

Regulators Kept Quiet as Subprime Lenders 'Targeted' Minorities

By Craig Torres

June 13 (Bloomberg) -- The U.S. agencies that supervise more than 8,000 banks haven't censured any of them for violating fair-lending laws, three years after Federal Reserve researchers began assembling data showing blacks and Hispanics are more likely than whites to be saddled with high-priced home loans.

Minorities stand to be hardest hit by rising delinquencies and foreclosures in subprime loans. While Census Bureau data show that homeownership rates rose to records among blacks in 2004 and among Hispanics in 2005, they still trail whites by 25 percentage points, and the gap may widen in the current bust.

"Black people and Hispanics have been targeted," said Alphonso Jackson, secretary of Housing and Urban Development, whose department is hiring to expand its own probe of discriminatory lending.

"Low and moderate-income people get one shot at home ownership," Jackson said in an interview in Washington. "And if they don't make it work, they don't get a second shot."

Subprime loans -- those made at higher interest rates to people whom banks consider risky or who have sketchy credit histories -- accounted for more than half of the home foreclosures in the fourth quarter of last year. The Fed's review, conducted by economists from its research and statistics division, covered lending data from 2004 and 2005, the first two years of expanded disclosure requirements for banks and the final two years of Alan Greenspan's tenure as chairman.

Closer Scrutiny

Fed researchers singled out 470 lenders for closer scrutiny over two years, with some lenders showing up in both 2004 and 2005. The Fed has turned the names over to the relevant regulators and other authorities, including in some cases state officials.

The central bank says its research isn't conclusive on whether discrimination occurred. Details on how lenders price loans, such as borrowers' credit histories and the ratio of the loan amount to the value of the home, weren't provided by banks.

Even so, concentrations of high-cost mortgages "shouldn't break down so blatantly and crudely to race," said Sarah Ludwig, co-director of the Neighborhood Economic Development Advocacy Project in New York and a member of the Fed's Consumer Advisory Council. "Neighborhoods are getting mauled, and the regulators have been asleep at the wheel."

Fragmented Supervision

The supervision of America's 8,650 banks is split among five agencies: the Fed, the Office of Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corp. and the National Credit Union Administration. Each has the power to uphold fair-lending laws and to punish offenders.

None of the five national regulators has published an enforcement action based on the data, according to agency spokespeople. Some lenders have been referred to the Justice Department for possible action, and investigations are continuing.

Interagency cooperation has benefited minorities in the past. A 2002 Fed referral to the Justice Department on lending practices by First American Bank of Carpentersville, Illinois, resulted in a \$5.7 million consent order in 2004 for new branches, investment and education in black and Hispanic neighborhoods.

Consumer groups say minority neighborhoods may be intentionally marketed for high-cost loans by non-bank lenders, while poor financial literacy among low-income borrowers may lead to wrong choices. A legacy of discrimination that has kept minorities from owning assets, building wealth and improving credit history may also put them at a disadvantage when loans are priced.

'Huge Inequities'

"There are huge inequities in our society and it is incumbent upon bank regulators to battle them," said Alys Cohen, an attorney at the National Consumer Law Center in Washington who previously investigated lending discrimination at the Federal Trade Commission. "I don't see any evidence that they are doing that."

FDIC Chairman Sheila Bair said she is troubled by the data and may act on two cases. "I don't believe, and I don't know that I have ever heard my colleagues say, that these disparities -- and they are significant -- can all be explained away through risk-based pricing," Bair said in an interview in Washington.

Consumer advocates using the Fed figures in their own research assert they do find evidence of discrimination. The Center for Responsible Lending in Durham, North Carolina, last year took the same mortgages analyzed by the Fed and matched them with its own proprietary information. The new data subset, of 177,487 subprime loans made in 2004, included credit scores, loan-to-value ratios and property locations.

Similar Risk

The model concluded that African-American and Latino borrowers were more likely to receive higher-rate loans than white borrowers with similar risk.

"What level of evidence is going to satisfy these guys?" Kathleen Keest, a former assistant Iowa attorney general and now senior policy counsel at the center, said in reference to regulators. "If you rule out risk, then what is it?"

The mortgage industry disputes the center's conclusions. "We have some real questions about the accuracy of that study," said Douglas Duncan, chief economist at the Mortgage Bankers Association in Washington. He called the loan match-ups a "crude approximation."

Kevin Petrasic, a spokesman for the Office of Thrift Supervision, said no violations were found in the 20 lenders under his agency's jurisdiction that showed disparities along ethnic lines in 2004.

Under Review

“When our folks went into the institutions, what the analysis showed was that the pricing aberration was linked to the FICO score, not disparate treatment of different classes of borrowers,” Petrasic said, referring to an industry measure of creditworthiness. The 24 lenders that surfaced in the 2005 data remain under review.

The National Credit Union Administration fined some institutions for filing their loan reports late, according to spokesman Justin Grove.

“We will continue to be vigilant to ensure discriminatory practices don't enter the national banking system,” said Kevin Mukri, a spokesman at the OCC in Washington, which had 80 of the institutions it regulates flagged over the two years. Mukri said he isn't aware of any enforcement actions linked to the 2004 and 2005 data.

The Fed itself conducted a fair-lending review of several of the 35 lenders it supervises that it had flagged for 2004, according to spokeswoman Susan Stawick. Of the 45 institutions that surfaced in 2005, examiners did “a full risk assessment for pricing discrimination on each,” she added. The central bank is now studying figures for 2006.

Red-Lining

The Justice Department's 2006 fair-lending report shows that one Fed referral on red-lining -- where a lender refuses to write mortgages in certain neighborhoods -- remained under investigation. Stawick said the central bank referred a discrimination case this year.

The FDIC has referred two cases to the Justice Department, officials said. “We are waiting for the Department of Justice to determine whether or not it will take action as a courtesy, and then we will take our own enforcement action,” said Robert Mooney, acting deputy director of supervision and consumer protection at the FDIC in Washington. “It could require full reimbursement to borrowers for paying the higher costs of these loans.”

A referral by the Department of Housing and Urban Development to the Justice Department also remains under review.

Congressional Attention

The issue is gaining attention in Congress, where the Fed's overseers have grown impatient with its emphasis on guideline-based regulation that doesn't give consumers recourse to litigation. Senate Banking Committee Chairman Christopher Dodd, a Connecticut Democrat, said in an interview last week he will propose legislation if the Fed doesn't use its authority to strengthen consumer protection.

For now, Congress wants to see aggressive action from the regulators, said Representative Al Green, a Texas Democrat and member of the House Financial Services Committee.

“There is enough smoke here for us to either conclude that there is a fire, or for us to investigate to determine whether there is fire,” he said in an interview. “We absolutely must do something.”

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