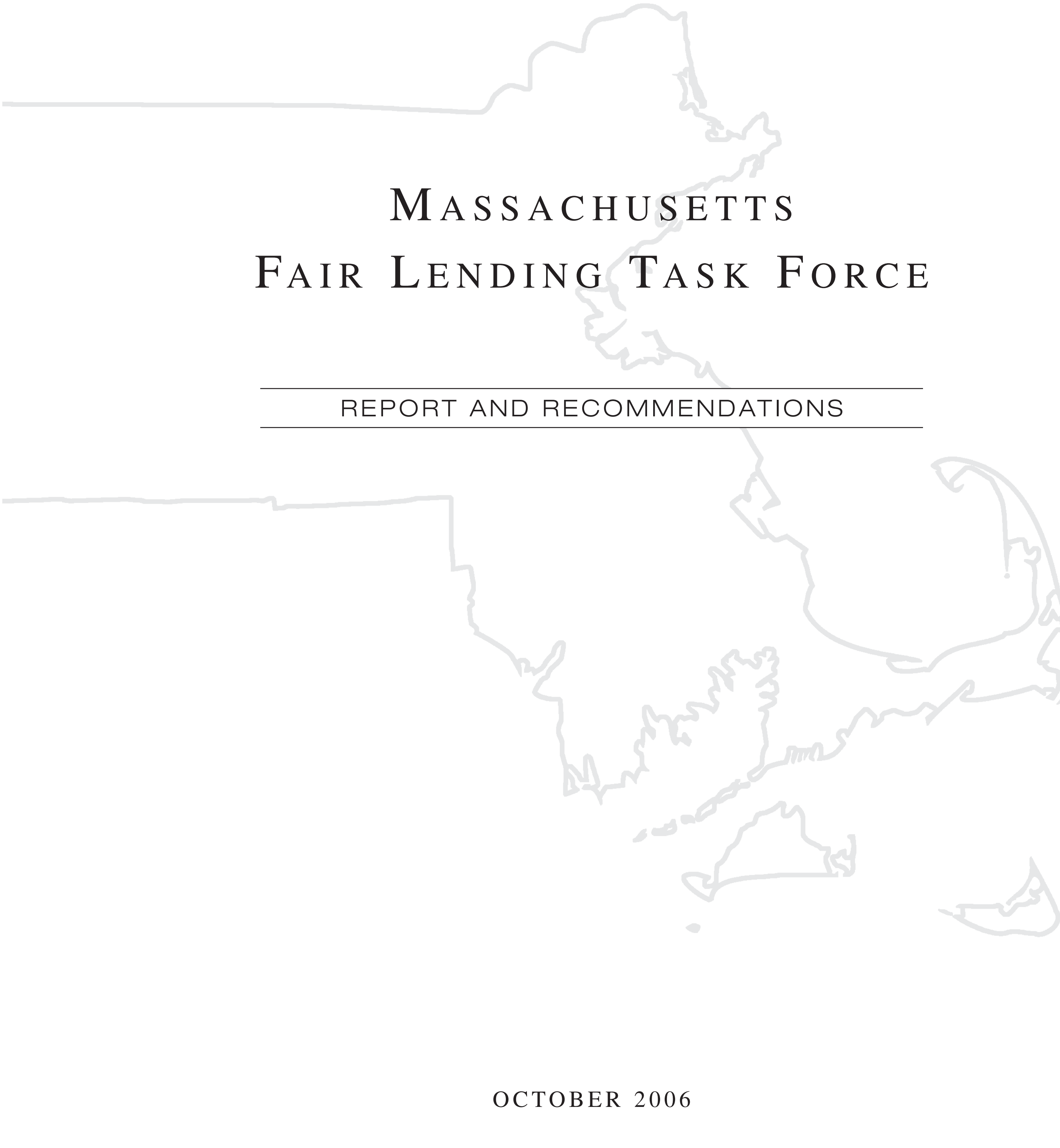
MASSACHUSETTS FAIR LENDING TASK FORCE



REPORT AND RECOMMENDATIONS

OCTOBER 2006

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INTRODUCTION

The Massachusetts Fair Lending Task Force was established in 2005 to promote and ensure fair and equitable mortgage lending to all individuals. The Task Force included representatives from the Massachusetts Bankers Association (MBA), the Massachusetts Community & Banking Council (MCBC), the Massachusetts Credit Union League (MCUL), the Massachusetts Mortgage Association (MMA), the Massachusetts Mortgage Bankers Association (MMBA), state and federal regulatory agencies and community-based organizations.[1]

While much progress has been made over the last several years in increasing the level of approved loans to minority group borrowers, the Task Force has worked to better understand the reasons why black and Latino homebuyers continue to have higher denial rates than white homebuyers – including potential areas of discrimination and/or unequal treatment. The Task Force also focused on developing strategies and recommendations to assist in reducing these denial rates and the disparity ratio between the denial rates for minority and white homebuyers.

To accomplish these goals, the Fair Lending Task Force's work included:

- Reviewing statistical and other analyses of mortgage lending patterns and reasons for denial;
- Surveying lenders on ways to reduce minority mortgage loans denials;
- Holding regional meetings to solicit broad-based industry, community and government input on the denial rate issue;
- Assessing the success of earlier fair lending initiatives and recommendations;
- Involving Fannie Mae and Freddie Mac in evaluating the impact of secondary market guidelines and procedures on mortgage loan approvals and denials;
- Evaluating the adequacy of consumer education and information on mortgage lending procedures and standards;
- Seeking input from government-sponsored housing agencies, private mortgage insurance firms, and credit reporting agencies on ways to increase lending to minority group borrowers;
- Developing and promoting specific recommendations to banks, credit unions, mortgage companies, real estate brokers, community-based organizations, and others to help reduce the rate of minority mortgage loan denials;
- Establishing an on-going process to promote and implement the Task Force recommendations and to evaluate progress in reducing minority denial rates and minority/white disparity ratios.

[1] A list of Task Force members is included in Appendix A.

This work would not have been possible without the active participation of many people. We are particularly grateful for the time and valuable assistance provided by representatives of the MBA, MCBC, MCUL, MMA and MMBA and of the following organizations and agencies who participated in the Fair Lending Task Force's deliberations:

Citizens Housing & Planning Association
Fair Housing Center of Greater Boston
Federal Deposit Insurance Corporation
Federal Reserve Bank of Boston
Massachusetts Affordable Housing Alliance
Massachusetts Division of Banks

This report is intended to share the findings of the Task Force's work and to provide recommendations to banks, credit unions, mortgage companies, community-based organizations, public officials and others on steps that they, individually and in partnership with others, can take to increase lending to minority group members while ensuring that all homebuyers have equal access to credit.

Finally, it should be noted that the Fair Lending Task Force itself includes diverse membership with a broad range of interests and priorities. While the recommendations in this report represent a consensus of Task Force members, not all members support all recommendations as presented.

Christopher Dunn, Senior Vice President
South Shore Savings Bank
Chair, Massachusetts Fair Lending Task Force

Kevin Kiley, Chief Operating Officer
Massachusetts Bankers Association

Kathleen Tullberg, Manager
Massachusetts Community & Banking Council

Mary Ann Clancy, Senior Vice President and General Counsel
Massachusetts Credit Union League

Denise Leonard, Executive Director
Massachusetts Mortgage Association

Kevin Cuff, Executive Director
Massachusetts Mortgage Bankers Association

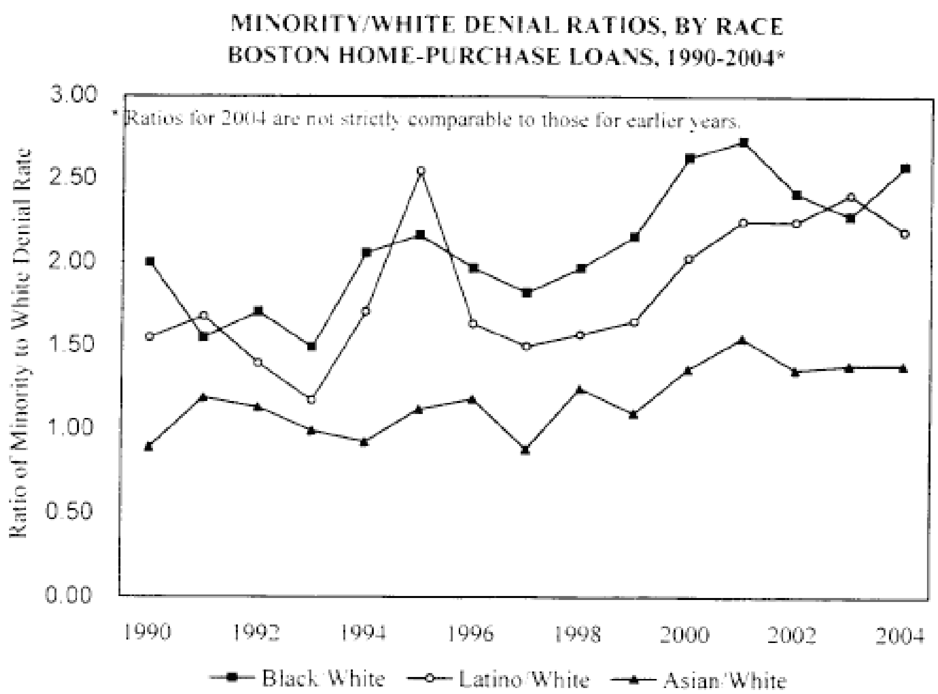
BACKGROUND

The Denial Rate Issue

Since 1995, the Massachusetts Community & Banking Council (MCBC)[2] has published an annual report on mortgage lending patterns in Greater Boston prepared by Jim Campen of the Gaston Institute at UMass/Boston. MCBC's most recent report, *Changing Patterns XII: Mortgage Lending to Traditionally Underserved Borrowers & Neighborhoods in Greater Boston, 1990-2004*[3], analyzed mortgage lending by race and income and the comparative performance of major types of lenders in 108 individual communities in and around Boston.

The report found that while there have been significant increases in the number of mortgage loans to black, Latino and Asian homebuyers in Boston and other Massachusetts cities, there continue to be certain racial disparities.

The Task Force found the continuing high rates of minority denials and high minority/white disparity ratios particularly troubling. In 2004, the denial rate for blacks



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[2] MCBC was established in 1990 as part of the Massachusetts Bankers Association's Community Investment Program to encourage community investment in low- and moderate-income and minority neighborhoods. MCBC brings together community and bank representatives to promote a better understanding of the credit and financial needs of lower-income neighborhoods and provides information, assistance and direction to banks and community groups in addressing those needs.

[3] A full copy of the report is available on MCBC's website at www.masscommunityandbanking.org.

was 2.84 times the white rate in the Metropolitan Area Planning Council (MAPC) Region[4] and was 2.58 times the white rate in the city of Boston. The Latino denial rate was 2.33 times the white rate in the MAPC Region and 2.19 times the white rate in the city of Boston. The black/white, Latino/white and Asian/white denial rate ratios in Boston have all increased since the late 1990s.

When mortgage applicants are grouped by income, the 2004 denial rates for blacks and Latinos in the city of Boston were in every case well above the denial rates for whites in the same income category. In the highest income category, consisting of borrowers with incomes above $150,000, black applicants experienced a denial rate of 26.8 percent, triple the 8.9 percent denial rate for white applicants with the same income; the 21.7 percent denial rate of Latinos with incomes above $150,000 was almost two and one-half times greater than the white rate.

In addition to the information provided in *Changing Patterns*, the Task Force also reviewed information based on 2001-2003 Home Mortgage Disclosure Act (HMDA) data prepared for the Task Force by Jim Campen. This information detailed statewide black and Latino denial rates and disparity ratios, denial rates and disparity ratios by income in selected cities, statewide denial rates and disparity ratios by size of lender and statewide reasons for denial, by race and income.

Reasons for Denial

HMDA regulations provide an opportunity for lenders to report the reasons that a mortgage loan is denied. Lenders supervised by the Office of Thrift Supervision or the Office of the Comptroller of the Currency must report at least one reason for denial; reporting reasons is optional for all other lenders. Lenders may report up to three reasons for denial of a mortgage loan application.

The Task Force recognized that the HMDA data on reasons for denial must be accepted with caution. For many lenders, the information is voluntary. Some lenders provide one reason for denial and others multiple reasons for denial. Most importantly, a significant percentage of reporting institutions do not provide any reason for denial (in 2003, 33.1 percent of all denials and 49.5 percent of denials by independent mortgage companies included no reasons for denial). Despite these limitations, the Task Force found the HMDA data to be useful and generally consistent with anecdotal reports from lenders represented on the Task Force and present at the Task Force's regional meetings.

The Task Force reviewed 2003 HMDA data on the reported reasons for denial in the MAPC Region. The data showed that 28.4 percent of all mortgage denials and 36.7 percent of all black mortgage denials included debt-to-income reasons (income insufficient for the amount of credit requested, excessive obligations in relation to income). In addition, 25.5 percent of all mortgage denials and 29.7 percent of all black mortgage denials included credit reasons (insufficient number of credit references

[4] The MAPC Region includes the city of Boston and 100 neighboring cities and towns.

provided, unacceptable type of credit references provided, no credit file, limited credit experience, poor credit performance with the lender, delinquent past or present credit obligations with others, garnishment, attachment, foreclosure, repossession, collection action or judgment, bankruptcy).

Changes in the Mortgage Market

Since the issue of minority mortgage loan denials was initially raised in the early 1990s, there have been significant changes in the mortgage lending market in Massachusetts. In 2004, mortgage companies and out-of-state banks made 77.7 percent of all Boston home purchase loans, a substantial jump from less than one-quarter of all loans in the early 1990s. The biggest Boston banks, together with their affiliated mortgage companies, made just 8.5 percent of all loans in the city of Boston in 2004, down significantly from the approximately 40 percent share these banks maintained between 1992 and 1995. The market share of home purchase loans by other Massachusetts banks and credit unions was 13.7 percent in 2004, their lowest share ever. Lenders classified as subprime lenders made 11.3 percent of total home purchase loans in the city of Boston in 2004, up significantly from only four percent in 1998.

In the MAPC Region, Massachusetts banks and credit unions made only 23.2 percent of 2004 home purchase loans. All other loans were made by out-of-state banks or by mortgage companies not affiliated with Massachusetts banks. Subprime lenders accounted for 10.3 percent of total home purchase loans in the MAPC Region in 2004. Across the state, the Division of Banks currently licenses 1,611 mortgage lenders and brokers (1,049 mortgage brokers, 360 lender/brokers and 202 mortgage lenders). In 2000, the Division licensed approximately 645 lenders and brokers. The Division also regulates 267 banks and credit unions (166 banks and 101 credit unions). In January 2000, the Division regulated 312 banks and credit unions.

Despite their reduced market share, Massachusetts banks and credit unions – whose local lending is covered by the state and/or federal Community Reinvestment Act (CRA) – directed a substantially greater share of their total Boston loans in 2004 to all of the traditionally underserved borrowers and neighborhoods examined in *Changing Patterns* than did prime mortgage companies and out-of-state banks not covered by CRA. The MAPC Region saw a similar pattern: Massachusetts banks and credit unions devoted substantially greater shares of their loans in 2004 to black and Latino borrowers, to low- and moderate-income borrowers and to low- and moderate-income census tracts than did other prime lenders. [5] While the pattern of lending varies by type of lender, Massachusetts banks, credit unions, mortgage companies and out-of-state banks have similar denial rates and minority/white disparity ratios.

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[5] All data from *Changing Patterns XII.*

Increases in Loans to Minority Homebuyers

In the early 1990s, the largest Massachusetts banks made commitments to increase the number of mortgage loans to minority and lower-income households in Boston. MCBC's most recent report shows that, since 1990, there have been significant increases in the number of mortgage loans to black, Latino and Asian homebuyers in Boston:

	Number of Home Purchase Mortgage Loans			
Race of the Borrower	1990	1995	2000	2004
Black	287	880	708	850
Latino	91	303	463	611
Asian	100	269	381	518
Total of These Groups	478	1,452	1,552	1,979

The *Changing Patterns* report also shows other positive news:

- The share of Boston home purchase loans that went to Latino borrowers rose for the seventh consecutive year, reaching the highest level on record.
- The share of Boston home purchase loans that went to Asian borrowers rose for the fifth consecutive year, also reaching a new high.
- In the MAPC Region, black borrowers received more than their proportionate share of home purchase loans in almost half of the individual communities in the Region.
- Latino borrowers received more than their proportionate share of loans in the MAPC Region as a whole, where they constitute 4.7 percent of total households and received 5.8 percent of total loans.

However, despite these changes, the report also shows that there is still work to be done in Boston and the surrounding communities in certain segments of the minority community:

- Black households continue to receive far less than their proportionate share of home purchase loans. In the MAPC Region as a whole, blacks constitute 6.6 percent of total households, but received just 4.1 percent of loans in the last three years. In Boston, while blacks made up 21.4 percent of total households, they received just 11.4 percent of all loans in 2004, up from 11.0 percent in 2003 but far below the peak level of 20.8 percent reached in 1994.
- Latinos also continued to receive less than their proportionate share of loans in the city of Boston. While Latinos made up 10.8 percent of the city's households, they received 8.2 percent of the loans made in Boston in 2004.

In addition, mortgage lending to both blacks and Latinos was highly concentrated in a small number of communities in the MAPC Region.

FAIR LENDING TASK FORCE

Since early 2005, the Fair Lending Task Force met regularly to review statistical data and to collect and consider information from Task Force members and others that could provide helpful background information or suggest useful strategies and recommendations on this topic. The Task Force also invited a number of individuals to share information and their personal perspective on the denial rate issue with Task Force members. These included:

Dennis Corrigan, Fannie Mae
Colleen Duffy, Fannie Mae
Eric Ellman, Consumer Data Industry Association (CDIA)
Lisa Fiandaca, MassHousing
Catherine Jones, Massachusetts Division of Banks
Chris Koczella, Quinn and Morris, representing CDIA
Peter Milewski, MassHousing
Michael Williams, Mortgage Guaranty Insurance Corporation
Peter Zorn, Freddie Mac

The Task Force also reviewed results from prior fair lending initiatives and recommendations:

Massachusetts Bankers Association 1994 Fair Lending Initiative

In 1994, the Massachusetts Bankers Association (MBA) launched a Fair Lending Initiative to assist Massachusetts banks and other mortgage lenders in their efforts to assure that all prospective borrowers are treated fairly in the loan application process; that they are given equal encouragement and support in access to financing for home ownership; and that all relevant laws and regulations are strictly observed. The MBA Initiative included recommendations in eight areas:

Initiative A: Education and Recruitment of Minorities
Initiative B: Consumer Education
Initiative C: Lender Training in Compliance Obligations
Initiative D: Compensation Structures
Initiative E: Internal Review
Initiative F: Secondary Market for Non-Conforming Loans
Initiative G: Promoting the Use of Self-Evaluation Techniques

A full description of the Initiative, including a brief history of the project, is included in Appendix B.

MCBC 2004 Roundtable Discussion on Minority Mortgage Loan Denials

In March 2004, MCBC convened a Roundtable Discussion on minority mortgage loan denials. The discussion was prompted by the findings in *Changing Patterns X*, MCBC's annual report on mortgage lending patters in Greater Boston, which showed continuing high rates of minority denials and minority/white disparity ratios. The purpose of the discussion was to learn more about the reasons for denials and to identify strategies that could help to reduce those numbers. The discussion was attended by over 50 bankers, homebuyer counselors, representatives from community-based organizations, public officials, regulators and other interested parties. In June 2004, MCBC published a report entitled *A Look at Minority Mortgage Loan* Denials on the experience and findings of that meeting. A full copy of that report and its recommendations is available on MCBC's website at www.masscommunityandbanking.org.

2004 Fair Lending Summit

On June 23, 2004, the MBA, the Massachusetts Mortgage Bankers Association (MMBA) and the Massachusetts Mortgage Association (MMA) conducted a Fair Lending Summit to review the earlier Federal Reserve Bank of Boston mortgage lending study and the1994 Massachusetts Bankers Association Fair Lending Initiative and to share the findings from *Changing Patterns X* with the industry. The summit focused on successful strategies to increase lending to minority applicants and new initiatives to expand outreach to low- and moderate-income borrowers.

In 2005, the Task Force also conducted two additional projects designed to solicit input from both lenders and the broader community:

Industry Survey

In April 2005, the four industry trade associations represented on the Task Force – the MBA, the Massachusetts Credit Union League (MCUL), the MMA and the MMBA – distributed a member survey on loan products and underwriting and fair lending practices and procedures, developed by the Task Force, to their respective members. The purpose of the survey was, in part, to help evaluate the success of the recommendations that were part of the 1994 Massachusetts Bankers Association Fair Lending Initiative. The survey was also intended to capture information on other industry fair lending procedures, including effective models and best practices.

The survey was conducted anonymously, that is, the recorded information was not attributed to any individual institution but was used only to provide aggregated data on current industry patterns. The collected data was compiled and summarized for the Task Force by staff in the Community Affairs Department of the Federal Reserve Bank of Boston.

In total, 118 completed surveys were returned. The largest group of respondents was Massachusetts banks with 74 responses, accounting for 63% of the total. Credit unions, with 32 responses, were second at 27%. Ten independent mortgage companies responded, along with one non-Massachusetts bank/subsidiary/affiliate.

Institutions responding to the survey described numerous strategies to increase lending to targeted populations, including minorities, low- and moderate-income households and census tracts, immigrants and first-time homebuyers, including:

- Targeted loan products
- "Second Look" programs
- Credit assistance/homebuyer counseling
- Outreach to minority groups

Among these strategies, actions relating to fair lending policies and extensive lender training were considered most important and effective. Many institutions indicated that they offered home purchase products specifically designed for these targeted populations and many made efforts to avoid denial on any applications. Most institutions established a "second look" procedure to look at denials to see if an approval were possible. If not, the denial was often followed up with counseling, a counteroffer for a different product or a combination of both.

Outreach to targeted groups (either for recruiting employees or attracting customers) was mainly achieved through networks, such as referrals from current customers and staff and involvement in the community. Larger institutions had a greater number of products, internal systems and forms of outreach. All market areas had equal access to the same variety of products, mainly because the largest institutions generally operated statewide. Although large institutions made up a very small portion of the survey respondents, they accounted for a very large share of the total originations in the state.

Because the survey responses were not representative of the total industry, the Task Force has utilized the survey results with care. Some survey results on specific questions are noted in the next section of this report. Since those results came mostly from banks and since banks have been the focus of past fair lending initiatives and are subject to active state and federal regulatory oversight, their comments on fair lending policies and procedures were considered credible for purposes of this report.

A summary of the results of selected portions of the Task Force's industry survey is included in Appendix C.

Regional Meetings

In an attempt to solicit broad-based industry and community input, the Task Force held five meetings across the state:

September 28, 2005 at Roxbury Community College, Boston
October 12, 2005 at Middlesex Community College, Lowell
October 27, 2005 at Stonehill College, Easton
November 9, 2005 at Technical Community College, Springfield
November 18, 2005 at Clark University, Worcester

Participants at each of the regional meetings were asked to provide comments and recommendations on fair lending issues, including:

- Why are minority homebuyers denied more than white homebuyers?
- What can mortgage lenders do to reduce minority denial rates and minority/white disparity ratios?
- What kind of internal company programs are most successful in ensuring fair lending practices? In reducing minority denial rates?
- What role can local organizations play in helping to reduce minority denial rates?

Over 175 individuals, representing local mortgage lenders, homebuyer counseling organizations, housing and community development organizations, housing advocates, regional planning groups, community development agencies and others responded to the Task Force's invitation. Participants at the regional meeting shared their personal experiences, their individual perspective and their recommendations. The need for more financial and credit education and for increased public awareness about money management and other credit issues clearly dominated discussion at all of the regional meetings. Participants also offered comments on company policies and procedures, regulatory issues, race and local lending issues. Comments from all the meetings were recorded in written form and were used extensively in the drafting of the Task Force's findings and recommendations.

New Reports

This year, the Task Force took note of two new and important reports on mortgage lending:

- In March, MCBC published *Borrowing Trouble? VI: High-Cost Mortgage Lending in Greater Boston, 2004*[6] which documented concentrations of high-cost mortgage loans among members of minority groups and the neighborhoods in which they live.

[6] A full copy of the report is available on MCBC's website at www.masscommunityandbanking.org

- In May, the Fair Housing Center of Greater Boston released *The Gap Persists: Discrimination in Mortgage Lending*[7] which reported on a series of investigations conducted by the Center in 2005 and 2006 to determine the extent and nature of discrimination against African-America, Latino, Asian and Caribbean homebuyers seeking mortgagees in Boston. The Fair Housing Center used trained volunteers to call and visit banks and mortgage companies to record their experience. Overall, the Fair Housing Center found differences in treatment which disadvantaged homebuyers of color in nine of the 20, or 45 percent of matched-pair tests conducted.

Both reports helped to inform and frame the Task Force's deliberations and, in some cases, its recommendations.

[7] A full copy of the report is available on the Fair Housing Center's website at www.bostonfairhousing.org

COMPANY POLICIES AND PROCEDURES

All lending companies are responsible for ensuring hospitable, fair and equal treatment of all customers by all staff at every stage in the mortgage process:

- Equal in customer service and welcome
- Equal in the types and levels of information provided on mortgage procedures and products
- Equal in the nature and amount of staff support, assistance and advocacy both offered and provided
- Equal in the review and judgment on each mortgage application.

To meet this responsibility, lenders should establish clear company policies and procedures that define staff performance standards; provide written, on-going training; include compensation structures consistent with company policy and monitor staff behavior.[8]

COMPANY POLICY

Senior management determines and creates company culture and all senior managers have a responsibility to be explicit in their commitment to fair lending. Designation of a specific lead individual with responsibility for the company's fair lending performance may help to focus staff attention and to assign accountability. A strong written fair lending policy provides a clear statement of senior management standards and expectations for staff performance. Among lenders that responded to the Task Force's survey, 88 percent reported having a written fair lending policy. Respondents rated fair lending policies as the second most effective way to ensure fair lending practices.

> **Recommendation: All lenders, including banks, credit unions, and mortgage companies, should implement their management's commitment to fair lending by developing a strong, written fair lending policy and by providing explicit personal support for that policy and company fair lending programs from the highest levels of the organization.**

STAFF RECRUITMENT

While black, Latino and Asian buyers are among the fastest growing segments of the Massachusetts mortgage market, some minority group homebuyers are still intimidated by financial institutions. Reasons for this include real or perceived cultural and/or

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[8] See FDIC Compliance Examination Manual on Fair Lending, Paart III: H3-61, Compliance Management Analysis Checklist, for guidance on reviewing areas of lending practices and standards, training and application processing aids, standards for employees to follow, audit function and correcting discriminatory conduct, www.fdic.gov/regulations/compliance/manual/part3/p3-h3.pdf.

linguistic barriers, concerns regarding their credit history and/or their understanding of institutional mortgage lending standards and procedures. Among survey respondents, 46 percent reported no minority originators. The Task Force strongly believes that recruitment of minority group sales staff, originators and underwriters can help to expand penetration of minority group markets both by increasing the comfort level of minority homebuyers and by sensitizing other staff to the needs and concerns of minority group homebuyers.

The 1994 Massachusetts Bankers Association (MBA) Fair Lending Initiative included a recommendation to develop, promote and maintain a statewide career development program "to equip minority applicants with the technical knowledge necessary to qualify for positions in the mortgage lending industry." In 1994, the MBA and the Massachusetts Mortgage Bankers Association (MMBA) jointly established a career development program at Roxbury Community College. In 1995, similar programs were offered at Springfield Technical Community College, North Essex Community College and at the University of Massachusetts in Dartmouth. While none of these programs are still available, the MMBA currently offers educational programs for mortgage professionals.[9]

> **Recommendation: Lenders should expand recruitment of minority sales staff, originators and underwriters to more closely represent the market and communities they serve.**
>
> **Recommendation: Industry trade associations should identify and recommend training and education programs for minority group members to encourage and advance career development for various positions in the mortgage lending industry.**

STAFF TRAINING

Fair lending, compliance and diversity training for all sales staff and mortgage originators, underwriters and processors continue to play a key role in communicating standards for staff performance at all stages in the mortgage process and in ensuring equal levels of assistance to all homebuyers. Lenders responding to the Task Force's survey ranked lender training as the most effective way to ensure fair lending practices. While 84 percent of respondents require training on fair lending regulations, only 50 percent require diversity/sensitivity training and only 66 percent require training on the special needs of first-time homebuyers. Seventy-seven percent of respondents reported senior management attendance at staff training. Attendees at the Task Force's regional meetings also emphasized the importance of product training to ensure that every customer is offered the best mortgage product.

Fair lending, compliance and diversity training were all included in the recommendations of the 1995 Massachusetts Bankers Association Fair Lending Initiative and the 2004 recommendations of the Massachusetts Community & Banking Council (MCBC).

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[9] A list of courses is available at www.massmba.com/ed_programs.html.

Recommendation: Lenders should continue to ensure that all senior managers, sales staff, mortgage originators, underwriters and processors receive appropriate fair lending, compliance and diversity training at least annually.

Recommendation: Lenders should ensure that all sales staff and mortgage originators receive extensive product training on an on-going basis to ensure that they are able to provide borrowers the best mortgage product for which they qualify.

COMPENSATION STRUCTURES

Compensation structures can provide important incentives and/or disincentives for staff performance in serving specific markets and/or promoting certain products. Only 16 percent of lenders responding to the Task Force's survey reported that they provided financial incentives for lending to inner-city, low-income and/or first-time homebuyers. Lenders attending the Task Force's regional meetings testified that financial incentives can clearly help to compensate for the additional time required to adequately assist inexperienced homebuyers and homeowners, those with credit or other problems and to process certain loan products. Such incentives may also serve to increase awareness of the variety of available mortgage products. Some community representatives commented that financial institutions that introduced compensation incentives saw an increase in lending to first-time, low- and moderate-income homebuyers.

Recommendations calling for company review of compensation structures were included in the 1994 Massachusetts Bankers Association Fair Lending Initiative and MCBC's 2004 report.

Recommendation: Lenders should review company compensation structures to ensure that loan production staff are encouraged to recommend a wide variety of mortgage products and/or to serve lower-income or first-time homebuyers.[10]

SECOND LOOK PROCEDURES

Among lenders that responded to the Task Force's survey, 91 percent reported having a formal internal review or second look process for denied loans. However, only a small

[10] Referring to the issue of racial patterns in the pricing of home mortgages, Federal Reserve Governor Mark W. Olson said "Most mortgage lenders have stated policies that they do not discriminate against any prohibited class of borrowers. It is the role of the CEO and senior management to ensure that procedures and controls throughout the organization support those policies. Start by evaluating compensation arrangements for your loan originators." (Consumer Bankers Association 2005 Fair Lending Conference, Arlington, Virginia, November 7, 2005)

number of lenders currently track the performance of their second look procedures to ensure that the process is effective and to identify potential problem areas. In the Task Force's survey, only 22 percent of respondents track loan denials by race and only nine percent by loan production staff and only 27 percent conducted a regular review of marginal approvals and denials to test for disparate treatment.

The review and assessment of current second look procedures were included in the 1994 Massachusetts Bankers Association Fair Lending Initiative and MCBC's 2004 recommendations. Much has changed since 1994 in the mortgage business, including the growing use of automated underwriting systems and credit scores in the mortgage approval process and the expanding role of third-party brokers in originating loans. In this context, the definition of and the need for improved second review procedures are critical to most lenders' loan policies.

Second review procedures should not simply provide for the review of loans that are denied. Automated underwriting and credit scoring systems do not approve and decline loans. At the margin, there needs to be a review of overrides - both "high-side" and "low-side"- to ensure that there are no inconsistent practices that might result in disparate treatment of loan applicants. Similarly, counter-offers, the use of credit scores and debt-to-income ratios need to be reviewed for consistency in equal treatment of applicants. Documentation of the results of such second review procedures and results are necessary in today's lending environment.

Information on specific second look procedures is often difficult to find. At the same time, not all second look procedures are appropriate for all lenders. The Task Force recommends that lenders review two separate series of articles on credit scoring and fair mortgage lending published in 2001 and 2002 by the Federal Reserve Bank of San Francisco and the Federal Reserve Bank of Boston:

- The Federal Reserve Bank of San Francisco published a five part series that provides for a "variety of perspectives on the credit scoring process and identifies areas where the use of credit scores may create disparities in the home mortgage process. The first four installments in the series address aspects of the use of credit scores and fair lending concerns, including the maintenance of scoring models, the use of third-party brokers, and the provision of assistance in the credit application process. The final installment addresses the use of counteroffers, overrides and second reviews of credit scored decisions."[11]

- The Federal Reserve Bank of Boston published a five part series entitled: "Perspectives on Credit Scoring and Fair Lending." This series includes articles on "Credit Scoring and Fair Lending" (Winter, 2001), "A Number or a Person" (Spring, 2002) "Mortgage Scoring and the Myth of Overrides (Fall, 2002) and "Lenders and Third Party Brokers" (Winter 2002)[12]

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[11] www.frbsf.org/publications/community/investments/0303/article1pf.html

[12] www.bos.frb.org/commdev/c&b/c&bback.htm

The Task Force believes that these series bring into better focus the changes that have taken place in the mortgage approval process in the last few years and provide a framework for lenders to review their second look policies and procedures. The Task Force has also concluded that it would be helpful for trade associations to assist lenders by identifying specific second look procedures, the rationale for their use and how they might be adopted by companies of various sizes and capacities.

> **Recommendation: Industry trade associations should develop "best practices" for second look procedures, including tracking and analysis.**

SELF-TESTING

Mystery shopping and other self-testing programs are the only way to survey actual staff behavior. Among lenders responding to the Task Force's survey, only 23 percent conducted mystery shopping of branches and only 12 percent conducted mystery shopping of mortgage originators. Many of these mystery shopping programs are limited to overall customer service and do not address potential racial/ethnic disparities. Some lenders participating in the Task Force's regional meetings expressed reluctance to establish or expand self-testing on disparate treatment because of cost and/or regulatory concerns.

The 1994 Massachusetts Bankers Association Fair Lending Initiative included a recommendation to promote the use of self-testing.

The FDIC publication, *Side by Side*, provides lenders with a guide to fair lending, including suggestions on creating self-assessment testing programs.[13] The publication was amended in 1996 to reflect the FDIC's new policy on an institution's rights regarding the sharing of self-testing results. Under that policy, examiners no longer ask to review the results of self-testing but will consider the results when institutions voluntarily provide them.[14] The Federal Reserve Bank, the Office of the Comptroller of the Currency, the Office of Thrift Supervision and other federal regulators have similar policies, as does the Massachusetts Division of Banks. To ensure full compliance and to protect their self-testing privileges, lenders are advised to seek legal counsel in the development and implementation of any self-testing program and any follow-up actions.

Information on specific self-testing programs is often difficult to find. The Task Force has concluded that it would be helpful for trade associations to assist their members by identifying a variety of self-testing models.

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[13] Available at www.fdic.gov/regulations/resources/side/

[14] See FDIC Compliance Examination Manual on Fair Lending, review of Fair Lending Internal/External Audit Reports, www.fdic.gov/regulations/compliance/manual/part3/p3-a.pdf

Recommendation: Industry trade associations should identify models for racial/ethnic self-testing and mystery shopping.

Recommendation: Lenders should use these "best practices" and models to assess the adequacy of current company procedures and to develop and/or improve internal policies and procedures.

MORTGAGE BROKERS

Many financial institutions and mortgage lenders use mortgage brokers to expand their market area. Lenders need to consider how their mortgage brokers comply with fair lending laws. The duty of fair housing and fair lending is non-delegable. Lenders who knowingly work with non-compliant brokers and take no action may face substantial legal and regulatory risk.

HUD regulations permit mortgage brokers to pull customer credit reports prior to application as part of the brokers' counseling services. However, brokers are not permitted to use those credit reports to essentially make a credit decision, e.g. telling a customer that his/her application would not be approved. Mortgage brokers that act as lenders are in violation of state regulations. Mortgage lenders that utilize mortgage brokers are responsible for the activity of those brokers acting on their behalf. The Federal Reserve Bank of Boston's publication, *Closing the Gap, A Guide to Equal Opportunity Lending*, provides guidance on working with mortgage brokers in the lending process.[15] For further information on lender responsibilities regarding mortgage brokers, the Task Force recommends that lenders review the articles on third-party brokers included in the Federal Reserve Bank of San Francisco's and the Federal Reserve Bank of Boston's series referenced below.[16]

Recommendation: Lenders should establish and enforce a rigorous review system to ensure that all mortgage brokers act in strict accordance with the company's fair lending policies and procedures.[17]

[15] Available at www.bos.frb.org/commdev/commaff/closingt.pdf

[16] See www.frbsf.org/publication/community/investments/0303/artcle3.html and www.bos.frb.org/commdev/c&b/2002/winter/winter02.pdf.

[17] Referring to the issue of loan pricing discrimination, Federal Reserve Governor Olson counseled financial institution to "ask whether your institution performs adequate due diligence and regular testing of its broker channels to verify that third parties are acting in accordance with your policies." (Consumer Bankers Association 2005 Fair Lending Conference, Arlington, Virginia, November 7, 2005)

TOOLS:

Company Policies and Procedures:

Massachusetts Division of Banks Regulatory Bulletin 2.3-101, Community Reinvestment and Fair Lending Policy (www.state.ma.us/dob)

Second Look Procedures:

Perspectives on Credit Scoring and Fair Mortgage Lending, Federal Reserve Bank of San Francisco (www.frbsf.org/publications/community/investments/0303/article1pf.html)

Perspectives on Credit Scoring and Fair Lending, Federal Reserve Bank of Boston (www.bos.frb.org/commdev/c&b/c&breseearch.htm#Credit)

Self-Testing:

Fair Housing Center of Greater Boston testing programs. Contact David Harris, Executive Director, at 617 399-0491, ext. 101.

FDIC Compliance Examination Manual on Fair Lending, review of Fair Lending Internal/External Audit Reports (www.fdic.gov/regualtions/compliance/manual/part3/p3-a.pdf)

Third Party/Mortgage Brokers:

Closing the Gap, Federal Reserve Bank of Boston (www.bos.frb.org/commdev/commaff/closingt.pdf)

Perspectives on Credit Scoring and Fair Mortgage Lending, Federal Reserve Bank of San Francisco (www.frbsf.org/publication/community/investments/0303/article3.html)

Perspectives on Credit Scoring and Fair Lending, Federal Reserve Bank of Boston (www.bos.frb.org/commdev/c&b/2002/winter/winter02.pdf)

SECONDARY MARKET

FANNIE MAE AND FREDDIE MAC

The secondary mortgage market plays an important role in establishing standards for mortgage approvals and in offering lenders a variety of mortgage products to meet their customers' needs, including special products to better serve minority and emerging markets homebuyers. At the time of the 1992 Federal Reserve Bank of Boston survey of mortgage denials, mortgage underwriting was essentially a manual process. Over the past several years automated underwriting systems (AUS) have become the tool of choice. Most importantly, they also have been found to more readily approve underserved applicants in comparison to other applicants.[18]

As part of its deliberations, the Fair Lending Task Force met with representatives of both Fannie Mae and Freddie Mac (the GSEs[19]). The Task Force was interested in the actual experience with AUS (Freddie Mac's Loan Prospector and Fannie Mae's Desktop Underwriter and Desktop Originator) as well as in specific efforts that the GSEs undertake to ensure fair lending. In summary, the GSEs found:

- Automated underwriting provides substantial benefits to consumers in that more people are approved for a loan under AUS than manual underwriting.

- AUS are more predictive of risk and default than manual underwriting.

- More loans are approved by AUS than manual underwriters and, as their models are continuously updated, they continue to expand their approval rate of applicants at the margin.

- Overall, higher approval rates have resulted, particularly for underserved applicants.

Questions of concern to the Fair Lending Task Force centered primarily on the issue of whether the AUS models themselves helped or hurt minority applicants. This is a difficult question to answer due to the lack of transparency of the AUS models. Does the fact that the models rely on historic data perpetuate any inequities that might have existed? When the models were developed, were there sufficient data on minority populations used in the initial development of these models?

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[18] Franklin Raines, former Chairman and CEO of Fannie Mae, said: "Automated underwriting reduces the human factor that can lead to differential treatment. It is the antidote to the Boston Fed study. Not only because the computer is color blind, so it cannot know the applicant's race, cannot hear his accent, and does not know what neighborhood he is from. More than that, the computer takes the load off the human underwriter." (June 8, 2000)

[19] Fannie Mae and Freddie Mac are both government-sponsored enterprises, or GSEs.

Through its discussion, the Task Force was able to confirm the following:

- Both GSEs invest considerable resources in assuring their models do not have the unintended consequence of discrimination. Proposed changes to the AUS models are tested for unintended discrimination and the results are monitored on an on-going basis.

- Both GSEs have concluded that the "accuracy" of the loan decision is better for AUS loans than those loans approved by manual underwriting.

- The implementation of AUS with the more "accurate" risk predictors has enabled the GSEs to develop more flexible loan products, particularly for underserved borrowers.

Notwithstanding the positives, both Fannie Mae and Freddie Mac conclude from their on-going experience that underserved borrowers are still less likely to be approved for a loan. In a report entitled "Automated Underwriting in Mortgage Lending: Good News for the Underserved," the authors wrote:

"…despite these positive developments in mortgage lending, underserved borrowers are still less likely to be approved for a loan. This differential mirrors broader social inequities in financial capacity and credit, which are key variables in both automated and manual underwriting. The challenge for the mortgage industry is to expand homeownership opportunities by reducing the differential credit effect for low income and minority borrowers." [20]

And, in his June 8, 2000 speech, Franklin Raines stated:

"So if automated underwriting can bring us all these good things – if it fights discrimination and expands loan approvals – why is there still an approval gap? Why doesn't a racially neutral system approve equally for all races? That brings us to the issue of differential impact – the question of how technology works. What does it look at? How does it make decisions? Is there anything tilted against minorities? ... And when the computer approves whites and minorities at different rates, people have a right to be a little agitated about what is going on."

It became clear to the Fair Lending Task Force that the issue of fair lending is front and center in the on-going evaluation of the Fannie Mae and Freddie Mac AUS models. Both GSEs acknowledged disparity in the decisions among underserved and minority applicants, despite the fact that the approval of many more loans to these groups has been a direct result of AUS. To eliminate this "differential credit effect" the above referenced 2002 report concluded that four key issues need to be addressed:

- Unbanked consumers – "Because AUS models rely on records established through traditional banking relationships, potential home buyers who lack these relationships are at a distinct disadvantage. Policy makers, regulators, and lenders must continue to explore ways to increase accessibility to financial services."

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[20] Susan Wharton Gates, Vanessa Gail Perry and Peter M. Zorn in Housing Policy Debate; Volume 13, Issue 2; Fannie Mae Foundation 2002.

- Financial literacy – "To achieve financial stability in our increasingly cashless society, consumers need to become familiar with information about credit and accumulation of wealth. Not all consumers obtain this information from reliable sources, potentially producing differences in its use."

- Home buyer education – "More mortgage programs require home buyer education. The basic premise is that borrowers who better understand how to obtain and maintain a mortgage are less likely to default. …there is some support for this premise in an empirical examination of the effect of home buyer education on credit risk. These results have profound implications for developing credit scoring models and for expanding home ownership opportunities."

- Digital divide – "To expand markets further, refinements in mortgage risk assessment must be accompanied by a greater focus by the mortgage industry on technological and informational disparities."

Fannie Mae has emphasized that any AUS model should (1) be consumer friendly in that, if there is something wrong with an applicant's credit, the problem is clear so he/she has a chance to correct it; (2) be transparent so it is understood what factors are used by the model; and (3) actually expand lending.

The Fair Lending Task Force acknowledges and commends both Freddie Mac and Fannie Mae for the great strides made in bringing more homeownership opportunities to low and moderate income home buyers. Despite this, the GSEs and the lending industry need to continue to focus more intensely on borrowers with non-traditional credit or no credit, and on how to incorporate risk factors associated with these credit profiles in the AUS models. The GSEs should continue to aggressively monitor, evaluate, and report on the decisions produced by their respective AUS models, particularly as they relate to measuring disparity in the approvals for minority applicants. The GSEs should be obligated to all lenders to report on any disparity so progress can be measured.

Many lenders have implemented automated underwriting. In fact, most, if not all third party mortgage brokers are mandated to use automated underwriting by their investors. Lenders who are currently using manual underwriting may want to consider the implementation of automated underwriting, given that there is evidence that more borrowers can be approved using these systems. Such use may also ensure greater consistency in underwriting decisions. This is not to suggest that manual underwriting should be eliminated – in fact, feedback at the Task Force's regional meetings indicated that many loans that are not approved by automated underwriting are approved by the use of manual underwriting through the evaluation of factors not necessarily captured in the models such as non-traditional credit.

It is important to note that automated underwriting models are not limited to Fannie Mae and Freddie Mac. Several other secondary market investors currently utilize AUS models. The Task Force did not meet with other secondary market investors regarding their use of such models.

Most respondents to the Task Force's industry survey reported using a mixture of automated and manual underwriting. About three-quarters of institutions used automated underwriting and nearly all used manual underwriting. Among institutions with data on both automated and manual underwriting, at least five percent ran all loans through both processes. About 22 percent ran all loans initially through automated underwriting and then followed with manual review for some loans, e.g. any loan denied by automated underwriting. Any use of automated underwriting was closely related to institution size, with 90 percent of the largest lenders reported using automated underwriting. There was no difference by institution type.

Recommendation: Lenders who are not currently using automated underwriting should consider implementing automated underwriting.

Recommendation: Even with the implementation of automated underwriting, manual underwriting should continue to be a part of most lenders' loan approval process since it is acknowledged that not all relevant factors are captured in the automated models that might result in a loan approval. Lenders should consider developing standards for how and when to utilize manual underwriting.

In addition, the Task Force also recommends:

- *Fannie Mae and Freddie Mac should continue to provide and promote flexible mortgage products to meet the needs of underserved populations.*
- *Fannie Mae and Freddie Mac should continue to expand their internal review of automated underwriting to test for fair lending.*
- *Fannie Mae and Freddie Mac should continue to communicate with lenders on changes to the AUS models and the potential impact of those changes on lender activity.*

MASSHOUSING

MassHousing products also provide an opportunity for lenders to serve traditionally underserved markets. MassHousing has launched a successful marketing program to promote MassHousing lenders to minority communities and the agency continues to demonstrate low minority group denial rates and disparity ratios. Approximately 25 percent of total MassHousing loans and 30 percent of insured loans are from minority homebuyers. MassHousing's minority group denial rate is five percent as compared to a denial rate of four percent for white applicants.

MassHousing reported to the Task Force that its denial rates were attributed in part to the fact that MassHousing focuses on first-time homebuyers and low or no down payment programs. MassHousing programs, however, do not serve borrowers with lower credit scores. As a secondary market investor, MassHousing issues loan program guidelines to the primary lender and, as a result, loans are essentially pre-qualified. Loans that do not meet their guidelines simply are not submitted to MassHousing. Some attendees at the Task Force's regional meetings suggested that the development of a risk-based pricing program could help to serve less-qualified applicants and, perhaps, reduce denial rates.[21]

MassHousing representatives acknowledged that it is a challenge to identify reasons for disparity and emphasize that, for the agency, sustainable homeownership is the most important issue. The MassHousing representative recommended the following action steps to increase lending to minority group members:

- Target marketing to specific minority populations
- Change the racial composition of origination staff to include more minority and bi-lingual staff
- Develop specific products to meet the needs of targeted populations
- Develop more risk-based pricing credit enhancements.

Recommendation: Lenders should more fully utilize MassHousing programs to better serve minority group and first-time homebuyers.

[21] Risk-based pricing or tiered rate lending allows the lender to charge different rates for different levels of risk identified in the evaluation of the credit application. It is the process of trying to match the expected risk of a loan with an appropriate interest rate that reflects this risk. For example, self-employed borrowers might have a different risk assessment than salaried employees; the risk of a loan-to-value ratio of 90 percent might be assessed a different risk level than a similar loan with a 60 percent loan-to-value; a credit score of 620 might be assessed a different risk level than a score of 750. Using a risk-based pricing approach, the lender assigns a value (cost) to these risk assessments and adds (or subtracts) from a base model in arriving at a final cost of the credit to the borrower.

TOOLS:

Fannie Mae (www.efanniemae.com)

- Business to business website for lending partners
- Home Counselor On-Line (www.efanniemae.com/is/hcounselors)
  - Provides housing counselors with technology tools to better manage counseling case loads
  - Increases business productivity and efficiency
  - Helps more clients achieve and maintain homeownership

Freddie Mac (www.freddiemac.com/learn/counselor)

- The Learning Center - CounselorMax training programs created by housing counselors for housing counselors with the vision of creating a more empowered home counseling industry.

MassHousing (www.emasshousing.com)

- Provides resources to lenders to do business with MassHousing

REGULATORY ISSUES

Most Task Force members and participants in the regional meetings believe that regulatory standards, guidance and oversight continue to be a critical component in improving fair lending performance. Some lenders report that regulations are open to interpretation, leading to differences in lender performance and reporting. While critical to assessing lender performance, HMDA data are incomplete and, in some cases, may be misleading. It is important to note that, for the first time, non-bank mortgage lenders in Massachusetts are now subject to new fair lending audits by the Division of Banks and, as a result, additional attention will be focused in this area.

HMDA DATA

To consider the reasons for high minority group denial rates, the Task Force reviewed Home Mortgage Disclosure Act (HMDA) data and, in particular, reported "Reasons for Denial." Only institutions regulated by the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) are required to provide "Reasons for Denial" in HMDA reports. For lenders regulated by other agencies - the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Bank (Federal Reserve), the Federal Trade Commission (FTC), the National Credit Union Administration (NCUA) and the U.S. Department of Housing and Urban Development (HUD) - the reporting of "Reasons for Denial" in the HMDA reports is totally voluntary. The Task Force found that in 2003, 33.1 percent of all denials and 49.5 percent of denials by independent mortgage companies included no reasons for denial. In testimony at the Task Force's regional meetings, lenders also had differences of opinion on the appropriate "Reason for Denial" for a specific loan. The lack of reported data and the potential for inconsistencies in the way the data are reported are significant barriers to lenders and others looking for clear information on why mortgage applicants are denied.

In 2004, the Federal Financial Institutions Examination Council (FFIEC) published a revised version of *Getting it Right*, a guide for lenders on how to report HMDA data.[22] *Getting it Right* provides guidance that should be considered in reporting action taken on a mortgage application and includes additional information on appropriate reporting of "Reasons for Denial."

> **Recommendation: All mortgage lenders doing business in Massachusetts are encouraged to report "Reasons for Denial" on their HMDA reports.**

> **Recommendation: All mortgage lenders doing business in Massachusetts should provide adequate training for all HMDA reporters on the correct reporting of "Reasons for Denial."**

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[22] Available at www.ffiec.gov/hmda/guide.htm

In addition, the Task Force strongly encourages all regulatory agencies to require all mortgage lenders to include "Reasons for Denial" in their HMDA reports.

While current HMDA data can be valuable in analyzing mortgage lending patterns and the performance of certain lenders, the data are limited by the exclusion of specific information on credit scores, debt-to-income ratios and other information that could provide further insight into denial rates. Traditionally, bank and mortgage trade associations have opposed any regulatory proposal for more HMDA data as an additional regulatory burden, particularly for smaller lenders, and for reasons of privacy (e.g. in cases where there is only one loan by a lender in a particular census tract). However, many of these same lenders agree that having that information would help to provide answers to many questions of lending disparities.

> **Recommendation: Industry leaders should reconsider their opposition to expanding HMDA data by adding information such as data on borrower/applicant credit (provided in a way that does not compromise the privacy of individual borrowers); data on loans-to-value ratios; and data on pricing – for all loans, rather than just on higher-cost loans – that includes information on fees as well as on the interest rate and that identifies loans as fixed-rate or adjustable-rate.**

MORTGAGE APPLICATIONS

Some lenders at the Task Force's regional meetings had differences of opinion on when a mortgage application is opened, when an application is denied and the treatment of counteroffers. They also noted that while mortgage brokers are authorized to pull a credit report prior to application, mortgage lenders are not.

The HMDA publication, *Getting it Right,* provides lenders with guidance on what constitutes an application, when it is considered opened for HMDA reporting purposes, how to handle counteroffers for reporting purposes if they are accepted or not and what constitutes a denial. *Getting it Right* also provides guidance to lenders on what activities constitute "making a credit decision." Pulling a credit report on an applicant is considered part of the application process since it allows the lending institution to make a credit decision. Requiring that a credit report be pulled before an application is received can present barriers to application or have other impacts that create disparate treatment and would be considered a discouragement to the application process. There does not appear to be explicit guidance on a lending institution recommending that potential applicants prepare for the application process by pulling their own credit reports.

The FDIC also offers guidance to lenders in its publication, *Mortgage Loan Prequalifications: Applications or Not.*[23] The publication provides guidance and case studies on the regulations and various application practices to determine what actually constitutes an application, including when pre-qualification or pre-approval practices may constitute an application for reporting purposes.

Recommendation: All mortgage lenders, including banks, credit unions, and mortgage companies, doing business in Massachusetts should provide adequate training to all staff on the appropriate handling of mortgage applications and denials.

Recommendation: Lenders should work with regulators to develop a checklist or Q&A to help customers identify credit and/or debt issues prior to application.

SELF-TESTING

Self-testing can be an effective way for lenders to survey staff behavior and identify potential problem areas. However, some lenders participating in the Task Force's regional meetings expressed reluctance to establish or expand self-testing programs on disparate treatment because of regulatory and/or legal concerns.

The FDIC publication, *Side by Side,* provides lenders with a guide to fair lending, including suggestions on creating self-assessment testing programs.[24] The publication was amended in 1996 to reflect the FDIC's new policy on an institution's rights regarding the sharing of self-testing results. Under that policy, examiners may no longer ask to review the results of self-testing but will consider the results when institutions voluntarily provide them.[25] The Federal Reserve, the OCC, the OTS, and the NCUA have similar policies. Massachusetts law[26] also provides self-testing privileges although with different procedures and a slightly broader scope.

The Task Force strongly recommends that all bank regulators clearly communicate these policies to their respective lending institutions and encourage those institutions to utilize self-testing to monitor staff behavior and to identify potential problem areas.

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[23] Available at www.fdic.gov/regulations/compliance/mortgage/preq2.pdf ; also cross-referenced in NCUA Regulatory Alert 97-RA-9, June 1997.

[24] Available at www.fdic.gov/regulations/resources/side/

[25] See FDIC Compliance Examination Manual on Fair Lending, review of Fair Lending Internal/External Audit Reports, www.fdic.gov/regulations/compliance/manual/part3/p3-a.pdf

[26] See M.G.L./ c. 176, sections 49-51

CONSUMER DISCLOSURES

Participants in the Task Force's regional meeting reported that many prospective homebuyers are confused by the mortgage process – confused by the language, confused by the process and, if something goes wrong, confused about what specific state or federal agency to go to for help. Speakers voiced concerns in two specific areas.

First, they said that, while there are lots of disclosures for both credit cards and mortgage loans, they often fade into a blur of fine print. They suggested that information needs to be prioritized and written in plain English. Current disclosure requirements are the result of different government regulations. Many are covered under the Federal Reserve's Truth in Lending regulation and others under HUD's RESPA regulations.

The Task Force strongly recommends that regulators take steps to ensure that all mortgage lenders provide consumers with adequate and easily understood disclosures on all credit card and home mortgage products.

Second, the speakers said that consumers should be provided with information on which federal and state regulators govern which lenders and brokers, what information is available from those regulators and where to find it.

The Equal Credit Opportunity Act (ECOA) establishes requirements for lenders to post information listing their regulator(s) in their place of business. In addition, ECOA (Reg B) governs the handling of declinations and the information that must be provided to the consumer, including a notice of the primary regulator. The posting requirement may be problematic in the case of mortgage brokers who conduct business away from their offices. The Massachusetts Division of Banks lists all of the lenders that are licensed by the state.[27]

The Task Force urges state agencies, including the Department of Consumer Affairs and Business Regulation, the Division of Banks and the Attorney General's Office; community organizations and homebuyer counseling organizations to take steps to provide consumers with easily accessible information on which federal and state regulators govern which lenders and brokers, what information is available from those regulators and where to find it.

[27] A list of licensees is available as an Online Service ("Find a Licensee") on the Division of Bank's website at www.mass.gov/consumer (select Division of Banks). The statute (G.L. 255E) provides an exemption from licensing for certain entities including mortgage subsidiaries of federally- and state-chartered banks. If an entity does not appear on the Division's list, individuals can contact the Division's consumer assistance unit at 1-800-495-2265 to find out if an entity is licensed or exempt from licensing.

REGULATORY EXAMINATIONS

Regulatory standards, guidance and oversight are critical in improving lender performance. This is particularly important in the case of non-bank lenders in Massachusetts now subject to new fair lending audits by the Division of Banks.[28]

The Task Force strongly recommends:

- *That the Division of Banks provide mortgage companies with feedback on the first series of new fair lending audits*
- *That adequate state funding be provided to ensure that staff resources at the Division of Banks are sufficient to fully enforce all current laws and regulations for all lenders.*

TOOLS:

HMDA Data:

Getting it Right, Federal Deposit Insurance Corporation (www.ffiec.gov/hmda/guide.htm)

Mortgage Applications:

Mortgage Loan Prequalifications: Application or Not, Federal Deposit Insurance Corporation (www.fdic.gov/regualtions/compliance/mortgage/preq2.pdf)

Self-Testing:

FDIC Compliance Examination Manual on Fair Lending, review of Fair Lending Internal/External Audit Reports
(www.fdic.gov/regualtions/compliance/manual/part3/p3-a.pdf)

[28] Chapter 268 of the Acts of 2004 amended Section 8 of the General Laws Chapter 255E to allow the Division to conduct fair lending examinations for any mortgage lender that made 50 or more home mortgage loans in the previous calendar year.

CONSUMER EDUCATION

There continues to be a need for more - and more effective - financial, credit and homebuyer and homeowner education for people at all age and income levels. Good financial management skills, like other life skills, need to be taught to all segments of the population.

At all of the Task Force's regional meetings, the issue of consumer education dominated the discussion. Mortgage lenders advocated for more education to better prepare homebuyers and as one way to help to reduce denial rates. Bankers and credit union officials supported more education as the key to creating better informed customers. Community representatives argued for more education to help local residents avoid high-cost loans, retain and build personal wealth and protect their housing investments. All interested parties advocated for broad-based support for financial education, including from schools, employers, churches, and community-based organizations and lenders.

Among Massachusetts homebuyers, credit and high debt-to-income ratios are the primary reasons for denial of mortgage loans. Speakers at the Task Force's meetings agreed that minority group homebuyers and homeowners are often at a disadvantage in the mortgage process, not just because of less generational wealth, fewer assets and historic patterns of social and economic discrimination, but because they often lack the information and assistance available to white borrowers from experienced families and friends. They see education as the key to bridging this knowledge gap and to providing those potential borrowers with the tools and assistance they need to successfully navigate the mortgage approval process.

FINANCIAL EDUCATION

Most people do not appreciate the need for financial education to effectively and wisely manage their household budget or business finances. Many people need help in learning to balance a checkbook, to establish a budget, to save for a major purchase, to plan for educational expenses or retirement and to make sound choices about financial products. While there are many financial education programs available – through community-based organizations, lenders, government agencies and credit bureaus, in local classes and on the Internet - they are generally underutilized, unconnected and unfamiliar to the general public. Many people are not attracted to and/or embarrassed by programs labeled financial "literacy." Others are unwilling to talk about personal finances in group settings. Attendees at the Task Force's regional meetings commented that, while homebuyer counseling programs often provide incentives for attendance (e.g. down payment assistance and qualification for special loan programs), many people do not see the direct benefits of taking time to attend stand-alone financial education programs. Some speakers at the Task Force's regional meetings suggested that financial fitness be promoted the way we promote physical fitness, as a smart thing to do.

Financial education should begin at a young age and should be provided to all students. Attendees at all of the Task Force's regional meetings emphasized that academic achievement alone does not prepare students for the real life situations they will face in managing money and credit. However, not all parents are knowledgeable enough about financial management and/or credit to provide education and guidance to their children. Many financial institutions have found it difficult to provide financial education in the public schools due to staffing issues and time constraints imposed by MCAS testing. Volunteer education programs are not sufficient to reach all students or to ensure quality financial education.

To be effective and to reach the broadest number of people, financial education needs to be provided where people live, work and learn and needs to be marketed as an important life skill.

> **Recommendation: Lenders, financial service providers, credit card companies and credit bureaus should partner with government, non-profits, community-based agencies, minority organizations and other local businesses to provide financial education.**

The entire community has a stake in ensuring that youth and other local residents have access to sound, comprehensive financial education. Therefore, the Task Force also strongly believes that:

- *The state should make effective financial education mandatory in all public schools.*

- *Colleges and universities should provide financial education to all in-coming students. Student programs should place special emphasis on the proper use of credit.*

- *Companies employing large numbers of youth should be encouraged to provide financial education at work.*

- *Community-based youth programs should provide and expand financial education programs.*

- *Adult education, English as a Second Language (ESL) and immigrant programs should incorporate financial education into their life skills programs.*

- *Financial education, credit counseling, homebuyer counseling, Individual Development Account (IDA) and other programs should increase coordination to serve a greater number of people more effectively.*

CREDIT EDUCATION

While poor credit and excessive debt are the primary reasons for mortgage denials, most homebuyers do not presently understand credit reports and/or credit scoring. For those at all income levels, a good credit score has become a critical factor in many areas of daily life including getting a job, qualifying for home and car insurance, renting an apartment and qualifying for loans.

Attendees at the Task Force's regional meeting reported that homebuyers are often fearful about their credit reports and that most do not obtain their credit reports before applying for a loan and that, of those who do, many do not understand the contents of the report and/or their implications. While all of the homebuyer counseling programs that are certified by the Massachusetts Homeownership Collaborative (see next section) include general information on credit as part of their pre-purchase homebuyer counseling curriculums, many homebuyer counselors are not fully educated on the mechanics of how credit scoring works or equipped (or funded) to provide longer-term, one-on-one credit counseling. Additionally, many lenders, homebuyer counselors and consumers are confused by what appears to be constant changes in the factors used to calculate credit scores.

> **Recommendation: Lenders should strongly encourage all homebuyers to obtain their credit reports and credit scores, to check the reports for accuracy, to take advantage of brochures and other information available on credit reports and credit scores to better understand the contents of their credit reports and, if necessary, to utilize credit assistance programs to correct errors and/or improve their credit scores.[29]**

In addition, the Task Force believes that:

- *Community organizations and homebuyer counselors should also strongly encourage all homebuyers to obtain their credit reports and credit scores, to check the report for accuracy, to take advantage of information on credit reports and credit scores to better understand the contents of their credit reports and, if necessary to utilize credit assistance programs to correct errors and/or improve their credit scores.*

- *Credit scoring and credit reporting agencies should improve communication with lenders, homebuyer counselors and consumer on the factors used to calculate credit scores and the impact of credit scores on the availability and cost of credit.*

- *All of the major credit bureaus should increase consumer access to basic information on what individuals can do to increase their scores.*

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[29] Lenders are cautioned that asking applicants to get their credit reports before applying for a loan could be construed as discouraging an application. Any appearance that a lender is discouraging applicants of a certain class, e.g. making the suggestion only to low-income and/or minority applicants, may have fair lending implications.

- *Local media outlets, community-based organizations and community leaders should take a lead role in alerting local residents to the risks and costs of certain credit products and in promoting the responsible use of credit.*

HOMEBUYER EDUCATION

In 1996, Citizens' Housing and Planning Association launched an initiative called the Massachusetts Homeownership Collaborative to promote an on-going dialogue among lenders, real estate professionals, homebuyer counselors, government officials and others supporting homebuyer education. The Collaborative has provided professional training, standardized curriculum and certification to 58 agencies in Massachusetts that provide pre-purchase, first-time homebuyer education. While the Collaborative has played a key role in ensuring effective education in Massachusetts, many of these programs are targeted to low- and moderate-income homebuyers and only reach a small percentage of homebuyers across the Commonwealth.

MCBC's reports have consistently shown that racial disparities in denial rates are not explained by lower incomes. In 2004 in the city of Boston, black borrowers in the highest income category (incomes above $150,000) had a denial rate of 26.8 percent, triple the denial rate experienced by their white counterparts; the 21.7 percent denial rate for Latinos with incomes above $150,000 was almost two and one-half times greater than the white rate of 8.9 percent. In general, black/white and Latino/white denial rate ratios were greater for higher income levels than they were for lower income levels.[30]

However, most higher-income minority homebuyers do not attend homebuyer counseling but depend on advice from family, friends, lenders, brokers and other trusted advisors, many of whom do not always provide the most knowledgeable advice or do not have a familiarity with a wide range of mortgage products. White homebuyers often have an advantage in the mortgage process, such as parents with more financial/credit experience, availability of family down payment assistance, greater generational wealth, no history of social and economic discrimination. Speakers at the Task Force's regional meetings reported that some minority group members are afraid of or intimidated by financial institutions and are more comfortable in an informal setting.

Pre-purchase homebuyer education offered by agencies through the Massachusetts Homeownership Collaborative or other certified programs is currently mandatory for many targeted mortgage programs as well as for programs providing government down payment and closing cost assistance. However, most homebuyers are not required to attend an education program or choose not to attend one and many look for the path of least resistance, and a quick approval, often resulting in higher rates and fees. Speakers at the Task Force's regional meetings testified that homebuyers are often encouraged to avoid homebuyer education programs by real estate and mortgage brokers anxious to make a quick sale and close the loan. More lenders need to find ways to persuade

[30] *Changing Patterns XII*.

consumers that quality homebuyer and/or credit education is in their self-interest. This is particularly important in a market that now promotes a wide variety of alternative and, in some cases, very complicated mortgage products from which to choose.

In 2004, MCBC recommended that mortgage lenders refer homebuyers to homebuyer or credit counseling agencies prior to application. Among lenders responding to the Task Force's survey, 64 percent provide homebuyers with information on local homebuyer counseling programs, while 48 percent advise homebuyers to obtain their credit reports prior to application. Some lenders who attended the Task Force's regional meetings expressed concern that such advice could be construed as discouraging an application. MCBC also recommended that mortgage lenders provide denied applicants with information on counseling options. Lenders responding to the Task Force's survey reported that 67 percent provide denied applicants with written information about credit counseling programs.

Homebuyer education can be good business for banks, credit unions and mortgage companies, providing them an opportunity to reach new markets and to develop better informed customers. Funding, however, is a real issue. Consolidation by financial institutions and reduced federal funding limit the numbers of homebuyers that these agencies can serve. Broader sources of financial support are needed to allow them to continue their programs and to expand educational programs to higher-income homebuyers.

MCBC's 2004 recommendations urged all mortgage lenders (including banks, credit unions, and mortgage companies) to continue to provide financial support for homebuyer education programs. Among lenders responding to the Task Force's survey, 62 percent reported that they provide financial support for community-based homebuyer counseling programs. In a survey conducted by the Homeownership Collaborative, 34 homebuyer counseling agencies reported that they received 23 percent of their total funding from banks and two percent from mortgage companies (financial support from foundations/other corporations and federal and local governments provided 75 percent of the agencies' program support). Clearly, financial support for homebuyer education is important in assisting low- and moderate-income borrowers and all lenders should be encouraged to provide financial assistance.

Recommendation: All lenders, including banks, credit unions, and mortgage companies, should provide funding support for homebuyer counseling programs with particular emphasis on those serving minority communities.

Recommendation: Lenders should work with community-based organizations and government agencies to develop, fund and/or provide information on homebuyer education programs that will reach middle- and upper-income minority homebuyers.

Recommendation: Lenders should work with community-based organizations to educate community leaders, real estate brokers and other trusted advisors on the benefits of homebuyer education.

Recommendation: Lenders should be encouraged to employ diverse staff reflective of their community to bring homebuyer education to people at locations in the community, e.g. through churches, through unions, and at job sites.

Recommendation: Lenders should refer applicants denied because of credit to credit counseling.

Homebuyer education programs themselves play an important role in adequately preparing homebuyers for the mortgage process and in assisting those not ready to buy. The Massachusetts Homeownership Collaborative has been instrumental in standardizing the curriculum for homebuyer education and in setting high standards for homebuyer programs. At the same time, it is important that individual homebuyer counseling agencies ensure that they are providing the best level of service to all of their clients. In addition to the recommendations listed above, *the Task Force also encourages homebuyer counseling agencies to continue to implement the recommendations for homebuyer counseling agencies included in MCBC's 2004 report:*

- *Improve screening of prospective homebuyers*
- *Require review of credit reports by all prospective homebuyers prior to application*
- *Provide training or refer homebuyers to workshops on financial fitness*
- *Work with credit counseling agencies to assist homebuyers with credit problems*
- *Provide on-going assistance and support to homebuyers not ready to buy*
- *Track program graduates*

PUBLIC AWARENESS

Among Massachusetts homebuyers, credit and high debt-to-income ratios appear to be among the primary reasons for denial of a home purchase loan. At all of the Task Force's regional meetings, both lenders and community representatives proposed a statewide public awareness campaign to help educate local residents on credit and to counteract the aggressive marketing programs of many credit card finance companies and subprime mortgage companies. They noted that local lenders are not able to compete with national companies with large advertising budgets. Participants suggested a partnership of business and community leaders, to include banks, credit unions, other mortgage lenders, the secondary market, government, retail establishments, utility companies, foundations, investment firms, Consumer Credit Counseling Service, credit reporting agencies, credit card companies and community-based organizations, to develop a program to promote the sound use of credit and to encourage local residents to utilize financial and credit education programs and resources.

The speakers at the Task Force meetings advised that the program should be developed on a statewide basis, and seek the greatest possible exposure to reach the greatest possible audience. The program should also supplement campaign messages with other efforts, including website access to information on and links to current programs and resources, partnerships with community-based efforts and local trusted advisors and corporate sponsorships. Participants noted that to raise awareness and modify behaviors, the campaign's message must resonate in the community and include messages on what people need to know and why they need to know it in language and using examples that are relevant to everyday life. The campaign's messages will need to be multi-cultural and multi-lingual and be directed to people at all income levels. To get people's attention, the campaign's message must be simple and bold and should educate, entertain and surprise.

Task Force members agree that increasing public awareness of the importance of a good credit history and providing assistance and resources to families and, in particular, to black and Latino families, to help them use credit responsibly can play an important role in helping to reduce minority group denial rates and minority/white disparity ratios.

To be successful, a public awareness campaign of this scope requires support and participation from a broad-based partnership of local, regional and national industry and community-based organizations, foundations and other groups. It also needs strong, visible leadership and significant financial support (current cost estimates exceed $1 million). While the Task Force supports the concept of such a campaign, many members do not believe that the campaign is financially feasible and most agree that it is beyond the scope and the capacity of the current Task Force membership.

In the absence of a formal, organized campaign, the Task Force encourages all stakeholders in the community to carefully examine their current programs, procedures and business practices to ensure that local residents receive balanced, fair and accurate information on mortgage lending and credit. Specific recommendations to lenders, financial service providers, local businesses, government agencies, non-profit and community-based agencies and others are included earlier in this report.

In addition, the Task Force believes that local print and broadcast media outlets play an especially important role in both their programming and advertising. *To this end, the Task Force strongly believes that:*

- *Local media outlets have a responsibility to monitor advertising content by lenders and should avoid carrying deceptive and/or misleading advertisements offering easy or low-cost credit.*

- *Local media outlets, community-based organizations and community leaders have a responsibility to take a lead role in alerting local residents to the risks and costs of certain credit products and in promoting the responsible use of credit.*

TOOLS:

Financial Education:

American Bankers Association (www.aba.com/Consumer+Connection/default.htm)

- This consumer page provides links to brochures and worksheets on budgeting, choosing the right mortgage, savings plans and other financing isues

America's Community Bankers (www.americascommunitybankers.com/tools/toolsbody.asp)

- This consumer tools section provides links to ACB statement stuffers, financial calculators and budgeting tools and other financial education sites

Bond Market Foundation (www.tomorrowsmoney.org)

- Website provides basic personal financial information, tools and resources

Boys & Girls Club of Lynn (www.bgcl.org)

- Offers financial education programs (781-593-1772)

Credit for Life Fair, Brockton

- One-day financial decision making simulation for high school students that teaches basic personal financial management skills. For further information, contact Leo Macneil, Senior Vice President, HarborOne Credit Union and Brockton Housing Partnership (508-895-1314)

Credit Union National Association (buy.cuna.org/static/hffrc.html)

- The Home & Family Resource Center provides member credit unions with online personal finance information that can be incorporated into credit union websites.

FDIC (www.fdic.gov)

- FDIC Money Smart (www.fdic.gov/consumers/consumer/moneysmart) - program to help adults outside the financial mainstream enhance their money skills and create positive banking relationships
- Publications (www.fdic.gov/consumers/consumer/news) focusing on different aspects of financial education:
  - "Fiscal Fitness for Older Americans: A Special Guide for Seniors and Families," includes practical tips to maintain financial stability and independence during retirement years (Fall '05)
  - "Taking Control of Your Finances: A Special Guide for Young Adults," help for young adults to take control of their finance (Spring '05)

Federal Reserve Bank of Boston (www.bos.frb.org)

- Financial education publications
  - "Know Before You Go…To Get A Mortgage: A Guide to Mortgage Products and A Glossary of Lending Terms"
  - "Pathways to Getting Ahead" (A financial learning tool for young adults)
  - "Phishing & Pharming: Helping Consumer Avoid Internet Fraud"
  - "Identify Theft"

  Publications are also available through the Consumer Hotline at 617 973-3755

IDA programs (www.massassets.org)

- MIDAS is the statewide collaborative of non-profit organizations that promote asset-building initiatives. For more information, contact Margaret Miley, MIDAS Coordinator (617-787-3874, ext. 214)

Junior Achievement Personal Economics (www.ja.org/programs)

- Elementary to high school level - addresses basic financial education
- Various other programs for grade-specific students

Lowell Boys & Girls Clubs (www.lbgc.org)

- offers financial education programs (978-458-4526)

Montachusetts Opportunity Council (978-342-7013)

- Self-sufficiency program (financial management, savings, credit repair); information on the agency can be found at www.masscap.org/agencies.html

MA Treasurer's Office (www.mass.gov/treasury/finedu.html)

- Savings Makes Cents - banking program for elementary school students focusing on ABC's of money management
- Money Conferences (www.themoneyconference.com) - in conjunction with YWCA NE Regional Council, these conferences provide information on financial management, retirement and investment strategies for women

MA Office of Consumer Affairs (www.mass.gov)

- HiFi High School Financial Literacy: a voluntary initiative to encourage high school superintendents, principals, department heads and teachers to recognize the need for teaching basic financial skills to students

Organization for a New Equality (www.newequality.org)

- Campaign for Economic Literacy (800-877-6631) provides financial education workshops for residents via local faith and community-based organizations

U.S. Government (www.mymoney.gov) (Spanish-language version available)

- Website dedicated to reaching all Americans the basics about financial education; includes information on budgeting and taxes, credit, financial planning, homeownership, retirement planning, savings and investments, starting a small business and other topics. Free "My Money" tool kit also available to order. Also provides a link to "Taking Ownership of the Future," the National Strategy for Financial Literacy prepared by the U.S. Financial Literacy and Education Commission

Worcester Community Action Council (www.wcac.net)

- Financial counseling programs (508-754-1176)

Your Money's Best Friend (www.moneysbestfriend.com)

- Sponsored by the Pennsylvania Office of Financial Education, this site provides consumers with information on a variety of financial issues including budgets, banking basics, savings and investing and credit and teachers with information on financial education curriculum. The site includes calculators and a glossary, along with links to other relevant websites.

Credit Education:

Credit Scores

- FICO (www.myfico.com) offers scores from Equifax, Transunion and Experian credit bureaus ($45 fee). Includes a description of the major factors influencing a credit score and the weight of each factor.
- Equifax (www.equifax.com) – credit reporting agency

- Experian (www.experian.com) – credit reporting agency, produces software (Credit Expert) to help customers identify ways to improve their credit scores ($6 fee)
- Transunion (www.transunion.com) – credit reporting agency
- www.annualcreditreport.com (877-322-8228) official site to help consumers obtain free credit reports once every 12 months; links to credit agency listed above.

Consumer Credit Counseling Agencies Approved for Massachusetts Residents by the U.S. Bankruptcy Trustee (Note: Out-of-state agencies provide credit counseling over the phone or via the Internet):

- Money Management International, Inc.,formerly Consumer Credit Counseling Services of Southern New England (www.moneymanagement.org)
- Allen Credit and Debt Counseling Agency (www.acdcas.com)
- Community Service Network, 271 Main Street, Suite 303, Stoneham MA 02180 (781 438-5981)
- Consumer Credit Counseling Service of Greater Atlanta (www.cccsinc.org)
- Consumer Credit Counseling Service of San Francisco (www.ssscsf.org)
- Credit Advisors Foundation (www.creditadvisors.org)
- Credit Counseling Centers of America (www.cccamerica.org)
- Garden State Consumer Credit Counseling, Inc. (www.novadebt.org)
- Greenpath,. Inc. (www.greenpathbk.com)
- Hummingbird Credit Counseling and Education, Inc. (www.hbcce.org)
- Institute for Financial Literacy (www.financiallit.org)
- Springboard Nonprofit Consumer Credit Management, Inc. (www.credit.org)

Freddie Mac CreditSmart (www.freddiemac.com/creditsmart/home)

- A curriculum to help consumers understand, build and maintain better credit; obtain knowledge and skills necessary to manage finances. Spanish language site at www.freddiemac.com/creditsmartespanol

HSBC (www.yourmoneycounts.com)

Site provided by HSBC that offers quizzes, articles and fact sheets on topics like understanding your credit score, the repercussions of spending choices, managing your money, choosing retirement plans and avoiding identity theft.

MasterCard® (www.debtknowhow.com)

Provides tips on assessing and managing debt (sponsored by MasterCard®)

Money Management International (www.moneymanagement.org)

- My Score Plus (www.moneymanagement.org/myscoreplus/) - Comprehensive service that provides information, tools, resources needed to analyze current credit situation
- Consumer Credit Counseling Services (www.moneymanagement.org/programs/) – various programs to help with budgeting, money management and credit issues

Taunton Federal Credit Union (508-824-6466)

- Community development consumer loan program

Homebuyer Education:

Fannie Mae (www.fanniemae.com/homebuyers/homepath)

- Homebuyer resources for finding a mortgage, becoming a homeowner, and mortgage fraud

Freddie Mac (www.freddiemac.com)

- Homebuyer resources - Buying and Owning a Home
- CreditWorks (www.freddiemac.com/singlefamily/credwks.html) - solutions to help families take positive steps to improve their credit and achieve homeownership

Massachusetts Homeownership Collaborative (www.CHAPA.org)

- First-time homebuyer workshop information

MassHousing (www.masshousing.com)

- Numerous tools for consumers including:
  - Homebuyer's Guide
  - Pre-qualifying
  - MassHousing loan programs
  - First-time buyer education
  - People who lack a credit history

Massachusetts Mortgage Bankers Association Foundation (www.massmba.com/foundation.html)

- "Protect Yourself from Abusive Lending Practices and Stop Mortgage Fraud!", a consumer brochure that lists the warning signs of predatory lending an a Borrower's Bill of Rights.

Mortgage Professor (www.mtgprofessor.com)

- Mortgage advice and counsel prepared for homebuyers by a retired finance professor; provides tutorials, calculators and glossary

North Central Massachusetts CRA Coalition

- Collaborative funding for homebuyer counseling - Lenders can waive application fees and/or provide "gift certificates" to denied homebuyers to encourage attendance at homebuyer and/or credit counseling programs.

NEXT STEPS

This report is intended to share the Task Force's findings and to provide recommendations to banks, credit unions, mortgage companies, community-based organizations, public officials and others on steps that they, individually and in partnership with others, can take to increase lending to minority group members while ensuring that all homebuyers have equal access to credit. The report represents completion of the Task Force's initial objectives. Its work, however, will continue:

> The industry trade associations – the Massachusetts Bankers Association, the Massachusetts Credit Union League, the Massachusetts Mortgage Association and the Massachusetts Mortgage Bankers Association – along with the Massachusetts Community & Banking Council (MCBC) will present the Fair Lending Task Force Report and Recommendations at an industry conference to be held on October 12, 2006.
>
> Following that conference, the trade associations and MCBC will establish and support a Fair Lending Coordinating Committee to plan, oversee and manage promotion of the Task Force's recommendations. The Committee's work will include:
>
> - Developing "best practices" for second look procedures
> - Identifying models for racial/ethnic self-testing and mystery shopping
> - Working with regulators to develop a checklist or Q&A to help customers identify credit and/or debt issues prior to application
> - Meeting with government, industry, not-for-profit organizations, community leaders and others to promote the Task Force recommendations and to identify opportunities for collaborative action
> - Preparing status reports and assessments
> - Developing on-going action agendas
>
> In addition, the trade associations will hold industry meetings to promote the Task Force recommendations to their members, will identify and recommend training and education programs for minority group members to encourage and advance career development in the mortgage lending industry and will report the findings of MCBC's annual report on mortgage lending patterns in industry publications.

While these actions can support and assist trade association members in their attempts to increase lending to minority group members and to reduce minority group denial rates and minority/white disparity ratios, it is, at the end of the day, the work of those individual banks, credit unions and mortgage companies that will make the difference in ensuring fair and equitable treatment for all homebuyers. It is the Task Force's hope that the information in this report will encourage and assist them in that effort.

APPENDIX A

Fair Lending Task Force Participants

Laura Berg, Stoneham Savings Bank (MBA)
Thomas Callahan, Massachusetts Affordable Housing Alliance (MCBC)
Mary Ann Clancy, Massachusetts Credit Union League
Kevin M. Cuff, Massachusetts Mortgage Bankers Association
Timothy DeLessio, Federal Deposit Insurance Corporation
James Dougherty, Massachusetts Mortgage Association
Christopher Dunn, South Shore Savings Bank (MBA), Chair
Charles A. Ferraro, Covenant Mortgage (MMBA)
David Harris, Fair Housing Center of Greater Boston (Community)
Frederick Healey, Workers' Credit Union (MCUL)
Bonita Irving, Massachusetts Division of Banks
Kevin Kiley, Massachusetts Bankers Association
Denise Leonard, Constituion Financial Group (MMA)
Paul Mayotte, Jeanne D'Arc Credit Union (MCUL)
Dana Neshe, Middlesex Savings Bank (MMBA)
Bruce Ocko, CCO Mortgage Corporation (MCBC)
John Patriakeas, Eastern Bank (MBA)
Janna Tetreault, Citizens Housing & Planning Association (Community)
Kathleen Tullberg, Massachusetts Community & Banking Council
Richard Walker, Federal Reserve Bank of Boston

MBA: Massachusetts Bankers Association representative
MCBC: Massachusetts Community & Banking Council representative
MCUL: Massachusetts Credit Union League representative
MMBA: Massachusetts Mortgage Bankers Association representative
MMA: Massachusetts Mortgage Association representative

APPENDIX B

Massachusetts Bankers Association
1994 Fair Lending Initiative

MASSACHUSETTS BANKER

FOURTH QUARTER 1994 VOLUME 8, NUMBER 4

Fair Lending: Building a Model

A lack of services of all kinds is a recognized problem in poorer communities, especially minority communities in urban areas. Inadequate police protection, few supermarkets, drug stores or shopping centers, expensive or unavailable property insurance, too few banking facilities, and difficulty in obtaining loans have all been among the common complaints.

Banks have been highlighted as offenders, not necessarily because their role is more important than that of other commercial or public sector actors or because their supposed offenses have been more serious, but rather because they are closely regulated and therefore subject to intense community-activist and political attention.

Banks' social obligations were most conspicuously formalized with the Community Reinvestment Act (CRA) of 1977. (A parallel Massachusetts CRA followed in 1982.) The focus of the act was on geography: Banks were mandated to invest a proportionate amount of deposits in the areas from which those deposits were drawn. CRA thus initially addressed concerns about urban disinvestment and decay in geographic and even housing-stock terms.

More recently, the urban investment issue has converged with the issue of racial disparities in mortgage lending documented on a national basis by the expanded Home Mortgage Disclosure Act (HMDA) data gathered in 1990 and thereafter.

It can be argued, as suggested above, that banks have been singled out because of their highly regulated status to rectify social problems of much larger dimensions. Ideally, analysis of those problems and the means used to address them would include many other business, government and non-profit institutions as well.

Be that as it may, the banking industry in Massachusetts has accepted the fact that all has not been well in the provision of credit on an even-handed basis to all who need it and can meet legitimate lending criteria. Conscious, intentional discrimination is, at most, a minor problem; no one who knows the industry believes that banks are turning away good business because of racial or ethnic prejudice.

However, structural problems in the lending process, problems of communication across racial and language divides, and the consequences simply of "doing things the way they have always been done" may well explain a "gap" in the granting of mortgages above and beyond the gap created by economic circumstances out of the industry's control.

Nowhere in the country have the converging issues of urban investment and fairness in lending been more explored, discussed and addressed than in Massachusetts. The latest sign of progress is the Massachusetts Bankers Fair Lending Initiative, now eight months old. Led by the Massachusetts Bankers Association and with a large commitment from the industry, the Fair Lending Initiative has set out to address identified barriers to fair lending in a systematic and effective way.

For the record and for the benefit of the many individuals and institutions across the country who have shown an interest in fair lending and related matters, this quarterly issue of the *Massachusetts Banker* presents the Fair Lending Initiative in detail. We believe it may well become a model for the country.

"We are going to have access to resources that would be out of the question if we had to pay for them on an individual basis."

THE REASONS WHY

James P. McDonough, Chairman Massachusetts Bankers Fair Lending Initiative

The Massachusetts Bankers Fair Lending Initiative involves such a large commitment on the part of our Association that it is reasonable to ask, "Why are we doing this?"

There are several answers to that question, the most important of which is that in developing and implementing the Initiative, the Association once again is fulfilling its most basic purpose: to provide collectively for the members a service which it would be more difficult and costly for them to provide for themselves. In short, the Fair Lending Initiative is a good example of why we have an Association.

Fair lending would have been a priority in any case, but it would not have taken its present form if it hadn't been for a jurisdictional dispute between

(Continued on page 6)

INSIDE: Details of the Fair Lending Initiative

The Massachusetts Bankers Fair Lending Initiative

Background

The Massachusetts Bankers Association became involved in community investment and related issues six years ago when it took the lead in bringing together member banks and community advocates to discuss the needs of underserved communities and how to address them.

The ensuing Massachusetts Bankers Association Community Investment Program, announced in 1990, produced three corporations: one to assist in the development of affordable housing, another to aid small and minority-owned businesses, and a third corporation to increase bank/community contacts and to address product and service concerns, especially of inner city areas.

This last MBA-created company, the Massachusetts Community and Banking Council, counts among its achievements a voluntary check-cashing program for welfare recipients who do not have bank accounts, a "basic banking" account for Massachusetts, and, perhaps most impressively, a joint banker/community-advocate branch-citing task force which helped to bring eight new branches and 25 ATMS to inner-city Boston neighborhoods.

Nevertheless, criticism of the banking industry's performance on a national scale became even more intense. With the addition of racial classifications to the annual Home Mortgage Disclosure Act (HMDA) data, a fairly uniform national disparity in the turn-down rate for white and non-white mortgage loan applicants rose as a prominent issue.

The Massachusetts Bankers Association discussed research to get beyond the limited HMDA data for a deeper look into the factors that may actually contribute to loan application rejections. Representatives of the Federal Reserve Bank of Boston sat in on these meetings and soon suggested that the Boston Fed itself had both superior resources to carry out this kind of research and more credibility as an uninvolved party.

One hundred and thirty-seven Eastern Massachusetts lenders voluntarily took part in the study, which was released in the fall of 1992. Its findings were controversial, especially within the research community. However, the Association accepted the gravamen of the study, publicly stating that the Fed had done a service in showing that the so-called gap fell from 2.7 to 1 to a more manageable 1.6 to 1 when legitimate criteria were taken into account. At the same time the Association began to consider ways the corporations set up in 1990 could be used to help to close the gap.

At this point the Massachusetts Attorney General entered the picture

The attorney general felt obliged to begin an investigation contrary, in the industry's view, to the spirit of the Boston Fed project. Furthermore, the industry felt a major jurisdictional principle was at stake: the implied right of the attorney general to become a de facto bank regulator.

Seeking a constructive resolution to the dispute over access to bank records, the attorney general and the Massachusetts Bankers Association reached an agreement on a voluntary program—subsequently to be known as the Massachusetts Bankers Fair Lending Initiative—to encourage and assist member banks in their efforts to assure equal treatment for all mortgage loan applicants. The agreement was signed in March of 1994.

A key aspect in the development of the Initiative was that all its elements should aid banks in meeting existing or proposed state and federal fair lending regulations. Compliance has become such a cost item for banks that aligning the Initiative with compliance obligations was both an incentive for banks to participate and a rational approach to the task.

The Fair Lending Initiative will continue through 1997, by which time it is expected that the best available policies and practices will have been widely implemented throughout the industry.

Formation of the Committee

Upon a vote of the board of directors of the Association, the Massachusetts Bankers Fair Lending Initiative was established as a full-fledged Association committee with **James P. McDonough**, president of Abington Savings Bank, as chairman. The committee quickly agreed that each of the seven major elements in the agreement should be addressed by its own task force. In all, more than 100 bankers and knowledgeable outsiders, including bank regulators, were quickly recruited and began their work. Through the summer of 1994, the task forces met more than 40 times, consultants were hired as needed, and contacts were made with other trade associations, with academic institutions, and with advocacy organizations which could help structure the assistance to banks envisioned by the agreement.

Mission Statement

The goal of the Massachusetts Bankers Fair Lending Initiative is to assist Massachusetts banks and other mortgage lenders in their efforts to assure that all prospective borrowers are treated fairly in the loan application process; that they are given equal encouragement and support in access to financing for home ownership; and that all relevant laws and regulations are strictly observed.

The Survey

From their first meetings, the task forces requested information about current industry practices to help them identify areas of need and potential resources. Rather than burdening the banks with a stream of individual requests, the committee decided to undertake an industrywide survey, with assurances of confidentiality for individual banks. Designed and conducted by **W. M. Sheehan & Company**, the survey generated an impressive 87% response from the membership and offered a look at industry practices probably unprecedented in the country.

Individual Initiatives

Initiative A: Education and Recruitment of Minorities

Mission: To develop, promote and maintain a career-development program statewide. Carried out in affiliation with the

(Continued on page 4)

Fair Lending Initiative
(Continued from page 3)

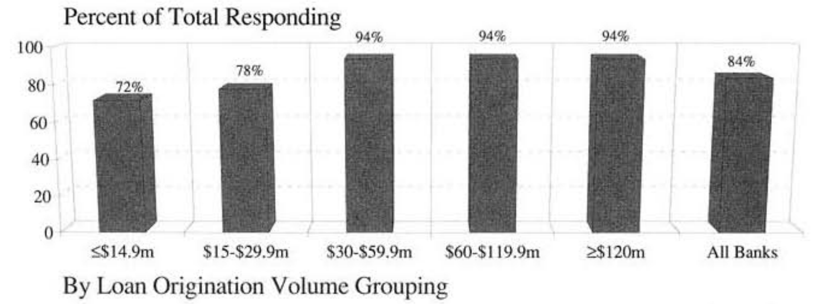
Massachusetts Mortgage Bankers Association, the program seeks to equip minority applicants with the technical knowledge necessary to qualify for positions in the mortgage lending industry.
Summary of Activities: Recently completed program offered at Roxbury Community College in conjunction with the Massachusetts Mortgage Bankers Association. Nineteen ninety-five program to be offered at Springfield Technical Community College, North Essex Community College, Lawrence, and the University of Massachusetts, Dartmouth. Bankers and other mortgage industry professionals are being recruited to coordinate and teach the classes. Those completing the program will receive placement assistance.

Initiative B: Consumer Education
Mission: to sponsor, organize and publicize credit and homebuyer education programs; to develop educational materials in languages other than English on managing family financial affairs; and to encourage member banks to institute first-time and/or flexible homebuyer programs for low-to-moderate income buyers. In pursuing this mission, the Initiative B Task Force will research existing programs; will identify basic financial education and budgeting materials for foreign language translation; and will conduct an industrywide "train-the-trainer" program to assist member banks in developing first-time homebuyer products and services.
Summary of Activities: Household budgeting and home-ownership education programs to be sponsored in conjunction with the Consumer Credit Counseling Service of Massachusetts at nine locations throughout the commonwealth. A "train-the-trainer" program is scheduled for the spring of 1995. Preliminary identification of consumer education and home-buying materials that already exist in or would be appropriate for translation into Chinese, French, Haitian Creole, Khmer, Portuguese, Russian, Spanish, and Vietnamese.

Initiative C: Lender Training in Compliance Obligations
Mission: To develop a training module which will address: lenders' legal obligations under federal and state statutes; issues of cultural diversity, pre- and post-application counseling of minority applicants; and secondary market guidelines regarding debt-to-loan ratios, credit histories, and sources-of-income standards. The module will be made available to members of the Association for in-house training and presentation at "train-the-trainer" seminars.
Summary of Activities: Almost 200 bankers attended a day-long fall seminar entitled "Bankers' Legal Obligations Under Fair Lending Guidelines." The program will be repeated in 1995. Also, small-group "train-the-trainer" workshops will be conducted in January with a specific focus on cultural diversity in the lending process.

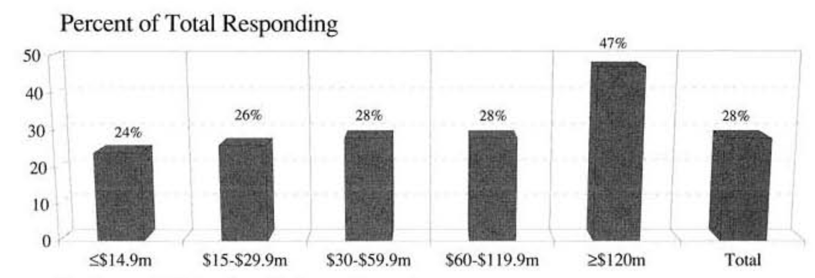
Initiative D: Compensation Structures
Mission: To encourage Association members to review, maintain or adopt compensation structures designed to increase the effectiveness of solicitation of mortgage loan applications from low-to-moderate-income customers. The Compensation Structures Task Force will provide members with information on possible alternative arrangements and guidelines in sufficient detail so that each member can identify a structure appropriate to its own mortgage lending operation.
Summary of Activities: A review with bank regulators of procedures used in compliance examinations to identify the impact of compensation structures on even-handedness in lending. A review with member banks of different compensation structures already being used to increase the volume of low-to-moderate-income applications. An educational program designed to help
(Continued on page 6)

MBA Fair Lending Survey
Banks Offering First-Time Homebuyer Products



Source: W.M. Sheehan & Company, Inc.

MBA Fair Lending Survey
Banks Utilizing Ombudspersons



79% also have lending responsibility
69% participate in a second review process

Source: W.M. Sheehan & Company, Inc.

WHAT DOES THE FAIR LENDING INITIATIVE ADDRESS?

Below in plain English are potential obstacles to an even-handed lending process which the Massachusetts Bankers Fair Lending Initiative will help banks to remove.

Initiative A

If loan personnel are all of similar race, ethnic, language, or cultural backgrounds, they may have difficulty identifying with and providing the fullest assistance to those who are not like them. Increasing the diversity of lending staffs is thus a way of promoting fairness as well as addressing the opportunities in changing markets. This will be easier to do if a pool of industry-trained candidates is available.

Initiative B

For many people who haven't been part of the financial mainstream, gaining basic financial information and skills and resolving any outstanding financial problems may be a crucial step toward home ownership. Credit and homebuyer programs can help, as can the availability of relevant information in languages other than English.

Initiative C

The priority concern for the typical bank is meeting its fair lending obligations under the law. Given the number of statutes and regulations, the sometimes different requirements of the several regulatory agencies, and the complexity of the lending process itself, a high standard of banker training in fair lending compliance is an industry priority.

Initiative D

Depending upon how loan originators are compensated for their work, a bank or mortgage company's lending process may inadvertently include a bias toward larger loan applications or more affluent areas. Compensation should be structured in such a way that this does not occur or, even better, should provide incentives for originators to make extra efforts in underserved markets.

Initiative E

Those who have been rejected for mortgage loans or who have encountered other difficulties in applying for loans may feel they have no route of appeal. The existence of an ombudsperson may help. By having a knowledgeable bank officer or bank-paid outsider to act as a mediator and counselor for loan applicants, insights may be gained that will allow the granting of a rejected loan or an alternative arrangement that may answer a borrower's needs.

A formalized "second look" by a committee composed of senior bank officers and possibly others outside the conventional lending process can add flexibility and help to assure fairness.

Finally, patterns of advantage to some borrowers or disadvantage to others, difficult to detect on an individual basis, may be revealed by rigorous comparison of granted and rejected loan applications. Where the number of applications is large, statistical analysis can be useful. Where a smaller number of loans are involved, side by side review or review against the performance of other lenders in the area can help to turn up such patterns.

Initiative F: Self-Testing

It is possible that cultural or language differences may affect the way some loan applicants are treated when they inquire about mortgages. One way to find out is to have individuals of different ethnic or other characteristics "shop" the bank and report on their reception. It is also helpful to bankers to have available the names of reliable firms in this very specialized area.

Initiative G: Secondary Market Options

Although the strictures of the secondary market have been relaxed, they may still constrain a bank's ability to make certain otherwise bankable loans. Exploring new secondary market options is thus a desirable thing to do.

INDUSTRY NOTES

Stoneham Savings Bank presents the "Friends of the Stoneham Library" with a gift of $26,300 to acquire one of the more advanced library CD-ROM systems in the state...**Bank of Boston**, in conjunction with the New England Council, supports passage of GATT legislation in full-page newspaper advertisements...**Country Bank for Savings, Monson Savings Bank, Spencer Savings Bank, North Brookfield Savings Bank, Ware Co-operative Bank, Shawmut Bank** and **Fleet Bank** pledge $300,000 in private lending capital to the Quaboag Region microlending pool...the Norwood office of **Fleet Bank of Massachusetts** donates $10,000 toward the construction of the South Norfolk County Association for Retarded Citizens' Westwood educational center...the **Boston Company** provides $400,000 to fund CityACCESS, a program to help lower-income people and communities take advantage of Boston's cultural resources...**Grove Bank** underwrites the printing of tickets for the Newton Symphony Orchestra's 1994-95 season...**Woronoco Savings Bank** rescues the imperiled transitional summer program of the Samaritan Inn, a Westfield homeless shelter...**Century Bank and Trust Company** pledges $7,500 toward the North Shore Community College capital campaign...a $10,000 grant from the **Bank of Boston** funds landscaping improvements in Roslindale's Adams Park...**Middlesex Savings Bank** donates $1,500 to the Framingham Civic League to support its children's programs...**Westfield Savings Bank** contributes $5,000 toward the restoration of the historic Congregational Church of Blanford...**BayBank** provides young participants in Brockton's Reclaim Our Community's Smart Banking Project with a seminar and $5 per student to open a bank account...the **Medway Savings Bank**, in cooperation with the local Lions Club, sponsors a walkathon which produces nearly $3,000 for the Camp Sunshine recreational program for special needs children...the recently completed Fairview Hospital capital fund campaign began with a $50,000 donation from the **Great Barrington Savings Bank**...**Brookline Savings Bank** provides a $16,500 matching grant for the restoration of the skating pavilion at Larz Anderson Park.

Fair Lending Initiative

(Continued from page 4)

the industry learn about compensation structures appropriate for different kinds of lenders and designed to assure fair lending.

Initiative E: Internal Review (Ombudsperson, Second Review and Systematic Comparative Review)

Mission: To survey member banks on the current use of ombudspersons, research the function and operation of the ombudsperson in the lending context, and define benefits to the industry; to assess the different forms of second review now in place and assist member banks in adapting second review policies and procedures which will ensure consistent treatment of applicants and respond to regulators' fair lending concerns; to undertake a survey of member banks to determine which systematic comparative review techniques are currently being used and to clarify the concept to encourage its wider use within the industry.

Summary of Activities: Data collection and preparation of guideline materials on the three topics; industry conference scheduled for January 24, 1995.

Initiative F: Secondary Market for Non-Conforming Loans

Mission: In concert with the attorney general's office, to explore with secondary market participants, private mortgage insurers, quasi-public agencies, and other interested parties the possible adoption of more flexible underwriting criteria to enlarge home-ownership opportunities for low- and moderate-income households.

Summary of Activities: Data collection on existing loan products and relevant practices and potential demand for non-conforming loan products; input from knowledgeable sources, including professional and advocacy groups, on the design of potential non-conforming loan products.

Initiative G: Promoting the Use of Self-Evaluation Techniques

Mission: To promote the use of self-testing to help eliminate any possibility of unfair lending.

Summary of Activities: Work with state legislators, with input from state and federal regulators, to secure passage of state and federal legislation protecting lenders from private litigation as a result of self-testing; development of a protocol for corrective action recommended by self-testing; development of a resource guide of qualified consultants with experience in the field.

The Reasons Why

(Continued from page 1)

our industry and the commonwealth's attorney general. In reaching an agreement with the attorney general, the Association declared once more what it has declared many times before: that while conscious discrimination on the part of anyone in the Massachusetts banking community is rare—if it exists at all—long-established policies and practices may have worked to favor some over others or to limit opportunities that should have been more widely available. To this extent, the industry has been open to critiques of its performance and ready to look for ways to make improvements.

More has been asked of us than other business sectors. However, we want to make that extra obligation a matter of pride as well as protest. We do not intend to wait to be defined as deficient nor try to get by just by doing the minimum. We have been and intend to continue to be on the cutting edge when it comes to the challenge of assuring even-handed credit access across cultural, racial and language frontiers.

At the same time, banks big and small, urban and non-urban, must comply with a host of fair lending laws and regulations that are steadily rising on the regulatory agenda. At an operational level this translates into emphasis on written policies, detailed procedures, extensive record keeping, and self-analysis. It is a burden smaller banks are often not equipped to handle on their own.

The Massachusetts Bankers Fair Lending Initiative is therefore a massive, statewide effort to provide information, training, forums for discussion, consultant references, and industry networking—all in the interests of heightened awareness, improved performance, and more satisfactory compliance where fair lending is concerned.

As the CEO of a small bank, I cannot emphasize enough that thanks to the Fair Lending Initiative, we are going to have access to resources that would be out of the question if we had to pay for them on an individual basis. In fact, this may turn out to be one of the best bargains we have ever gotten for our Association dues.

With that said, I would like to make several acknowledgments. First of all, I want to thank all those 100 or more bankers and others close to the industry who have served on our seven Fair Lending Initiative task forces. They have given liberally of their time and talent, and all of us are in their debt.

Next, I would like to thank our big bank colleagues. Our largest banks have generously shared policies, programs, procedures, research methods, and other fair lending-related resources developed at sometimes great expense. Furthermore, they have made key management personnel available for hours of meetings, for research work, and for seminar presentations. I have never before seen such willingness throughout the industry to share for the common good, and foremost among those who have shared are the regional giants. They deserve the gratitude of all.

Finally, I want to thank and congratulate Association President Dick Driscoll and his staff, not only for their commitment to fair lending but for the remarkably efficient way they have organized people and resources to make first-rate fair lending performance achievable by our entire industry.

The Fair Lending Initiative is voluntary, as it should be. However, I am confident that the great majority of our member banks will pick and choose with care among the programs and information offered to make sure they are doing the best job they can for their communities and, in the process, staying on top of an ever larger mountain of regulatory obligations.

Appendix C

Massachusetts Fair Lending Task Force
Selected Summary Results of Industry Survey

I. Summary

Institutions responding to the Massachusetts Fair Lending Task Force Survey described pursuing numerous strategies to increase lending to targeted populations, including minorities, low- to moderate-income households and tracts, immigrants, and first-time homebuyers. Among these strategies, actions relating to Fair Lending policies and extensive lender training were considered the most important and effective.

Many institutions offered home purchase products specifically designed for these targeted populations, and made efforts to avoid denials on any applications. Most institutions took a “second look” at any denial to see if an approval were possible. If not, the denial was often followed up with counseling, a counteroffer for a different product, or a combination of both.

Outreach to targeted groups (either for recruiting employees or attracting customers) was mainly achieved through networks, such as referrals from current customers and staff, and involvement in communities.

Larger institutions had a greater number of products, internal systems, and forms of outreach. All market areas had equal access to the same variety of products, mainly because the largest institutions generally operated statewide. Although large institutions made up a very small portion of the survey respondents, they accounted for a very large share of the total originations in Massachusetts.

II. Lender Characteristics

A. Institution Type

Four types of institutions were identified in the survey: (1) Massachusetts banks, which included all banks with a major branch presence in Massachusetts (even if they were based in another state or had a majority of their branches in another state) as well as all mortgage company subsidiaries or affiliates of those banks, (2) credit unions, (3) out-of-state banks, including all other banks, as well as all of their mortgage company subsidiaries and affiliates, and (4) independent mortgage companies.

By far, the largest group of respondents was Massachusetts banks, accounting for 63% of the total. Credit unions were second, at 27%. Ten independent mortgage companies responded, along with one non-Massachusetts bank/subsidiary/affiliate, and one institution that answered "none of the above."

Table 1: Types of Institutions **Number and Percentage of Responding Institutions**		
MA Bank/Subsidiary/Affiliate	74	63%
Credit Union	32	27%
Independent Mortgage Company	10	8%
Out-of-State Bank	1	1%
Other	1	1%
Total	118	100%*
Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005 * Due to rounding, column may not sum to exactly100%.		

B. Institution Size / Volume of Originations

Many institutions responding to the survey had small home purchase lending operations; just over half had made more than 100 home purchase originations in 2004. Thirteen noted that they had no originators and four had only one originator. Some also suggested that they had no full-time originators. Most of the smaller-staffed institutions were Massachusetts banks/subsidiaries/affiliates or credit unions. Eight institutions (7%) did not service their own loans. This included one-half of the independent mortgage companies.

Throughout these analyses, the volume of home purchase originations in 2004 was used as the measure for institution size.

Table 2: Number of Home Purchase Originations, 2004 **Number and Percentage of Responding Institutions**		
More than 1,000	12	10%
500-1,000	13	11%
250-500	17	14%
100-250	24	20%
50-100	25	21%
Less than 50	27	23%
Total	118	100%
Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005 * Due to rounding, column may not sum to exactly100%.		

While smaller institutions made up a large portion of respondents, these firms generated only a small share of originations. Institutions that made fewer than 100 originations in 2004 accounted for 44% of the survey respondents, but likely only made about 7% of the originations (estimated from midpoints of origination volume categories).

Table 3: Respondent Distribution by Institution's Lending Operation Size and Lender Type **Percentage of Total Respondents**				
	Institution Type			
	MA Banks/ Affiliates/ Subsidiaries	Credit Unions	Independent Mortgage Companies	Other Institutions
Number of Home Purchase Originations, 2004				
… Over 1,000	3%	1%	4%	2%
… 500-1,000	8%	1%	2%	-
… 250-500	11%	3%	1%	-
… 100-250	13%	7%	1%	-
… 50-100	15%	5%	1%	-
… Fewer than 50	12%	11%	0%	-
Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005 * Due to rounding, rows and columns may not sum to exactly100%.				

Table 4: Expected Share of Home Purchase Originations, by Institution's Lending Operation Size and Type **Percentage of Home Purchase Originations**				
	Institution Type			
	MA Banks/ Affiliates/ Subsidiaries	Credit Unions	Independent Mortgage Companies	Other Institutions
Number of Home Purchase Originations, 2004				
… Over 1,000	11%	3%	14%	6%
… 500-1,000	22%	2%	4%	-
… 250-500	14%	3%	1%	-
… 100-250	8%	4%	1%	-
… 50-100	4%	1%	0%	-
… Fewer than 50	1%	1%	0%	-
Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005 Note: Number of originations approximated using "Number of Originations" category midpoints. "Over 1,000" set to 1,000. Due to rounding, rows and columns may not sum to exactly 100%				

III. Institutional Policies

A. Fair Lending Policy

Most responding institutions had a fair lending policy or program. The 12% of institutions without one tended to be smaller, and they included Massachusetts banks/subsidiaries/affiliates, credit unions, and independent mortgage companies.

Table 13: Fair Lending Policy and Forms of Senior Management Support **Number and Percentage of Responding Institutions**		
Institution has a written fair lending policy/program		
… Yes	100	88%
… No	14	12%
Forms of senior management support for policy/program (Multiple answers possible)		
… Attendance at fair lending training	77	77%
… Board of Directors review of fair lending performance	59	59%
… Regular statements to all staff	43	43%
… Including fair lending in staff performance evaluations	11	11%
Other forms of support (Written in by respondents)		
… Internal Audits		
… Review all mortgages		
… Blind testers		
Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005		

B. Lender Training

Most responding institutions required their staff to attend training, particularly on fair lending regulations. Specific questions were asked about fair lending regulations, cultural diversity/ sensitivity, and first-time homebuyers; about one-third of institutions conducted training in all three.

Table 14: Required and Available Lender Training **Number and Percentage of Responding Institutions**		
Require training on fair lending regulations		
… Yes	94	84%
… No	18	16%
Provide cultural diversity/sensitivity training		
… Yes	56	50%
… No	56	50%
Provide training about special needs of first-time homebuyers		
… Yes	74	66%
… No	38	34%
Other relevant training (Written in by respondents)		
… Frequent internal and external seminars (no specific topic)		
… Training on regulations and compliance		
… Training on products		
… Training on outreach to customers		
Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005 * Due to rounding, column may not sum to exactly100%.		

C. Internal Review

Most responding institutions conducted some form of internal review or second-look process for denied loans; most had multiple checks. Nearly all institutions that reported that they had no formal review later described that, in fact, a "second look" was provided by management, underwriters, or senior officers. Less than one-quarter had an ombudsman/mediator/counselor available to applicants.

Table 15: Internal Reviews **Number and Percentage of Responding Institutions**		
Institution has an ombudsman/mediator/counselor available to applicants		
… Yes	26	23%
… No	86	77%
Institution has a formal internal review or second-look process for denied loans		
… Yes	105	91%
… No	10	9%
Specific processes used (Multiple answers possible)		
… Review of all denied loans	98	85%
… Multilevel review	46	40%
… Reporting to senior management	39	34%
… Review by committee	30	26%
… Tracking of loan denials by race	25	22%
… Review by a single manager	20	17%
… Targeted review, e.g. all LMI denials, all denials in LMI tracts*	14	12%
… Tracking of loan denials by loan production staff	10	9%
… Internal goal-setting	7	6%

Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005
* All institutions with targeted reviews of denials were also institutions that reviewed all denials.

D. Self-Evaluation

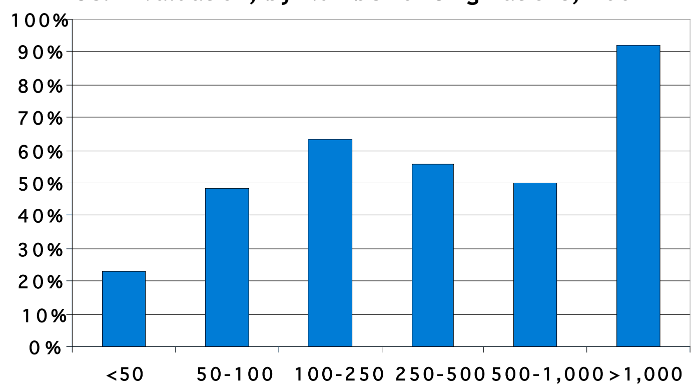
Half of responding institutions conducted some form of regular self-evaluation. Most common was the regular review of the institution's denial rates by applicant characteristics, such as race and income. Specialized fair lending compliance software was least common, used by only seven institutions. The most frequently reported software was from CRA Wiz/PCI or HMDA Quest.

About one-quarter of responding institutions regularly review multi-year trends in denial rates and/or disparity ratios. Most of these institutions have seen both rates and ratios stay the same.

Regular self-evaluation was strongly linked to the size of the institution. At the smallest firms (those generating fewer than 50 originations per year), just over 20% conducted regular self-evaluation. In contrast, more than 90% of the largest firms (those originating over 1,000 home purchase loans per year) conducted self-evaluations.

Table 16: Regular self-testing **Number and Percentage of Responding Institutions**		
Institution conducts regular self-testing		
… Yes	59	51%
… No	56	49%
Institution uses any of the following (Multiple answers possible)		
… Regular review of institution's denial rates (e.g., by race and/or income)	40	35%
… Regular review of approved and denied loans to test for disparate treatment	31	27%
… Mystery shopping of branches	27	23%
… Regular review of institution's disparity ratios	27	23%
… Regular review of multiyear trends in denial rates and/or disparity ratios	27	23%
… Mystery shopping of mortgage originators	14	12%
… Used of specialized fair lending compliance software	7	6%
Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005		

Figure 3: Share of Institutions Conducting Regular Self-Evaluation, by Number of Originations, 2004



E. Compensation Structure

The compensation structure for originators varied across institutions. Most paid originators a combination of commission and salary.

About 16% of institutions encouraged lending to inner-city, low-income, and/or first-time homebuyers through financial incentives for staff.

Table 17: Originator Pay and Staff Incentives **Number and Percentage of Responding Institutions**		
Originator pay structure		
… A combination of commission and salary	46	46%
… Solely on salary	32	32%
… Solely on commission	23	23%
Staff receives financial incentive for lending to inner-city, low-income, and/or first-time homebuyers		
… Yes	18	16%
… No	87	83%
Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005 * Due to rounding, column may not sum to exactly100%.		

At most institutions, the lender determined the price offered to the borrower. Twenty-one percent of respondents checked "Other," e.g. secondary market/investor, company management, etc.

Table 18: Pricing **Number and Percentage of Responding Institutions**		
Who determines the price offered to the borrower		
… The lender	78	71%
… The sales person/originator	9	8%
… Other	23	21%
Other (Written in by respondents)		
… Management (e.g., Board of Directors/VP/Section Head …)		
… Daily rate sheet (internal or external, e.g., FNMA)		
… Pricing committee		
… A combination of lender and originator		
Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005		

F. Minority Group Staff Recruitment

One-quarter of responding institutions make a special effort to recruit minority mortgage originators. About 20 institutions listed various kinds of recruitment, with some noting that no form seemed to work particularly well. Most common was networking, such as employee referral and word-of-mouth, and advertising, especially in the language group specifically targeted by the institution. About two-thirds of the institutions with originators had no minority originators, but this varied strongly by size of the institution.

Table 19: Mean Percentage of Originators Who Were Minorities **Number and Percentage of Responding Institutions**		
	Percentage of Originators Who are Minorities	Percentage of Firms with No Minority Originators
	Mean	
All Institutions	6%	46%
By Number of Home Purchase Originations, 2004		
… More than 1,000	11%	8%
… 500-1,000	6%	54%
… 250-500	10%	65%
… 100-250	5%	46%
… 50-100	3%	52%
… Less than 50	4%	41%
Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005		

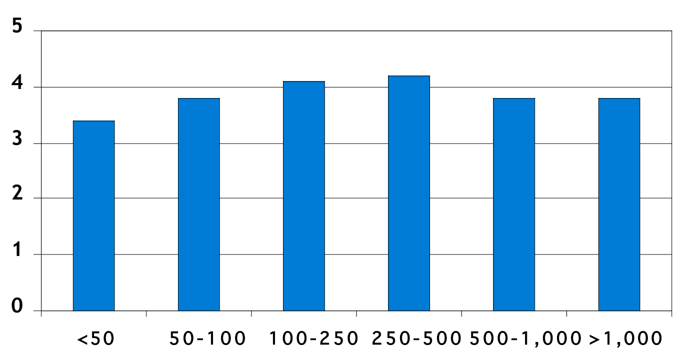
IV. Outreach

A. Consumer Education

Nearly all responding institutions offered some form of consumer education for existing and potential customers. The most commonly used form was written information explaining the mortgage application and approval process. Close to 80% participated in, funded, or referred customers to a community-based homebuyer counseling program.

Midsize institutions participated in the most forms of consumer education. While the largest institutions offered more forms of outreach than the smallest institutions, they tended to have fewer relationships with local community groups, lowering their overall scores.

Figure 4: Average Number of Consumer Education Programs*, by Home Purchase Originations, 2004



* From seven programs specified in survey

Table 20: Consumer Education **Number and Percentage of Responding Institutions**		
Institution participates in the following forms of consumer education (Multiple answers possible)		
… Provide written description of the mortgage application and approval process	103	90%
… Participate in community-based homebuyer counseling program(s)	77	68%
… Provide denied applicants written information about credit counseling services	76	67%
… Provide information on local homebuyer counseling programs prior to application	73	64%
… Provide financial support for community-based homebuyer counseling programs	71	62%
… Advise potential homebuyers to pull their credit reports prior to application	54	48%
… Provide other consumer education to potential homebuyers	65	56%
Provide consumer education	**113**	**97%**
(… do all of the above)	12	10%
(… do 5-6 of the above)	41	43%
(… do 3-4 of the above)	33	28%
(… do 1-2 of the above)	17	16%
Do not provide consumer education	**5**	**3%**
Other (Written in by respondents)		
… Homebuying seminars		
… First-time homebuyer seminars		
… Financial literacy seminars (including Money-Smarts)		
… One-on-one counseling		
… Referrals to seminars at nonprofits		
… Publications		
Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005		

B. Marketing and Outreach

Most responding institutions used multiple marketing and outreach strategies. More than half used a combination of more than five strategies.

Direct outreach by loan officers was both the most commonly used method and the method estimated to attract highest share of business. Ninety-seven firms checked that they used "Other Forms" of marketing and outreach; those who wrote in additional information almost always described some type of referral—most often from customers, but also from staff and branches, and professionals, such as contractors and lawyers.

Larger firms tended to use a greater number of marketing strategies. Institutions making over 50 originations in 2004 averaged 6.6 products, while smaller ones averaged 4.9.

Less than one-half of firms had special outreach for minorities and/or immigrants. Most often, this included outreach to community-based organizations and targeted advertising, with most using a combination of both. The share of firms using targeted outreach rose significantly with institution size.

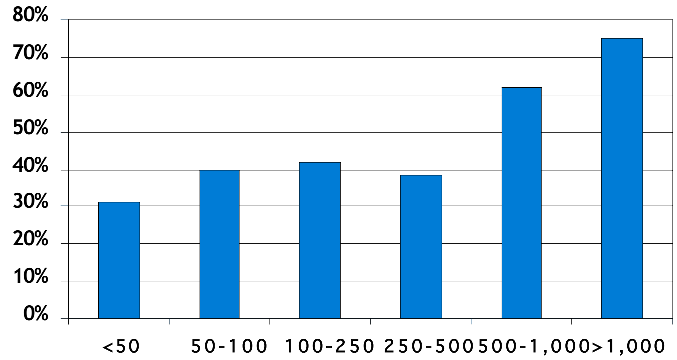
Table 21: Forms of Marketing and Outreach **Number and Percentage of Responding Firms Using Each Form (Multiple Responses Acceptable)**				
	Count of Firms	Percentage of Firms	Average Share of Business Generated from Source	
			Mean	Median
Use of specific forms of marketing (Multiple answers possible)				
… Loan officer direct	91	79%	34%	30%
… Advertising – print media	86	75%	12%	10%
… Advertising – radio	41	36%	2%	0%
… Advertising – television	24	21%	1%	0%
… Web Site	86	75%	9%	5%
… Personal relationships	78	68%	16%	10%
… Referrals from real estate brokers	65	57%	8%	1%
… Direct mail	57	50%	6%	0%
… Affiliated business agreement	15	13%	2%	0%
… Other	97	82%	16%	0%

Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005
Note: Blanks were excluded from percentages, means, and medians.

Table 22: Outreach to Minorities and/or Immigrants **Number and Percentage of Responding Institutions**		
	Count of Firms	Percentage of Firms
Use of specific kinds of targeted outreach (Multiple answers possible)		
… Outreach to community-based organizations	35	30%
… Advertisements in targeted newspapers	31	27%
… Foreign language brochures	29	25%
… Advertisements in other targeted media	16	14%
Use targeted outreach	**51**	**44%**
(… do 3-4 of the above)	20	17%
(… do 0-2 of the above)	31	26%
Do not use targeted outreach	**65**	**57%**
Use other kinds of outreach (Written in by respondents)		
… Direct mailing to minority census tracts		
… Foreign-language homebuyer seminars		
… Foreign-language web sites		
… Involvement with community-based organizations		

Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005
* Due to rounding, column may not sum to exactly100%.

Figure 5: Percent of Institutions with Targeted Outreach, by Number of Home Purchase Loans, 2004



V. Overall Effectiveness

Institutions were asked to rank the following categories to indicate which had been the most important and/or most effective in ensuring fair lending in their institution and/or in reducing minority group denial rates. Lender Training and Fair Lending Policy were clearly identified as the most important factors at most institutions.

Table 23: Most Effective Categories of Actions To Ensure Fair Lending and/or Reduce Minority Group Denial Rates
Rank and Top Scores

	Overall Rank	Number of Firms Rating Category at Top Ranks			
		1st	2nd	3rd	4th
Lender Training	1	44	25	9	6
Fair Lending Policy	2	20	33	8	11
Loan Products/Underwriting	3	11	16	22	15
Internal Review	4	4	5	22	14
Marketing and Outreach	5	1	2	13	12
Consumer Education	6	1	6	7	13
Self-Evaluation	7	1	4	2	12
Compensation Structures	8	1	1	2	7
Minority Staff Recruitment	9	1	4	0	2

Source: Tabulations of MA Fair Lending Task Force Industry Survey #1, 2005