, some enforcement officials said that ECOA violations may also be investigated under FHA, which has longer statutes of limitations. Specifically, under FHA, DOJ may bring an FHA action based on a pattern or practice or for general public importance within 5 years for civil penalties and within 3 years for damages; there is no limitation period for injunctive relief. However, not all ECOA violations necessarily constitute FHA violations as well. Enforcement agency officials also said that in some cases they may be able to obtain tolling agreements as a means to manage the ECOA and FHA statutes of limitations. Tolling agreements are written agreements between enforcement agencies, or private litigants, and potential respondents, such as lenders subject to investigations or examinations for potential fair lending violations, in which the respondent agrees to extend the relevant statute of limitations so that investigations and examinations may continue. Enforcement agency officials said that lenders often agree to tolling agreements and work with the agencies to explain potential fair lending law violations, such as disparities in mortgage pricing. The officials said that the lenders have an incentive to agree to tolling agreements because the enforcement agencies otherwise may file wide-ranging complaints against them on the basis of available information shortly before the relevant statute of limitations expires. However, enforcement officials said it is not always possible to obtain lenders' consent to enter into tolling agreements, and our review of fair lending examination files confirmed this assessment. We found several instances in which depository institution regulators had difficulty obtaining tolling agreements. Because federal enforcement efforts to manage ECOA's 2-year statute of limitations may not always be successful, the agencies' capacity to thoroughly investigate potential fair lending violations and take appropriate corrective action in certain cases may be compromised.

Conclusions

Federal enforcement agencies and depository institution regulators face challenges in consistently, efficiently, and effectively overseeing and enforcing fair lending laws due in part to data limitations and the fragmented U.S. financial regulatory structure. HMDA data, while useful in screening for potentially heightened risks of fair lending violations in mortgage lending, are limited because they currently lack the underwriting data needed to perform a robust analysis. While requiring lenders to

collect and report such data would impose additional costs on them, particularly for smaller institutions, the lack of this information compromises the depository institution regulators' ability to effectively and efficiently oversee and enforce fair lending laws. Such data also could facilitate independent research into the potential risk for discrimination in mortgage lending as well as better inform Congress and the public about this critical issue. A variety of options could mitigate costs associated with additional HMDA reporting, including limiting the reporting to larger lenders or restricting its use for regulatory purposes. While these alternatives would limit or restrict additional publicly available information on the potential risk for mortgage discrimination compared to a general data collection and reporting requirement, these are tradeoffs that merit consideration because additional data would facilitate the consistent, efficient, and effective oversight and enforcement of fair lending laws.

The limited data available about potentially heightened risks for discrimination during the preapplication process also affects federal oversight of the fair lending laws for mortgage lending. Currently, enforcement agencies and depository institution regulators lack a direct and reliable source of data to help determine if lending officials may have engaged in discriminatory practices in their initial interactions with mortgage loan applicants. While researchers and consumer groups have conducted studies using testers that suggest that discrimination does take place during the preapplication process and federal officials generally agree that testers offer certain benefits, federal officials also have raised several concerns about their use. For example, they have questioned the costs of using testers and the reliability of data obtained in using them. Nevertheless, the lack of a reliable means to assess the potential risk for discrimination during the preapplication phase compromises depository institution regulators' capacity to ensure lender compliance with the fair lending law in all phases of the mortgage lending process. In this regard, FDIC's possible incorporation of testers into its examination process, depository institution regulators' ongoing efforts to update the interagency fair lending examination guidance, or the Interagency Task Force on Fair Lending may offer opportunities to identify improved means of assessing discrimination in the preapplication phase. Moreover, the potential use of consumer surveys as suggested by the Department of the Treasury in its recent report on regulatory restructuring may represent another approach to assessing the potential risk for discrimination during the preapplication phase.

Data limitations may have even more significant impacts on depository institution regulators' and enforcement agencies' capacity to assess fair lending risk in nonmortgage lending (such as small business, credit card, and automobile lending). Because Federal Reserve Regulation B generally prohibits lenders from collecting personal characteristic data for nonmortgage loans, agencies generally cannot target lenders for investigations or examinations as they can for mortgage loans. Consequently, federal agencies have limited tools to investigate potentially heightened risks of violations in types of lending that affect most U.S. consumers. While depository institution regulators and enforcement agencies have tried to develop ways to provide oversight in this area, the existing data limitations have affected the focus of oversight and enforcement efforts. While requiring lenders to collect and report personal characteristic data for nonmortgage loans as well as associated underwriting data as may be appropriate raises important cost and complexity concerns, the absence of such data represents a critical limitation in federal fair lending oversight efforts.

There also are a number of larger challenges to fair lending oversight and enforcement stemming from the fragmented U.S. regulatory structure and other factors such as mission focus and resource constraints. Specifically,

- Independent lenders, which were the predominant originators of subprime and other questionable mortgages that often were made to minority borrowers in recent years, generally are subject to less comprehensive oversight than federally insured depository institutions and represent significant fair lending risks. In particular, enforcement agencies do not conduct investigations of many independent lenders that are identified as outliers through the Federal Reserve's annual analysis of HMDA data to determine if these disparities represent fair lending law violations. The potential exists that additional instances of discrimination against borrowers could be taking place at such firms without being detected. Such limited oversight could undermine enforcement agencies' efforts to deter violations. While depository institution regulators' outlier examinations differ in important respects from enforcement agency investigations, depository institution regulators generally conduct examinations of all lenders identified as outliers to assess the potential risk for discrimination, which likely contributes to efforts at deterrence. Moreover, enforcement agencies, unlike most depository institution regulators, generally do not initiate fair lending investigations of independent lenders on a routine basis that are not viewed as outliers, which represents an important gap in fair lending oversight.

- The Federal Reserve lacks clear authority to assess fair lending compliance by nonbank subsidiaries of bank holding companies, which also have originated large numbers of subprime mortgages, in the same way that it oversees the activities of state-chartered depository institutions under its jurisdiction. The lack of clear authority to conduct routine consumer compliance examinations of nonbank subsidiaries is important because the Federal Reserve identifies many potential fair lending violations at state-chartered banks through such routine examinations. Without similar authority for nonbank subsidiaries, the Federal Reserve's capacity to identify potential risks for fair lending violations is limited.

- Despite the joint interagency fair lending examination guidance and various coordination efforts, we also found that having multiple depository institution regulators resulted in variations in screening techniques, the management of the outlier examination process, examination documentation standards, and the number of referrals and types of examination findings. While differences in these areas may not be unexpected given the varied types of lenders under each depository institution regulator's jurisdiction, these differences raise questions about the consistency and effectiveness of regulatory oversight. For example, the evidence suggests that lenders regulated by FDIC, the Federal Reserve, and OTS are more likely than lenders regulated by OCC and NCUA to be the subject of referrals to DOJ for being at potentially heightened risk of fair lending violations. Our current work did not fully evaluate the reasons and effects of identified differences and additional work in this area could help provide additional clarity.

Finally, federal depository institution regulators and enforcement agencies also face some challenges associated with the 2-year statute of limitations under ECOA applicable to federal district court actions brought by DOJ. Because it takes about 6 months for the Federal Reserve to reconcile and review HMDA data, depository institution regulators and enforcement agencies typically review the HMDA data almost one year after the underlying loan decisions occurred, and may have a limited opportunity to conduct thorough examinations and investigations in some cases. While strategies may be available to manage the ECOA 2-year statute of limitations, such as obtaining tolling agreements, they are not always effective. Therefore, ECOA's statute of limitations may work against the act's general objective, which is to penalize and deter lending discrimination.

Matters for Congressional Consideration

To facilitate the capacity of federal enforcement agencies and depository institution regulators as well as independent researchers to identify lenders that may be engaged in discriminatory practices in violation of the fair lending laws, Congress should consider the merits of additional data collection and reporting options. These varying options pertain to obtaining key underwriting data for mortgage loans, such as credit scores as well as LTV and DTI ratios, and personal characteristic (such as race, ethnicity and sex) and relevant underwriting data for nonmortgage loans.

To help ensure that all potential risks for fair lending violations are thoroughly investigated and sufficient time is available to do so, Congress should consider extending the statute of limitations on ECOA violations.

As Congress debates the reform of the financial regulatory system, it also should take steps to help ensure that consumers are adequately protected, that laws such as the fair lending laws are comprehensive and consistently applied, and that oversight is efficient and effective. Any new structure should address gaps and inconsistencies in the oversight of independent mortgage brokers and nonbank subsidiaries, as well as address the potentially inconsistent oversight provided by depository institution regulators.

Recommendation for Executive Action

To help strengthen fair lending oversight and enforcement, we recommend that DOJ, FDIC, Federal Reserve, FTC, HUD, NCUA, OCC, and OTS work collaboratively to identify approaches to better assess the potential risk for discrimination during the preapplication phase of mortgage lending. For example, the agencies and depository institution regulators could further consider the use of testers, perhaps on a pilot basis, as well as surveys of mortgage loan borrowers and applicants or alternative means to better assess the potential risk for discrimination during this critical phase of the mortgage lending process.

Agency Comments and Our Evaluation

We provided a draft of this report to the heads of HUD, FTC, DOJ, FDIC, the Federal Reserve, NCUA, OCC, and OTS. We received written comments from FTC, FDIC, NCUA, the Federal Reserve, OCC, and OTS, which are summarized below and reprinted in appendixes III through VIII. HUD provided its comments in an e-mail which is summarized below. DOJ did not provide written comments. All of the agencies and regulators, including DOJ, also provided technical comments, which we incorporated into the report where appropriate. We also provided excerpts of the draft report to two researchers whose studies we cited to help ensure the

accuracy of our analysis. One of the researchers responded and said that the draft report accurately described his research, while the other did not respond.

In the written comments provided by FDIC, the Federal Reserve, NCUA, OCC, and OTS, they agreed with our recommendation to work collaboratively regarding the potential use of testers or other means to better assess the risk of discriminatory practices during the premortgage loan application process, and generally described their fair lending oversight programs and, in some cases, planned enhancements to these programs. In particular, the Federal Reserve stated that it would be pleased to provide technical assistance to Congress regarding potential enhancements to HMDA data to better identify lenders at heightened risk of potential fair lending violations and described its existing approaches to fair lending oversight, including for the nonbank subsidiaries of bank holding companies. Further, the Federal Reserve stated that it is developing a framework for increased risk-based supervision for these entities. While such enhancements could strengthen the Federal Reserve's oversight of nonbank subsidiaries, the lack of clear authority for it to conduct routine examinations continues to be an important limitation in fair lending oversight and enforcement.

OCC also described its fair lending oversight program and planned revisions. First, OCC stated that it planned to enhance its procedures by formalizing headquarters involvement in the oversight process. For example, senior OCC headquarters officials will receive reports on at least a quarterly basis on scheduled, pending, and completed fair lending examinations to facilitate oversight of the examination process. Second, OCC plans to strengthen its fair lending examination documentation through, for example, changes in its centralized data systems so that the systems contain, in standardized form: relevant examination dates, the risk factors that were identified through the screening and other processes for each lender, the focal points of the examination, the reasons for any differences between the focal points and the areas identified through the risk screening processes, and the key findings of the examinations. OCC also noted that it (1) plans to expand its "HMDA-plus" pilot program to collect underwriting data from large banks at an earlier stage to facilitate screening efforts, (2) views working with other regulators to enhance the effectiveness and consistency of screening efforts as appropriate, and (3) will undertake work with other regulators and DOJ to address variations in referral practices.

NCUA's Chairman generally concurred with the draft report's analysis and recommendations and offered additional information. First, the Chairman stated that additional study is needed to assess the depository institution regulators' varying referral practices, but that such study should be conducted before drawing any conclusions about the effectiveness of NCUA's fair lending oversight. The Chairman stated that NCUA has not made any referrals to DOJ because the agency did not identify any potential violations during the period covered by the report. Further, the Chairman stated NCUA uses the same examination procedures as the other depository institution regulators and offered reasons as to why violations may not exist at credit unions. For example, the Chairman said that credit unions have a specified mission of meeting the credit and savings needs of their members, especially persons of modest means (who typically are the target of discriminatory actions). We have not evaluated the Chairman's analysis as to why fair lending violations may not exist at credit unions, but note that there is a potential for discrimination in any credit decision and that all federal agencies and regulators have a responsibility to identify and punish such violations as well as deter similar activity. The Chairman also (1) concurred that additional data collection under HMDA could enhance efforts to detect lenders at heightened risk of violations, but believes that such requirements should pertain to all lenders rather than a subset; (2) agreed that ECOA's statute of limitations should be extended; and (3) concurred with the recommendation that NCUA work collaboratively with other regulators and agencies to better assess the potential for discrimination during the preapplication phase of mortgage lending.

In an e-mail, HUD said that improved communication and cooperation among the federal agencies responsible for overseeing federal fair lending laws could improve federal compliance and enforcement efforts. HUD also concurred with the draft report's analysis that expanding the range of data reported, by mortgage lenders pursuant to HMDA would significantly expand the department's ability to identify new cases of potential lending discrimination. In particular, HUD stated that requiring lenders to report underwriting data, such as borrowers' credit scores, would allow the department to more accurately assess lenders' compliance with the Fair Housing Act. However, HUD urged careful consideration be paid to any proposal to limit the range of lenders subject to new reporting requirements under HMDA. HUD stated that, in its experience, smaller lenders, no less than larger lenders, may exhibit disparities in lending that warrant investigation for compliance with federal law. In addition, HUD stated that many smaller lenders may already collect and maintain for

other business purposes the same data, which may be sought through expanded HMDA reporting requirements.

FTC's Director, Bureau of Consumer Protection, stated that the draft report appropriately drew attention to limitations in HMDA data as a means to identify lenders at heightened risk of fair lending violations. The Director also highlighted two conclusions in the draft report and noted that limitations of the data warranted collecting additional data before any conclusions about discrimination could be drawn. First, the Director stated that the report concluded that independent lenders have a heightened risk of potential violations compared to depository institutions. The Director said that many lenders make very few or no high-priced loans and thus cannot be evaluated by an analysis of HMDA pricing data whereas independent lenders disproportionately make such loans. Therefore, the Director said it is not possible to draw conclusions as to which types of lenders are more likely to have committed violations solely on the basis of HMDA data or the outlier lists and that such a conclusion about independent lenders is especially tenuous. The Director also stated that the report recommends that additional underwriting data be collected to supplement current mortgage data but does not address the importance of discretionary pricing data. The Director stated that lender discretion in granting or pricing credit represents a significant fair lending risk, and that the agency collects such information, in addition to underwriting information, as part of its investigations. In sum, the Director stated that while HMDA data is useful, additional data must be collected from lenders before any conclusions about discrimination can meaningfully be drawn.

We have revised the draft to more fully reflect the Director's views regarding limitations in HMDA data and its capacity to identify lenders at heightened risk of fair lending violations and draw conclusions about potential discrimination in mortgage lending. However, HMDA data may have limitations with respect to identifying mortgage pricing disparities as the Director noted. We do not concur that statements in the draft report suggesting that independent lenders may represent relatively heightened risks of fair lending violations are especially tenuous. As stated in the draft report, subprime loans and similar high cost mortgages, which are largely originated by independent lenders and nonbank subsidiaries of holding companies, appear to have been made to borrowers with limited or poor credit histories and subsequently resulted in significant foreclosure rates for such borrowers. Further, our 2007 report noted that subprime lending grew rapidly in areas with higher concentrations of minorities. While the scope or our work did not involve an analysis of the feasibility and costs of incorporating discretionary pricing data into HMDA

data collection and reporting requirements, we acknowledge that the lack of such information may challenge oversight and enforcement efforts.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from report date. At that time, we will send copies of this report to other interested congressional committees, and to the Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Comptroller of the Currency, Office of the Comptroller of the Currency; Acting Director, Office of Thrift Supervision; Inspector General, the National Credit Union Administration; the Chairman of the Federal Trade Commission; the Secretary of the Department of Housing and Urban Development; the Attorney General; and other interested parties. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions regarding this report, please contact me at (202) 512-8678 or williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IX.

Orice Williams Brown
Director, Financial Markets and
Community Investment

List of Congressional Requesters

The Honorable Barney Frank
Chairman
Committee on Financial Services
House of Representatives

The Honorable Melvin L. Watt
Chairman
Subcommittee on Domestic Monetary Policy and Technology
Committee on Financial Services
House of Representatives

The Honorable Luis V. Gutierrez
Chairman
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
House of Representatives

The Honorable Maxine Waters
Chairwoman
Subcommittee on Housing and Community Opportunity
Committee on Financial Services
House of Representatives

The Honorable Gregory W. Meeks
Chairman
Subcommittee on International Monetary Policy and Trade
Committee on Financial Services
House of Representatives

The Honorable Dennis Moore
Chairman
Subcommittee on Oversight and Investigations
Committee on Financial Services
House of Representatives

The Honorable Joe Baca
The Honorable Michael E. Capuano
The Honorable André Carson
The Honorable Emanuel Cleaver
The Honorable Keith Ellison
The Honorable Al Green
The Honorable Rubén Hinojosa
The Honorable Paul W. Hodes

The Honorable Carolyn B. Maloney
The Honorable Carolyn McCarthy
The Honorable Gwen Moore
House of Representatives

Appendix I: Objectives, Scope, and Methodology

The objectives of our report were to (1) assess the strengths and limitations of data sources that enforcement agencies and depository institution regulators use to screen for lenders that have potentially heightened risk for fair lending law violations and discusses options for enhancing the data; (2) assess federal oversight of lenders that may represent relatively high risks of fair lending violations as evidenced by analysis of Home Mortgage Disclosure Act (HMDA) data and other information; (3) examine differences in depository institution regulators' fair lending oversight programs; and (4) discuss enforcement agencies' recent litigation involving potential fair lending law violations and challenges that federal officials have identified in fulfilling their enforcement responsibilities.

To address the first objective for assessing the strengths and limitations of data to screen for lenders that appear to be at a heightened risk for potentially violating fair lending laws, we reviewed and analyzed fair lending examination and investigation guidance, policies, and procedures, and other agency documents. We gathered information on how enforcement agencies—the Department of Housing and Urban Development (HUD), the Federal Trade Commission (FTC), and the Department of Justice (DOJ)—and depository institution regulators—the Board of Governors of the Federal Reserve System (Federal Reserve), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Office of Thrift Supervision (OTS)—use data sources such as HMDA data to screen for high-risk lenders. HMDA requires many mortgage lenders to collect and report data on mortgage applicants and borrowers. In 2004, HMDA was amended to require lenders to report certain mortgage loan pricing data. To assess the strengths and limitations of these data, we reviewed academic research, studies from consumer advocacy groups, Inspectors General reports, Congressional testimonies, and prior GAO work on the strengths and limitations of HMDA data and the limited availability of data for nonmortgage lending. We also reviewed available information on current initiatives to gather enhanced HMDA data (adding underwriting information such as loan-to-value ratios and credit scores) earlier in the screening and examination process, such as OCC's pilot project. In addition, we interviewed officials from the enforcement agencies and depository institution regulators listed above—including senior officials, examiners, policy analysts, economists, statisticians, attorneys, and compliance specialists—to discuss how they use various data sources to screen for high-risk lenders, gather their perspectives on the strengths and limitations of available data sources, and obtain information on the costs of reporting HMDA data. We did not interview

NCUA economists or attorneys and NCUA does not have statisticians. We did interview senior officials, examiners, policy analysts and compliance specialists. We also discussed current initiatives to address screening during the preapplication phase of lending, and the potential benefits and limitations of using testers during this phase. We evaluated the depository institution regulators' examination guidance and approaches for the preapplication phase. We interviewed researchers, lenders, representatives from community and fair housing groups, and independent software vendors to gather perspectives on the strengths and limitations of HMDA data in the fair lending screening process and the benefits and costs of requiring the collection of additional or enhanced HMDA data.

To address the second objective, we reviewed and analyzed enforcement agency and depository institution regulator documents. More specifically, we reviewed and analyzed internal fair lending examination and investigation guidance, policies, and procedures; federal statutes and information provided by the agencies on their authority, mission and jurisdiction; the Federal Reserve's annual HMDA outlier lists; information on staffing resources; documentation on the number of fair lending enforcement actions initiated and settled; and other agency documents to compare and contrast the agencies' and depository institution regulators' authority and efforts to oversee the fair lending laws, including enforcement and investigative practices. We also obtained information on depository institution regulators' outlier examination programs from internal agency documents and our file review of examinations of outlier institutions, as discussed below. Furthermore, we interviewed key agency officials from the eight enforcement agencies and depository institution regulators that oversee the fair lending laws to gather information on their regulatory and enforcement activities and compare their approaches. To gather information on state coordination of fair lending oversight with federal agencies, as well as to compare and contrast fair lending examination policies and practices, we also interviewed state banking regulatory officials and community groups.

We also evaluated certain aspects of depository institution regulators' compliance with fair lending outlier examination schedules and procedures. Specifically, we conducted a systematic review of 152 fair lending examination summary files derived from each depository institution regulator's annual list of institutions identified to be at higher risk for fair lending violations (that is, their outlier lists). We examined outlier lists based on 2005 and 2006 HMDA data because they fully incorporated pricing data (first introduced in 2004 HMDA data), and because the examinations based on these lists had a higher likelihood of

being completed. We systematically collected information and evaluated each examination's compliance with key agency regulations and interagency and internal fair lending guidance. For instance, we reviewed the files to determine if outlier examinations had been initiated in a timely fashion; if examination scoping, focal points, and findings had been documented; and if recommendations were made to correct any deficiencies. We limited our focus to assessing regulatory compliance with applicable laws, regulations, and internal guidance and did not make judgments on how well agencies conducted the examinations. For three of the depository institution regulators—the Federal Reserve, FDIC, and OTS—we reviewed summary documentation (such as reports of examination, scope and methodology memorandums, exit and closing memorandums, and referral documentation to DOJ) of completed examinations for every institution on their 2005 and 2006 HMDA data outlier lists when relevant. This amounted to 32 examinations for the Federal Reserve, 38 for FDIC, and 40 for OTS. Because NCUA (1) does not have a centralized process for identifying outliers, (2) was unable to respond to our document request in a timely manner, and (3) had a relatively low number of credit unions identified as outliers by the Federal Reserve, we randomly selected and reviewed summary documentation for a sample of 10 examinations conducted in 2007 to capture examinations that analyzed loans made in 2005 and 2006 (out of 25 examinations).

We also reviewed a random sample of national banks due to limitations in OCC's fair lending examination documentation and the need to conduct our analysis in a timely manner. We randomly selected a simple sample of 27 examinations of institutions from a population of 231 institution examinations derived from OCC's annual outlier lists for 2005 and 2006 HMDA data. Because OCC also randomly selects a sample of banks (both HMDA and non-HMDA filing) to receive comprehensive fair lending examinations, we also reviewed examination files from 2005 for five of these institutions (out of a population of 31). Thus, our sample totaled 32 lender examinations and we requested that OCC provide all fair lending oversight materials for each of these lenders from 2005 through 2008 so that we could discern the extent to which OCC was complying with regulations and guidance for its outlier examination program. We collected the same information for these examinations as from the other depository institution regulators.

In addition, we reviewed guidance, policies, procedures, relevant statutes, and other documents from the Federal Reserve to assess the extent of fair lending oversight conducted for nonbank subsidiaries of bank holding companies. We also reviewed past GAO reports on the history of oversight

of nonbank subsidiaries of bank and thrift holding companies. We interviewed agency officials and consumer advocacy groups to gather their perspectives on the extent of current oversight for nonbank subsidiaries of bank holding companies. We also spoke with agency officials to gather information on a current interagency pilot program between the Federal Reserve, OTS, FTC, and the Conference of State Bank Supervisors to monitor the activities of nonbank subsidiaries of holding companies.

For the third objective, in addition to reviewing our analysis of depository institution regulators' compliance with fair lending examination policies as described above, we (1) conducted further comparisons of their outlier examination screening processes, (2) reviewed documentation and reports related to their management of the outlier examination process and documentation and reporting of examination findings; and (3) reviewed documentation related to their referral practices and outlier examination findings. We also reviewed relevant federal internal control standards for documentation and reporting and compared them to the depository institution regulators' practices as appropriate. We also discussed these issues with senior officials from the depository institution regulators and state financial regulatory officials from New York, Washington, and Massachusetts.[1] In addition, we discussed their efforts to coordinate fair lending oversight programs through the development of interagency examination guidance and participation in meetings of the Interagency Task Force on Fair Lending and related forums.

To address the fourth objective, we reviewed agencies' internal policies, procedures, and guidance as well as federal statutory requirements that depository institution regulators use when making referrals or notifications to HUD or DOJ for potential violations of the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act. We also analyzed information on enforcement agencies' and depository institution regulators' staff resources and any time constraints they might face related to ECOA's 2-year statute of limitations for making referrals to DOJ for follow-up investigations and potential enforcement actions. To obtain information on the enforcement activities of federal agencies, we conducted an analysis of the number of fair lending investigations

[1]We chose these three states based on a recommendation from officials of the Conference of State Bank Supervisors, who noted that the three are among the more active states as relates to fair lending supervision and enforcement activities.

initiated, complaints filed, and settlements reached by each enforcement agency. We also interviewed officials from each depository institution regulator and enforcement agency to gather information on investigative practices that enforcement agencies use when deciding whether to pursue a fair lending investigation or complaint against an institution and possible challenges that enforcement agencies and depository institution regulators face in enforcing the fair lending laws, specifically ECOA's 2-year statute of limitations.

For all the objectives, we interviewed representatives from financial institutions and several consumer advocacy groups and trade associations such as the Center for Responsible Lending, the National Community Reinvestment Coalition, and the National Fair Housing Alliance, Leadership Conference on Civil Rights, a large commercial bank, and Consumer Bankers' Association. We obtained their perspectives on regulatory efforts to enforce fair lending laws, which include screening lenders for potential violations, conducting examinations, and enforcing the laws through referrals, investigations, or other means, and any collaborative activities between depository institution regulators and state entities.

We conducted this performance audit from September 2008 to July 2009 in Washington, D.C., in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Federal Oversight Authority for FHA and ECOA

The table below lists the federal regulatory and enforcement agencies that examine and enforce compliance with the fair lending laws Fair Housing Act (FHA),[1] and Equal Credit Opportunity Act (ECOA)[2] at depository institutions and their affiliates and subsidiaries, independent lenders, servicers, holding companies, and the nonfunctionally regulated subsidiaries of their holding companies. See the table notes for statutory cites and brief explanations of the statutory authorities.

[1]Under 42 U.S.C. § 3608(a), HUD has authority and responsibility for administering FHA. All executive departments and agencies must administer their programs and activities relating to housing and urban development to affirmatively further the purposes of FHA and to cooperate with HUD, including the agencies having regulatory or supervisory authority over financial institutions. 42 U.S.C. § 3608(d). HUD has authority to issue rules to carry out FHA under 42 U.S.C. § 3601 note. Furthermore, the financial regulatory agencies must provide notice to HUD and the alleged injured party when they have reason to believe that an FHA and ECOA violation has occurred but such violation has not been referred to DOJ. 15 U.S.C. § 1691e(k).

HUD has administrative enforcement authority under FHA. 42 U.S.C. §§ 3610-3612. Complaints of FHA violations may be filed with HUD, or HUD may file a complaint on its own initiative, which HUD investigates and upon determining that reasonable cause exists to believe that a discriminatory housing practice has occurred, or is about to occur, HUD must file a Charge of Discrimination on behalf of the aggrieved person. 42 U.S.C. § 3610. If the aggrieved person or the respondent elects to have the case decided in a civil court action, DOJ is charged with bringing the case in federal court. If no party elects to go to federal court, under 42 U.S.C. § 3612, HUD must provide an opportunity for a hearing before an administrative law judge and issue a final decision. Relief may include actual damages suffered by the aggrieved person and injunctive or other equitable relief, as well as a civil penalty in an amount up to $65,000, depending on the circumstances. 42 U.S.C. § 3612(g)(3); 24 C.F.R. § 180.671.

In addition to election cases under 42 U.S.C. § 3612, DOJ also has enforcement authority under FHA to bring civil actions in U.S. district court for cases involving a pattern or practice of discrimination or the denial of rights to a group of persons. *See* 42 U.S.C. § 3614. Relief may include preventive relief, injunction, restraining order, or other relief as is necessary to assure the full enjoyment of the rights granted by the FHA, and other relief as the court deems appropriate, including actual and punitive damages to the aggrieved persons; and civil penalties of up to $55,000 for a first violation; and up to $110,000 for any subsequent violation. 42 U.S.C. § 3614(d); 28 C.F.R. § 85.3(b)(3).

[2]The Federal Reserve has authority to issue regulations to carry out the purposes of ECOA. 15 U.S.C. § 1691b; 12 C.F.R. § 202.1(a). Except for certain entities (see note iv below), FTC has enforcement authority for ECOA and a violation of ECOA is deemed to be a violation of a requirement imposed under the Federal Trade Commission Act. 15 U.S.C. § 1691c(c). Moreover, DOJ has authority under 15 U.S.C. § 1691e(h) to bring civil action in any appropriate U.S. district court against any lender for such relief as may be appropriate, including actual and punitive damages and injunctive relief. Cases must be referred to DOJ whenever the supervising agency has a reason to believe that a creditor engaged in a pattern or practice of denying or discouraging applications for credit in violation of ECOA. 15 U.S.C. § 1691e(g).

Table 7: Federal Agencies That Have Examination and Enforcement Authorities for Fair Lending Laws, by Type of Entity (Depository Institutions, Independent Lenders, Servicers)

Type of Entity	Examination Authority	FHA Enforcement Authority[a]	ECOA Enforcement Authority[b]
Bank holding companies	Board of Governors of the Federal Reserve System (Federal Reserve)[c]	Federal Reserve,[d] Department of Housing and Urban Development (HUD), Department of Justice (DOJ)	Federal Reserve,[d] DOJ
Nonfunctionally regulated subsidiaries of bank holding companies	Federal Reserve[c]	Federal Reserve,[d] HUD, DOJ	Federal Reserve,[d] DOJ, Federal Trade Commission (FTC)
National banks	Office of the Comptroller of the Currency (OCC)[e]	OCC,[a] HUD, DOJ	OCC,[b] DOJ
Operating subsidiaries of national banks	OCC[e]	OCC,[a] HUD, DOJ	OCC,[b] FTC, DOJ
Affiliates of national banks (not regulated by another functional regulator)	OCC[f]	OCC,[a] HUD, DOJ	OCC,[b] FTC, DOJ
State banks, members of the federal reserve system	Federal Reserve[g]	Federal Reserve,[a] HUD, DOJ	Federal Reserve,[b] DOJ
Subsidiaries of state banks that are members of the Federal Reserve System	Federal Reserve[g]	Federal Reserve,[a] HUD, DOJ	Federal Reserve,[b] FTC, DOJ
Affiliates of state banks that are members of the Federal Reserve System (not regulated by another functional regulator)	Federal Reserve[h]	Federal Reserve,[a] HUD, DOJ	Federal Reserve,[b] FTC, DOJ
State banks, not a member of the Federal Reserve System	Federal Deposit Insurance Corporation (FDIC)[i]	FDIC,[a] HUD, DOJ	FDIC,[b] DOJ
Subsidiaries of state banks, not a member of the Federal Reserve System	FDIC[i]	FDIC,[a] HUD, DOJ	FDIC,[b] FTC, DOJ
Affiliates of state banks, not a member of the Federal Reserve System (not regulated by another functional regulator)	FDIC[j]	FDIC,[a] HUD, DOJ	FDIC,[b] FTC, DOJ
Savings and loan holding companies	Office of Thrift Supervision (OTS)[k]	OTS,[l] HUD, DOJ	OTS,[l] DOJ
Subsidiaries of savings and loan holding companies	OTS[k]	OTS,[l] HUD, DOJ	OTS,[l] FTC, DOJ
Savings associations	OTS[m]	OTS,[a] HUD, DOJ	OTS,[b] DOJ
Subsidiaries of savings associations	OTS[m]	OTS,[a] HUD, DOJ	OTS,[b] FTC, DOJ
Affiliates of savings associations	OTS[n]	OTS,[a] HUD, DOJ	OTS,[b] FTC, DOJ

Type of Entity	Examination Authority	FHA Enforcement Authority[a]	ECOA Enforcement Authority[b]
Bank service company or independent servicer providing mortgage or lending-related services to a bank or savings association	Federal Reserve, OCC, FDIC, or OTS as appropriate[o]	HUD, DOJ, Federal Reserve, OCC, FDIC, or OTS as appropriate[o]	FTC, DOJ, Federal Reserve, OCC, FDIC, or OTS as appropriate[o]
Federal credit unions	National Credit Union Administration (NCUA)	NCUA,[p] HUD, DOJ	NCUA,[p] DOJ
Federally insured state-chartered credit unions	NCUA[q]	HUD, DOJ	FTC, DOJ
Credit Union Service Organizations	NCUA[r]	HUD, DOJ	FTC, DOJ
Independent nonbank lender	No regulatory agency has this authority	HUD, DOJ	FTC, DOJ

Sources: GAO analysis of statutes and agency information.

[a]The Federal Reserve, OCC, FDIC, and the OTS (federal banking agencies) generally may take an administrative enforcement action against an insured depository institution or an institution-affiliated party that is violating or has violated a law, rule, or regulation. 12 U.S.C. § 1818(b). The appropriate federal banking agency will have enforcement authority over an institution-affiliated party that is not itself an insured depository institution with a different appropriate federal banking agency or a holding company, provided that the affiliate otherwise meets the definition of an institution-affiliated party. 12 U.S.C. §§ 1813(q), (u) and 1818. An institution-affiliated party means

(1) any director, officer, employee, or controlling stockholder (other than a bank holding company) of, or agent for, an insured depository institution;

(2) any other person who has filed or is required to file a change-in-control notice with the appropriate Federal banking agency under [12 U.S.C. § 1817(j)];

(3) any shareholder (other than a bank holding company), consultant, joint venture partner, and any other person as determined by the appropriate Federal banking agency (by regulation or case-by-case) who participates in the conduct of the affairs of an insured depository institution; and

(4) any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in—

(A) any violation of any law or regulation;

(B) any breach of fiduciary duty; or

(C) any unsafe or unsound practice, which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution,

which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution.

12 U.S.C. § 1813(u). For example, the term "institution-affiliated party" is defined to include OTS-regulated institution's employees, directors and officers, controlling shareholders, agents, consultants and other "persons participating in the conduct of the affairs" of an institution, and under certain circumstances independent contractors. When an institution-affiliated party engages in a direct or indirect violation of any law or regulation the appropriate regulatory agency is authorized to remove such party from office or prohibit such party from any further participation in the conduct of the affairs of any insured depository institution in certain circumstances. 12 U.S.C. § 1818(e)(1). This is in addition to cease and desist authority. 12 U.S.C. § 1818(b). Moreover, civil money penalties may be imposed for each day that a violation continues. 12 U.S.C. § 1818(i)(2).

[b]See note.[a] FTC has authority to enforce ECOA except to the extent that enforcement is specifically committed to another government agency, and is authorized to use "[a]ll of the functions and powers of the [FTC] under the Federal Trade Commission Act" to do so. 15 U.S.C. § 1691c(c). Under the FTC Act, FTC may sue in federal court for an injunction and other equitable relief, 15 U.S.C. § 53(b), for civil penalties, 15 U.S.C. § 45(m)(1)(A), and in some circumstances for damages, 15 U.S.C. § 57b(b); or FTC may institute administrative proceedings under 15 U.S.C. § 45(b). Under pertinent parts of 15 U.S.C. § 1691c(a), OCC, the Federal Reserve, FDIC, and OTS are each charged with enforcing ECOA under 12 U.S.C. § 1818 regarding the depository institutions they supervise, and NCUA is charged with enforcing ECOA under 12 U.S.C. § 1751 et seq. regarding federal credit unions. See also 12 C.F.R. pt. 202, app. A. DOJ has authority to bring civil actions regarding pattern or practice violations of ECOA against any lender, regardless of regulator, and to bring civil actions to redress FHA violations against any lender so long as the claim is based on a real estate-based transaction.

[c]Under 12 U.S.C. § 1844(c)(2)(A)(i)-(ii), the Federal Reserve may examine bank holding companies and nonfunctionally regulated subsidiaries (including nonbank subsidiaries) of bank holding companies to determine the nature of their operations, their financial condition, risks that may pose a threat to the safety and soundness of a depository institution subsidiary and the systems of monitoring and controlling such risks. In addition, the Federal Reserve may examine a bank holding company or nonfunctionally regulated subsidiary (including a nonbank subsidiary) to monitor compliance with certain laws, including any federal law that the Federal Reserve has specific jurisdiction to enforce against the bank holding company or nonfunctionally regulated subsidiary and those laws governing transactions and relationships between any depository institution subsidiary and its affiliates. See 12 U.S.C. § 1844(c)(2)(A)(iii). ECOA explicitly addresses enforcement by the federal banking agencies. In particular, 15 U.S.C. § 1691c(b) provides authority for among others the federal banking agencies to exercise any other authority conferred by law. ECOA provides the Federal Reserve with enforcement authority against bank holding companies and their nonbank subsidiaries. See 15 U.S.C. § 1691c(b). FHA has no similar enforcement provisions.

[d]The Federal Reserve has general authority to enforce any law or regulation with respect to a bank holding company and subsidiary (other than a bank). 12 U.S.C. § 1818(b)(3). In addition, the Federal Reserve has specific jurisdiction to enforce ECOA violations against a bank holding company and nonbank subsidiary pursuant to the enforcement authority conferred by 12 U.S.C. § 1818. 15 U.S.C. § 1691c(b).

[e]OCC's authority to examine national banks and national bank operating subsidiaries derives from 12 U.S.C. § 481. See also, 12 C.F.R. § 5.34(e)(3) (regarding examination and supervision of national bank operating subsidiaries).

[f]OCC may conduct such examinations of certain affiliates of national banks as shall be necessary to disclose fully the relations between the bank and such affiliates and the effect of these relations on the affairs of the bank. 12 U.S.C. § 481.

[g]The Federal Reserve examines state member banks and their subsidiaries under 12 U.S.C. § 325.

[h]12 U.S.C. § 338 provides authority for the Federal Reserve to examine the affairs of affiliates of a state member bank as necessary to determine the relations between a bank and its affiliates and the effect of those relations on the affairs of the bank.

[i]12 U.S.C. §§ 1819(a) Eighth and 1820(b)(2).

[j]12 U.S.C. § 1820(b)(4) provides authority for FDIC to examine any affiliate of any depository institution as may be necessary to disclose the relationship between the depository institution and an affiliate; and the effect of such relationship on the depository institution.

[k]12 U.S.C. § 1467a(b)(4).

[l]12 U.S.C. § 1818(b)(9).

[m]12 U.S.C. §§ 1463 and 1464.

[n]OTS, in making an examination of a savings association may make examinations of the affairs of all affiliates of the savings association as shall be necessary to disclose fully the relations between the savings association and such affiliates and the effect of these relations on the affairs of the savings association. 12 U.S.C. § 1464(d)(1)(B)(i).

[o]12 U.S.C. § 1867 permits examination and regulation of bank service companies or independent servicers performing under a contract or otherwise any service for a federally regulated depository institution by the appropriate Federal banking agency of the depository institution acquiring the service, which includes OCC, the Federal Reserve, FDIC, and OTS.

[p]12 U.S.C. § 1786 generally provides NCUA authority to take enforcement action against an insured credit union or an institution-affiliated party that is violating or has violated a law, rule or regulation, which is somewhat comparable to 12 U.S.C. § 1818(b) authority. See note.[a] NCUA has the authority to enforce ECOA against federal credit unions as the other regulatory agencies have for the institutions they supervise. See note.[b]

[q]The state supervisory authority (SSA) has primary examination authority for federally insured state-chartered credit unions (FISCU); however, NCUA may examine in this area if it believes there is a safety and soundness concern.

[r]For credit union service organizations (CUSO) providing services only to federal credit unions (FCU), NCUA has review authority. For CUSOs that provide services to both FCUs and FISCUs, NCUA and the appropriate SSA have review authority. Effective June 29, 2009, NCUA regulation provide NCUA the authority to review any CUSO that provides service to a FISCU. However, the NCUA Board may exempt FISCUs in a given state from compliance with section 712.3(d)(3) if the NCUA Board determines the laws and procedures available to the SSA in that state are sufficient to provide NCUA with the degree of access to CUSO books and records it believes is necessary to evaluate the safety and soundness of credit unions having business relationships with CUSOs owned by credit union(s) chartered in that state.

Appendix III: Comments from the Federal Trade Commission

Office of the Director
Bureau of Consumer Protection

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

July 10, 2009

Ms. Orice M. Brown
Director, Financial Markets and Community Investment
United States Government Accountability Office
Washington, D.C. 20548

Dear Ms. Brown:

Thank you for the opportunity to comment on the draft report on *Fair Lending: Data Limitations and the Fragmented U.S. Financial Regulatory Structure Challenge Federal Oversight and Enforcement Efforts* (GAO-09-704).[1] The Report appropriately brings attention to the limitations of the data that mortgage lenders are required to report under the Home Mortgage Disclosure Act (HMDA) and the consequences of those limitations for the ability of the agencies responsible for enforcing the Equal Credit Opportunity Act (ECOA) and Fair Housing Act to do so effectively.[2] This letter offers additional important information as to the implications of the data limitations under HMDA.

The Report acknowledges that HMDA data, by itself, are insufficient to fully assess the likelihood of ECOA violations and that more information is needed from lenders in order to do so. However, the Report appears to rely on the Federal Reserve Board's analysis of HMDA data (known as the "outlier list") to draw two conclusions. First, the Report concludes that independent mortgage lenders are more likely than depository institutions to engage in discrimination when originating home loans. Second, the Report recommends that additional data as to applicants' underwriting characteristics be reported by lenders under HMDA but does not address the importance of discretionary pricing data.

As to the first conclusion, the Federal Reserve's outlier list is based on a review of HMDA pricing data which, under Regulation C, lenders only report for higher-priced loans. Many lenders, however, make very few or no higher-priced loans and thus cannot be evaluated by an analysis of HMDA pricing data. The lenders who do report large numbers of higher-priced loans under HMDA are disproportionately independent mortgage lenders. Therefore, it is impossible to reach *any* conclusion about which entities are more or less likely to engage in discrimination based solely on HMDA data or the outlier list; the conclusion that independent mortgage lenders present a higher risk of discrimination than do depository lenders is especially

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[1] The views expressed in this letter are my own and do not necessarily represent the views of the Commission.

[2] The Federal Trade Commission does not enforce the Fair Housing Act.

tenuous.

Second, the Federal Reserve's outlier list is the result of an analysis of HMDA pricing data that does not include discretionary pricing data. As a result, the outlier list is only of limited utility in detecting lenders with illegal pricing disparities. As demonstrated by both our recent investigations and our cases over the last three decades, discretion in granting or pricing credit presents a significant fair lending risk. Thus, in our investigations, we seek information concerning whether lenders' business practices allow for discretion, along with data reflecting both applicants' underwriting characteristics and the discretionary prices charged to borrowers. Both types of data, along with information about lenders' business practices, are needed to identify true instances of discriminatory conduct.

In sum, although HMDA data have provided a useful tool in identifying lenders that may merit further scrutiny, the data have limitations that necessitate gathering more information about the prices of all loans, including specifically discretionary prices, and about lenders' business practices before any conclusions about discrimination can meaningfully be drawn.

Sincerely,

David C. Vladeck
Director

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Appendix IV: Comments from the Federal Deposit Insurance Corporation

FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990
Division of Supervision and Consumer Protection

July 10, 2009

Mr. Richard J. Hillman, Managing Director
Financial Markets and Community Investment
U.S. Government Accountability Office
441 G Street, NW
Washington, D.C. 20548

Dear Mr. Hillman:

Thank you for the opportunity to review and comment on the Government Accountability Office's (GAO) report entitled, *FAIR LENDING: Data Limitations and the Fragmented U.S. Financial Regulatory Structure Challenge Federal Oversight and Enforcement Efforts (GAO-09-704).* In this report, you examined, 1) data used by agencies and the public to detect potential violations and options to enhance the data, 2) federal oversight of lenders that are identified as at heightened risk of violating the fair lending laws, and 3) recent cases involving fair lending laws and associated enforcement challenges. You recommend that the FDIC and other federal regulatory and enforcement agencies work collaboratively to identify approaches to better assess the potential for discrimination during the preapplication phase of mortgage lending. For example, you suggest we could further consider the use of testers, perhaps on a pilot basis, as well as surveys of mortgage loan borrowers and applicants or alternative means to better assess the potential for discrimination during the preapplication phase of the mortgage lending process. The FDIC agrees with this recommendation.

The FDIC has long had a robust fair lending examination and enforcement program. As you note in your report, we require a thoroughly documented fair lending review at every consumer compliance examination. All consumer compliance examiners receive fair lending training. Further, Fair Lending Examination Specialists in our regional and Washington offices assist with the most complex examinations, including the Home Mortgage Disclosure Act (HMDA) pricing "outlier" cases. This process is supported by economists and statisticians in our Division of Insurance and Research who perform detailed reviews of HMDA data, and attorneys in the FDIC's Legal Division.

The FDIC fully investigates all the institutions that appear on its outlier lists to determine the source of the disparities reflected in the HMDA data. For most of the outlier reviews to date, the FDIC found that non-discriminatory reasons explain the disparities. However, where the FDIC determined that the disparities resulted from discrimination in violation of the Equal Credit Opportunity Act (ECOA) or the Fair Housing Act (FHA), it utilized its full array of enforcement authorities to remedy the situation.

Under Section 8 of the Federal Deposit Insurance Act, the FDIC may pursue enforcement actions to remedy any unsafe or unsound practice or a violation of any law, including fair lending laws.

The FDIC utilizes both informal and formal enforcement actions to remedy this misconduct. Informal enforcement actions may include a resolution issued by the institution's board of directors or a Memorandum of Understanding (i.e., a written agreement with the FDIC), documenting the actions the institution commits to take to remedy the situation. In more serious situations, the FDIC takes formal enforcement actions against financial institutions and individuals. In addition to ordering compliance with consumer protection laws, these actions may seek restitution on behalf of consumers and assess civil money penalties. Moreover, even where no statistically significant lending disparities have been found, the FDIC has utilized its informal enforcement authority to require banks to improve weak internal monitoring and audit systems, to eliminate or modify programs that have the potential to result in discrimination, and to ensure that HMDA reporting is accurate.

Under ECOA, the FDIC may take its own actions even in cases where it refers matters to the DOJ because of a reason to believe there is evidence of a pattern or practice of discrimination. However, to avoid duplication, the FDIC and the DOJ consult about which agency is better situated to remedy the violation.[1] In most mandatory referral cases the DOJ defers to the FDIC's administrative enforcement process.

The FDIC continues to seek additional means of finding and remedying illegal discrimination. We believe that a variety of approaches are necessary in light of the myriad operational models presented by institutions of different sizes and business strategies. Ensuring effective compliance involves a thorough understanding of supervised institutions and their operations. Bank examinations play an essential role in discovering and remedying specific violations as well as requiring actions by institutions to prevent future violations. We support your recommendation that the agencies collaborate to consider undertaking mystery shopping activities, perhaps as a pilot, and that we also consider the potential use of consumer surveys as an alternative means to detect potential discrimination. During the coming year we will work with the other agencies, through the established Joint Agency Task Force on Fair Lending, to carefully review these possible actions and determine whether and to what extent they could provide useful information about potential discrimination.

Sincerely,

Sandra L. Thompson
Director

[1] *See* "Policy Statement on Discrimination in Lending" 59 Fed. Reg. 18267, April 15, 1994 at Q. 13, for a discussion of coordination.

Appendix V: Comments from the Board of Governors of the Federal Reserve System

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

SANDRA F. BRAUNSTEIN
DIRECTOR
DIVISION OF CONSUMER
AND COMMUNITY AFFAIRS

July 9, 2009

Ms. Orice Williams Brown
Director, Financial Markets and Community Investment
Government Accountability Office
Washington, DC 20548

Dear Ms. Brown:

Thank you for the opportunity to comment on the draft report entitled "Fair Lending: Data Limitations and the Fragmented U.S. Financial Regulatory Structure Challenge Federal Oversight and Enforcement Efforts," GAO-09-704. The draft report recommends that federal agencies work collaboratively to identify approaches to better assess the potential for discrimination during the pre-application phase of mortgage lending. The report cites testers and surveys of borrowers as examples of techniques that may warrant further consideration. Currently, the Federal Reserve uses the Interagency Fair Lending Examination Procedures, as well as statistical analysis, to identify pre-application discrimination. Pursuant to the Interagency Fair Lending Examination Procedures, examiners analyze the potential for steering at institutions that engage in both prime and subprime lending, or have both prime and subprime affiliates. For example, examiners consider whether the institution has clear, objective standards for referring applicants to subsidiaries or affiliates, classifying applicants as "prime" or "subprime," or deciding what kinds of alternative loan products should be offered to applicants. In our statistical analysis of mortgage pricing, we look for evidence that minorities are targeted for more expensive loans or loans with potentially onerous terms, such as prepayment penalties. We would be pleased to work with the other agencies to share what we have learned and to explore other techniques to identify illegal discrimination at the pre-application phase.

We note that the draft report raises other matters for Congressional consideration, including expanding the Home Mortgage Disclosure Act (HMDA) data set, collecting application information on non-mortgage loans, extending the statute of limitations for the Equal Credit Opportunity Act, and taking steps to ensure that fair lending laws are comprehensively and consistently enforced. The Board would be pleased to provide technical assistance to Congress on any of these proposals.

The draft report analyzes federal fair lending enforcement efforts, including each regulatory agency's fair lending examination process. The Federal Reserve is committed to ensuring that every institution it supervises complies fully with the fair lending laws. As noted in the draft report, Federal Reserve Board staff provide significant oversight of the fair lending examination process. The Federal Reserve Board has a dedicated Fair Lending Enforcement Section to ensure that the fair lending laws are enforced rigorously throughout the Federal

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Reserve System. The section centrally manages the HMDA screening process discussed in the draft report and described more fully below. The section also tracks potential fair lending violations across the system and provides legal and statistical guidance to examiners to ensure that each potential fair lending violation is fully evaluated and that appropriate enforcement action is taken.

The draft report also describes the efforts of the federal agencies to use HMDA data to facilitate fair lending enforcement. As the draft report notes, the Federal Reserve Board has developed statistical screens of the HMDA data to identify institutions with statistically significant pricing disparities by race and ethnicity. The Federal Reserve follows a highly rigorous process to ensure that we effectively use these screens to identify institutions under our supervision at risk for pricing discrimination. Federal Reserve examiners prepare a comprehensive pricing discrimination risk assessment for each institution supervised by the Federal Reserve that is identified through our HMDA pricing screens. These risk assessments consider the institution's fair lending compliance program, our past supervisory experience with the institution, consumer complaints, and the presence of fair lending risk factors, such as discretionary pricing and incentives to charge borrowers higher prices. We place particular emphasis on the presence of discretionary pricing, such as allowing overages, and financial incentives that reward loan officers for charging higher prices to borrowers. Based on these comprehensive assessments, we determine which institutions should receive a targeted pricing review.

Our rigorous fair lending enforcement process extends to nonbank subsidiaries of bank holding companies. As noted in the draft report, the Federal Reserve has taken significant steps in recent years to increase its consumer compliance supervision of nonbank subsidiaries. In 2006, we established a specific unit at the Federal Reserve Board dedicated to large and complex banking organizations, including nonbank subsidiaries of bank holding companies. While nonbank subsidiaries are not subject to routine consumer compliance examinations, they are subject to risk-based supervisory reviews, such as in depth risk assessments. These supervisory reviews have resulted in the identification of several fair lending issues, which are then subject to a full evaluation, including the analysis of loan files when appropriate. In 2008, for example, a nonbank subsidiary was referred to the Department of Justice after a supervisory review identified a discriminatory lending policy.

Additionally, nonbank subsidiaries of bank holding companies are subject to the same rigorous HMDA screening process described above. We have performed robust pricing reviews of several nonbank subsidiaries and referred one to the Department of Justice for pricing discrimination. As a result of our supervisory experience with nonbank subsidiaries, including the subprime pilot discussed in the draft report, the Federal Reserve Board is developing a framework for increased risk-based supervision of nonbank subsidiaries to further strengthen the review of these entities.

We appreciate the professionalism of the GAO's review team in conducting this study.

Sincerely,

Appendix VI: Comments from the National Credit Union Administration

National Credit Union Administration

July 13, 2009

Office of the Chairman

ENCRYPTED ELECTRONIC MAIL DELIVERY: PhillipsW@gao.gov

Mr. Wesley Phillips, Assistant Director
Financial Markets and Community Investment
United States Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Phillips:

Thank you for the opportunity to review and comment on GAO's draft report, dated June 26, 2009, entitled *Fair Lending: Data Limitations and the Fragmented U.S. Financial Regulatory Structure Challenge Federal Oversight and Enforcement Efforts (GAO-09-704)*. The discussion below responds specifically to your report's comments, conclusions, and recommendations.

Regulator Referral Practices Vary

The report states "*While it is difficult to fully assess the reasons for the differences in referrals and outlier examination findings across the depository regulators without additional analysis, they raise important questions about the consistency of fair lending oversight. In particular, depository institutions under the jurisdiction of OTS, FDIC, and the Federal Reserve appear to be far more likely to be the subject of fair lending referrals to DOJ.*" GAO concludes that "*Under the fragmented regulatory structure, differences across the depository regulators in terms of their determination of what constitutes an appropriate referral as well as fair lending examination findings are likely to persist.*"

Furthermore, the Conclusion section states: "*Despite the joint interagency fair lending examination guidance and various coordination efforts, we also found that having multiple depository institution regulators resulted in variations in screening techniques, the management of the outlier examination process, examination documentation standards, and the number of referrals and types of examination findings. While differences in these areas may not be unexpected given the varied types of lenders under each regulator's jurisdiction, these differences raise questions about the consistency and effectiveness of regulatory oversight. For example, the evidence suggests that lenders regulated by FDIC, the Federal Reserve, and OTS are more likely than lenders regulated by OCC and NCUA to be the subject of referrals to DOJ for potential fair lending violations. Our current work did not fully evaluate the reasons and effects of identified differences and additional work in this area could help provide additional clarity.*"

NCUA concurs that additional study is needed relative to DOJ referrals; however, it should be done prior to reaching the conclusion about the consistency and effectiveness of NCUA's regulatory oversight. As the report points out, NCUA has not referred any fair lending violations to the Department of Justice (DOJ). Such referrals should only be done where there is a clear pattern or practice of discriminatory actions. NCUA did not identify any such actions during the time period covered by the report. NCUA uses the same fair lending examination procedures

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as the other banking regulators thereby providing a consistent approach to identifying potential DOJ referrals.

Violations may not exist in credit unions because credit unions: (1) are member owned and member managed; (2) have a defined field of membership which enables them to have a better understanding of their members' financial needs, (3) are nonprofit entities; and (4) have specified mission of meeting the credit and savings needs of members, especially persons of modest means (who typically are the target of discriminatory actions).

Matters for Congressional Consideration

Additional data collection and reporting options. NCUA concurs obtaining key underwriting data for mortgage loans would assist in analyzing the HMDA data and enhance the ability of identifying potential fair lending concerns in an efficient manner. NCUA does not concur with applying that strategy to a subset of institutions who report HMDA data and recommends that all institutional reporters report the same information.

ECOA statute of limitations. NCUA concurs with extending the ECOA statute of limitations to 5 years.

Recommendation for Executive Action

Interagency collaboration. NCUA concurs with the recommendation for the DOJ, FDIC, Federal Reserve, FTC, HUD, NCUA, OCC, and OTS to work collaboratively to identify approaches to better assess the potential for discrimination during the preapplication phase of mortgage lending.

Thank you again for the opportunity to comment on the draft report. NCUA trusts the requested report changes submitted to the GAO on July 10, 2009 will be incorporated into the final report. If you have any questions or need further information, please feel free to contact NCUA Executive Director David M. Marquis at (703) 518-6320.

Sincerely,

Michael E. Fryzel
Chairman

Appendix VII: Comments from the Office of the Comptroller of the Currency

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

July 10, 2009

Ms. Orice Williams Brown
Director
Financial Markets and Community Investment
United States Government Accountability Office
Washington, DC 20548

Dear Ms. Brown:

We have received and reviewed your draft report, "Fair Lending: Data Limitations and the Fragmented U.S. Financial Regulatory Structure Challenge Federal Oversight and Enforcement Efforts." I offer the following comments on behalf of the Office of the Comptroller of the Currency (OCC).

I. Background on the OCC's Fair Lending Supervisory Process

It is helpful at the outset to briefly describe the OCC's fair lending compliance program in order to give context to our comments. Assuring fair access to credit and fair treatment of national bank customers are fundamental responsibilities of the OCC as administrator of the national banking system. The OCC's fair lending supervisory and enforcement process is designed to monitor the level of fair lending risk in every national bank; assess compliance with fair lending laws and regulations; obtain corrective action when significant weaknesses or deficiencies are found in a bank's policies, procedures, and controls; and ensure that enforcement action is taken when warranted, including referrals to the Department of Justice (DOJ) and notifications to the Department of Housing and Urban Development (HUD).

The foundation of the OCC's integrated safety and soundness and compliance supervisory process is the detailed, core knowledge that examiners develop and maintain about each bank's organizational structure, culture, business lines, products, services, customer base, and level of risk. With that as a starting point, the OCC's fair lending supervisory and enforcement process uses a combination of analytical tools, bank-specific lending reviews, and risk-based targeted fair lending examinations to evaluate credit decisions made by a bank and to help us determine whether different outcomes are the result of unlawful discrimination.

For banks that have a large volume of applications, as well as a variety of loan product types, the OCC often uses statistical models to compare information from large numbers of files and to test for high risks of potential unlawful discrimination. Examiners first review the bank's underwriting and pricing policies, and then work with quantitative experts to construct a

statistical model to test for potential discrimination. As part of this process, the OCC receives a large amount of information from the bank that is not contained in the Home Mortgage Disclosure Act (HMDA) data and that may explain variations in underwriting and pricing decisions by race, ethnicity, or sex. For example, underwriting policy information can include cutoffs or threshold values for certain key variables, like debt-to-income ratios. In pricing examinations, examiners will request rate sheets, policies on "overages" and "underages," and exceptions to pricing policies. Because underwriting and pricing decisions can vary by bank, channel, and product, the exact model specifications also can vary bank to bank, and exam to exam. Once a model is developed, we focus on the magnitude and significance of the estimated disparities between prohibited basis groups and a control group, using standard statistical tests. These techniques help to identify particular applications or originations that appear to be outliers or to identify applicants who appear to be similarly situated, but who experienced different outcomes. This process helps to identify the corresponding loan files to be reviewed.

Midsize and community banks have smaller loan volumes and less diversity in loan types than the larger institutions we supervise. While we use statistical techniques to assist in fair lending examinations at a number of midsize institutions, for other midsize institutions and for community banks, statistical analysis is not appropriate or feasible. For these reasons, after setting the examination focus and scope, the next stage of a fair lending examination for midsize and community banks is typically a comparative file review, rather than the use of statistical analysis.

For all banks, when potential unlawful discriminatory results are found, examiners present their findings to bank management for an explanation. If the bank's explanation is inadequate to rebut preliminary examination findings, the findings are documented, and decisions are made on what OCC supervisory or enforcement action should be taken and on whether the matter must be referred to the DOJ or HUD.

II. Discussion of Draft Report Findings and Recommendations, and OCC Responses

The following describes several issues and recommendations raised in the GAO's draft report and the actions that the OCC will be taking with respect to those issues.

Centralized oversight of fair lending functions. While the report does not take issue with the OCC's substantive oversight of its fair lending functions, it notes that our approach to managing and documenting the examination programs for institutions that have been identified as "outliers" in our fair lending screening processes is not centralized in the OCC headquarters office. This is only partially correct. The OCC's fair lending risk screening process and policy development is managed in headquarters; however, the conduct and oversight of fair lending examinations themselves rests primarily with senior supervisory managers in our four district offices (for our midsize and community banks), and with the examiners-in-charge (for our large banks). We have found this approach to be effective and efficient, and information about the status of our examination activities is available to headquarters managers through databases that centralize this information. And as the report recognizes, we have made a number of enhancements to our systems in order to facilitate retrieval of information of key exam status

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information. Nevertheless, based on conversations with my staff about these issues after reading the draft report, I have determined that there are additional steps we could take to enhance our procedures by formalizing aspects of headquarters involvement in our oversight process. First, as described in more detail below, we are implementing additional enhancements to our data systems to facilitate ready retrieval of key examination status information. Second, going forward, I have directed that senior level officials in our headquarters offices – the Senior Deputy Comptroller for Large Bank Supervision and the Senior Deputy Comptroller for Midsize/Community Bank Supervision, as applicable – receive reports on at least a quarterly basis of scheduled, pending, and completed fair lending examinations, to enable these senior managers to have readily available and uniform information that will facilitate their oversight of the types, timeliness, and findings of these examinations on an ongoing basis.

Documentation of fair lending examinations. As noted in the report, the OCC already has taken a number of steps to improve fair lending compliance documentation practices. I have directed my staff to further refine these documentation procedures so that our centralized databases contain information in a standardized form for: the relevant dates the examination was conducted (for our largest banks, this generally would be the calendar year); the risk factors that were identified in the screening or risk assessment process applicable to the bank; the time frame of the HMDA data that were used in the screening process; the focal points of the examination; reasons for any difference between those focal points and the areas identified through the risk screening process; and the key findings of the examination. In addition, specified types of significant back up documents relating to a fair lending examination, such as statistical analyses and conclusion memoranda, will be included in these records in a uniform way for easy "one-stop" access by OCC supervisory staff and senior management.

Limitations on HMDA data. The report discusses the limitations on the data that are collected and reported under HMDA. Key underwriting information is not contained in the publicly reported HMDA data, and the report suggests that annual screening processes at the banking agencies could be made more efficient if each agency had access to additional underwriting data when screening for outliers. As the report notes, however, the OCC already has undertaken to collect and use such additional information in our fair lending supervision of large banks. This year, we began a pilot program at six of the largest national banks to collect "HMDA-plus" information – expanded data on all relevant underwriting factors – at the earliest possible stage in the examination cycle, and we use this information as part of a comprehensive screen for fair lending risks at these banks. We have found that the approach we followed in our pilot program has the potential to significantly improve the efficiency and quality of our fair lending screening process at these banks. Therefore, I have directed my staff to expand the "HMDA-plus" screening process to additional banks in our large bank supervision program.

Need for information about potential preapplication discrimination. The report also discusses other data limitations, such as information about potential discrimination during the pre-application process, and it concludes that the lack of such information may limit the federal banking agencies' fair lending enforcement efforts. The report specifically recommends that the federal banking and enforcement agencies "work collaboratively to identify approaches to better assess the potential for discrimination during the preapplication phase of mortgage lending." In

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particular, it suggests that the agencies further evaluate the use of testers and also explore other means of obtaining information about potential preapplication discrimination such as conducting surveys of applicants. We agree that enhanced tools to combat potential preapplication discrimination are desirable; the key question is whether and how the use of testers can reliably accomplish that goal. We welcome discussions with the other banking agencies, DOJ, and HUD about how to improve our joint procedures in this regard.

Interagency coordination on fair lending activities. As noted in the report, coordination by the federal banking agencies, DOJ, and HUD on fair lending issues is an important, and ongoing, process given our respective responsibilities. We also agree that more effective coordination and information sharing would be appropriate to ensure consistency in our fair lending oversight. Another issue raised in your report that bears particular interagency scrutiny is why the overwhelming majority of referrals to DOJ are marital status violations and why relatively very few referrals are race and ethnicity matters. This fact is true for all of the federal banking agencies – even though each agency conducts some form of analysis of HMDA data in order to identify the institutions that appear to have significant disparities in denial rates and loan prices along race and ethnicity lines. Improving the effectiveness and consistency of the banking agencies' screening processes and standards for referrals is also very appropriate to take up on an interagency basis.

Variations in referral practices. With respect to referral practices in particular, the report noted that there were significant differences in the practices the regulators employed to make referrals to DOJ and the number of referrals made. For example, as the report describes, the OCC conducts a variety of in-depth analyses, which may include statistical analysis and loan file reviews, before making a decision to make a referral to DOJ. We also discuss issues with DOJ on an ongoing basis to assist in the determination of whether a referral is warranted. Based on the information contained in the report, it appears that our pre-referral decision activities may be more extensive than other agencies. This weeding out process may account for the low number of referrals to DOJ by the OCC. Nevertheless, it does illustrate the differences that exist among the agencies' processes and our respective interpretations of DOJ's guidance on referrals by the federal banking agencies. We agree that more consistency in the standards and processes employed in the area is very desirable, and we will undertake to work with the other federal banking agencies and DOJ to further that objective.

Need for oversight of non-federally supervised lenders. Finally, the report notes the significant gaps in oversight between institutions supervised by the federal banking agencies compared to independent lenders who were the "predominant originators of subprime and other questionable mortgages that often were made to minority borrowers." As the report points out, these lenders accounted for almost half of lenders on the Federal Reserve Board's outlier list despite the fact that they account for only 20% of all HMDA reporters. This is a troubling statistic, and it underscores the need for action to address the "gaps and inconsistencies in the oversight of independent mortgage brokers and nonbank subsidiaries" cited in the report.

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We appreciate the opportunity to comment on the draft report.

Sincerely,

John C. Dugan
Comptroller of the Currency

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Appendix VIII: Comments from the Office of Thrift Supervision

Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W., Washington, DC 20552 • (202) 906-6372

John E. Bowman
Acting Director

July 10, 2009

Orice M. Brown
Director, Financial Markets and Community Investment
United States Government Accountability Office
441 G Street NW
Washington, DC 20548

Dear Ms. Brown:

Thank you for the opportunity to review and comment on the Government Accountability Office (GAO)'s draft report entitled, *Fair Lending: Data Limitations and the Fragmented U.S. Financial Regulatory Structure Challenge Federal Oversight and Enforcement Efforts* (GAO-09-704). Various agencies share responsibility for oversight of the federal fair lending laws, including the Office of Thrift Supervision (OTS). The report examines data used by agencies and the public to detect potential violations and options to enhance the data; federal oversight of lenders that are identified as at heightened risk of violating the fair lending laws; and recent cases involving fair lending laws and associated enforcement challenges.

GAO outlines matters for Congressional consideration as well as a recommendation directed to the agencies. To help strengthen fair lending oversight and enforcement, GAO recommends that DOJ, FDIC, Federal Reserve, FTC, HUD, NCUA, OCC and OTS work collaboratively to identify approaches to better assess the potential for discrimination during the preapplication phase of mortgage lending. While OTS currently works closely with the OCC, FDIC, Federal Reserve and NCUA (collectively the federal banking agencies) on common supervisory and examination programs and issues, OTS concurs with the report's executive recommendation and will collaborate with the federal banking agencies, FTC, HUD, and DOJ to review, identify, and evaluate approaches to better assess the potential for discrimination during the preapplication phase of mortgage lending.

Thank you again for the opportunity to review and respond to your draft report.

Sincerely,

John E. Bowman

Appendix IX: GAO Contact and Staff Acknowledgments

GAO Contact

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Staff Acknowledgments

In addition to the individual name above, Wesley M. Phillips, Assistant Director; Benjamin Bolitzer; Angela Burriesci; Kimberly Cutright; Chris Forys; Simin Ho; Marc Molino, Carl Ramirez; Linda Rego; Barbara Roesmann; Jim Vitarello; and Denise Ziobro made major contributions to this report. Technical assistance was provided by Joyce Evans and Cynthia Taylor.

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