Decision of the
Supervision Appeals Review Committee

<u>Case No. 2008-01</u>

I. Summary of Findings.

After consideration of the timely filed written submissions and the oral presentations at the September 9, 2008 meeting of this Committee, as well as the record of this case, we have denied the Bank's appeal. For the reasons set forth in this decision, the Committee finds that the Bank's Consumer Compliance Rating of "3" is well-founded and supported by the record of a compliance program that lacked sufficient training and monitoring to prevent the violation of the anti-discrimination statutes. The Committee finds that the Division of Supervision and Consumer Protection has demonstrated a reasonable basis underlying its belief that the Bank has engaged in a pattern or practice of discrimination based on race. The Committee also upholds the CRA Rating of "Needs to Improve," as properly denoting that the Bank's performance has been adversely affected by evidence of discriminatory credit practices.

II. Background.

This appeal arises from disputed material supervisory determinations set forth in the December 13, 2005 concurrent Compliance Report of Examination ("Compliance Exam") and Community Reinvestment Act Performance Evaluation ("CRA Evaluation,") (together, the "ROE") for ***, ***, *** ("the Bank"), issued on March 4, 2007, by FDIC's Atlanta Regional Office.

The Bank contests its Consumer Compliance Rating of "3" and its CRA Rating of "Needs to Improve" set forth in the ROE. On August 10, 2006, the Division of Supervision and Consumer Protection ("DSC," or the "Division"), by letter (the "15-day Letter," or the "Letter"), notified the Bank of its preliminary findings – that there was "reason to believe" that the Bank had engaged in a pattern or practice of discrimination on the basis of race in pricing first-lien refinance loans on owner-occupied properties for 2004, violating the Equal Credit Opportunity Act ("ECOA") and the Federal Reserve Board's ("FRB," the "Fed") implementing regulation ("Regulation B"), as well as the Fair Housing Act ("FHA") and the Department of Housing and Urban Development's ("HUD") implementing regulations.

In the 15-day Letter, DSC disclosed the basis of its preliminary findings, summarizing its analysis that black borrowers were charged interest rates higher than similarly situated non-Hispanic white borrowers. The analysis focused on the discretionary portion of the pricing procedure: the deviation between the actual rate charged (the note rate) and the rate-sheet rate given for the particular loan product. The 15-day Letter explained that DSC had run simple linear regressions on 184 refinance

loans to compare the rate deviations. On average, black borrowers were charged a 70 basis-point greater deviation from the rate sheet than non-Hispanic white borrowers. The Letter specified that such an unexplained differential was significant at the one percent level.[1] The Letter also stated that DSC had controlled for certain pricing factors:

> When we added controls for the refinance product type, whether a refinance loan was an inside refinance loan, whether the refinance loan was a debt consolidation loan, and the loan-to-value ["LTV"] ratio, our statistical analyses show the unexplained differential charged to black applicants increased slightly to 71 basis points. This unexplained differential charged black applicants remains significant at the one percent level.

15-day Letter at 2.

Finally, DSC informed the Bank that if DSC ultimately concluded that there was reason to believe that the Bank had engaged in a pattern or practice of discrimination, the FDIC was required by ECOA to refer the matter to the Department of Justice ("DOJ," or "Justice"). 15 U.S.C. § 1691e(g). The Letter invited the Bank to submit any response to DSC's preliminary findings within 15 days of receipt.

The Bank's September 7, 2006 response ("the Bank Letter Response") argued that there were valid reasons for the rate variance and that no discrimination had taken place. Further, *** (Mr. X), the Bank's president and CEO, pointed out:

> Of particular importance are the credit histories of the customers at issue. It is our understanding that lack of documentation in the loan files, especially related to credit history, contributed to the FDIC's preliminary findings. Many of these files, of both black and white customers, had no credit information in file. However, these borrowers were current customers of the Bank, and the loan officers had sufficient credit history information within our own CIF[2] system to use in pricing decisions. However, when the FDIC requested copies of our loan files, we were not asked to provide the related information from our CIF system.

the Bank Letter Response at 2.

The Bank further asserted that the credit histories of the affected borrowers revealed a higher percentage of black customers had less than satisfactory credit (specifically, 42.1% of black customers had poor credit histories, while only 32.6% of non-Hispanic white customers had poor credit histories, [tabulated in an exhibit

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[1] That is, the odds are less than one in one hundred that the observed pattern could have developed by chance, if the model controls for all relevant pricing factors used by the Bank.

[2] The "CIF" is the Bank's Customer Information File.

submitted in the Bank's reply]). Mr. X also compared the deviation from the rate-sheet rate for black and non-Hispanic white customers with similar credit histories (submitted in another exhibit, using prior credit information from the Bank's CIF). This comparison revealed no discrimination, Mr. X argued. He also acknowledged:

> As part of our review, however, certain inconsistencies were noted in the rates charged by our loan officers. The inconsistencies were not uniformly in favor of one group or another and do not indicate discrimination. Our loan officers range in experience from 11 years to over 30 years, and the particular circumstances of each loan vary from case to case. Therefore, we would expect that some degree of inconsistency is only natural. Nonetheless, we are mindful that we can do a better job of providing guidance that would lead to consistently applied underwriting principles among all of our loan officers.

the Bank Letter Response at 3.

DSC, after reviewing the Bank's response, referred the matter to Justice on October 23, 2006. At that time, DOJ initiated an investigation and, on September 30, 2008, notified the Bank that it had reviewed the information compiled by the FDIC, as well as the FDIC's analysis and that, based on the FDIC's referral as well as on its own independent review and investigation, the Acting Assistant Attorney General for Civil Rights had authorized the filing of a complaint, alleging, among other discriminatory conduct, that the Bank had engaged in a pattern or practice of discrimination on the basis of race or color in the pricing of mortgages in 2004.

On March 4, 2007, DSC issued the ROE to the Bank, finding that the Bank had engaged in a pattern or practice of discrimination on the basis of race in pricing its loans, thereby violating ECOA and FHA.

The Bank filed its request for review of the Compliance and CRA Ratings on May 4, 2007, with the Director of DSC (the "Director"), arguing that the sole basis for DSC's finding that in 2004 the Bank had engaged in a pattern or practice of discrimination, was its statistical analysis, which the Bank asserted was fatally flawed. The interest-rate deviation model used by DSC, the Bank argued, could not present a complete or meaningful pricing comparison because, although it reflected the deviation between the actual rate charged and the rate-sheet rate for each loan, it failed to convey the true price of a borrower's loan, which also includes points and fees, as well as interest rates.

DSC, on the other hand, is critical of the two analyses by the Bank's expert as based on data and pricing criteria not provided DSC in any of seven attempts by the Division to obtain such information and not documented by loan officers. On August 6, 2007, the Director determined the findings of both the Compliance Exam and the CRA Evaluation were appropriate.

In accordance with the *Guidelines for Appeals of Material Supervisory Determinations* ("*Guidelines*"),[3] the Committee reviews for consistency with the policies, practices, and mission of the FDIC, as well as the reasonableness of and support for the positions of the parties. The Committee granted the Bank's request to appear at the September 9, 2008 meeting of the Committee. Under the *Guidelines*, the burden of proof on all matters at issue rests with the institution. Further, the scope of the Committee's review is limited to the facts and circumstances existing at the time of the Compliance Exam (December 13, 2005 – March 4, 2007). No consideration has been given to facts or circumstances that developed after that.

III. Summary of the Parties' Arguments.

A. The Statistical Analyses Conducted by the Bank.

The Bank argues that it has presented substantial evidence, including the opinions of the Federal Reserve Board, confirming that the use of the annual percentage rate ("APR"), as the loan price in the regression model is a more comprehensive, statistically sound approach than the use of interest-rate deviation from rate sheets for determining whether any observed pricing disparities existed between minority and non-minority borrowers based on loan originations in 2004. The Bank also contends that the regression models used by its consultant control for more relevant variables with regard to the existence or non-existence of discriminatory pricing for loan products. The Bank posits that, because the FDIC's narrow regression model fails to account for numerous relevant variables, it runs the very real and likely danger of producing biased and unreliable and/or inconsistent conclusions. Yet these pricing factors, the Bank contends, are included in its regression model.

Further, the Bank argues that the FDIC has failed to establish a *prima facie* case of discrimination based on race under ECOA or the FHA using statistical evidence. The deficiencies in the FDIC's rate-sheet deviation analysis preclude either the establishment of a viable finding of discriminatory pricing or that such alleged practices were the cause of any discrepancies in loan pricing.

The Bank's appeal argues that the Director has conceded that there are two acceptable models of statistical analysis for measuring loan discrepancies: (1) FDIC's interest-rate model "unique to its internal processes"; and (2) the "APR model used by everyone else." the Bank asserts it has submitted substantial evidence the APR model is more probative; the results of the two models are contradictory; and it would be fundamentally unfair to find discrimination by relying on one statistical model while discounting or ignoring the superior one.

Finally, the Bank contends that there is no evidence of discriminatory pricing in either 2005 or 2006, undercutting such a finding for 2004.

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[3] The *Guidelines* in effect at the time of this case are set out in FDIC Financial Institution Letter ("FIL") 113-2004 (Oct. 13, 2004) and at 69 Fed. Reg. 41,479 (July 9, 2004).

Two statistical analyses from the ***, the Bank's expert ("A"), were included in the appeal: a January 11, 2007 analysis and one dated February 2, 2007. In both, A conducted linear regression analyses of APR.

1. The January 11, 2007 Analysis.

This regression analysis included the following control variables:

- loan amount;
- income;
- loan product type (balloon, interest-only, single-pay);
- loan term (in 4 categories: up to 12 months, greater than 12 months up to 36 months, greater than 36 months up to 60 months, and greater than 60 months);
- LTV (in 5 categories: LTV missing, below 75%, above 75% up to 80%, above 80% up to 95%, and above 95%);
- rate sheet used to price each loan (3 rate sheets);
- whether the borrower had a past bankruptcy at loan origination;
- whether the borrower had demand deposit account charge-offs on file;
- whether the borrower had one or more 60-day (or longer) late payments;
- whether the borrower had some 30-day late payments but no 60-day or longer late payments.

After adding all the control variables, A found a remaining APR disparity of 30 basis points, which was not statistically significant at generally accepted levels. The "raw" APR disparity (data with no control variables) was 39 basis points and was not statistically significant at generally accepted levels.

2. The February 2, 2007 Analysis.

In their second regression analysis of APR, A added the following control variables to their previous regression:

- whether the loan was an "inside refinance loan" (refinancing of a loan that was originated by the Bank); and
- whether the loan was a debt consolidation loan.

After adding these two new variables, A found a remaining APR disparity of 31 basis points, which, again, was not statistically significant at generally accepted levels of significance. Here, too, the "raw" APR disparity was 39 basis points – not statistically significant at generally accepted levels of significance.

B. The Statistical Analyses Conducted by DIR.

DSC recommends that the Committee deny the Bank's appeal and uphold DSC's findings of discrimination and the resulting compliance and CRA ratings. DSC Staff identified the Bank as an "outlier" after reviewing the Home Mortgage Disclosure Act ("HMDA") pricing information (available in September 2005) in which it appeared that the Bank exhibited a higher than average risk of having discriminated in the pricing of certain loan products to black borrowers.[4]

Accordingly, to inquire systematically into these disparities, on November 21, 2005, the Atlanta Deputy Regional Director requested information from the Bank by letter, on how it priced "conventional refinance residential real estate loans," which had been identified as the high-risk area in the HMDA screening. The record discloses seven attempts to collect pricing criteria from the Bank, summarized below:

(1) ***12/14/05*** – the Bank provided 2005 HMDA information and explained (a) it used risk-based pricing during 2004; (b) loan officers were provided rate sheets; (c) loan officers had discretion to increase or decrease interest rate, based on the customer's overall relationship with the Bank and credit risk; (d) increases to the rate sheet were capped at 100 basis points; and (e) loan officers also considered ability to repay, deposit relationship, and/or additional collateral, if offered;

(2) ***1/10/06*** – the Regional Fair Lending Examination Specialist (the "FLEX") conducted an interview with the Bank President and the Executive Vice President and Senior Loan Officer ("EVP") to clarify the Bank's written responses. (The EVP was identified to the FLEX by Bank management as the party most knowledgeable about the Bank's loan-pricing policies and procedures.) The President stated that loan officers were told to use rate sheets in combination with credit risk observed by loan officers but stated that he would be surprised if the loan officers deviated from the rate sheets; the EVP contended that loan officers had discretion to price above or below the rate sheet;

(3) ***1/19/06*** – The FLEX held a follow-up meeting with the President and EVP, informing them that a review of a sample of loan files indicated that loan officers had frequently charged

[4] DIR conducts statistical analyses of the HMDA data using "screens" developed in consultation with DSC. The screens identify those banks as "outliers" that are outside a range of normal disparities in average APR spreads on certain loans, considering gender, race, and ethnicity. However, the HMDA data do not contain sufficient information to determine whether such disparities result from discrimination or from non-discriminatory pricing factors. Those data can only be used to identify an institution requiring additional review.

rates higher than the rates specified on the rate sheets, especially to black borrowers;

(4) ***1/25/06*** – The FLEX interviewed the EVP about any criteria in addition to the rate sheet that the Bank used to price residential refinance loans; the EVP listed five additional pricing criteria: (a) previous loan performance with the Bank; (b) a "judgmental review" of the borrower's credit bureau report; (c) debt-to-income ratio; (d) LTV ratio; and (e) term of credit (one-, three-, and five-year balloons; higher rate for longer term). However, the ***only written guidance*** the Bank provided to its loan officers was the rate sheets. To test the Bank's reliance on credit risk for pricing, the FLEX made a follow-up call to a senior loan officer on ***2/8/06***, who stated that he always priced according to the rate sheet, regardless of credit risk and only used credit risk as a factor during the underwriting process;

(5) ***Approximately 2/8/06*** – examiners copied loan files and recorded data for the spreadsheet that DIR would use for statistical analysis. Examiners found that most of the interest rates charged were higher than the rate-sheet rates and exceeded the 100 basis-point gap that the Bank had explained it used. The majority of the files did not have information that could be used to evaluate credit risk (*i.e.*, credit reports). None of the files contained information about previous loans. In response to the FLEX's inquiry on the lack of documentation, the compliance officer indicated that she believed that the Bank used the CIF reports to evaluate credit risk. However, the compliance officer provided examiners with a copy of a CIF page dated 2/8/06 for most of the borrowers whose 2004 loans were being reviewed. The reports failed to identify the information that was available to the loan officer at the time the loan was made. None of the 2004 loan files contained any indication that the loan officers had printed or reviewed any CIF information at the time the loans were made;

(6) ***2/9/06*** – The FLEX met with the EVP, who stated that one percent should be added to the balloon rate for debt consolidation loans; and

(7) ***3/2/06*** – The FLEX conducted a criteria follow-up phone interview with the EVP to clarify the rate sheets and pricing policy for loans not specifically addressed on the rate sheets, 15-year terms, and real estate construction loans. The EVP provided additional guidance regarding how loans were priced using the rate sheet.

DIR performed five statistical analyses – April 6, 2006, June 23, 2006, May 2007, July 27, 2007, and September 8, 2008.[5] The first four analyses were linear regressions comparing deviations of note rate from the rate-sheet rate for black borrowers to deviations for non-Hispanic white borrowers. In the fifth analysis, three different regressions were run to examine disparities in APR between black and non-Hispanic white borrowers. Because of the timing of the last three analyses, only the first two analyses are described below and included as evidence in this proceeding.

1. The April 6, 2006 Analysis.

In the April 6 analysis, DIR conducted a multivariate regression analysis of conventional 1-4 family owner-occupied, first-lien, site-built home refinance loans extended by the Bank in 2004; the analysis was conducted using 184 loans (40 to black, and 144 to non-Hispanic white borrowers). DIR added as control variables the three factors the Bank had indicated in the criteria interviews that it uses in pricing loans:

- product type (2-year balloon, 3-year balloon, 5-year balloon, 4-year fixed rate, 15-year term, and real estate construction ("RE construction"));
- whether the loan was an "inside refinance loan" (refinancing of a loan that was originated by the Bank); and
- whether the loan was a debt consolidation loan.

The "raw" disparity in deviation of note rates from rate-sheet rates was 70 basis points, which was statistically significant at the 1 percent level. After including control variables to account for all three pricing factors, DIR found a remaining 109 basis-point disparity in deviation of note rate from rate-sheet rate, statistically significant at the 1 percent level.

2. The June 23, 2006 Analysis.

In the second regression analysis, DIR added two more control variables to the regression following DSC's January 25, 2006 pricing criteria interview:

- LTV ratio; and
- fee deviation (the discretionary component of fees).

Considering only the first two DIR analyses, after including control variables to account for the four pricing factors (the three from the April 2006 analysis and the LTV ratio) and for deviation of fees from predicted fees, DIR found a remaining 71 basis-point disparity in deviation of note rate from rate-sheet rate, which was statistically significant at the 1 percent level.

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[5] As the analyses were performed by DIR, hereafter, we refer to the analyses as DIR's and the ROE findings (which are based on DIR's analyses) as DSC's.

IV. The Committee's Analysis.

A. Preliminary Matters.

1. Untimely Analyses Are Not Properly Before the Committee.

The principal dispute in this case centers on the probative value of the DIR statistical analyses employed by DSC to make its finding on price discrimination. Of the five analyses developed by DIR for DSC, we consider only the first two, as only they were performed before the ROE was issued and thus could form the basis of DSC's final determinations issued to the Bank in the ROE on March 7, 2007. Accordingly, the first two analyses constitute proper evidence in this proceeding.

2. The Parties Are Directed to Meet.

It was apparent that, when the parties met on September 9, 2008 to make their presentations to this Committee, there was substantial disagreement on the underlying data used in the parties' analyses, including such key issues as the number and identity of relevant loans and the underlying methodology of each party. Accordingly, on October 27, 2008, in the interest of developing a clear and accurate record, the Committee directed that the parties, accompanied by their economists/consultants meet, prepared to discuss their analyses with one another, including all underlying data, variables, and modeling used by each party in its analyses. Following that conference, the parties were asked to submit final written analyses and argument to the Committee. DSC submitted written analysis and argument; the Bank only submitted argument.

The record revealed that, prior to the September 9, 2008 meeting of the Committee, DSC had only shared with the Bank a summary of its final statistical analysis and the list of loans comprising the analysis. The Committee is troubled by this DSC practice. Regulated entities are due an opportunity to respond to the regulator's findings and therefore should be provided with sufficient information to replicate the regulator's analyses. When there is no transparency to regulatory findings, institutions are denied an opportunity to make their arguments in defense of their procedures, to challenge the analyses forming the basis of the regulator's findings, or to present remedial suggestions for their procedures. The Committee believes that, in general, upon request, and the signing of a confidentiality agreement, the parties should engage in an exchange of information. Following execution of such an appropriate agreement, DSC should provide the data, program code and output of the statistical models that form the bases of the material supervisory determinations, and the bank should then provide the data, program code and output that underlie its response. This exchange develops a clear record and a common baseline from which the parties may proceed. It is important that each party understands what statistical models underlie and inform each analysis offered as evidence.

B. Whether DSC Had "Reason to Believe" That The Bank Had Engaged in a Pattern or Practice of Discrimination.

In its post-meeting submittal, DSC correctly cites the Riegle Act[6] as mandating "a review by an agency official who does not directly or indirectly report to the agency official who made the material supervisory determination under review." The legislative history of 12 U.S.C. § 4806[7] reflects congressional intention to establish an informal neutral second review to protect insured depository institutions "from uneven treatment by examiners."[8] Congress contemplated that an intra-agency review would involve a neutral independent review to ensure examiners were consistently following and applying legal and regulatory requirements. Among those legal and regulatory requirements are the strictures of ECOA.

This agency is required to refer to the Department of Justice any bank that the FDIC has "reason to believe" has engaged in a pattern or practice of discrimination. 15 U.S.C. § 1691e(g). Moreover, under the Federal Deposit Insurance Act ("FDI Act") the FDIC may issue a cease and desist notice when "in the opinion" of the [FDIC], a bank "is engaging or has engaged, or the agency has reasonable cause to believe" that the bank "is about to violate a law, rule or regulation . . . ." 12 U.S.C. § 1818(b)(1) ("Section 8").

When a supervisory determination has been appealed to the SARC, the current *Guidelines* provide that the Committee shall review the appeal "for consistency with the policies, practices and mission of the FDIC and the overall reasonableness of and support offered for the positions advanced."[9] In determining the reasonableness of and support for the positions advanced in this case, we look to discrimination jurisprudence in the federal courts. We do not make a *de novo* judgment but review the record to determine whether DSC has "reason to believe" that the Bank has violated ECOA by engaging in a pattern or practice of discrimination.

As both the Bank and DSC point out, this matter has been referred to the Department of Justice for a final determination of whether the Bank has engaged in a pattern or practice of discrimination by discouraging or denying applications for credit, through its pricing of loans, on the basis of race. Because we cannot hold an exam open indefinitely, our proceeding will advance, regardless of any ultimate finding by DOJ or

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[6] Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325, September 23, 1994, 108 Stat. 2160 (12 U.S.C. §§ 4701 *et seq*.).

[7] That section is titled, **Regulatory appeals process, ombudsman, and alternative dispute resolution.**

[8] S. Rep. No. 103-169 at 57 (1994) *reprinted in* U.S.C.C.A.N. 1881, 1935.

[9] On September 16, 2008, the FDIC's Board of Directors adopted revised *Guidelines*, eliminating certain appeals to better align the SARC process with the material supervisory determinations appeals procedures of the other Federal banking agencies. The revised *Guidelines* eliminate the right of an institution to file an appeal with the Committee with respect to determinations underlying a recommended or pending enforcement or referral action. Notice of *Guidelines*, 73 Fed. Reg. 54,822 (September 23, 2008). Under the procedures now in effect, the Bank's request for review would not have been accepted by the Director.

the courts. We stress that any limitation on the Committee actually finding a violation under the anti-discrimination statutes does not hinder this agency from carrying out its proper enforcement role under Section 8 of the FDI Act. The standard the Committee applies in considering the overall reasonableness of and support offered for the positions advanced, though informed by the discrimination jurisprudence of the federal courts, is not in fact determined by that jurisprudence. That role would be performed by the Department of Justice should the case go forward.

Finally, we reject the Bank's contention of unfairness (the Bank's Post-Meeting Submittal at 9) that it must face both pricing and redlining claims by DOJ stemming from an "incomplete review of approximately 40 inside loan renewals occurring in 2009." Justice is an independent agency and has a separate statutory authorization to proceed in cases referred to it. More to the point, as DOJ made clear in its September 2008 notice, its case was built, not simply on information compiled by the FDIC, but on its own independent review and investigation.

C. Whether DIR's Analyses Survive the Bank's Challenges.

The Bank argues that the DIR analyses are insufficient as a matter of law to prove discrimination. DSC has made a finding, supported by DIR's analyses, that the Bank engaged in a pattern or practice of discrimination on the basis of race in the pricing of certain loans, violating ECOA and Regulation B, as well as the FHA and HUD implementing regulations. As we have observed, this Committee does not reach the question of whether the Bank has or has not engaged in a pattern or practice of discrimination. The Committee reviews DSC's decisions for consistency and reasonableness.

1. The Establishment of a **Prima Facie** *Case of Discrimination.*

ECOA and Regulation B prohibit lenders from discriminating against any applicant with respect to any credit transaction because of his or her race, color, religion, national origin, sex, marital status, age, and other bases. *See* 15 U.S.C. § 1691 *et seq.*; 12 C.F.R. § 202.1. Courts historically analyze disparate treatment and disparate impact claims under ECOA and the FHA similarly to Title VII employment cases. *Jones v. Ford Motor Credit Co.*, 2002 WL 1334812 (S.D. N.Y.) *Powell v. American General Finance, Inc.*, 310 F. Supp. 2d 481, 487 (N.D. N.Y. 2004).

Under Title VII of the Civil Rights Act of 1964, an employer may be liable for unlawful discrimination under multiple theories, two of which are relevant here: (1) disparate treatment; or (2) disparate impact. Disparate treatment claims require proof of discriminatory intent; disparate impact claims do not. A pattern or practice violation can be argued under either a disparate treatment or disparate impact theory. *In re Employment Litig. Against the State of Alabama*, 198 F.3d 1305, 1310 n.8 (11th Cir. 1999). Under either theory, a *prima facie* case may be established by statistics alone if the statistics are sufficiently compelling. *Eastland v. Tennessee Valley Authority*, 704

F.2d 613, 618 (11th Cir. 1983), *opinion modified; holding undisturbed*, 714 F.2d 1066 (11th Cir. 1983), *cert. denied*, 465 U.S. 1066 (1984).

Once the plaintiff establishes a *prima facie* case of disparate treatment, the burden shifts to the defendant to rebut the inference of discrimination by showing that the statistics are misleading or by presenting legitimate non-discriminatory reasons for the disparity. *Texas Department of Community Affairs v. Burdine*, 450 U.S. 248 (1981). If the defendant meets its burden, the plaintiff must then show that the asserted explanations are inaccurate or are otherwise unworthy of credence. The ultimate burden of persuasion remains at all times with the plaintiff. *Eastland* at 619.

In a disparate impact case, neutral company practices are proscribed that, while non-discriminatory on their face, have an adverse, disproportional impact on a statutorily protected group. *Griggs v. Duke Power Co.*, 401 U.S. 424, 431 (1971) (Title VII prohibits practices that are fair in form but discriminatory in operation). A *prima facie* case is established by identification of a neutral practice (here, a lending policy allowing discretion to deviate from interest rates set on rate sheets), coupled with proof of its discriminatory impact. *Johnson v. Uncle Ben's Inc.*, 657 F.2d 750, 753 (5th Cir. 1981), *cert. denied*, 459 U.S. 967 (1982). Once the plaintiff establishes a *prima facie* case, the burden shifts to the defendant, who must then show either that the practice is based on legitimate business reasons or that the plaintiff's statistical proof is flawed. *EEOC v. Joe's Stone Crab*, 220 F.3d 1263, 1275 (11th Cir. 2000). The burden then shifts back to the plaintiff, either to provide an alternative, non-discriminatory practice that would have served the defendant's stated objective, or to demonstrate that defendant's statistical defense is unworthy of credence.

2. The Use of Regression Analyses in Making a Racial Discrimination Case.

In establishing either of these theories by the use of statistics, a plaintiff must offer statistical evidence of a kind and degree sufficient to show that the practice complained of has caused the exclusion of certain benefits to individuals due to their membership in a protected class. *EEOC v. Joe's Stone Crab, Inc.*, 220 F.3d at 1274 (explaining different theories of discrimination claims in the context of gender discrimination). The Bank argues in its appeal that the deficiencies in DIR's statistical analyses preclude DSC either from demonstrating that there was discriminatory pricing or that the alleged discriminatory practices were the cause of any discrepancies in the pricing. the Bank has two principal objections to the statistical analyses, each of which, it believes, affects the probative value of DIR's numbers: (1) DIR's use of interest-rate deviation as the dependent variable in the analysis, rather than APR as the dependent variable (*i.e.*, the APR model) that the Bank urges is the more widely used model; and (2) DIR's use of control variables that the Bank views as insufficient because the Bank contends that those variables fail to include all relevant pricing factors.

In this case, both DIR and the Bank used regression analyses – the principal differences lie in the control variables and the use of APR rather than the interest-rate

deviation for the dependent variable (the loan price). The probative value of a regression analysis depends in part on the inclusion of all major control variables likely to have a significant impact on the dependent variable (loan price). *Wilkins v. University of Houston*, 662 F.2d 1156 (5th Cir.), *vacated*, 459 U.S. 809 (1982), *remanded on other grounds*, 695 F.2d 134 (5th Cir. 1983); *cited with approval*, *Eastland v. TVA*, 704 F.2d 613, 621 (11th Cir. 1983). By evaluating the basis on which the party selected the variables included in its regression, the court may assess the model's validity. *Eastland* 704 F.2d at 623. "[Multiple regression analysis] measures the probability that the calculated disparity could occur randomly. . . . If the tested disparity is based on erroneous assumptions or suffers from flaws in the underlying data, then standard deviation analysis is foredoomed to yield an equally faulty result." *Maddox v. Claytor*, 764 F.2d 1539, 1552 (11th Cir. 1985); *see also Eastland*, 704 F.2d at 621-24. That is, a proper regression analysis for determining loan price must be based on all the variables that the Bank uses (or at least tells the examiners it uses) in determining the loan price. As the importance of such underlying assumptions is so critical, we examine those first.

D. The Different Analytical Approaches and the Different Results of the Parties.

1. A Preliminary Matter: Correction of Data Discrepancies.

As a result of the exchange of data between DSC and the Bank at the conference of economists and subsequent verification of the data from the files, the post-meeting submittals indicate that the underlying data used in the analyses were corrected by both DIR and A for 25 loans (out of 173 loans used in the DIR analysis and 174 loans used in the A analysis). This left 26 loans with data discrepancies between the parties. These loans were corrected for either appraisal value or the debt consolidation indicator, two variables that the parties agreed had the largest effects on the final outcomes. While there were other variables for which there were discrepancies in the data, the parties agreed that these other discrepancies did not appear to have much effect on final outcomes. FDIC Post-Meeting Submittal, at 12 n.8.

Whether a loan was a debt consolidation loan operated as a key control variable used in both DIR's and A's analyses.[10] However, DIR and the Bank's consultant used different criteria for designating a loan as a debt consolidation loan. The criteria used by DSC were based on EVP ***("Y"'s definition that a debt consolidation loan is one that combines all existing debt, regardless of creditor (FDIC Post-Meeting Submittal, at 13) and thus represented actual Bank practice. A did not designate a loan as a debt consolidation loan if the HUD-1 Settlement Statement provided that the loan was a renewal of two or more loans. the Bank Post-Meeting Submittal, at 4-5. The Committee determines that the fact that the A definition is at odds with the EVP's definition is clear evidence that the definition did not depict Bank practice.

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[10] There were 8 loans for which discrepancies remained in this variable (out of 173 loans used by DIR and 174 loans used by A).

Further, in its post-meeting submittal, the Bank complains that DSC failed to "mine" relevant information contained in the entire loan file for each loan at issue:

> For example, at least 12 of the loans in the FDIC 2006 Rate-Sheet Analysis have incorrect appraisal values according to the Bank and, therefore, incorrect loan-to-value amounts. Furthermore, the FDIC was missing appraisal data for 14 loans, and these loans were simply dropped from the FDIC 2006 Rate-Sheet Analysis. Had the FDIC spoken with the loan officers or reviewed the entire loan files, many of these appraisal values were available.

the Bank Post-Meeting Submittal at 4.

After correcting the data discrepancies, DIR re-analyzed the data. Looking only at the model that corresponds to the control variables used in DIR's second analysis, DIR continued to find a remaining disparity of 69 basis points in the deviation of note rate from rate-sheet rates, which was statistically significant at the 1 percent level. FDIC Post-Meeting Submittal at 11-12. It appears to the Committee that in re-analyzing the data for the final analysis, DIR did ***not*** drop the loans that were missing appraisal information. Moreover, DSC spoke with EVP Y, the individual identified by the Bank as the party with knowledge of how the loan program worked, and reviewed the loan files that EVP Y identified as the working files containing the pertinent information.

Unfortunately, although invited to, the Bank's post-meeting submittal did not include a revised analysis from A based on the corrected data. An updated analysis on the corrected data is of critical importance because the initial analyses from the Bank and DIR were based on different sets of data. Moreover, the Bank makes a series of arguments in its post-meeting submittal (at 4-5) critical of DIR's initial analyses, which are unsupported by any analyses on the agreed-upon discrepancies. Therefore, we could not evaluate the effect of these data corrections on A's initial results. Without more, the Bank's criticism of DIR's analyses must fail; the Bank simply has not sustained its burden of proof as to this issue.

2. Substantially Different Control Factors.

As we have alluded to above, under *Eastland,* as well as under the Interagency Policy Statement on Discrimination in Lending,[11] the probative value of a regression

[11] Issued jointly by HUD, DOJ, the Office of Comptroller of the Currency ("OCC"), the Office of Thrift Supervision ("OTS"), the FRB, the FDIC, the Federal Housing Finance Board ("FHFB"), the Federal Trade Commission ("FTC"), the National Credit Union Administration ("NCUA"), and the Office of Federal Housing Enterprise Oversight ("OFHEO"). The FHFB and OFHEO were replaced by a new agency on July 30, 2008, the Federal Housing Finance Agency ("FHFA"), when the president signed into law the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, July 30, 2008, 122 Stat. 2654 (12 U.S.C. §§ 2654 *et seq.*).

analysis depends on inclusion of the major control variables that reflect the pricing factors actually used by the Bank:

> A pattern or practice of disparate treatment on a prohibited basis may also be established through a valid statistical analysis of detailed loan file information, provided that the analysis controls for possible legitimate explanations for differences in treatment. ***Where a lender's underwriting decisions are the subject of a statistical analysis, detailed information must be collected from individual loan files about the applicants' qualifications for credit.*** Data reported by lenders under the HMDA do not, standing alone, provide sufficient information for such an analysis because they omit important variables, such as credit histories and debt ratios. HMDA data are useful, though, for identifying lenders whose practices may warrant investigation for compliance with fair lending laws. HMDA data may also be relevant, in conjunction with other evidence, to the determination whether a lender has discriminated.

Interagency Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,267 (April 15, 1994) (emphasis supplied); *see also Eastland* at 621-24.

Specifically in this context, detailed information must be collected from individual loan files on the applicants' qualifications that the Bank actually used when it priced the loans. The control variables that DIR used in the first analysis reflected the pricing factors specified by the Bank in pricing criteria interviews. DIR added LTV and fees deviation in the second analysis. These variables were added incident to DSC's fourth attempt (January 25, 2006) to collect data from the Bank specifying the criteria it used to price residential refinance loans.

A included in its regression models many more control variables than were included in DIR's models. However, the Committee is interested in the ***source*** of those variables – whether they represent actual data from the loan files that were used by loan officers when they priced the loans at issue. In their January 11, 2007 analysis, A said that they "control for factors that ***we believe*** are relevant for pricing." Analysis, at 9 (emphasis added). Their inclusion of the bankruptcy indicator, the presence of demand deposit account charge-offs, and the extent of the presence of late mortgage payments in the applicant's credit history, "is based upon industry standards for pricing of loans in accordance with credit risk." "Notes for Turnover of Consultant Materials to the U.S. Department of Justice," Memo to *** (Z), dated April 13, 2007, at 8. In other words, A appears to be relying on factors that industry participants in general tend to use rather than on factors that the Bank ***actually*** used to price its loans.

a. Inclusion of the "HMDA variables" loan amount and income as control variables by A.

A included control variables that they termed "HMDA variables" (loan amount and income) in their APR regression models. These variables were included "in an attempt to ***control for those characteristics that differed among borrowers . . . ,***" an approach that they argue was "***recommended by the Federal Reserve Board in bulletin articles that were issued in 2005 and 2006.***" Z Memo, *supra* at 2. (Emphasis added.)

In the post-meeting conference of parties and their experts, DSC declared that FDIC's fair lending regression analyses, as a rule, control only for factors that the Bank asserts that ***it actually used*** to price the loans being analyzed. This would include factors cited by the Bank in interviews with DSC and factors listed in the Bank rate sheets.[12] A responded that loan amount was a pricing factor that was listed on the Bank rate sheets. However, DSC asserts that an examination of the Bank rate sheets conducted during the conference of economists demonstrated that loan amount was only a pricing factor for unsecured consumer loans (not at issue in this proceeding) but was not a rate-sheet pricing factor for mortgage loans.

A claims that the Federal Reserve Board has recommended controlling for borrower characteristics using HMDA data in its 2005 and 2006 Bulletin articles. However, in the 2005 article,[13] the authors state that the reason they control for specific borrower characteristics in their national comparison of pricing and denial rate disparities by race, ethnicity, and gender is:

> ***HMDA data do not include all the factors that are involved in credit underwriting and pricing***. However, by controlling for variations so as to make borrowers as similar as possible ***on the dimensions of the data that are available***, one can account for some of the factors that may explain differences in the outcomes of the lending process among groups.

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[12] DSC does not control for "industry-standard" pricing factors not specifically mentioned as pricing factors by the Bank because they are ***not*** pricing factors used by the Bank, but also because:

(1) Most FDIC-supervised banks are very small mortgage lenders compared to the average mortgage lender in the industry. (FDIC banks comprised almost 32 percent of all the lenders who reported HMDA data in 2004 but accounted for only about 6 percent of the mortgage loan applications submitted in 2004.) These FDIC-supervised small mortgage lenders, in DSC's examination experience, seldom use "industry-standard" pricing factors.

(2) Some "industry-standard" pricing factors are correlated with race, ethnicity, and/or gender. For example, loan amounts are, on average, lower for minority and female borrowers. Controlling for these factors in the regression when the lender does not actually use them in determining pricing can obscure disparities due to race, ethnicity, and/or gender.

[13] "New Information Reported under HMDA and its Application in Fair Lending Enforcement," Avery, Robert B., and Glenn B. Canner. *Federal Reserve Bulletin*, vol. 91 (Summer 2005).

Federal Reserve Bulletin at 372 (emphasis added). *See also*, "Higher-Priced Home Lending and the 2005 HMDA Data," Avery, Robert B., Kenneth P. Brevoort, and Glenn B. Canner. *Federal Reserve Bulletin*, vol. 92 (September 2006), at A158 (to the same effect).

Thus, when using HMDA data in the aggregate to compare lending outcomes across groups, ***in the absence of specific data on the pricing factors used***, borrower characteristics data from HMDA could be used as a proxy for these factors. It appears to the Committee that, since DIR has data from the Bank on the specific pricing factors the Bank asserts control the loans at issue, DIR has no need to control for other borrower characteristics that are industry-wide and available in HMDA ***but were not used by the Bank in pricing its loans.*** The Federal Reserve Bulletins are not to the contrary. The Committee is persuaded that DIR's control variables were determined by reference to the specific factors that the Bank advised examiners that it used in pricing its loans; the Bank's experts seem to have consistently used "proxies."

b. Differences in controls for loan product types: Product G.

Differences in loan product-type control variables appeared to have a large effect on the differences in the two parties' results. Specifically, the control variable Product G (which controlled for RE construction loans) had a large effect on the estimated disparity (for both APR and note-rate deviation) because the only three Product G loans were all loans to black borrowers, and all three loans received highly favorable rates. The Committee observes that the Bank acknowledges that these loans carried an interest rate of 5% when the rate-sheet rate was 6.9%. The Bank Post-Meeting Submittal at 6. The Bank argues that adding a control variable for Product G "erroneously eliminates their statistical effect from the overall measure of pricing disparity."

In the conference among economists, the Bank's consultant revealed that all three Product G loans were loans that were made by the Bank through a developer, and those loans received special rates per agreement with the developer. *See* the Bank Post-Meeting Submittal, at 7; FDIC Post-Meeting Submittal, at 11. The Committee determines that since these loans were priced differently from other loans due to the agreement, these three loans were appropriately separately controlled for in each of DIR's regression analyses to reflect their belonging to a special rate program.

E. The Committee's Conclusions.

It appears to the Committee that the control variables used by DIR are a more accurate representation of the pricing factors used by the Bank than the control factors used by A. Moreover, the control factors used (specifically the controls for loan-product types and the inclusion or exclusion of loan amount) were large contributors to the differences in the results from the two parties. These facts undercut the Bank's argument asserting the superiority of the application of its regression model. As we have observed, the selection of control variables affects the regression analysis. All factors being equal, statistical evidence based on accurate variables and data will have more probative value

than statistical evidence based on inaccurate ones. Hence, it is important to examine the accuracy of the data bases. *See Penk v. Oregon State Board of Higher Education*, 816 F.2d 458 (9th Cir. 1987) (Title VII action by women faculty members; district court admitted plaintiffs' multiple regression evidence but later chose to discount weight on basis that analyses omitted or inadequately represented several critical decisionmaking variables).

DIR does not control for borrower credit characteristics in either of its analyses. If these characteristics were used by the Bank in their loan pricing decisions, and if the credit characteristics of the black borrowers were weaker than the credit characteristics of the non-Hispanic white borrowers, then the magnitude of the disparity in the deviation of note rate from rate-sheet rate is potentially overstated if the analyses failed to control for these characteristics. However, the Committee finds that the February 2006 file review revealed that (1) the majority of the files did not have information that could be used to evaluate credit risk; (2) none of the files contained information about previous loans; (3) the CIF reports that the Bank's compliance officer claimed were used to evaluate credit risk failed to identify the information that was available to the loan officers when the loans were priced; and (4) none of the 2004 loan files contained any indication that the loan officers had printed or reviewed any CIF information at the time the loans were priced, in any event. The Committee determines that, with no evidence to support the use of borrower credit characteristics, DIR properly did not account for credit risk in its statistical analysis for loan pricing.

The Bank raises three principal arguments in its post-meeting submittal: (1) the DSC's rate-sheet deviation model arguments were based on several key yet faulty assumptions; (2) the APR has long been recognized as the appropriate measure for determining the cost of credit; and (3) DIR's statistical analysis is insufficient as a matter of law.

1. DIR's Interest-Rate Deviation Model Was Based on Data from the Loan Files and the Procedures Outlined by the Bank's EVP/Senior Loan Officer.

Terming the DIR's rate-sheet analysis "inherently unreliable" and "built using incomplete and often incorrect data and assumptions," the Bank identifies what it argues are DSC's key flawed assumptions: (1) the Bank's rate sheets set specific interest rates; (2) the Bank allowed for only limited exceptions to the rate-sheet rates; and (3) the reasons for all authorized deviations were documented in the 2004 portion of the master loan files.

The Bank then argues, "Apparently, the FDIC developed these assumptions based on conversations with a single Bank officer (Y) during the exam. ***This, however, was clearly not the manner in which the subject loans were in fact priced.***" (Emphasis in the original.)

This Committee finds that the "single Bank officer" on which examiners relied was Executive Vice President and Senior Loan Officer Y – the individual identified by Bank management as the party most knowledgeable about the Bank's pricing policies and procedures, given that he had almost two decades of lending experience with the Bank. The examiners interviewed Mr. Y, who indicated that loan officers used rate sheets to price first-lien refinance loans, but that they had discretion to deviate from the rate, based on the customer's overall relationship with the Bank and his credit risk. He indicated that loan officers considered five pricing criteria when deviating from the rate-sheet rate: (1) previous loan performance with the Bank; (2) credit history performance; (3) debt-to-income ratio; (4) LTV ratio; and (5) term of credit.

According to DSC, Mr. Y also explained that an additional one percent was added to the rate of debt consolidation loans.[14] Mr. Y stated that while fees were mostly fixed, there was one discretionary fee charged to borrowers—a loan origination fee. Under the Bank's policy, a loan origination fee of $45 would be charged for all refinance loans that originated with the Bank (inside refinance). Additionally, an origination fee of .5 percent, or $250, whichever was greater, would be charged for refinance loans from other financial institutions, although loan officers had discretion to deviate from this guidance.

Based on how the Bank said it actually priced its loans, examiners reviewed each of the loan files to extract information and found that the files lacked much of the information originally discussed in the Bank's interviews. Further, after examiners spoke to the Bank's compliance officer, the CIF reports were found to provide insufficient information to determine that loan officers had printed, relied upon, or even reviewed any credit risk specifics at the time the loans were priced. Moreover, in his response to DSC's 15-day Letter, the Bank's president, although noting the importance of the customers' credit histories in the Bank's pricing policies, at the same time admitted that "certain inconsistencies were noted in the rates charged by our officers," that "we can do a better job at providing guidance that would lead to consistently applied underwriting principles among all our loan officers," and that there was a "lack of documentation in the loan files." The Bank Letter Response at 3.

All told, the record discloses seven attempts by DSC to collect pricing criteria from the Bank (five attempts in addition to the two noted interviews of Mr. Y). Moreover, examiners were told by the EVP that the Bank had no formal written guidance for loan officers to avail themselves of, other than the rate sheets, a fact corroborated by the FLEX in a follow-up call to a senior loan officer. Given this record, the Committee finds DSC's position reasonable.

The Committee finds that in making its ROE findings, DSC considered that the Bank could not reasonably be said to rely on information routinely missing from its loan files. Given that absence, therefore, DIR's analyses could not consider the borrower's

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[14] As noted earlier, a "debt consolidation loan" was defined by the Bank in the criteria interviews as a loan that combined all existing debt, regardless of creditor, into a mortgage loan. In addition, cash-out refinances are not considered debt consolidation loans.

previous loan performance with the Bank, credit history, or debt-to-income ratio. DIR's decision not to attempt to consider borrowers' previous loan performance (which is undocumented) finds further support in the admissions by the Bank's CEO describing "inconsistencies in the rates charged," a "lack of documentation in the loan files," and the need to do a "better job at providing guidance," which would lead to "consistently applied underwriting principles." On the other hand, because the files did contain information on the terms and debt consolidation status, and over 90% of the files contained the appraisal information necessary to compute LTV ratios, this information was used in DIR's analysis.

DIR's interest-rate analysis has been adopted and used by DOJ, the agency charged with enforcing ECOA in federal court. 15 U.S.C. §§ 1691e(g) – (h). Under the Fair Lending Procedures, examiners are to evaluate "applicable pricing policies and guidance for exercising discretion over loan terms and conditions." OCC, FDIC, FRB, OTS, NCUA: *Interagency Fair Lending Examination Procedures* 4-5 (August 19, 2004) (adapted from the Interagency Policy Statement issued March 1994). Additionally, under the Fair Lending Procedures, discretion in pricing is an indicator of potential disparate treatment in pricing. *Id.* at 7-8.

The Committee finds that, consistent with the Fair Lending Procedures, DSC (1) determined the factors considered in setting loan pricing by speaking with EVP Y, the responsible official, and by examining the actual loan files; (2) determined the factors over which loan officers exercised discretion; and (3) focused on those discretionary factors by constructing their regression analyses on the (stated) discretionary portion of the Bank's pricing policy – the deviation between the actual rate charged and the rate-sheet rate for each loan.

2. *DIR's Statistical Analysis Is Fact-Based Under Fair Lending Standards and Persuasive.*

The Committee finds the Bank's inclusion in its models of control variables based on "industry standards" rather than actual data used in credit pricing decisions, to be unacceptable. If a regression analysis "is based on erroneous assumptions or suffers from flaws in the underlying data, then standard deviation analysis is foredoomed to yield an equally faulty result." *Maddox v. Claytor* at 1552. Finally, we also reject the Bank's argument that the fact that DSC has made no finding of discriminatory pricing as to 2005 and 2006 should have some effect on this Committee's finding with respect to the 2004 loans. Any evidence as to 2005 and 2006 is not properly before this Committee under its *Guidelines.*

3. *The Bank's Model Uses APR as the Dependent Variable in Its Analysis.*

The Committee is unpersuaded by the Bank's contention that the use of APR as the dependent variable is inherently superior to the interest-rate deviation regression used by DIR. The Bank makes two arguments in support of its use of APR as the loan price

(or dependent variable) in its regression analysis: (1) APR is used by the OCC, the Fed, Justice and HUD; and (2) DIR's interest-rate deviation regression does not reflect the full price of the loan because it does not include fees, and is therefore inferior to the Bank's use of APR, which reflects the full price of the loan (including fees and points as well as interest rates).

As to the Bank's contention that APR is the favored measure of loan price and "used by everyone" except the FDIC, we hold that that assertion is belied by the Interagency Policy Statement on Discrimination in Lending, which, as we pointed out earlier, does ***not*** favor any particular measure of price or dependent variable but instead stresses that the pivotal issue involves the selection of the correct control variables – the detailed information that must be culled from individual loan files. 59 Fed. Reg. 18,267. The Policy Statement was issued jointly with HUD, DOJ, OCC, OTS, FRB, FHFB, FTC, NCUA and OFHEO.

Nor does the Bank's citation of *Federal Reserve Bulletin* articles further their argument. As we have noted, those articles, too, speak primarily of the choice of appropriate control variables, ***not*** about the superiority of any particular dependent variable (here, APR) as the loan price. That being said, the Committee also sees the value of, and encourages the use of, different models as robustness checks.

Similarly, the Committee cannot agree with the Bank's claim that DIR's interest-rate deviation fails to reflect the full price of the loan as it does not include fees. DIR's second model by its terms, specifically ***does*** consider the discretionary components of fees. *See supra,* at sect. III.B.2.

F. The Bank's Compliance Rating.

The Bank disputes the Consumer Compliance Rating of "3." FDIC's *Compliance Handbook* (the *Handbook*) contains the Compliance Examination policies and procedures in effect for this ROE. The *Handbook* describes a "3" rated institution:

> Generally, an institution in this category is in a less than satisfactory compliance position. It is a cause of supervisory concern and requires more than normal supervision to remedy deficiencies. Violations may be numerous. In addition, previously identified practices resulting in violations may remain uncorrected. Overcharges, if present, involve a few consumers and are minimal in amount. There is no evidence of discriminatory acts or practices. Although management may have the ability to effectuate compliance, increased efforts are necessary. The numerous violations discovered are an indication that management has not devoted sufficient time and attention to consumer compliance. Operating procedures and controls have not proven effective and require strengthening. This may be accomplished by, among other things, designating a compliance officer and

> developing and implementing a comprehensive and effective compliance program. By identifying an institution with marginal compliance early, additional supervisory measures may be employed to eliminate violations and prevent further deterioration in the institution's less-than-satisfactory compliance position.

The Bank failed to provide any separate discussion of its Compliance Rating other than to argue that its statistical evidence is more probative and reliable than DSC's and stands in contrast to the absence of any statistically significant evidence of discriminatory pricing advanced by DSC. The Bank also argues that its efforts to improve its processes should be given greater weight in determining its Compliance Rating.

According to the ROE, the Bank's compliance program lacked sufficient training and monitoring to prevent violation of the anti-discrimination statutes. Further, although the written compliance program calls for quarterly reviews by the compliance officer, the reviews were only reported to the Board annually. Although numerous infractions were noted in the reviews, particularly in the lending area, management was not required to provide any written responses detailing corrective actions. The Compliance Exam also reveals that, as management was slow to take corrective action, the same infractions were repeatedly pointed out during quarterly reviews.

Monitoring of the Bank's subsidiary, ***, is limited to a review of loan files to ensure compliance with the Home Mortgage Disclosure Act. Although regional managers are responsible for providing oversight, the ROE indicates that regional managers are no longer performing reviews of the subsidiary's lending activity.

In addition to the fair lending evidence, the Compliance Exam notes significant violations of the Real Estate Settlement Procedures Act ("RESPA") (at both the Bank and its subsidiary) and the Fair Credit Reporting Act ("FCRA") (at the subsidiary), which the Bank apparently does not dispute.

The Uniform Interagency Compliance Rating System states that for a 3-rated institution, "[t]here is no evidence of discriminatory acts or practices," and that it is the "4" Rating that specifically addresses discrimination findings. However, DSC has stated, and this Committee agrees, that the other factors for a "4" Rating are not present in this institution. In light of our findings outlined in this opinion that DSC has demonstrated a reasonable basis for its belief that the Bank has engaged in a pattern or practice of discrimination on the basis of race, the Committee finds that the criteria for a "3" Rating are met.

G. The Bank's CRA Rating.

The Bank disputes the CRA Rating of "Needs to Improve" that was assigned to the Bank in the CRA Evaluation, although here, too, the Bank has not provided a separate discussion of its CRA Rating, other than the objections noted above, with respect to its Compliance Rating. The *Handbook* contains FDIC's CRA policies and procedures in

effect during the applicable period. The *Handbook* describes a "Needs to Improve" rated institution:

> An institution in this group needs to improve its overall record of helping to meet the credit needs of its assessment area, including low- and moderate-income neighborhoods, in a manner consistent with its resources and capabilities.

The FDIC assesses the CRA performance of a bank in Subpart B of Part 345, the Community Reinvestment Act regulation. Section 345.28(c)[15] states in pertinent part, "FDIC's evaluation of a bank's CRA performance is adversely affected by evidence of discriminatory or other illegal credit practices in any geography by the bank or in any assessment area by an affiliate whose loans have been considered as part of the bank's lending performance." In addition "evidence of discriminatory or other credit practices that violate an applicable law, rule, or regulation includes, but is not limited to:

i. Discrimination against applicants on a prohibited basis in violation, for example, of [ECOA] or the FHA;
ii. Violations of the Home Ownership and Equity Protection Act;
iii. Violations of section 5 of the [FTC Act];
iv. Violations of section 8 of RESPA; and
v. Violations of Truth in Lending Act provisions regarding a consumer's right of rescission."

Although under the CRA regulation, the presence of discriminatory fair lending violations will clearly negatively affect an institution's rating, identification of illegal credit practices does not automatically result in a downgrade in the CRA Rating. Determination of the propriety of a rating downgrade is dependent on mitigating factors set forth in Section 345.28(c)(2), which include: (1) the nature, extent, and strength of the evidence of the practices; (2) the policies and procedures that the bank (or the affiliate, as applicable) has in place to prevent the practices; (3) any corrective action that the bank (or the affiliate, as applicable) has taken or has committed to take, including voluntary corrective action resulting from self-assessment; and (4) any other relevant information.

The ROE describes the Bank's compliance program as lacking sufficient training and monitoring to prevent the anti-discrimination issues. The Bank's use of internal repayment delinquencies (from its CIF) to account for the difference in treatment of similarly situated black borrowers and non-Hispanic white borrowers was not documented by the Bank to examiners. Moreover, such a procedure was not suggested by Bank management during the criteria interviewing process or during the on-site examination. Nor did the Bank issue any written guidance to loan officers on how to quantify delinquencies.

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[15] 12 C.F.R. § 345.28(c).

Although Bank management did not agree with DSC's findings, they have made changes to improve their internal systems. These improvements exemplify corrective action in the form of prospective relief. However, the Bank fails to address corrective actions to provide retrospective relief to borrowers that may have been the victims of discrimination. Specifically, according to the ROE, Bank management does not address: (a) restitution to black borrowers who received an interest rate higher than the comparable rate offered non-Hispanic white borrowers; and (b) furnishing of notice to affected black borrowers of their rights under ECOA.

In consideration of the strong statistical evidence of a pattern or practice of discrimination in certain mortgage lending, the Committee finds that the Bank did not have appropriate systems in place to prevent the practice, and the relief to which the Bank has committed is prospective only. Accordingly, the CRA Rating of "Needs to Improve" is justified.

V. Conclusion.

For the reasons set forth above, the Bank's appeal is denied. The Committee reviews the appeal for the overall reasonableness and support offered for the positions advanced. We find that DSC had reason to believe that the Bank had engaged in a pattern or practice of discrimination on the basis of race in pricing first-lien refinance loans on owner-occupied properties for 2004, in violation of the anti-discrimination statutes. Finally, the Committee believes that an exchange of information and analyses is to be encouraged. In that regard, and as outlined in this opinion, the Committee strongly urges DSC to review its policies regarding sharing information with financial institutions that form the bases of the material supervisory determinations that DSC makes with respect to those institutions. Specifically, those revised policies would include (1) upon the signing of an appropriate confidentiality agreement with a regulated institution, to provide the data, program code and output of the statistical models that form the bases of the material supervisory determinations, to the extent that the regulated institution, in turn, provides the data, program code and output that underlies its response; and (2) in order to avoid any potential for dispute over the validity of different models, to incorporate the use of the APR model as an additional check on the robustness of their statistical conclusions.

By direction of the Supervision Appeals Review Committee of the FDIC, dated April 30, 2009.

Gary A. Kuiper
Counsel
Executive Secretary Section