

Winter 1995

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Recommended Citation

Deanna Caldwell, An Overview of Fair Lending Legislation, 28 J. Marshall L. Rev. 333 (1995)

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AN OVERVIEW OF FAIR LENDING LEGISLATION

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INTRODUCTION

This Article provides an overview of the Home Mortgage Disclosure Act, the Equal Credit Opportunity Act, and the Community Reinvestment Act and it is not intended to be a comprehensive legal analysis. These laws, frequently referred to as "fair lending laws," ensure equal access to home, business, and consumer credit.

I. HOME MORTGAGE DISCLOSURE ACT

The Home Mortgage Disclosure Act¹ (HMDA) was enacted in 1975 and is implemented by the Federal Reserve Board's Regulation C.² HMDA is a disclosure law which requires certain entities to collect and report certain data concerning home purchase and home improvement applications. HMDA does not prohibit any activity, but rather, makes data available to the public indicating the extent to which lenders are servicing the housing credit needs of their communities.

Entities potentially covered under HMDA include depository institutions (banks, credit unions, and savings associations) and non-depository institutions (mortgage companies, loan brokers) located in or originating loans in a Metropolitan Statistical Area (MSA). In general, the law covers depository institutions originating home loans with assets exceeding ten million dollars at the end of the last calendar year and with a home or branch office in an MSA. For-profit non-depository mortgage lenders must comply with HMDA if the institution's home purchase originations equal or exceed ten percent of total loan originations and if there is an

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1. 12 U.S.C. §§ 2801-2810 (1992).
2. 12 C.F.R. § 203 (1989).

office or at least five applications from an MSA and assets equal or exceed ten million dollars in the last calendar year. However, non-depository institutions which meet all coverage criteria except total asset size must still report data if there were one hundred or more home purchase loan originations in the preceding calendar year.³

Institutions covered by HMDA must collect and report two general types of data: data about the application and data concerning the applicant.⁴ Data related to the application that is required to be reported includes: date application received; type of loan (i.e., conventional, FHA, VA, FmHA); purpose (i.e., purchase, home improvement, refinance, or multifamily); amount of loan requested or granted; owner occupancy status of property; location (by census tract) of the property affected by the application; disposition of the application (i.e., originated, approved not accepted, denied, withdrawn, incomplete, and purchased); and the date action was taken on the application. When loans are originated and sold within the same calendar year, the reporting institution also must report the type of institution purchasing the loan.

Applicant characteristics that must be reported are race, sex, and gross annual income. The racial classifications are American Indian, Asian or Pacific Islander, Black, Hispanic, White, and other. In addition, the application can indicate: information not provided in mail or telephone application, or not applicable. For denied applications, covered reporters have the option of reporting up to three reasons why the application was not approved (i.e., debt-to-income ratio; employment history; credit history; collateral; insufficient cash; unverifiable information; application incomplete; mortgage insurance denied; other).⁵ All data is reported on a "loan application register" (LAR).

Supervisory agencies take the LAR, which is also referred to as raw data, and produce a Disclosure Statement for each reporting institution.⁶ The Disclosure Statement may have up to eight

3. HMDA was amended in 1989 and again in 1992 to include most independent, non-depository mortgage lenders. For example, the 1993 calendar year data reflects data from 750 mortgage companies that were not previously covered.

4. A 1989 amendment to HMDA greatly expanded the data elements required to be reported by covered institutions. 12 U.S.C. § 2801. The most significant additions were the census tract location of property affected by the application, race, sex, and income of applicants. 12 U.S.C. § 2803(b)(4).

5. Reporting the reason for denial is optional for all covered reporters *except* for institutions supervised by the Office of Thrift Supervision.

6. The agencies responsible for supervising the nation's depository institutions are: Federal Deposit Insurance Corporation (FDIC); Federal Reserve System; Office of the Comptroller of the Currency (OCC); Office of Thrift Supervision (OTS); and the National Credit Union Administration (NCUA). The Department of Housing and Urban Development (HUD) has oversight responsibility for non-depository institutions reporting HMDA data.

sets of tables which combine and display data concerning the application and the applicant in a variety of ways to facilitate comparisons between such characteristics as denial rates by race, gender, and purpose of loan.⁷ Each reporter will receive a Disclosure Statement for the applications received in a specific MSA (a separate Statement per MSA).

Disclosure Statements are made available to the public via several sources. First, each reporting institution must make a copy of its Disclosure Statement available for public inspection and copying. A reasonable fee to cover costs incurred is permitted. As of March 31, 1993, LAR data — modified to protect privacy of applicants — also must be provided upon request. A second source for Disclosure Statements is the central HMDA depository located in each MSA. The central depository will vary by location, but is most often a public library or a regional planning body. Finally, Disclosure Statements are available from the Federal Financial Institutions Examination Council (FFIEC).⁸

The supervisory agencies also compile aggregate HMDA statements for each MSA. The aggregate statements are substantially similar to the Disclosure Statements provided for each reporting entity, but combine data for all reporters in the MSA. Aggregate statements are accessible to the public from the central depository located in each MSA or from the FFIEC.

HMDA data is useful for analyzing home mortgage lending patterns (e.g., loans by location and income of applicant) and for identifying “red flags” of possible discriminatory practices or policies related to home lending. HMDA is an important tool for the supervisory agencies in detecting potential areas of concern, but it is not conclusive as to the presence or absence of illegal discrimination. The data does not include basic underwriting criteria factored into any loan decision process. Examples of factors not included but which are critical to the approval/denial of a loan would be: the monthly debt-to-income ratio; credit history; cash

7. The eight sets of tables which may appear in a Disclosure Statement (depending upon applicability) are: Disposition of Loan Applications by Location of Property and Type of Loan; Loans Purchased by Location of Property and Type of Loan; Loans Sold by Characteristics of Borrower and of Census Tract in which Property is Located and by Type of Purchaser; Disposition of Applications by Race, Gender, and Income of Applicant; Disposition of Applications by Income and Race of Applicant; Disposition of Applications by Income and Gender of Applicant; Disposition of Applications by Characteristics of the Census Tract in Which Property is Located; Reasons for Denial of Applications by Race, Gender, and Income of Applicant.

8. The FFIEC is an umbrella group for the financial institution supervisory agencies. The FFIEC publishes a list of central depositories by MSA and provides HMDA data in a variety of formats for a fee. To request order forms and prices for HMDA data, call (202) 452-2016.

resources; employment/income stability; and loan to collateral ratio.

"Red flags" of possible discrimination are the data trends or data anomalies that will require further investigation to determine whether fair lending violations exist. Examples of red flags would be: high relative denial rates between minority and white applicants; high relative denial rates between female and male applicants; high relative denial rates between single and joint applicants; high percentages of withdrawn, incomplete, or approved not accepted applications; low application rates by race when compared with the percentage of householders in the reporters community; and the failure to record the race or sex of applicants. In all cases a close examination of loan files is required to determine if a lender is in violation of fair lending law.

HMDA data which included the race, sex, and income of applicants was collected for the first time in the 1990 calendar year. That data shows significant disparities in loan denial rates between white and minority applicants. HMDA data for calendar year 1993 was recently released for public inspection. The 1993 data reflects higher proportions of loans extended to minority applicants and to low- and moderate-income applicants when compared with the previous year's data. The 1993 data, however, still reflects significant, even if smaller, relative loan denial rates between white applicants and applicants of color.⁹

II. THE 1968 EQUAL CREDIT OPPORTUNITY ACT

The Equal Credit Opportunity Act¹⁰ (ECOA) was enacted in 1975 and is implemented by the Federal Reserve Board's Regulation B.¹¹ The ECOA prohibits discrimination in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, receipt of income from public assistance, and the good faith exercise of rights under the Consumer Credit Protection Act.¹² Regulation B applies to any creditor and to any applicant. Therefore, extensions of credit to businesses as well as to consumers are covered by Regulation B.¹³

In addition to a general prohibition against discrimination on the basis of factors not related to the creditworthiness of an applicant, Regulation B prohibits creditors from discouraging persons

9. The 1993 denial rates by race for home purchase applications are: blacks — 34%; Native Americans — 28%; Hispanics — 25%; Asians — 15%; and whites — 15%.

10. 15 U.S.C.A. §§ 1691(a)-(f)(1992).

11. 12 C.F.R. § 202 (1985).

12. See 15 U.S.C.A. §§ 1691(a)-(f).

13. See generally 12 C.F.R. § 202.

from making or pursuing an application for credit.¹⁴ This prohibition applies to oral and telephone inquiries, personal contact, and advertising.

The regulation also sets forth information creditors can request and consider when taking applications for credit, denying credit, and granting credit.¹⁵ When a creditor is permitted to request information, Regulation B governs the manner in which details about an applicant can be requested.

Creditors can never ask about birth control practices, intentions concerning child bearing or rearing, or the capacity to bear children. Creditors can ask about the number and age of dependents. Creditors cannot ask about race, color, national origin, religion, sex, and marital status with certain exceptions based on the type of application or collateral.

A significant exception is the requirement to request race/national origin, sex, marital status, and age for all loans primarily for the purchase or refinancing of an applicant's principal residence where that dwelling will secure the extension of credit. This exception was made to assist supervisory agencies in detecting potential illegal discrimination in home loans.

Requests for information that may divulge the sex of an applicant are permitted but must be disclosed as optional to the applicant and the creditor can only request preferences in terms of curtesy titles (i.e., Mr., Mrs., Ms., Miss).

The marital status of an applicant may be requested only for joint credit, secured credit or for unsecured credit in community property states. When the creditor is permitted to request marital status, only the terms "married," "unmarried," and "separated" may be used. Information concerning a spouse or former spouse is permitted when the spouse will be permitted to use the account, income from the spouse is relied upon as a basis for repayment, the applicant resides in or relies on property in a community property state to support the credit request, or the applicant is relying on alimony, child support or separate maintenance income to repay the debt.

Cosigners or guarantors can be required only when an applicant does not meet the creditor's underwriting standards for individual credit. Creditors cannot request a specific individual, such as a spouse, for the cosigner or guarantor. When an individual applicant relies on jointly owned property to qualify for a loan, signatures of co-owners may be required for perfecting collateral liens or security agreements; however, signatures of co-owners may not be required for debt instruments.

14. See *id.*

15. Regulation B does not distinguish between oral and written applications in its prohibition of discriminatory action. See *id.*

Age can be considered only for the purpose of determining a pertinent element of creditworthiness, such as capacity to contract, with one exception. In evaluating applications, elderly applicants may be considered favorably. The ECOA defines elderly as sixty-two years of age or older.

Regulation B requires creditors to provide notification of the action taken on an application within thirty days after receiving a completed application.¹⁶ Notification of both favorable and adverse action is required. When adverse action is taken, the creditor must provide a statement of reasons for denial of the credit.¹⁷ The notice must be in writing listing specific reasons for denial or the creditor must provide a written notification of an applicant's right to receive a statement of reasons. Although both consumer and business credits are covered under the adverse action requirements, the notifications concerning business credits are slightly different and less strenuous.

As of June 14, 1994, Regulation B requires creditors to provide applicants with a copy of appraisal reports for credit secured by a residential structure.¹⁸ Creditors may routinely provide a copy of appraisals to applicants or they may provide written notification to the applicant of the right to request and receive a copy. The appraisal must be provided promptly (generally within thirty days) from the latter of: the date of request, the receipt of appraisal report, or reimbursement from applicant for the cost of the appraisal.¹⁹

Clarification regarding the prohibitions of the ECOA was provided in a March, 1994 policy statement jointly adopted by ten federal government agencies responsible for implementing and enforcing fair lending laws.²⁰ The policy statement identifies specific discriminatory practices prohibited by ECOA and the Fair

16. *See id.*

17. Adverse action is defined as:

[A] denial or revocation of credit, a change in the terms of an existing credit arrangement, or a refusal to grant credit in substantially the amount or on substantially the terms requested. Such term does not include a refusal to extend additional credit under an existing credit arrangement where the applicant is delinquent or otherwise in default, or where such additional credit would exceed a previously established credit limit.

15 U.S.C.A. § 1691(c).

18. *See* 12 C.F.R. § 202.5a (1993).

19. *See id.*

20. 59 Fed. Reg. 18,266 (1994). The participating federal agencies are: The Department of Housing and Urban Development; The Department of Justice; The Office of the Comptroller of the Currency; The Board of Governors of the Federal Reserve; The Office of Thrift Supervision; The Federal Deposit Insurance Corporation; The Federal Housing Finance Board; The National Credit Union Administration; The Federal Trade Commission; and The Office of Federal Housing Enterprise Oversight.

Housing Act.

Under one or both of these laws, a lender may not, because of a prohibited factor: 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 inquires 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 use different standards for pooling or packaging a loan in the secondary market.²¹

The policy statement also discusses three methods or types of evidence recognized by courts for proving lending discrimination: overt evidence, evidence of disparate treatment, and evidence of disparate impact.²²

Overt discrimination occurs "when a lender blatantly discriminates on a prohibited basis."²³ For example, a lending officer tells a customer "We don't make loans to married women without the husband as joint applicant." Expressions of a discriminatory preference would constitute a violation of law even if the lender does not act on the preference. For example, a lending officer tells a potential applicant, "We don't like to make loans to married women without the husband as co-signer, but the law requires us to and we have to comply with the law."

"Disparate treatment occurs when a lender treats credit applicants differently based on"²⁴ a prohibited factor such as race or sex. For example, a lender provides assistance concerning preparation of a home purchase credit application to white applicants (such as identifying compensating factors, general encouragement concerning probable success, or potential solutions to problems), but does not provide similar assistance to black applicants. Disparate treatment may be overt or subtle and does not require evidence that differences in treatment were caused by prejudice or conscious intention to discriminate.

The application of disparate impact to lending discrimination has not been tested extensively in the court systems and interpretations of the theory are under development. However, it has been clearly established that this method of proof requires several steps. Evidence of disparate impact exists when a lender applies a policy or practice uniformly to all applicants, but the policy or

21. *Id.* at 18,268.

22. *Id.*

23. *Id.*

24. *Id.*

practice has a disproportionate effect on groups protected under the ECOA or Fair Housing Act.²⁵ Nevertheless, a violation of law does not exist when a disparity created by a policy or practice is justified by "business necessity"²⁶ and there is no less discriminatory alternative. An example of a policy which might create an illegal disparate impact would be a policy not to extend loans for single family residences for less than \$60,000.²⁷ If the policy is shown to exclude potential minority applicants, for example, from consideration due to income levels or property values, the lender would be required to justify the business necessity for the policy.

III. COMMUNITY REINVESTMENT ACT

The Community Reinvestment Act²⁸ (CRA) was enacted in 1977 and is implemented by substantially identical regulations adopted by the four federal supervisory agencies.²⁹ CRA applies to banks, savings banks, and savings associations in the business of providing credit to the public.

The privileges afforded to financial institutions (e.g., federal deposit insurance) has long supported the principle that convenience and needs of communities should be served. The CRA encourages and affirms that covered institutions have an obligation to help meet the credit needs of their entire communities, including low- and moderate-income neighborhoods.

Amendments to the CRA which became effective July 1, 1990, require the supervisory agencies to prepare and make public a written assessment of the CRA performance for each institution examined. The assessments, called CRA Performance Evaluations, are available to the public through two sources. Financial institutions must make the Performance Evaluation accessible within thirty business days after receipt. Nominal fees to cover the costs of duplication and/or mailing may be charged. Performance Evaluations also are available directly from the institution's supervisory agency.

The Performance Evaluations describe the activities of an institution under twelve assessment factors categorized under five basic groupings. The first grouping is the ascertainment of community credit needs. This grouping evaluates the efforts to communicate with the community regarding credit services and the

25. See generally *id.*

26. See *id.* at 18,269.

27. See *id.*

28. 12 U.S.C. §§ 2901-2905 (1977).

29. The supervisory agencies enforcing CRA and their respective CRA regulations are: Federal Deposit Insurance Corporation (12 C.F.R. § 345), Federal Reserve Board (Regulation BB, 12 C.F.R. § 228), Office of the Comptroller of the Currency (12 C.F.R. § 25), and Office of Thrift Supervision (12 C.F.R. § 563e).

extent to which the board of directors participate in formulating and reviewing policies and procedures. The second grouping includes the marketing and types of credit offered and extended. This grouping consists of an evaluation of the institution's activities to market credit services to every segment of the community, to originate home and business loans, and to participate in government loan programs. The third grouping is the geographic distributions of credit approvals and denials as well as a record of the opening and closing of offices. The reasonableness of the institution's delineated community is evaluated along with the distribution of credit extensions and denials and the record of opening and closing of offices and providing services. The fourth grouping considers discrimination and other illegal credit practices. Specifically, this grouping focuses on the extent to which the institution complies with the ECOA, the HMDA, and the Fair Housing Act. The fifth grouping centers on community development efforts. These efforts include the extent of participation in community development projects or programs and other special activities.

An institution's overall CRA performance is reflected in a descriptive rating disclosed in the public evaluation. The potential ratings are: Outstanding, Satisfactory, Needs to Improve, or Substantial Noncompliance.

To facilitate public involvement in the CRA process, CRA regulations place technical disclosure standards on covered institutions. First, a CRA statement must be adopted and reviewed annually by the institution's board of directors for each local community the institution serves. The statement must contain a map depicting the local community, a list of the types of loans the institution is willing to make within the community, and a notice of the process by which the public can comment on the institution's CRA performance.

Secondly, the institutions principal office and at least one office in each local community must maintain a public CRA file. The public file should contain written comments concerning the institution's CRA performance, any responses from the institution to written comments, the institution's CRA statements for the past two years, and the most recent CRA Performance Evaluation prepared by its supervisory agency.

The final technical requirement is the posting of a notice in the lobby of each of the institution's offices which lets the public know how to: get copies of the CRA statement; send comments regarding CRA performance; locate the public file; address the supervisory agency; access the Performance Evaluation; and obtain announcements from the supervisory agency of any applications, for which CRA is considered, filed by the institution. In addition, the notice must indicate whether the institution is

owned by a holding company.

The CRA attempts to provide encouragement and incentive to financial institutions to meet community credit needs. Perhaps the most powerful incentive is the requirement placed upon supervisory agencies to take the CRA rating into account in considering certain applications for business expansion.³⁰ Poor performance in meeting CRA obligations can result in the denial of an application.

Since the advent of public disclosures of CRA ratings, the emphasis of CRA assessments has been the subject of controversy within the public sector and within the banking industry. To address the concerns expressed, President Clinton asked the supervisory agencies to develop less burdensome, more performance based regulations. The agencies issued a CRA reform proposal in December, 1993, and received a large number of comments. The December proposal was subsequently revised and issued for public comment again in September, 1994. The agencies hope to finalize regulations in 1995.³¹

30. The types of applications covered are those asking the agencies for permission to: obtain federal deposit insurance; establish a branch or deposit taking facility, or relocate a main office or branch; merge, consolidate, or acquire another financial institution, or acquire deposits from another institution; or to form a bank or savings association holding company.

31. Copies of the CRA reform proposals can be obtained from any of supervisory agencies. To obtain copies from the FDIC, contact the Division of Compliance and Consumer Affairs, 1730 Pennsylvania Avenue N.W., 7th floor, Washington, D.C. 20006. The telephone number is (202) 942-3100. The FDIC's Community Affairs Program promotes compliance with fair lending laws through outreach and training activities.