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# THE ATTORNEY GENERAL'S COMPREHENSIVE PROGRAM TO REFORM THE MORTGAGE LENDING INDUSTRY IN MASSACHUSETTS

RICHARD COLE\*

## INTRODUCTION

The Civil Rights Division of the Massachusetts Attorney General's Office has engaged in a sweeping attack on fair lending barriers in the mortgage lending industry in Massachusetts. The Attorney General's Office launched a comprehensive investigation of the mortgage lending industry immediately following and primarily in response to the October, 1992 release of the Federal Reserve Bank of Boston Study.<sup>1</sup> This study concluded that minority mortgage applicants with the same economic and property characteristics as white applicants in Massachusetts experienced a sixty percent higher rate of denial. The Federal Reserve Report suggested that the denial rate is caused by systemic barriers prevalent in the mortgage lending industry.

Without question, no consumer transaction is more critically important to Massachusetts residents than the purchase of their own home. Home ownership is the foundation for maintaining the stability of neighborhoods. It not only serves as the primary vehicle for generating family wealth, but also as a resource for financing education and obtaining emergency funding. Homeowners have a stake in maintaining the economic viability of their home and community. Few can make such a purchase if access to home mortgage loans is unfairly denied. Such a denial diminishes the opportunity of future economic growth and independence for a significant proportion of the Massachusetts population. Fair lending is not only a desirable goal, but serves the economic well-being of the lending industry, the low- and moderate-income, minority,

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\* Chief, Civil Rights Division, Assistant Attorney General, Massachusetts Attorney General's Office. The author wishes to express his appreciation to Thomas Samoluk and Freda Fishman, Assistant Attorneys General, for their assistance in editing this Article. The views expressed in this Article are solely those of the author and do not necessarily reflect the views of the Attorney General or the office of the Attorney General of Massachusetts.

1. ALICIA H. MUNNELL ET AL., MORTGAGE LENDING IN BOSTON: INTERPRETING THE HMDA DATA (Fed. Reserve Bank of Boston Working Paper No. 92-7, 1992).

and urban communities in the Commonwealth, and the Commonwealth as a whole.

The Attorney General's authority to address mortgage lending barriers is based on his broad statutory and common law powers to enforce public rights and protect the public interest.<sup>2</sup> In applying the state's antidiscrimination and consumer protection laws,<sup>3</sup> Attorney General Scott Harshbarger has interpreted his legal mandate broadly.

#### I. THE GOALS OF THE ATTORNEY GENERAL IN ADDRESSING FAIR LENDING BARRIERS IN THE MORTGAGE LENDING INDUSTRY

Through the industry-wide fair lending review, the Attorney General sought to achieve three major goals. By combating economic and credit discrimination, the Attorney General anticipated contributing to the economic revitalization of low- to moderate-income and urban communities in Massachusetts. Second, by focusing on barriers to equal credit, the Attorney General hoped to develop and establish industry-wide change to eliminate mortgage lending barriers in Massachusetts, rather than solely challenging the practices of a single lender. Third, the Attorney General hoped to develop fair lending practice standards in which non-compliance would be at a lender's legal peril.

The primary barriers to fair lending in Massachusetts which the Attorney General sought to address included:

(1) The general absence of comprehensive and effective loan solicitation and marketing programs in low- and moderate-income and minority communities;

(2) The discouragement of minorities at the pre-application stage;

(3) The refusal of minorities to apply because of their perception that they will not be fairly treated by banks and traditional lenders;

(4) The failure of many lending institutions to adopt appropriate management, monitoring and review systems to safeguard against discrimination, including adequate complaint resolution processes;

(5) The lack of comprehensive fair lending training programs for staff to overcome racial, linguistic, and cultural barriers to fair lending; and

(6) The inconsistent application of underwriting standards, counselling and documentation requirements resulting in significant delay in mortgage approval of minorities as well as a higher

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2. See MASS. GEN. L. ch. 12, § 10 (1990); *Lowell Gas Co. v. Attorney Gen.*, 377 Mass. 37, 48 (1979); *Commonwealth v. Mass. CRINC.*, 392 Mass. 79, 88-89 (1984).

3. MASS. GEN. L. chs. 151B, 93A, §§ 4,5.

rate of denials.

## II. VEHICLES USED TO ACHIEVE GOALS

### A. *Non-Litigation Approaches*

#### 1. *Home Improvement Loan Scam Investigation*

In 1991 and 1992, prior to the investigation of fair lending barriers in Massachusetts, the Attorney General's staff engaged in a home improvement loan-scam investigation. That investigation targeted certain unscrupulous home improvement contractors who had persuaded low-income, minority, and elderly homeowners to enter into home improvement contracts, secured by a second mortgage on their homes, with finance charges often over twenty percent. The contractors then sold these loans to Boston banks, which then held second mortgages on these homes. Some of these homeowners previously had their direct loan requests denied by the same banks which purchased the loans from the home improvement contractors. The lenders who preyed on these vulnerable consumers appeared to be interested primarily in the equity that these homeowners had built up in their homes, rather than whether the consumers, many of whom had low incomes, could repay the loans with their monthly incomes. Many of the homeowners eventually defaulted on their loans, and in hundreds of cases lost their homes through foreclosure. As a result of enforcement actions brought by the Attorney General's office, home improvement contractors, mortgage companies, mortgage company executives and six Boston area banks agreed to provide over fifty million dollars in restitution to victims and to fund special loan programs for the Boston minority community.

The Attorney General's staff learned from this home improvement, second mortgage investigation that banks had been generally inaccessible to minority homeowners for credit services. Mainstream lending institutions failed to create attractive loan products or to provide access to banking services to urban and minority communities. The void left by the mainstream lenders was filled by unscrupulous contractors and second mortgage lenders offering high rate loans to vulnerable homeowners.

From the investigation, the Attorney General's staff also learned that many blacks and hispanics would not turn to traditional banks for their financial needs because they believed their applications would not be considered, or that they would otherwise be unfairly treated. Finally, the Attorney General's staff learned that financial institutions were failing to police their own industry. Given that the lending industry failed to prevent (and some mainstream lenders actually financed) these high rate loans, it became apparent that there was an urgent need to identify and develop systemic solutions for eliminating fair lending barriers in

Massachusetts. The nature of the problems were further defined by the findings of the Federal Reserve study as well as the information obtained at a conference sponsored by the Attorney General.

## 2. *Conference On Systemic Discrimination*

On April 1, 1993, the Attorney General sponsored a working session on systemic discrimination in the residential mortgage lending industry. The conference brought together a broad cross-section of interested industry and community participants. The Attorney General's goal was to develop a comprehensive understanding of the nature and extent of past and present systemic discrimination in residential mortgage lending and to identify specific systemic solutions aimed at eliminating future discrimination in the industry. The conference was attended by leading federal and state regulators, representatives from the Department of Housing and Urban Development and Fannie Mae and Freddie Mac, leaders of the Massachusetts banking and mortgage lending associations, various banking and mortgage lending officials, community advocates, members of the Attorney General's staff and other experts in the field of residential mortgage lending. Many of the attendees submitted written statements and research papers and made oral presentations on specific aspects of the residential mortgage lending industry. The conference agenda separated the program into three separate and distinct areas: "Minority Access into the Mortgage Application System;" "Application and Loan Processing;" and "Holding and Selling — Improving Secondary Market Access." After the conference, a series of specific recommendations to systematically reform the industry were developed, detailed, and disseminated.

## 3. *Recommendations of the Attorney General's Special Report*

In October, 1993, the first anniversary of the release of the Federal Reserve Study, the Attorney General's office released a Special Report.<sup>4</sup> The Special Report proposed a comprehensive action plan to address the institutional barriers to fair lending in the residential mortgage lending industry in Massachusetts.<sup>5</sup>

The purpose of the Special Report was to provide an analysis

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4. Massachusetts Attorney General, *Systemic Reform of the Mortgage Lending Industry To Eliminate Discrimination And Revitalize Minority And Urban Communities In Massachusetts* (1993) (final report) [hereinafter Special Report].

5. The Special Report later served as the blueprint for negotiations between the Attorney General, the Massachusetts Bankers Association and numerous individual lenders, with many of its recommendations ultimately adopted in whole or in part. See *infra* Part III.

of lending barriers that result in systemic discrimination and to offer financially feasible, systemic solutions to those problems. The Attorney General's Special Report called on the banking and mortgage lending associations and their members to work with the Attorney General's Office, regulators, and community advocates to adopt the specific initiatives outlined in the Special Report. The Special Report's recommendations included:

(1) An industry-wide comprehensive training module and program to train banking and mortgage company staff to better understand and serve the credit needs of minority and low- and moderate-income communities and to correctly apply secondary market (e.g., Fannie Mae) standards;

(2) The creation of an industry sponsored statewide community education program to educate members of minority and low- and moderate-income communities in topics ranging from types of mortgage products, benefits of home ownership, credit, finances and managing a budget, property values, appraisals, and private mortgage insurance;

(3) The establishment of a comprehensive complaint resolution system in each lending institution, including the designation of an ombudsman to receive complaints from consumers and real estate agents and brokers;

(4) The expansion of outreach to linguistically diverse communities, by hiring multi-lingual staff to perform outreach and to translate pamphlets, automatic teller machine instructions, and other banking services into the various languages used within the lender's service territory;

(5) Development and financing of an educational program, to be based in colleges in different sections of the state, by the banking and mortgage lending association and its members, to provide enrolled linguistic, cultural, and racial minority students the technical knowledge necessary to qualify for positions in the financial industry, including the development of a model curriculum and an apprenticeship component;

(6) Industry financed independent testing organization to assist lenders in self-testing for discrimination in the pre-application and post-application stages of mortgage lending decisions, as a confidential management tool for lenders to monitor their internal practices and fair lending compliance by staff;

(7) Public-private partnership of private, federal and state funds for commercial and housing development of the minority, low-income and urban communities of Massachusetts to increase employment and residential property values in those areas;

(8) Industry funded joint risk-sharing pool to reduce financial disincentives that prevent lenders, particularly smaller financial institutions, from making loans to qualified minority and low-income consumers because of concern that those loans may not be

purchased by the secondary market;

(9) Industry created standardized checksheet to be used by all lenders to summarize all essential information about the loan applicant. This would serve as an economical, readily accessible means for management and regulators to evaluate fair lending practices and compliance with legal and regulatory requirements;

(10) Industry developed and sponsored community training program for appraisers who evaluate residential properties located in the minority and urban communities, and adoption of objective appraisal criteria to ensure that only fair, appropriate assessment factors are applied; and

(11) Adoption by lenders of a second level review with an expert appraiser to ensure that denial decisions are not based on discriminatory appraisal reports.

#### *4. Recommended Legislative and Regulatory Action*

In addition to industry-sponsored reform recommendations, the Attorney General's Report called for specific legislative and regulatory action, including:

(1) Establishment of a state fund to support municipal tax abatements in areas of high concentration of abandoned housing or mortgage foreclosures;

(2) Amendment of the Federal Fair Housing Act<sup>6</sup> to permit post-application testing for discrimination, which under current law is only permitted prior to the customer's submission of an application;

(3) Amendment of the state banking law<sup>7</sup> and the federal Community Reinvestment Act<sup>8</sup> (CRA) in two respects: (a) to bring mortgage companies, which currently have no CRA obligations, into the scope of the law and require them to market and originate loans in minority and low- and moderate-income communities; and (b) to amend the CRA to ensure evaluation of lenders' quantitative record of performance in minority and low-income communities; and

(4) Amendment of statutes and regulations that permit private mortgage insurers to apply stricter eligibility standards than Fannie Mae or Freddie Mac.

#### *5. Fair Lending Administrative Bulletin*

On August 31, 1993, the Massachusetts Division of Banks, after extensive consultation with the Attorney General's Office and others, promulgated an Administrative Bulletin on enforce-

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6. 42 U.S.C. § 3601 (1988); 18 U.S.C. § 1001 (1990).

7. MASS. GEN. L. ch. 167, § 14 (1990).

8. 12 U.S.C. §§ 2901-2905 (1992).

ment of the Community Reinvestment Act. The Administrative Bulletin governs the Division of Banks' CRA examination and evaluation of the fair lending practices of state chartered banks and credit unions in Massachusetts. In examining fair lending performance under state law the Banking Commission now includes analysis of staff fair lending training, staff composition and compensation, outreach, credit products and underwriting standards, marketing, credit education, counselling, second review practices and internal control procedures.

#### *6. The Attorney General / Banking Commission Referral Protocol*

In August, 1993, the Massachusetts Banking Commission agreed to refer to the Attorney General evidence of discrimination discovered in the Banking Commission's CRA examination of lenders, including failure to follow the Commission's fair lending guidelines.

### III. LITIGATION

#### *A. Identification of Certain Minority Loan Applicants*

As a result of its October, 1992 study, the Federal Reserve Bank of Boston identified 140 black and hispanic applicants who statistically had a 50% or greater likelihood of approval but were denied a mortgage loan in 1990 based on an analysis of 38 separate factors, with all other factors being controlled except the race or ethnic background of the applicant. In December, 1992, the Civil Rights Division issued Civil Investigative Demands (CIDs) pursuant to the state consumer protection statute<sup>9</sup> to 170 banks and mortgage companies engaged in mortgage lending in Massachusetts. In addition to seeking to identify the 131 institutions that volunteered for the Federal Reserve Study, the Civil Rights Division also sought to identify those lenders that denied the 140 minority loans. The Federal Reserve had refused to provide that information to the Attorney General. A second set of CIDs was issued to thirty-six lenders in June 1993 to obtain the actual minority loan files identified by the Federal Reserve Study.

#### *B. Marketing and Solicitation of Minorities; Applicant Flow Data*

Through the use of the Civil Investigative Demands, served in December, 1992 and in June and July, 1993, the Attorney General also collected Home Mortgage Disclosure Act<sup>10</sup> (HMDA) data and other categories of information from residential mortgage

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9. MASS. GEN. L. ch. 93A, § 6 (1990).

10. 12 U.S.C. §§ 2801-2810 (1992).

lenders doing business in Massachusetts. Information regarding the provision of credit, applicant flow data, including the number of minority applicants and the number of white applicants, as well as materials relating to their loan solicitation and marketing programs was obtained. This effort was in response to the Federal Reserve's shocking finding that only 1,200 blacks and hispanics<sup>11</sup> applied for mortgage loans in the Boston Metropolitan Statistical Area in 1990. The Attorney General's staff learned from the Study that the large resident minority population living in the potential service area for banks and mortgage companies doing business in Massachusetts was in striking contrast to the extremely low number of minority applicants for most of these institutions. This number reflected a disturbing lack of minority access to mortgage lenders in Massachusetts. The information also raised significant concerns of lender redlining. The low minority applicant numbers also indicated that specific policies and practices of Massachusetts lenders had discouraged minorities from either contacting banks and mortgage companies, or from formally applying for a residential mortgage loan.

*C. Judicial Challenge to Attorney General's Legal Authority to Combat Credit Discrimination*

In July, 1993, the Massachusetts Bankers Association (MBA) and ten lending institutions each filed separate civil actions in the state Superior Court challenging the authority of the Attorney General to issue the June and July, 1993 CIDs. The MBA and the ten banks argued that the Attorney General lacked jurisdiction to investigate alleged racial or ethnic discrimination in the provision of home mortgage loans under Chapter 93A,<sup>12</sup> the state consumer protection statute. They argued that the Massachusetts statutory scheme established to address discrimination<sup>13</sup> was the exclusive remedy to redress credit discrimination.<sup>14</sup> The Attorney

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11. As compared to over 16,000 whites, or less than one per cent of all loan applications. Special Report, *supra* note 4, at 19, 21.

12. MASS. GEN. L. ch. 93A (1990).

13. MASS. GEN. L. ch. 151B (1990).

14. Some members of the Massachusetts banking community argued that the Federal Reserve Study should not serve as a basis for the Attorney General's investigation of the mortgage lending industry in Massachusetts, asserting that various flaws in the Study, including miscoding errors, the failure of the Study to control for certain variables in the mortgage lending decision-making, and the disparities in the underwriting policies of the lenders participating in the Study, rendered its findings invalid. Notwithstanding these criticisms, twenty-six Massachusetts lenders agreed to have an independent Panel of experts review the minority files identified by the Federal Reserve Study as potentially being inappropriately denied. See also James H. Carr & Isaac F. Megbolugbe, *Federal Reserve Bank of Boston Study on Mortgage Lending Revisited*, 4 J. HOUSING RES., no. 2,

General argued that discriminatory lending also fell under the prohibitions of the Consumer Protection Act, in that the requested documents were relevant to possible unfair and deceptive acts and practices in the provision of home mortgage loans. On August 2, 1993, the Attorney General filed a Motion to Transfer the eleven cases from the Superior Court to the Supreme Judicial Court of Massachusetts, arguing that the lawsuits raise important legal issues of great public importance which should be resolved as promptly and efficiently as possible. On November 18, 1993, the motion was granted, with the cases consolidated and docketed in the Supreme Judicial Court of Massachusetts.

In September, 1993, while the Motion to Transfer was pending, representatives for the MBA and the ten lenders contacted the Attorney General's Office and expressed an interest in attempting to resolve the dispute and the underlying issues raised by the Attorney General's investigation. In December, 1993, after extensive negotiations, the broad parameters of an agreement with the MBA and the ten "litigating" banks was reached, and an Agreement in Principle was executed. Negotiations then ensued with nineteen other lending institutions that had complied with the CIDs and had not challenged the legal authority of the Attorney General to issue the CIDs.

#### *D. Settlement Agreements with Individual Lenders*

In March, 1994, the Attorney General entered into a final precedent-setting agreement with twenty-eight banks and mortgage companies. On September 29, 1994, one additional lender entered into a settlement agreement with the Attorney General. Separate agreements were entered into with twenty-six of the twenty-nine banks and mortgage companies to provide a process to compensate certain black and hispanic applicants, identified by the Federal Reserve Study, who may have been inappropriately denied a mortgage loan in 1990. The agreements set up a process whereby a panel of three banking experts will review ninety-nine denied minority loan applications which were the subject of the October, 1992 Federal Reserve Study, to determine if the loans probably would have been purchased by the secondary market in 1990. The Panel does not need to determine if the applicant was a victim of discrimination, which would require an intensive comparative file review process.<sup>15</sup> It was agreed that comparative file

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277-313 (1993) (confirming the Federal Reserve Study's findings, while effectively responding to the varied criticisms).

15. Rarely, if ever, will loan files contain statements reflecting an intent to discriminate against minorities. Therefore, in order to prove discrimination, a careful analysis of both white and minority loan files is the only effective method to identify distinctions in treatment or the disparate application of underwriting

reviews of similarly situated whites who were approved for a loan by that lender would not be performed by the Panel.<sup>16</sup> One member of the Panel was selected by the Attorney General, another by the Massachusetts Bankers Association, with the chairperson jointly selected.

Consumers whose loans the Panel determines should have been approved, will be awarded a remedy of \$15,000 or, at their option, other relief in the form of refinancing, obtaining a new mortgage loan, or restructuring of an existing loan.<sup>17</sup> The panel established under the agreement must report to the Attorney General every sixty days until it has completed its loan file review and consumer restitution responsibilities. A final report summarizing the work of the Panel will be produced at the completion of the Panel's work, which will be available to the public.<sup>18</sup> The Attorney General also entered into agreements with three other lenders to address, through programmatic changes, their low minority applicant numbers. As a result of these settlements, the

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standards based on the race or ethnic background of the applicant.

16. Thus, for example, in making its determination, the Panel will not be able to compare the treatment of minority applicants who had credit problems and who were denied a mortgage loan, with similarly situated whites with credit problems, who were approved and their loans sold in the secondary market in 1990. The decision not to have the Panel engage in a comprehensive comparative file analysis was based on the prohibitive cost and time necessary to engage in comparative file reviews for each of the denied minority applicants for each of the 26 lending institutions participating in the Panel review process.

17. Minority applicants who applied in 1990 to the Shawmut Bank could also potentially obtain a recovery through the United States Justice Department settlement agreement with Shawmut. It was agreed to by Shawmut, the Massachusetts Attorney General's office and the Justice Department that these files would first be subject to review by the Panel, based on 1990 secondary market standards. If the Panel determined that the applicant should be granted the \$15,000 remedy as compensation, a review of the file under the Justice Department agreement with Shawmut would be precluded. If however, the Panel determines that recovery under 1990 secondary market standards is not appropriate, the Justice Department agreement with Shawmut would become operative. Shawmut would then determine if the application should have been approved, subject to the Justice Department's review, based on 1993 secondary market standards. Under the Justice Department agreement, if it is determined that a minority applicant should have been approved, he or she will receive \$10,000 in compensation.

18. The results of the panel review process and the findings of the Federal Reserve Study should not be compared, nor should anyone attempt to reconcile them. Unlike the Panel's review process, the findings of the Federal Reserve Study resulted from a comparison of the files of similarly situated whites, blacks and hispanics. Second, the Federal Reserve Study differed from the Panel's review standard in that it did not analyze whether approved white applicants, with files similar to denied minorities, likely could have had their mortgage loans purchased by the secondary market in 1990. Nor did the Study review whether any or all of the 140 blacks and hispanics with poor credit histories may have been *appropriately* denied, while the whites in the Study with similar poor credit histories may have had their loans *inappropriately* approved.

action docketed in the Supreme Judicial Court was dismissed without prejudice.

*E. Massachusetts Bankers Association/Attorney General Agreement*

On March 4, 1994, an Agreement was separately reached with the Massachusetts Bankers Association (MBA), on behalf of its two hundred members, as part of the comprehensive settlement package with the Massachusetts banking industry. This settlement is the first in the country to mandate industry-wide commitments. The Agreement requires the MBA to establish four specific state-wide programs and two loan incentive initiatives to increase minority home ownership, and to ensure fair and equal access to mortgage loans without regard to race or ethnic background. It also commits the industry to develop with the Attorney General and other interested parties, certain legislation to enhance fair lending and to ensure equal treatment of applicants, regardless of race or ethnic background.

The MBA has committed itself to implementing these state-wide initiatives through industry-wide task forces, which include participation by numerous large, medium and small-sized Massachusetts lenders. To date, over 100 bankers from a broad cross-section of the industry have participated in the taskforces and program development working groups.

*F. Statewide Initiatives to be Implemented Through MBA Task Forces*

*1. College-level Training and Employment Recruitment Program*

Within six months of the date of agreement, an educational college-level program to train and recruit racial, ethnic, and linguistic minorities for employment in the mortgage lending industry, including a student apprenticeship component was to be established. The agreement required publicity about the career development program with the MBA assisting in placing those who successfully complete the program in positions within the lending industry. Programs have now been initiated in four community colleges located in different regions in the state, with staff from MBA members serving as faculty. Graduates have already been employed by members of the MBA.

*2. Credit and Home Buyer Community Educational Programs*

This program aims to establish, within nine months of the date of agreement, the organization and multi-lender/MBA sponsorship of ongoing Credit and Home Buyer Community Educational Programs throughout Massachusetts in various racial, ethnic,

and linguistic minority communities on a regular basis to reach minorities. Industry sponsored education programs are now organized to be held in eight or nine separate locations in the Commonwealth.

### *3. Bank Fair Lending Compliance Training Module*

The task force was to develop, within nine months of the date of agreement, a comprehensive training module and program on fair lending practices and diversity training for mortgage lending employees and management throughout the industry. Lenders are either to adopt the module, send employees to a MBA sponsored training program, or create a substantially similar program. In the fall of 1994, over 190 bankers attended a day long training, which will be repeated in 1995. Those officers and employees of MBA members who will serve as trainers have been identified and have been provided written curricula materials.

### *4. Multi-language Educational Materials*

This program will aid in the development and distribution of educational materials that provide basic information on managing a budget, finances, the mortgage lending industry and its application process, within six months of the date of the agreement. These documents are to be translated into Chinese, French, Haitian Creole, Khmer, Portuguese, Russian, Spanish and Vietnamese, within one year of the date of agreement.

## *G. Legislative Initiatives*

### *1. Self-testing and Comparative File Review*

This program will establish the joint promotion of legislation that will help to promote bank self-testing and comparative file review evaluation of closed application files by lenders. It will improve management monitoring of fair lending compliance by bank employees. A draft bill has now been introduced in the Legislature.

### *2. Reinsurance Program for "Non-Conforming" Loans*

The Attorney General and MBA will jointly promote legislation to set up a state-sponsored reinsurance program for "non-conforming" loans and to expand opportunities to sell these loans through adoption of more flexible secondary market guidelines. They have already proposed legislation to modify state banking laws that require a minimum down payment of five percent, when the mortgage loan is written in accordance with the requirements of any federal or state secondary mortgage market lender ap-

proved by the Massachusetts Commissioner of Banks.

### *H. Internal Practice Changes*

The MBA also agreed to encourage and to ensure that its two hundred members adopt certain internal practice to eliminate fair lending barriers in Massachusetts. This agreement, in effect, establishes new fair lending practice standards for mortgage lending in Massachusetts.

#### *1. Complaint Management System — Bank Ombudsman*

The establishment of an ombudsman at banks in Massachusetts to handle inquiries and complaints from denied loan applicants and brokers. The ombudsman reports directly to senior level management.

#### *2. Internal Review Programs*

The establishment of an internal formalized system of second-tier reviews by supervisors for preliminarily denied low- and moderate-income mortgage applicants prior to adverse action notice issuance, and adoption of a systematic comparative file reviews program developed with technical assistance from the MBA. In January, 1995, a statewide conference was held for bankers to inform them about effective techniques and programs.

#### *3. Compensation Structures*

Compensation structures designed to create financial incentives for effective solicitation by loan originators of low- and moderate-income consumers. Since execution of the agreement, the MBA has designed an educational program to assist bankers in identifying a full range of potential compensation structures.

##### *I. Loan Incentive Programs*

The MBA has also agreed to commit itself and its members to foster investment in low-income neighborhoods by: (1) *Non-conforming* Loan Incentives which will promote the development of various initiatives to provide market incentives to mortgage lenders to make so-called "non-conforming" loans; and (2) *Incentives for Low-priced Neighborhood Investment* which aims at the development of incentives to encourage banks to offer specialized loan products to increase lending in low-priced neighborhoods consistent with the Community Reinvestment Act.

The agreement with the Association has a three-year term and requires the MBA to report semi-annually to the Attorney General regarding the industry's progress in implementing the terms of the agreement.

*J. First N.H. Mortgage Corp. Agreement with the  
Attorney General*

On December 29, 1993, a comprehensive agreement was reached with First N.H. Mortgage Corp., one of the largest mortgage lenders in Massachusetts, to establish a model residential mortgage loan program in Massachusetts. The agreement sought to increase First N.H.'s relatively low number of minority loan applicants in Massachusetts.

First N.H., a mortgage company that is not governed by the Community Reinvestment Act, agreed to establish a model lending pilot project in Springfield, Massachusetts and a second city to be named in July, 1994, and to make certain changes in the manner in which they handle residential loan applications. On July 1, 1994, First N.H. selected the Lowell, Lawrence, and Haverhill areas of Massachusetts for its second pilot project.

This is the first reported agreement in the country in which the factual predicate for the agreement related solely to the relatively low number of minorities that applied for a residential mortgage loan, rather than allegations of discriminatory denial of minority mortgage applicants.

Under the agreement, First N.H. agreed to adopt or maintain certain fair lending initiatives in the minority and low- and moderate-income communities. The initiatives for the two pilot projects include:

(1) *Credit and Home Buyer Educational Program.* This program consists of holding a number of community-based seminars in the targeted communities to reach a broad spectrum of members of the minority and low- and moderate-income communities on topics ranging from types of mortgage products it provides, managing a budget, and how to apply for and have the best opportunity to be approved for a mortgage loan at First New Hampshire.

(2) *Comprehensive Advertising and Marketing Plan.* By May, 1994, First N.H. established an ongoing comprehensive loan solicitation and marketing program in the targeted communities designed to attract qualified low- and moderate-income applicants. This program has succeeded in significantly increasing the numbers of qualified minority applicants, in the Lowell, Lawrence, and Haverhill areas of Massachusetts.

(3) *New Compensation Structures.* Commencing in March, 1994, First N.H. adopted new compensation structures for its sales force assigned to work on the pilot projects, designed to encourage loan origination and service to low- and moderate-income consumers.

(4) *Home Buyer Financial Incentives.* First N.H. has institut-

ed a program of special financial incentives for first-time home buyers and low-income borrowers, including payment of application fees by the lender.

In addition, certain initiatives have been implemented by First N.H. relative to the general manner in which First N.H. deals with residential mortgage applicants including:

(1) *Fair Lending Training of Staff*. Expanded comprehensive ongoing staff training program to train its mortgage company staff to serve the credit needs of minority and low- and moderate-income communities, which include training by representatives of the Attorney General's Office.

(2) *Complaint Management System*. This system includes the designation of an ombudsman to receive complaints, with notification to consumers and real estate agents and brokers of the name of the ombudsman. The ombudsman is a member of the mortgage review committee of First N.H.

(3) *Internal Loan Denial Review System*. First N.H. has adopted a system of internal second-tier reviews and comparative file reviews designed to ensure that minorities are not being inappropriately discouraged to apply, or denied for a residential mortgage loan; solicitation of customer feedback and documentation of originators' contacts with consumers.

(4) *Recruitment of Minorities For Employment*. This program aims to ensure participation in the Massachusetts Bankers Association and Massachusetts Mortgage Bankers Association educational programs designed to train and to recruit linguistic, cultural, and racial minorities for employment.

(5) *Monitoring of Fair Lending Practices*. The creation and use of a standardized checklist, which serves as a readily accessible means for management, to ensure fair lending practices and compliance with legal requirements.

(6) *Eliminating Minimum Loan Amounts*. This program eliminates any requirements for minimum loan amounts.

(7) *Compensation Structure*. First N.H. modified the compensation it furnishes its originators to provide further financial incentives to loan to low- and moderate-income borrowers.

(8) *Specialized Loan Products*. First N.H. developed a new loan product which is particularly attractive to low- and moderate-income borrowers.

(9) *Reporting*. First N.H. has reported quarterly its progress in implementing the provisions of the Agreement to the Attorney General's Office.

The agreement with The First N.H. Mortgage Corp. has a two and a half year term which commenced in January 1, 1994.

#### CONCLUSION

Hopefully, the initiatives undertaken by the Attorney Gener-

al over the past two years will serve as a model to law enforcement, regulators, and community advocates to achieve our mutual goals of fair lending for all people, regardless of their race or ethnic background. Adoption and implementation of the recommendations of the Special Report and the provisions of the agreements with the Massachusetts Banking Association and individual lending institutions should significantly reform the industry in Massachusetts and provide minorities and low- and moderate-income residents of Massachusetts greater opportunities for home ownership. Ideally, the publication of the provisions of our agreements and initiatives will provide new creative ideas to those individuals already engaged in the process of innovative reform of the mortgage lending industry.