Office of Inspector General

September 20, 2004
Report No. 04-036

Supervision Appeals Review Committee Decision Regarding the Appeal of a Fair Lending Violation

AUDIT REPORT

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Federal Deposit Insurance Corporation
801 17th St. NW Washington DC 20434 Office of Inspector General

DATE: September 20, 2004

MEMORANDUM TO: Donald E. Powell
Chairman

[Electronically produced version;
original signed by Gaston L. Gianni, Jr.]

FROM: Gaston L. Gianni, Jr.
Inspector General

SUBJECT: *Supervision Appeals Review Committee Decision Regarding the Appeal of a Fair Lending Violation* (Report No. 04-036)

This report presents the results of our audit of a Hotline complaint received by the Federal Deposit Insurance Corporation (FDIC) Office of Inspector General (OIG) regarding an FDIC-supervised bank (Bank). The complainant alleged that the FDIC's Supervision Appeals Review Committee (SARC)[1] made an incorrect decision in granting the Bank's appeal of the material supervisory determination related to a fair lending violation identified during a compliance examination of the Bank. The OIG does not substitute its judgment for that of the SARC and will not opine on the merits of a SARC decision. Instead, our objective was to determine whether the SARC has the authority to decide on supervisory appeals related to fair lending violations, all relevant facts were considered, and applicable requirements and procedures were followed in the Bank case. We deferred beginning our audit until after the SARC made its final decision so as not to interfere with the SARC's deliberative process.

Appendix I contains information related to the audit objective, scope, and methodology; Appendix II summarizes fair lending laws and regulations; and Appendix III provides additional details on the terms used throughout this report.

BACKGROUND

During the compliance examination of the Bank, examiners determined that an office of the Bank's wholly owned mortgage loan subsidiary implemented a policy of not making any loans to finance the purchase of properties on Indian reservations, in violation of both the Fair Housing Act (FHA) and the Equal Credit Opportunity Act (ECOA). The complainant also stated that the policy constituted "overt discrimination" and, therefore, had to be reported to the U.S. Department of Justice (DOJ).

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[1] During the period covered by our review, the SARC consisted of the FDIC's Vice Chairman; Ombudsman; General Counsel; the Director, Division of Supervision and Consumer Protection; and the Director, Division of Insurance and Research (or their designees). As described on pages 3 and 4, the SARC was established by the FDIC to independently review material supervisory determinations (such as examination ratings) made for insured depository institutions that the Corporation supervises.

A state civil rights agency had concluded an investigation in response to a discrimination complaint against the Bank and found reasonable cause to believe the Bank's policy constituted unlawful discrimination. A Federal Reserve Bank and a private mortgage broker had filed complaints with the FDIC against the Bank. Prior to the start of the compliance examination, the Federal Reserve Board (FRB) asked the FDIC to look into the matter. Since the Bank's compliance examination was to start in a few months, the FDIC's Division of Supervision and Consumer Protection (DSC) Regional Office responsible for examining and supervising the Bank decided to include a targeted review of the issue in the scope of the examination.[2]

During the Bank's compliance examination, the Bank was informed of the apparent fair lending violation by the Examiner-in-Charge (EIC), and that the FDIC Deputy Regional Counsel and DSC senior management concurred with the examination findings. As a result of the violation, the DSC's Regional Office lowered the Bank's Community Reinvestment Act (CRA) Performance Evaluation rating. The compliance report of examination was transmitted to the Bank and, at that time, the Bank informed the Regional Office that it would appeal the material supervisory determination of the violation. Within 60 days of receipt of the compliance examination report, the Bank appealed both the compliance violation finding and the lowered CRA rating. As a result, DSC delayed referring the violation to DOJ until the appeal was decided by the SARC.

Basis of Supervisory Appeal

The Bank's appeal raised two primary issues concerning the fair lending violation. First, the Bank claimed that refusing to make mortgage loans on reservation lands was not discrimination on the basis of race.

Regarding the second issue, the Bank asserted that even if the policy constituted overt discrimination, no "discouragement" occurred because the policy was communicated only to mortgage brokers and not to potential applicants for credit. However, the state civil rights agency established that the policy had been communicated to mortgage brokers, real estate brokers, and at least one mortgage loan applicant.

DSC and SARC Appeal Decision

The DSC Regional Office recommended that the Bank's appeal be denied and that the findings of fair lending violations be affirmed. The DSC Washington, D.C., office recommended that the SARC deny the appeal. However, the SARC decided the appeal in the Bank's favor, with four of five SARC voting members approving the appeal.[3] The SARC's notification letter sent to the Bank stated:

> After considering the matter at length, the Committee has concluded that the Bank's

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[2] DSC currently maintains six regional offices located in New York, Atlanta, Chicago, Kansas City, Dallas, and San Francisco. In addition, DSC operates two area offices in Boston and Memphis. The specific regional office responsible for examining and supervising the Bank has been omitted to protect the Bank's identity.

[3] Only four of the five SARC members voted. The Deputy Director for Compliance and Consumer Protection, representing the DSC Director, recused herself from voting.

> appeal should be granted. The Committee believes that, on balance, DSC presented insufficient evidence to support its position that the Bank, through its subsidiary, engaged in a pattern or practice of "overt discrimination."

According to DSC, if the SARC had denied the appeal, the violation would have been referred to DOJ, and the CRA rating would have been downgraded.

RESULTS OF AUDIT

We concluded that the FDIC's SARC has the legal authority to decide whether a fair lending violation has occurred at an FDIC-supervised institution, and we found no evidence that the SARC acted outside of its delegated authority. Additionally, the SARC and DSC followed applicable requirements and procedures in the Bank case. We also found that the SARC was not provided all available information related to the case to assist in its decision-making process; however, inclusion of the information could have compromised the independent nature of the appeals process and conflicted with the congressional mandate requiring the creation of such a process. Specifically, the information resulted from unofficial external consultations, and it would not have been appropriate for DSC to provide that information to the SARC. As a result, we are not making any recommendations related to our audit findings.

FINDING A: AUTHORITY OF THE SARC TO DECIDE FAIR LENDING VIOLATIONS

The OIG conducted a review of the laws and regulations applicable to appeals of material supervisory determinations and concluded that the FDIC SARC has the legal authority to decide whether fair lending violations have occurred.

Section 309 of the Riegle Community Development and Regulatory Improvement Act, Public Law No. 03-325 (the Act), mandates that each federal banking agency establish an independent intra-agency appellate process to review material supervisory determinations made for insured depository institutions that the agency supervises. The Act defines an independent appellate process as 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 Act also states that material supervisory determinations include determinations relating to the adequacy of loan loss reserve provisions and classifications of loans that are significant to an institution. The FDIC expanded its review of determinations to include a CAMELS rating, Electronic Data Processing, Trust, and CRA ratings, among others.

On December 28, 1994, the FDIC published in the *Federal Register* a notice and opportunity to comment on its proposed rule to establish a SARC. Initially, the FDIC proposed that the term "material supervisory determination" would not include:

- determinations for which other appeals procedures exist;
- decisions to initiate formal enforcement actions;
- decisions to initiate informal enforcement actions;
- determinations relating to a violation of statute or regulation; and

- any other determinations not specified in the Act as being eligible for appeal.

Based on public comments received during the initial notice and comment period, the FDIC decided that the initial proposal was unnecessarily restrictive regarding the scope of determinations eligible for appeal. Subsequently, the FDIC expanded the scope of determinations eligible for appeal to include determinations relating to a violation of a statute or regulation that may impact the capital, earnings, or operating flexibility of an institution. The FDIC justified this change by recognizing that interpretations of statutes or regulations are often points of disagreement between examiners and the institution involved and that because such matters may have a material effect on the supervisory treatment of an institution, they are appropriate subjects for review.

An apparent fair lending violation has a material effect on the supervisory treatment of an institution; therefore, a fair lending violation determination may result in stricter regulatory supervision of a bank or the imposition of administrative corrective measures. This, in turn, may impact the capital, earnings, or operating flexibility of the institution.

On March 21, 1995, the FDIC issued *Guidelines for Appealing Material Supervisory Determinations* (Guidelines). Under the Guidelines, the SARC would review material supervisory determinations made at insured depository institutions that the FDIC supervises. During a compliance examination, examiners document findings and conclusions that serve to inform an institution of related FDIC material supervisory determinations. According to Section V of the DSC *Compliance Examination Manual*, examiners are required to make clear to an institution's management that such determinations are subject to change during the review process in the regional office. Under the Guidelines, institutions may appeal material supervisory determinations within 60 days following receipt of written notice of such determinations, including those relating to violations of laws or regulations. In addition, according to the Guidelines, if an appeals case involves a CRA rating or a fair lending issue, the FDIC's Washington Office Fair Lending Section will assign a staff member to participate in reviewing the appeal and to coordinate the review with the applicable regional office. Part V of the DSC *Compliance Examination Manual* states that division directors may approve any recommendation to grant an appeal in favor of the institution. However, if the appeal cannot be promptly resolved in favor of the institution, the director will present the appeal, along with any other relevant information, to the SARC.

Conclusion

In summary, our audit determined that the SARC was within its legal authority to decide on fair lending violations at FDIC-supervised institutions. As a result, the Hotline allegation was not substantiated, and we are not making a recommendation related to this finding.

FINDING B: APPEALS DATA PROVIDED TO THE SARC

The SARC considered all relevant facts in making its decision to grant the Bank's appeal, and the SARC and DSC followed applicable requirements and procedures in the Bank case. DSC did receive some information from various sources regarding the case that was not made available to

the SARC. That information consisted of opinions from non-FDIC sources as to whether or not the Bank had violated fair lending laws. We determined that it would have been inappropriate to include this information in the appeals package for several reasons discussed later in this section of the report.

During the FDIC compliance examination, the Bank's case was discussed informally with DOJ and at an inter-agency task force meeting. Although a DOJ representative unofficially stated that the Bank policy was in violation of fair lending laws, and members of the task force agreed it appeared that the Bank's policy constituted a pattern or practice of discrimination, this information was not communicated to the SARC for consideration during the appeal. Consequently, the members of the SARC did not have all of the information available to the FDIC when making the decision to grant the Bank's appeal.

Additionally, the FDIC Office of the Ombudsman conducted an independent review of the material included in the appeal package prepared by DSC. The Office of the Ombudsman identified issues in the package prior to the SARC hearing but informed only DSC prior to the SARC's deliberations of the appeal. According to the Office of the Ombudsman, it provided the information to DSC in its role as intermediary, not as a SARC member, and doing so was appropriate because the DSC SARC designee had recused herself from the matter. DSC took no steps to address the issues identified in the appeal package.

DOJ policy supports the FDIC's process for notifying DOJ of fair lending violations. The DOJ procedures state that referrals may be submitted in writing or orally. DOJ will not act on a referral until it is formalized; that is, it will not review a referral until a final determination on the violation has been made by the FDIC. According to DOJ policy, the agency official making the referral will obtain an informal response about whether DOJ might act on the referral. DOJ requests that the regulatory agency not contact a bank about a referral until the agency receives DOJ's written response (accepting or returning the referral).

In the letter notifying the Bank of the SARC's decision to grant its appeal, the SARC stated, "DSC presented insufficient evidence to support its position that the Bank, through its subsidiary, engaged in a pattern or practice of 'overt discrimination.'" We conducted interviews with the SARC members and, according to the four voting members of the SARC, the evidence presented did not support the finding of overt discrimination.

SARC members also informed us that they were not aware that a DOJ attorney had been informed of the matter and had informally stated that the Bank's lending policy for properties on Indian reservations gave the appearance of a pattern or practice of discrimination. The SARC members stated that it would have been helpful if the SARC had been provided DOJ's position in such cases. However, SARC members also cautioned that:

- Informal guidance from DOJ would not be binding. DOJ prosecutes only one of every few hundred cases it receives of this type. Therefore, there is very little case law available for guidance on the application of fair lending laws.

- Contact with DOJ could slow down the examination process even more. From the start of the compliance examination until the final SARC decision, about 22 months had passed. The timeliness of the examination process could be affected because the FDIC will not issue an examination report until after DOJ has decided on the violation.

- The bank's position is not provided to the inter-agency task force; therefore, it does not have all of the information available to the SARC.

Conclusion

Our audit determined that the SARC was not provided all of the available data related to the appeals case; however, it would have been inappropriate to include some of the relevant information in the appeal package provided to the SARC. In the case of the consultations with DOJ and the inter-agency task force, the pre-decisional nature of these discussions renders disclosure of the substance of the communications premature. These discussions do not constitute official agency positions but are brainstorming sessions through which agency officials exchange ideas and conclusions. Disclosure of the content of these discussions could hinder inter-agency communication on fair lending issues before any meaningful research or investigation has been conducted. Furthermore, informing the SARC of these discussions could bias the appeals decision by compromising the independent nature of the process through the use of information not subject to refutation by the appellant.

With regard to the Ombudsman's role in the process, we consider it reasonable for the Ombudsman's office to have closely analyzed the appeal case in order to be able to render a more informed decision as a SARC member under the 1995 Guidelines. Under the March 1995 Guidelines promulgated by the FDIC, the Ombudsman could consider the merits of matters under review by the DSC Director or on appeal to the SARC only in the Ombudsman's role as a SARC member. However, on June 28, 2004, the FDIC approved revised Guidelines, to be published in the *Federal Register*, that changed the composition and procedures of the SARC:

- The FDIC's Ombudsman will no longer have a formal role on the FDIC's SARC, and the membership will drop from five to three members.[4]

- The Ombudsman may consider the merits of a material supervisory determination before an institution has made an appeal to the SARC.

- The material supervisory determinations that have been appealed to the SARC or that have been resolved in a final SARC decision are ineligible for consideration by the Ombudsman.

- The Ombudsman may attend SARC meetings only at the invitation of the SARC.

The revised Guidelines address our concerns regarding the Ombudsman's role in the SARC's review of the appeal. Also, as discussed previously, the data based on external consultations was

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[4] In its new form, the SARC will consist of one of the three FDIC internal Directors, along with special assistants or deputies of the other two internal Directors. The FDIC's General Counsel would serve as a nonvoting member.

unofficial, and it would have been inappropriate to include such information in the appeal package provided to the SARC. As a result, we are not making a recommendation related to this finding.

CORPORATION COMMENTS AND OIG EVALUATION

We provided the SARC chairman and members a draft of this report, and an FDIC senior management official responded that they had no comments.

OBJECTIVE, SCOPE, AND METHODOLOGY

The overall audit objective was to determine whether the SARC has the authority to decide on supervisory appeals related to fair lending violations, all relevant facts were considered, and applicable requirements and procedures were followed in the Bank case. Although the Hotline complainant alleged that the SARC's decision was incorrect, the OIG does not substitute its judgment for that of the SARC and, therefore, does not opine on the merit of a SARC decision. We conducted audit work from November 2003 through June 2004 in accordance with generally accepted government auditing standards. We deferred beginning our audit work until after the SARC made its final decision so as not to interfere with the SARC's deliberative process.

To accomplish our objective we did the following:

- reviewed laws, policies, and procedures related to appeals of material supervisory determinations and referrals of fair lending violations to DOJ;
- reviewed DSC management and tracking reports for appeals;
- reviewed the DSC recommendations related to the Bank's appeal and the SARC hearing transcript;
- interviewed appropriate DSC management and staff;
- interviewed SARC members involved in the appeal; and
- interviewed state banking regulators involved in the case.

Government Performance and Results Act, Reliance on Computer-Generated Data, Fraud and Illegal Acts, and Management Controls

The limited nature of the audit objective did not require reviewing related performance measures under the Government Performance and Results Act or determining the reliability of computer-processed data obtained from the FDIC's computerized systems. Not performing assessments of these areas did not affect the results of our audit. In addition to reviewing the Hotline allegation associated with the appeals process, our audit included steps for providing reasonable assurance of detecting fraud and illegal acts. Additionally, we gained an understanding of relevant control activities by examining DSC-applicable policies and procedures as presented in the DSC *Compliance Examination Manual* and Regional Directors Memoranda. Our testing of internal controls was limited to reviews of compliance with applicable laws, regulations, policies, and procedures.

Pertinent Laws and Regulations

Section 309(a) of the Riegle Community Development and Regulatory Improvement Act of 1994, Public Law No. 103-325, codified at 12 U.S.C. (United States Code) § 4806, requires the FDIC (as well as the other federal banking agencies and the National Credit Union Administration) to establish an independent intra-agency appellate process to review material supervisory determinations. Guidance on the FDIC's intra-agency appellate process was published in the *Federal Register* on March 28, 1995. We did not find any instances in which the FDIC was not in compliance with pertinent laws and regulations. Appendix II of this report contains a summary of other laws, regulations, and FDIC policies related to appeals of material

supervisory determinations and referrals of fair lending violations to the DOJ.

Prior Audit Coverage

On March 26, 2004, the OIG issued an audit report entitled, *Division of Supervision and Consumer Protection's Supervisory Appeals Process* (Report No. 04-015). The report presented the results of the OIG's audit of the FDIC's process for reviewing safety and soundness ratings questioned and appealed by FDIC-supervised institutions. The objective of this audit was to determine whether the DSC followed appropriate procedures in upgrading a preliminary examination component rating of an institution and in processing the institution's appeal of its final safety and soundness examination ratings. We concluded that the FDIC complied with procedures related to upgrading preliminary examination ratings. However, we found opportunities to improve the procedures for processing appeals of material supervisory determinations and made four recommendations to address the area.

APPLICABLE LAWS, REGULATIONS, AND FDIC POLICIES AND PROCEDURES

Fair Lending Laws

<u>Fair Housing Act (42 U.S.C. § 3605, as implemented by regulations issued by the Department of Housing and Urban Development (HUD), 24 C.F.R. (Code of Federal Regulations), Part 100)</u>

The FHA was enacted by Public Law No. 90-284, as Title VIII of the Civil Rights Act of 1968. Under the FHA, it is unlawful to discriminate in: (1) the sale or rental of housing, (2) residential real-estate-related transactions, or (3) the provision of brokerage services. According to Section 805 (42 U.S.C. § 3605):

> It shall be unlawful for any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin.

As used in this section, the term "residential real-estate-related transaction" refers to:

> . . . the making or purchasing of loans or providing other financial assistance for purchasing, constructing, improving, repairing, or maintaining a dwelling; or secured by residential real estate; or the selling, brokering, or appraising of residential real property.

The enforcement responsibilities of the U.S. Attorney General are contained in Section 814 (42 U.S.C. § 3614) of the FHA, which states that:

> Whenever the Attorney General has reasonable cause to believe that any person or group of persons is engaged in a pattern or practice of resistance to the full enjoyment of any of the rights granted by this title, or that any group of persons has been denied any of the rights granted by this title and such denial raises an issue of general public importance, the Attorney General may commence a civil action in any appropriate United States district court.

<u>Equal Credit Opportunity Act (15 U.S.C. § 1691 et seq., as implemented by the FRB's Regulation B, 12 C.F.R., Part 202)</u>

The ECOA was enacted by Public Law No. 90-321 in 1974 as Title VII of the Consumer Credit Protection Act. The Congress found that there was a need to ensure that the various financial institutions and other firms engaged in the extensions of credit exercised their responsibility to make credit available with fairness, impartiality, and without discrimination. Specifically, Section 701(a) (15 U.S.C. § 1691(a)) of the Act states:

> It shall be unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction (1) on the basis of race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract);
> (2) because all or part of the applicant's income derives from any public assistance

program; or (3) because the applicant has in good faith exercised any right under the Consumer Credit Protection Act.

Section 702 (15 U.S.C. § 1691(a)) of the ECOA defines the term "applicant" as any person who applies to a creditor directly for an extension, renewal, or continuation of credit or applies to a creditor indirectly by use of an existing credit plan for an amount exceeding a previously established credit limit. The term "credit" means the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment or to purchase property or services and defer payment thereof.

Compliance with the requirements imposed under this title shall be enforced under Section 8 of the Federal Deposit Insurance Act (12 U.S.C. § 1818). According to Section 704(a)(1)(C) (15 U.S.C. § 1691c), the Board of Directors of the FDIC has administrative enforcement authority for state banks insured by the FDIC (other than members of the FRB) and insured state branches of foreign banks. The agencies having responsibility for administrative enforcement, if unable to obtain compliance with the ECOA, are authorized to refer the matter to the Attorney General with a recommendation that an appropriate civil action be instituted. Each agency shall refer the matter to the Attorney General whenever the agency has reason to believe that one or more creditors has engaged in a pattern or practice of discouraging or denying applications for credit in violation of section 701(a).

Appeals of Material Supervisory Determinations

Section 309(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 requires the FDIC (as well as the other federal banking agencies and the National Credit Union Administration) to establish an independent intra-agency appellate process to review material supervisory determinations.

The FDIC's *Intra-Agency Appellate Process* (61 *Federal Register* 7042, published March 28, 1995) implements Section 309(a) of the Riegle Community Development and Regulatory Improvement Act of 1994, requiring the FDIC to implement an appellate process for review of material supervisory determinations. The policy includes the *Guidelines for Appealing Material Supervisory Determinations*.

Financial Institution Letter No. 28-95, *Guidelines for Appealing Material Supervisory Determinations* (dated April 4, 1995), describes the types of determinations that are eligible for review, requirements for appeals, and the process by which appeals will be considered and decided.

Regional Director Memorandum 95-056, *Procedures for Processing Appeals of Material Supervisory Determinations* (dated May 15, 1995), establishes policy and procedures for meeting the obligations under the FDIC's appeal process.

DSC *Case Manager Procedures Manual*, Part I, Section 7, *Appeals*, contains case managers' instructions for processing appeals.

Filing Appeals with the FDIC is a brochure prepared by the FDIC Office of the Ombudsman.

The brochure describes the FDIC appeal process for material supervisory determinations and provides the steps, timeframes, and procedures associated with a formal appeal to the FDIC.

Referrals of Fair Lending Violations

Section 223 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), Public Law No. 102-242, amended Sections 706(g) and 706(h) of the ECOA to provide for referrals to the DOJ or notifications to HUD of suspected instances of credit discrimination as well as certain other violations of ECOA or the FHA. The FDIC's implementing guidelines are contained in FDIC Transmittal No. 97-003, *Guidelines for Referring Violations of Anti-Discrimination Provisions of the Equal Credit Opportunity and Fair Housing Acts to the Department of Justice or Notifying the Department of Housing and Urban Development of Violations of the Fair Housing Act* (Referral Guidelines), dated March 31, 1997.

The Referral Guidelines, together with the *Inter-agency Policy Statement on Discrimination in Lending* (Inter-agency Policy Statement), and the Federal Financial Institutions Examination Council (FFIEC) *Supervisory Enforcement Policy for Violations of Equal Credit Opportunity and Fair Housing Acts* (Enforcement Policy Statement), provide procedural guidance for addressing violations of the fair lending laws applicable to FDIC-supervised institutions.

The purpose of the Referral Guidelines is to provide procedures and instructions for referring violations of the anti-discrimination provisions, imposing affirmative corrective action, and providing advisement of rights whenever violations of the anti-discrimination provisions of the ECOA or FHA occur. According to the Referral Guidelines:

> The referral provisions of the ECOA, as amended by FDICIA, require that the federal financial institution regulatory agencies refer matters to the DOJ "whenever the agency has reason to believe that one or more creditors engaged in a pattern or practice of discouraging or denying applications for credit" in violation of ECOA's general rule prohibiting discrimination. Further, whenever one of the agencies has reason to believe, as a result of receiving a consumer complaint, conducting a consumer compliance examination or otherwise that: a) a violation has occurred and b) has reason to believe that the alleged violation would also be a violation of the FHA, and c) does not refer the matter to the DOJ, the agency must notify HUD of the alleged violation and must notify the applicant that HUD has been notified of the alleged violation and that remedies for the violation may be available under the FHA.

As a result of concern that some prospective homebuyers and other borrowers may be experiencing discriminatory treatment in their efforts to obtain loans, the inter-agency task force established a uniform policy against discriminatory lending. The Inter-agency Policy Statement applies to all lenders, mortgage brokers, issuers of credit cards, and any other person who extends credit of any type.

The Enforcement Policy Statement sets forth the general policies that apply to the FFIEC member agencies when enforcing provisions of the ECOA and the FHA. According to the Enforcement Policy Statement, coordination among the agencies is desirable to bring about uniformity in the administrative actions that will be taken when violations of the statutes are

detected. The policy states:

> The objective of this Enforcement Policy Statement is to ensure that the rights of credit applications are protected by requiring creditors to take corrective action for certain, more serious past violations of the Equal Credit Opportunity and Fair Housing Acts as well as to be in compliance in the future…. Whenever violations addressed by this Policy Statement are discovered, the creditor will be required to take action to ensure that such violations will not recur and to correct the effects of the violations discovered.

GLOSSARY OF TERMS

CAMELS	According to the *FDIC Manual of Examination Policies,* the Uniform Financial Institutions Rating System (UFIRS) was adopted by the Federal Financial Institutions Examination Council (FFIEC) on November 13, 1979. Examination ratings are based on a careful evaluation of an institution's managerial, operational, financial, and compliance performance. In 1996, revisions were made to UFIRS to include the addition of a sixth component addressing sensitivity to market risks. As a result, the six key components used to assess an institution's financial condition and operations are: **c**apital adequacy, **a**sset quality, **m**anagement capability, **e**arnings quantity and quality, adequacy of **l**iquidity, and **s**ensitivity to market risk. The six performance areas are identified by the acronym CAMELS.
Community Reinvestment Act (CRA)	The CRA was enacted as Title VII of the Housing and Community Development Act of 1977 and applies to all regulated federally insured financial institutions, excluding credit unions. The FDIC is responsible for evaluating the CRA activities of insured, state-chartered, nonmember financial institutions. CRA evaluations are used by the FDIC and the public to assess how a bank meets the lending, investment, and service needs of the community it serves. When a CRA evaluation is conducted, examiners must comment on any apparent fair lending violations and, if any exist, the CRA rating is affected.
Compliance Examination	Congress, by statute, has assigned the FDIC enforcement responsibilities for various consumer protection laws and regulations as they apply to financial institutions supervised by the FDIC. The compliance examination is the primary means by which the FDIC determines the extent to which a financial institution is meeting its responsibilities to comply with the requirements of these laws and regulations.
Fair Lending Requirements	Fair lending requirements are contained in two federal statutes. The first statute, the Fair Housing Act (FHA), was enacted by Title VIII of the Civil Rights Act of 1968. The second statute, the Equal Credit Opportunity Act (ECOA), was enacted by Title VII of the Consumer Credit Protection Act of 1974. Appendix II of this report contains a summary of the applicable sections of these laws.
Federal Financial Institutions Examination Council (FFIEC) Members	Members of the FFIEC include the Board of Governors of the Federal Reserve System, the FDIC, the National Credit Union Administration, the Office of Thrift Supervision, and the Office of the Comptroller of the Currency.

Guidelines for Appealing Material Supervisory Determinations	According to the FDIC's *Guidelines for Appealing Material Supervisory Determinations,* dated March 21, 1995, a material supervisory determination generally includes: examination ratings, determinations relating to the adequacy of loan loss reserve provisions, classifications of loans and other assets in dispute, determinations relating to violations of a statute or regulations, and any other supervisory determination that may affect the nature and level of supervisory oversight or impact on the capital, earnings, operating flexibility, or capital category for prompt corrective action purposes.
Guidelines for Referring Violations of Anti-Discrimination Provisions of the Equal Credit Opportunity and Fair Housing Acts to the Department of Justice (DOJ) or Notifying the Department of Housing and Urban Development (HUD) of Violations of the Fair Housing Act	Section 223 of the FDIC Improvement Act of 1991 amended the ECOA to require that the federal financial institution regulatory agencies refer matters to the Attorney General "whenever the agency has reason to believe that one or more creditors has engaged in a pattern or practice of discouraging or denying applications for credit" in violation of the ECOA's general rule prohibiting discrimination. The FDIC implemented this requirement through DSC Regional Director's Memorandum No. 97-003, dated March 31, 1997, which requires that the federal financial institution regulatory agencies refer matters to the DOJ "whenever the agency has reason to believe that one or more creditors are engaged in a pattern or practice of discouraging or denying applications for credit" in violation of ECOA's general rule prohibiting discrimination.
Inter-agency Fair Lending Examination Procedures	According to the *Inter-agency Fair Lending Examination Procedures*, the courts have recognized three methods of proof of lending discrimination under the ECOA and FHA: (a) overt discrimination occurs when a lender blatantly discriminates on a prohibited basis; (b) disparate treatment occurs when a lender treats applicants differently based on one of the prohibited factors; and (c) disparate impact occurs when a lender applies a practice uniformly to all applicants but the practice has a discriminatory effect on a prohibited basis and is not justified by business necessity.
Inter-agency Policy Statement	The *Inter-agency Policy Statement* describes the general principles that the member agencies will consider to identify lending discrimination in violation of the ECOA and FHA. The statement discusses what constitutes lending discrimination under these statutes and answers questions about how the agencies will respond to lending discrimination and steps lenders might take to prevent discriminatory lending practices. These agencies and departments participated in establishing the Inter-agency Policy Statement: the Office of Federal Housing Enterprise Oversight, Office of the Comptroller of the Currency, Office of Thrift Supervision, Board of Governors of the Federal Reserve System, FDIC, Federal Housing Finance Board, Federal Trade Commission, National Credit Union Administration, DOJ, and HUD.

Loan Loss Reserve (also called Allowance for Loan and Lease Losses (ALLL))	Federally insured depository institutions must maintain a loan loss reserve level that is adequate to absorb the estimated credit losses associated with the loan and lease portfolio (including all binding commitments to lend). To the extent not provided for in a separate liability account, the loan loss reserve should also be sufficient to absorb estimated credit losses associated with off-balance sheet credit instruments such as standby letters of credit.