Consumer and Community Affairs

In 1997 the Board's activities in the consumer protection area centered on making disclosures about transactions more helpful to consumers and focused particularly on automobile leases and real estate mortgages. The Board developed a major consumer education campaign related to the disclosures that consumers receive under its consumer leasing regulations. The initiative had participation from more than thirty agencies and organizations, resulting in the publication of an educational brochure on how to make informed leasing choices and the creation of a public Web site.

In the area of mortgage transactions, the Board joined with the U.S. Department of Housing and Urban Development (HUD) to review the disclosures currently given to consumers under the Truth in Lending Act and the Real Estate Settlement Procedures Act, seeking ways to make the disclosures more useful. The agencies determined that regulatory change alone would not achieve the desired improvements called for by the Congress and turned their attention to legislative changes to reform the current disclosure scheme.

The Board acted on bank and bank holding company applications that involved Community Reinvestment Act (CRA) protests, adverse CRA ratings, and issues of fair lending and noncompliance with consumer protection regulations. Several applications involving major bank mergers elicited both strong support and strong opposition from members of the public; all were protested on CRA grounds. After extensive analysis, the Board approved all these applications, finding in each case that convenience and needs factors were consistent with approval.

For CRA examinations of state member banks, the Board in 1997 focused on working with the other financial regulatory agencies to foster consistency in the application of examination procedures and on analyzing the data collected by large banks on small business and small farm loans and community development lending. For large institutions, revised CRA regulations became fully effective on July 1, 1997, so that all such institutions are now examined under the revised regulation and no longer have the option to be examined under the previous regulation.

In the fair lending area, in addition to pursuing corrective measures on its own, the Board referred several discrimination cases involving state member banks to the Department of Justice, including a case of alleged redlining in brokered loans. The Board referred other cases raising claims of alleged mortgage discrimination to HUD for investigation. The Board also published final rules governing "self tests" that allow lenders to keep findings from any self-tests they conduct confidential under a legal privilege; the rules are parallel to rules issued by HUD under the Fair Housing Act. The Board continued to improve the System's process for fair lending examinations, using enhanced statistical techniques to test large institutions for compliance.

Acting on behalf of the Federal Financial Institutions Examination Council (FFIEC) and HUD, the Board prepared Home Mortgage Disclosure Act statements for individual lenders and aggregate reports for metropolitan areas, meeting the statutory target for delivery. From the data, the Board noted that denial rates continued to show disparities among racial and ethnic groups and that although the number of loans to black applicants increased in 1996 as it had in previous years, the rate of growth decreased.

These matters are discussed below, along with other actions by the Board in the areas of consumer protection and community affairs.

Leasing Education and Regulatory Changes

Regulation M, which implements the Consumer Leasing Act, requires lessors to give consumers uniform disclosures of the costs and terms of a lease before the lease becomes legally binding. In September 1996, the Board adopted a revised Regulation M following a multiyear review under its Regulatory Planning and Review program. Through the review the Board identified ways to simplify the regulation to carry out more effectively the congressional intent of consumer protection. The review also led to the modernization of the rules, to address changes that have taken place in consumer leasing since 1976, the year the Consumer Leasing Act was enacted. The revisions included new disclosures, primarily for motor vehicle leasing, to improve consumers' understanding of lease transactions. The Board determined that these revisions were especially necessary given that about one-third of all passenger cars now delivered to consumers are leased rather than purchased and financed.

Throughout 1997, the Board worked to develop an educational program to ensure that consumers could take maximum advantage of the new disclosures about lease transactions. It organized a broad-based coalition of more than thirty agencies and organizations from the private and public sectors, including automobile manufacturers and dealers, leasing trade associations, consumer advocacy groups, Reserve Banks, the Federal Trade Commission, and state attorneys general.

This leasing education team developed "core messages" about leasing—key information that consumers need to make informed choices:

- Leasing is different from buying
- Consumers need to consider the costs at the beginning of, during, and at the end of the lease
- Consumers need to compare lease offers and negotiate some terms
- Consumers need to know their rights and responsibilities in lease transactions.

These core messages were incorporated into a new brochure, *Keys to Vehicle Leasing—A Consumer Guide*, which was released at a press conference in December. One million copies of the brochure were printed and are being distributed by the Federal Reserve and the other organizations that participated in its preparation.

The information in the brochure is also available on the Board's public Web site, and copies can be printed from there (http://www.bog.frb.fed.us/pubs/leasing). The Web site includes a glossary of leasing terms and provides links to the sites of some members of the leasing education team. In December alone, the Web site recorded almost 20,000 visits.[1]

1. The Board's Web site provides a wide array of other information, including educational brochures on home mortgages, guidance for filing complaints, the consumer compliance handbook, and credit card information. It also provides links to the Web sites of the FFIEC and the other financial regulatory agencies. For CRA, the agency sites provide data on CRA ratings, reports,

In March the Board amended Regulation M to implement changes to the Consumer Leasing Act enacted in 1996. The changes primarily streamline the advertising disclosures as specified in the act; they also revise the rules for disclosure of up-front costs in lease agreements to parallel the advertising rules and include several other technical changes.

The revised leasing rules adopted in 1996 made it necessary for leasing companies and automobile dealerships to develop new leasing forms and to reprogram the computer software used to produce the lease disclosures. The new rules (and the commentary interpreting them) were to become mandatory on October 1, 1997. In September 1997, the Board delayed the mandatory effective date for compliance to January 1, 1998, to give the nation's more than 22,500 new-car dealerships more time to install and test the computer software used to produce the disclosures.

TILA and RESPA Rules

During 1997 the Board and HUD studied ways to improve the disclosures about home mortgage transactions given to consumers under the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA). In 1996 the Congress required the two agencies to simplify and improve the disclosures if possible and to create a single format for use in complying with both laws. In December 1996, the agencies jointly published an advance notice of proposed rulemaking, seeking comment on regulatory and legislative changes that might achieve those goals.

and examination schedules; at year-end, work was under way to create a centralized interagency database of CRA ratings.

Following a review of the comments and an analysis conducted by the Board and HUD, the Board in March 1997 published a finding that, to achieve the goals set forth in the amendments, legislative rather than regulatory changes would be necessary. The Board invited public comment on possible statutory changes to TILA and received numerous letters from individual consumers. Consumers' primary concern was that disclosures about mortgage costs be given earlier in the process than they are now, so that they can use the disclosures to comparison shop before applying for a loan from a particular lender. Consumers also want the cost disclosures to be as accurate as possible, so that they will not face unexpected charges at loan closing, when they no longer have the flexibility to seek other financing.

In July, the Board and HUD testified before the Senate Banking Committee on ways to improve the disclosures and outlined their plans to develop legislative recommendations. Also in July, the Board and HUD held a public forum to hear views on major issues raised by reform efforts. The participants, who included consumer advocates, officials of state agencies, and trade associations representing lenders, mortgage brokers, and providers of settlement services, discussed the goals of TILA and RESPA and considered whether significant improvement can be made to the existing statutes or whether more comprehensive reform is needed. They talked about whether lenders should guarantee rates and other costs at the time of application. They also discussed preliminary findings from survey data on consumer credit shopping presented by the Board indicating that although many consumers rely on the annual percentage rate—the APR—when selecting a loan, few understand the measure's mathematical significance.

At year-end, the Board and HUD were preparing a report and recommendations on disclosures about home mortgage transactions, targeted for delivery to the Congress in 1998.

Other Regulatory Matters

Regulation B (Equal Credit Opportunity)

During 1997 the Board and HUD developed rules to govern "self tests" under the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act. (The two agencies were directed by amendments to the statutes to issue "substantially similar" rules.) In December 1996 the Board published a proposal to allow a creditor that voluntarily conducts a self-test of its operations to keep the results confidential under a legal "privilege." The privilege serves as an incentive to do self-testing by ensuring that any evidence of discrimination produced by a self-test conducted voluntarily will not be used against the creditor, provided the creditor takes appropriate corrective measures for any discrimination that is found.

The primary issue addressed in the rulemaking process was whether to define "self test" narrowly or broadly; the Board used a narrow definition in the proposal but solicited public comment on a broader definition.

The Board's final rule, published in December 1997, adopted the narrow definition. It defines a self-test as any program, practice, or study designed and used specifically to determine the extent or effectiveness of a creditor's compliance with the ECOA by creating data or other factual information that is not available and cannot be derived from loan or application files or other records related to credit transactions. It applies to the practice of using fictitious applicants for credit ("testers") but does not apply to creditor reviews and evaluations of loan and application files. (HUD published a similar rule to revise regulations implementing the Fair Housing Act.)

Regulation C (Home Mortgage Disclosure)

The Congress in 1996 raised the asset threshold for coverage of depository institutions under the Home Mortgage Disclosure Act (HMDA) from $10 million, setting a standard based on the consumer price index for urban wage earners and clerical workers (the CPIW); it left unchanged the asset measure for nondepository institutions. To implement this amendment, the Board in January 1997 published an interim rule making an initial adjustment to the asset threshold—to $28 million—on the basis of the change in the CPIW between 1975 and year-end 1996. The Board made the rule final in May. It will make future changes using the annual average of the CPIW for the twelve-month period ending in November, a schedule that will allow publication by December of any change in the threshold for the coming year.

The rule made final in May also establishes, pursuant to statutory changes, an alternative way for institutions to make HMDA disclosure statements available for public inspection. An institution must make a complete copy of its disclosure statement available to the public at its home office. For branch offices located in other metropolitan areas, it previously had to make disclosures available at one office in each area within ten calendar days; now it has the option of posting a notice informing the public that disclosures will be provided on request (and indicating the address to which requests should be sent).

In December, the Board adjusted the asset threshold to $29 million for data collection in 1998.

Regulation E (Electronic Fund Transfers)

In January 1997, the Board published a proposal to revise Regulation E to implement amendments to the Electronic Fund Transfer Act (EFTA) included in the Personal Responsibility and Work Opportunity Reconciliation Act of 1996. The amendments exempt from coverage ''needs tested'' electronic benefit transfer (EBT) programs established by or administered by state or local governments, including those for the disbursement of food stamps and cash assistance to needy families.

Federally administered programs—as well as pension and other employment-related EBT programs established by state or local governments—remain subject to Regulation E's special rules for government programs. Compliance with these special rules, which the Board adopted in 1994, became mandatory on March 1, 1997.

In March the Board submitted to the Congress, as required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996, a report on the possible costs and consumer benefits resulting from application of the EFTA to electronic stored-value products. The report considered several alternative approaches, including allowing competition in the market to determine which consumer protections are provided for a given electronic stored-value product. Among the sources of information used for the analysis were comments submitted to the Board in response to its 1996 proposal to extend the disclosure provisions of Regulation E to some electronic stored-value products.

The report noted that even minimal regulation (such as requiring only initial disclosures) could affect the development of electronic stored-value products if the incremental costs of complying with the regulation were large or if they differed from one product to the next. Because experience with electronic stored-value products to date is limited, the report concluded that it would be difficult to predict whether the benefits to consumers from any particular regulatory provision would outweigh the corresponding costs of compliance. The report did not endorse or recommend any specific course of action at this time.

Regulation Z (Truth in Lending)

In January the Board published proposed revisions to Regulation Z to carry out changes to the Truth in Lending Act enacted by the Congress in 1996. The amendments apply to variable-rate loans having a term of more than one year that are secured by the consumer's principal dwelling. Previously, creditors had to give a fifteen-year historical example of index values related to the interest rate. Now they have the option of providing a statement that the periodic payment may increase or decrease substantially, together with the disclosure of a maximum interest rate and a corresponding payment based on a $10,000 loan amount. The Board adopted a final rule in November.

In June the Board held public hearings in Los Angeles, Atlanta, and Washington, D.C., to determine how well the Home Ownership Equity Protection Act (HOEPA) is working. The HOEPA provisions of Truth in Lending apply to loans secured by the homeowner's principal dwelling if the interest rate or closing costs exceed certain levels. The law seeks to protect against abusive mortgage lending practices that target the elderly and the unsophisticated. The act requires credit disclosures, beyond those normally given, three days before a homeowner becomes obligated on a loan.

The Board heard a wide range of views. Lenders criticized the complexity of HOEPA's coverage tests and suggested simplifying the rules about which fees count toward the closing costs threshold (and raising the rate and fee thresholds to keep the same level of coverage). They also expressed concern about having to give new disclosures to correct even a small error, because doing so triggers a new three-day waiting period before funds can be disbursed. Consumer advocates asked for a more effective enforcement tool to address continuing abuses and also favored a prohibition on practices that they say place homes at risk of foreclosure, such as loans to borrowers who have high debt-to-income ratios and repeated refinancings (loan flipping) that add fees on top of fees.

Although the June hearings were devoted primarily to home equity lending, the Board also used them to explore other issues that it must consider in the future, including issues related to how Truth in Lending's finance charge disclosure could more accurately reflect the cost of consumer credit.

Actions under the Fair Credit Reporting Act

In March the Board submitted to the Congress a report concerning the availability and use of sensitive identifying information about consumers, such as their social security numbers. The report, required by amendments to the Fair Credit Reporting Act adopted in 1996, addresses the potential use of such information to commit financial fraud and the corresponding risk of loss to insured depository institutions.

The Board found that information about consumers is widely available from both government and commercial sources and that few legal constraints limit its collection, use, or dissemination. Some of the information is sensitive and can be used to facilitate unlawful activities, such as "identity theft" involving the illegal use of personal data to commit financial fraud. Losses from identify theft do not seem to present a significant risk to insured depository institutions at this time. Nonetheless, the report notes, this type of fraud is a growing risk to consumers and financial institutions, and relatively easy access to personal information may increase the risk. The report suggests steps that consumers and financial institutions could take to reduce the likelihood of fraud, but it makes no recommendations for legislative or administrative action.

In July the Board published for comment proposed amendments to the model forms in Regulation B related to consumer rights under the Fair Credit Reporting Act. The proposal relates to the disclosures that consumers must be given when they are denied credit on the basis of information obtained from a consumer reporting agency or from an affiliate of the creditor. Final action was pending at year-end.

Interpretations

In February the Board revised the official staff commentary to Regulation Z (Truth in Lending). The update gives guidance about new tolerances for the disclosure of finance charges and other matters in connection with home-secured installment loans.

In March the Board revised the official staff commentary to Regulation M (Consumer Leasing). The update offers guidance for compliance with Regulation M as revised by the Board in September 1996.

HMDA Data and Lending Patterns

The Home Mortgage Disclosure Act requires that mortgage lenders covered by the act collect and make public certain data about their home purchase, home improvement, and refinancing loan transactions. Depository institutions generally are covered if they were located in metropolitan areas and had assets above a certain threshold at the preceding year-end; mortgage companies are covered if they were located in or made loans in metropolitan areas and had assets of more than $10 million at the preceding year-end (when combined with the assets of any parent company), and are also covered, regardless of asset size, if they originated 100 or more home purchase loans in the preceding year.[2] In 1997, 8,367 depository institutions and affiliated mortgage companies and 961 independent mortgage companies reported HMDA data for calendar year 1996.

Lenders covered by HMDA submit information about the geographic location of the properties related to their loans and applications, the disposition of loan applications, and, in most cases, the race or national origin, income, and sex of applicants and borrowers. The Federal Reserve Board processes the data and produces disclosure statements on behalf of HUD and the member agencies of the Federal Financial Institutions Examination Council.[3]

The FFIEC prepares individual disclosure statements for lenders that reported data—one statement for each metropolitan area in which a lender had offices and reported loan activity. The 42,936 statements produced from the 1996 data cover 14.8 million loans and applications; the 32 percent increase in loans and applications over 1995 is largely attributable to a sharp increase in refinancing activity.[4] In July, each institution made its disclosure statements public; and in August, reports containing aggregate data for all lenders in a given metropolitan area were made available at central depositories in the nation's 332 metropolitan areas.

Lending institutions tend to specialize in different types of home loans. In 1996, depository institutions continued to be the predominant source of home improvement loans and loans for multifamily residences. Mortgage companies accounted for about 52 percent of the conventional home purchase loans reported under HMDA and about 80 percent of the government-backed home purchase loans.

Mortgage originators and institutions in the secondary market for mortgages, such as Fannie Mae (the Federal National Mortgage Association) and Freddie Mac (the Federal Home Loan Mortgage Corporation), offer a variety of conventional home loan programs, often in concert with private mortgage

2. Through 1996, the asset threshold for depository institutions was $10 million. In September 1996, the Congress amended HMDA to raise the asset threshold according to changes in the CPIW. See "Other Regulatory Matters" above.

3. The member agencies of the FFIEC are the Board, the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

4. A summary of the 1996 HMDA data appears in a series of special tables in the *Federal Reserve Bulletin*, vol. 83, no. 9 (September 1997), pp. A68–A75.

insurers, to benefit low-income and minority households and neighborhoods. In recent years, these institutions have expanded their program offerings, which may account for the continuing increase in loans to these homebuyers. From 1993 to 1996 the number of conventional home purchase loans to low-income borrowers increased 37 percent, compared with 23 percent for high-income borrowers.

The Federal Housing Administration (FHA) also has adopted measures to enhance borrowing opportunities for low-income households; at the same time, it has worked to make FHA loans more competitive. The agency has lowered its insurance premiums, increased flexibility in its underwriting standards, and raised the maximum size of the loans that it will back. Between 1993 and 1996 the number of government-backed home purchase loans (predominantly FHA-insured) increased 19 percent for low-income borrowers, compared with 5 percent for high-income borrowers.

Lending Patterns

Home purchase lending to minority homebuyers has increased markedly in recent years: From 1993 to 1996 the number of home purchase loans extended to black applicants increased 53 percent, to Hispanic applicants 56 percent, and to Asian applicants 15 percent—compared with 14 percent for white applicants. However, the growth of lending to blacks slowed in 1996 and was less than the national average. The slower growth may have been due in part to the relatively weaker housing markets in that year in states that have relatively large black populations, principally some states in the mid-Atlantic region and a number of southern states.

The 1996 HMDA data continue to show higher rates of credit denial for conventional home purchase loans for black and Hispanic applicants than for Asian and white applicants, even within the same income brackets. Overall denial rates for conventional home purchase loans were 49 percent for black applicants, 34 percent for Hispanic applicants, 14 percent for Asian applicants, and 24 percent for white applicants. All these rates were higher than in 1993, 1994, and 1995.[5]

The increase in denial rates over time stems in part from changes in the home lending market. First, the number of applications submitted to ‘‘subprime’’ lenders and to institutions that extend loans for the purchase of manufactured homes has increased substantially. These lenders’ denial rates are quite high (about 55 percent on average, compared with about 13 percent for other lenders), and their increasing share of all applications for conventional home purchase loans (25 percent in 1996 compared with 11 percent in 1993) results in higher overall denial rates. Second, applications by low-income households constitute an increasing share of all applications. Because low-income households tend to have relatively high denial rates, overall denial rates also tend to rise. Finally, the incidence of multiple applications has increased over time. Applicants who submit applications to more than one prospective lender have high denial rates, and their growth in the pool of all applicants also tends to raise overall denial rates.

The data collected under HMDA do not include the wide range of financial and property-related factors that lenders consider in evaluating loan

5. For details, see the Special Tables section in the September issue of the *Federal Reserve Bulletin* for 1995 and subsequent years.

applicants. Thus, the HMDA data alone do not provide an adequate basis for determining whether a particular lender is discriminating unlawfully. But because they can be supplemented by other information available to lenders' supervisory agencies, the data are an important tool in the enforcement of fair lending laws.

Use of Data by Other Agencies

Lenders who sell their loans in the secondary market are required under HMDA to identify the category of purchaser (for example, Fannie Mae or Freddie Mac). The information helps make it possible to assess the relative performance of institutions in serving the credit needs of lower-income and minority homebuyers.[6]

In its oversight of the housing activities of government-sponsored entities, HUD uses the HMDA data to help assess the efforts of Fannie Mae and Freddie Mac to support mortgages for low- and moderate-income families and mortgages on properties in targeted communities. The data also serve as one component of the fair lending reviews conducted by HUD and the Department of Justice. In addition, the data assist HUD, the Department of Justice, and state and local agencies in responding to allegations of lending discrimination filed by loan applicants and borrowers and assist in the agencies' targeting of lenders for further inquiry.

6. See, for example, the discussion of which institutions bear the credit risk of mortgages extended to lower-income and minority homebuyers in Glenn B. Canner, Wayne Passmore, and Brian J. Surette, "Distribution of Credit Risk among Providers of Mortgages to Lower-Income and Minority Homebuyers," *Federal Reserve Bulletin,* vol. 82 (December 1996), pp. 1077–1102.

Private Mortgage Insurance

The FFIEC, on behalf of the nation's eight active private mortgage insurance (PMI) companies, compiles information on applications for private mortgage insurance similar to the information on home mortgage lending collected under HMDA. Lenders typically require private mortgage insurance for conventional mortgages that involve small down payments.

Working through their national trade association, the Mortgage Insurance Companies of America, the PMI companies submit their data to the FFIEC on a voluntary basis. The FFIEC prepares disclosure statements for each company and aggregate reports for metropolitan areas. These reports are available for public review at the central depositories at which the HMDA data are available.[7]

Fair Lending

Under the Equal Credit Opportunity Act, the Board is required to refer to the Department of Justice any violations that it has reason to believe constitute a "pattern or practice" of unlawful discrimination. The Board made four such referrals during 1997. Two of the cases involved discrimination on the basis of marital status, and a third, discrimination on the basis of age. The three matters were returned to the Board for enforcement.

The fourth case, which was still under consideration by the Department of Justice at the close of 1997, involved a determination that a lender had apparently engaged in discriminatory "redlining" in residential loans, in violation of

7. A summary of the 1996 PMI data appears in a series of special tables in the *Federal Reserve Bulletin,* vol. 83, no. 9 (September 1997), pp. A76–A79.

both the ECOA and the Fair Housing Act. The alleged redlining occurred when the lender, which brokered loans for another institution, honored the practice of that institution to refrain from taking applications from persons residing in designated urban areas. The Board's examination had demonstrated that those urban areas had significantly higher percentages of minority residents than the remainder of the institution's market area and that the lender appeared to have no nondiscriminatory explanation for adhering to the institution's redlining policy.

Community Development

The Federal Reserve System, through its Community Affairs programs at the Board and the Reserve Banks, engages in ongoing outreach, informational, and educational activities to help financial institutions and the public understand and address financial services issues affecting low- and moderate-income persons.

In 1997, six Reserve Banks—Boston, New York, Cleveland, St. Louis, Chicago, and San Francisco—reached the final stages of their Residential Mortgage projects following a two-year initiative in selected cities to help identify and address barriers to equal access to credit in the homebuying process. In earlier stages, the Reserve Banks had brought together community representatives and key industry participants in the homebuying process to discuss problems that affect minority and lower-income homebuyers and to forge solutions. Task groups reported their findings during 1997. Implementation of their recommendations by community and industry groups, separately and in joint efforts, is expected to improve equal access to credit over the long term in the cities studied.

Although community development, reinvestment, and fair lending continued to be central to Community Affairs educational and technical assistance activities, 1997 was marked by a broader approach to the economic issues confronting low- and moderate-income communities. The New York Reserve Bank, for example, sponsored a conference on welfare reform and its implications for lower-income communities. The Minneapolis Reserve Bank helped organize focus groups to discuss the possible effects of increased use of electronic banking services on low- and moderate-income residents.

The development and sponsorship of educational activities remained a major undertaking of the Federal Reserve's Community Affairs programs in 1997. Overall, the Reserve Banks sponsored or cosponsored 233 conferences, seminars, and informational meetings on community development, reinvestment, and fair lending topics. The programs were attended by more than 11,600 bankers, bank examiners, and representatives of small businesses and community and consumer groups. Additionally, staff members from the Board and the Reserve Banks made more than 275 presentations at conferences, seminars, and meetings sponsored by banking, governmental, business, and community organizations.

Programs in 1997 reflected a growing concern with issues related to small business finance and economic development. The Cleveland Reserve Bank, working with the U.S. Small Business Administration and the National Council for Smaller Enterprises, spearheaded an "Access to Capital" initiative for the Cleveland area. The initiative will bring together business leaders to review the credit process, identify possible barriers faced by small firms, and make recommendations for improving these firms' access to financing. The Boston and San Francisco Reserve Banks sponsored conferences and workshops on the financing and technical assistance needs of women-owned businesses. The Dallas Reserve Bank sponsored a symposium on financing for very small firms—‘‘microenterprises’’—and the Boston Reserve Bank helped create a training curriculum on microenterprise development.

Economic development in rural areas and on Indian reservations was the focus of educational forums at several Reserve Banks. The Chicago Reserve Bank sponsored a conference on rural community economic development, and the Minneapolis Reserve Bank sponsored a workshop on women’s access to credit and capital in rural areas and on Indian reservations. The Kansas City and Minneapolis Reserve Banks worked with the Montana–Wyoming Tribal Leaders Council and the University of Montana Law School to cosponsor a conference on building tribal infrastructure to support economic prosperity.

In 1997 the Community Affairs programs developed or expanded a variety of publications and other informational resources directed at bankers, small businesses, and community organizations. The Minneapolis Reserve Bank published a revised and expanded second edition of *Principles and Practices for Community Development Lending*, and the Richmond Reserve Bank published a special *Marketwise Report* on ‘‘Community-Based Development.’’ The Reserve Banks published a combined total of thirteen different community affairs newsletters dealing with various aspects of community and economic development, reinvestment, and fair lending. The combined circulation of these newsletters in 1997 grew to more than 73,000, including bankers, small-business owners, representatives of community-based development and consumer groups, and housing, community, and economic development officials.

Outreach and technical assistance to banks—and to community representatives interested in bank involvement in reinvestment and community development initiatives—continued to play a major role in Community Affairs programs in 1997. Members of the Community Affairs staffs at the Board and the Reserve Banks conducted more than 1,600 outreach meetings with representatives of financial institutions and local communities to explore community credit needs and issues related to the provision of financial services.

In conjunction with their outreach efforts, several Reserve Banks develop, for selected communities, profiles that identify key community and economic development needs and describe some organizations that can serve as resources. These profiles are made available to banks and to community and business organizations, and they often help stimulate collaborative approaches to community reinvestment. During 1997, the New York Reserve Bank published profiles for Westchester County in New York and for Bergen and Passaic Counties in New Jersey, and the Chicago Reserve Bank published a profile for the metropolitan area of Saginaw–Bay City–Midland in Michigan.

The St. Louis Reserve Bank developed a profile for the Springfield, Missouri, metropolitan area and worked with the Dallas Reserve Bank on a profile of the Texarkana metropolitan area. The Richmond Reserve Bank developed a profile of the tricounty area surrounding Petersburg, Virginia.

The San Francisco Reserve Bank developed profiles for the states of Utah, Idaho, and Washington and the cities of Portland, San Diego, Los Angeles, Sacramento, San Francisco, San Jose, Las Vegas, and Phoenix. Each profile, about sixty pages long, gives an overview of the economic and demographic characteristics of the area and includes a directory of community and government organizations, programs of interest to bankers, and lending, service, and investment opportunities for financial institutions.

The Atlanta Reserve Bank completed work on a community contacts database designed to facilitate accessibility and greater use of outreach information. The database has been adopted for use by several other Reserve Banks, and the database design has been adopted by the FFIEC to facilitate interagency sharing of community contact information for use in assessments of CRA performance.

In 1997, the Board helped organize the first formal interagency meeting of Community Affairs representatives of the federal supervisory agencies. Participants exchanged information on their agencies' community affairs programs, discussed community development and reinvestment issues, and explored ways in which the agencies might coordinate their activities.

Community Affairs programs continued in 1997 to provide support as the Federal Reserve carried out its supervisory responsibilities. Board and Reserve Bank staff members helped to review proposals regarding community development investment by banks and bank holding companies and to analyze HMDA and CRA data on small-business lending for use in community affairs research and publications; and in conducting CRA examinations, Reserve Bank examiners increasingly made use of community contacts and other information provided by Community Affairs staff members.

Finally, Board and Reserve Bank staff members provided considerable support to members of the Board of Governors and to Reserve Bank presidents, who in 1997 gave increased attention to community development, reinvestment, fair lending, and consumer credit issues. Members of the Board made speeches at conferences and meetings of community, consumer, and civil rights groups and toured lower-income neighborhoods and community development projects in Reserve Bank cities. A member of the Board continued to serve on the board of directors of the Neighborhood Reinvestment Corporation. Activity by the Subcommittee on Community Affairs of the System's Conference of Presidents also increased.

Economic Effects of the Electronic Fund Transfer Act

In keeping with statutory requirements, the Board monitors the effects of the Electronic Fund Transfer Act on the compliance costs and consumer benefits related to electronic fund transfer services. In 1997 the economic effects of the act generally increased because of continued growth in the use of EFT services, although an exemption for certain electronic benefit transfer programs reduced costs for state and local governments.

As revised in 1997, Regulation E exempts "needs tested" EBT programs established or administered by state or local governments. The exemption reduces the cost of providing benefits electronically and eliminates uncertainty about potential losses associated with Regulation E's liability rules. Thus, it will likely encourage the states to develop EBT programs. Without Regulation E, the protections previously afforded benefit recipients, especially protections against unauthorized use, may be diminished somewhat. However, electronic delivery will likely provide benefit recipients greater security than the paper-based delivery systems previously used.

During the 1990s, the proportion of U.S. households using EFT services has grown at an annual rate of about 2 percent. About 85 percent of households now have one or more EFT features on their accounts at financial institutions.

Automated teller machines remain the most widely used EFT service. Nearly two-thirds of all U.S. households currently have ATM cards, and most of the nation's depository institutions offer consumers access to ATMs. Access to ATMs has been enhanced by the operation of shared networks; almost all ATM terminals are part of one or more shared networks. Over the past year, the number of ATM transactions increased about 3 percent, from 890.3 million per month in 1996 to 915.0 million per month in 1997. Over the same period, the number of installed ATMs rose 19 percent, to 165,000.

Direct deposit is another widely used EFT service. More than half of all households in the United States receive direct deposit of funds into their accounts. Direct deposit is particularly widespread in the public sector, accounting for more than half of social security payments and two-thirds of federal salary and retirement payments. It is less common in the private sector but has grown substantially in recent years. Taking into account both public and private payments, the proportion of households receiving direct deposits has grown about 5 percent a year during the 1990s.

Nearly a third of households now have debit cards, which consumers use at the point of sale to debit their transaction accounts. Point-of-sale systems still account for a small share of electronic transactions, but their use continued to grow rapidly in 1997. Over the past year, the number of point-of-sale transactions rose 26 percent, to 120.2 million per month from 95.5 million per month in 1996, and the number of point-of-sale terminals rose 49 percent, to 1.3 million.

The incremental costs associated with the EFTA are difficult to quantify because no one knows how industry practices would have evolved in the absence of statutory requirements. The benefits of the law are also difficult to measure because they cannot be isolated from consumer protections that would have been provided in the absence of regulation.

The available evidence suggests no serious consumer problems with electronic transactions at this time. In 1997, about 94 percent of depository institutions examined by federal banking agencies were in full compliance with Regulation E. Violations primarily involved failure to provide all the required consumer disclosures. Consumer complaints and inquiries filed with the System are another source of information about potential problems. In 1997, 114 of the complaints processed involved electronic transactions; of the 52 that involved state member banks, none involved a violation of the EFTA or Regulation E. The 62 complaints that did not involve state member banks were forwarded to other agencies for resolution.

Compliance Examinations

Since 1977 the Federal Reserve System has maintained a consumer compliance examination program to ensure that state member banks and foreign banking organizations subject to Federal Reserve examination comply with federal laws governing consumer protections in financial services.

The Oversight Section of the Board's Division of Consumer and Community Affairs coordinates compliance examinations, which are conducted by the consumer affairs examination units of the twelve Reserve Banks. The section reviews a sample of the examinations for effectiveness, adherence to System policy, and uniformity of approach.

During the 1997 reporting period (July 1, 1996, through June 30, 1997), the Federal Reserve conducted 839 examinations for compliance with consumer protection laws: 599 of state member banks and 240 of foreign banking organizations.[8]

Examiner training in the areas of consumer compliance, fair lending, and the Community Reinvestment Act is an important aspect of the Federal Reserve's compliance program. New Reserve Bank examiners attend a two-week basic consumer compliance school, and examiners with six to twelve months of field experience attend a two-week advanced consumer compliance school, a two-week fair lending school, and a one-week course in CRA examination techniques. During the 1997 reporting period, the System conducted three basic consumer compliance schools for a total of fifty-nine participants, two advanced consumer compliance schools for thirty-two participants, three fair lending schools for fifty-three participants, and three courses in CRA examination techniques for sixty-six participants.

The Reserve Banks supplement examiner training through departmental meetings and special training sessions. In addition, examiners from the Reserve Banks routinely participate in special projects that give them an opportunity to widen their perspective through working with other System examiners and Board staff.

During 1997, the Board and the FDIC entered into a memorandum of understanding to jointly develop an examiner-workstation module to provide automated assistance in three areas of compliance examinations: loans, deposit operations, and home mortgage disclosures. The goals of this joint effort are to increase consistency in examinations, to reduce the time examiners spend on site, and to provide tools that decrease the time examiners spend entering data needed for examinations.

The FFIEC is the interagency coordinating body charged with developing uniform examination principles, standards, and report forms. In 1997, the member agencies of the FFIEC jointly revised examination procedures to reflect changes in consumer protection laws and regulations, including the Flood Disaster Protection Act, the Truth in Lending Act, the Fair Debt Collection Practices Act, the Real Estate Settlement Procedures Act, and the Electronic Fund Transfer Act.

In addition, the FFIEC worked to promote consistency in examinations among the agencies responsible for implementing the CRA. Examiners from the Board, the FDIC, the OCC, and the OTS reviewed the examination process for small institutions, and the agencies implemented some of their recommendations for revising examination procedures and the public evaluation format.

8. The foreign banking organizations examined by the Federal Reserve are organizations operating under section 25 or 25(a) of the Federal Reserve Act (Edge Act and agreement corporations) and state-chartered commercial lending companies owned or controlled by foreign banks. These institutions are not subject to the Community Reinvestment Act, and, typically, in comparison with state member banks, engage in relatively few activities that are covered by consumer protection laws.

To foster consistency in the application of the examination procedures for large institutions, the agencies held three interagency training sessions under the auspices of the FFIEC. The agencies are also reviewing the implementation of the procedures for examining institutions under the lending, investment, and service tests by reviewing the written performance evaluations and conducting interagency examinations of eight large institutions. They expect to provide examiner training on the basis of their findings and to provide interpretive guidance on issues identified through the project.

The FFIEC expanded its CRA Web site to make information on CRA more readily available to the public. The site now includes the CRA regulation; an interagency question-and-answer document; examination procedures; interpretive letters; CRA data collected from large institutions; and links to each member agency's CRA Web site for information on CRA ratings, examination schedules, and performance evaluations.

Community Reinvestment Act

The Federal Reserve assesses the CRA performance of state member banks during regular compliance examinations and takes the CRA record (as well as other factors) into account when acting on applications from state member banks and from bank holding companies.

The Federal Reserve System has a three-faceted program for fostering and enforcing better bank performance under the CRA:

- Examining institutions to assess compliance
- Disseminating information on community development techniques to bankers and the public through community affairs offices at the Reserve Banks
- Performing CRA analyses in connection with applications from banks and bank holding companies.

During the 1997 reporting period (July 1, 1996–June 30, 1997), the Federal Reserve conducted 586 CRA examinations. Of the banks examined, 152 were rated ''outstanding'' in meeting community credit needs, 423 were rated ''satisfactory,'' 10 were rated ''needs to improve,'' and 1 was rated as being in ''substantial noncompliance.''

Regulation BB, as revised in 1995, provides for different evaluation methods depending on an institution's size, structure, and operations. The performance standards for small banks became effective on January 1, 1996. Also as of that date, institutions could choose whether (1) to submit a strategic plan to serve as a basis for their evaluations, (2) to be evaluated under the lending, investment, and service tests if they were large institutions, or (3) to request to be designated wholesale or limited purpose institutions and be examined under the regulation's community development test. Using the lending, service, and investment tests for large retail institutions was mandatory after July 1, 1997, meaning that they could no longer be evaluated under the earlier regulation. Of the 586 CRA examinations conducted by the Federal Reserve during the reporting period, 460 used the new assessment method for small banks; 86 used the assessment-factor method of the earlier regulation; 39 used the lending, investment, and service tests; and 1 used the community development test. During the 1997 reporting period, the Board also approved one bank's strategic plan and approved four banks' requests to be designated wholesale institutions.

Agency Reports on Compliance with Consumer Regulations

The Board is required to report annually on compliance with the regulations that implement the Equal Credit Opportunity Act, the Electronic Fund Transfer Act, the Consumer Leasing Act, the Truth in Lending Act, and the Expedited Funds Availability Act and with the prohibition in Regulation AA against unfair and deceptive practices. For purposes of this report, the Board assembles data from the Reserve Banks and collects data from the four other financial regulatory agencies (the FDIC, the OCC, the OTS, and the NCUA) and from other federal supervisory agencies.[9] The extent of compliance with these regulations varied widely in 1997, but, overall, compliance was better than in 1996. The following sections summarize compliance data for July 1, 1996, through June 30, 1997 (referred to here as the 1997 reporting period, or simply 1997).

Equal Credit Opportunity Act (Regulation B)

The five financial regulatory agencies reported that 80 percent of the institutions examined during the 1997 reporting period were in full compliance with Regulation B, compared with 78 percent for the 1996 reporting period. Of the institutions not in full compliance, 71 percent had one to five violations (the lowest frequency category). The most frequent violations involved the failure to take one or more of the following actions:

- Provide a written notice of adverse action containing a statement of the action taken, the name and address of the creditor, an ECOA notice, and the name and address of the federal agency that enforces compliance
- For monitoring purposes, collect information about the race or national origin, sex, marital status, and age of applicants seeking credit primarily for the purchase or refinancing of a principal residence
- Notify an applicant of the action taken within the time frames specified in the regulation
- Give a statement of reasons for adverse action that is specific and indicates the principal reasons for the credit denial or other adverse action
- Take a written credit application for the purchase or refinancing of a principal residence
- Retain proper records of credit transactions.

The OTS issued three formal enforcement actions addressing violations of Regulation B, and the FDIC issued two formal enforcement actions addressing violations of consumer protection regulations, including Regulation B.

In 1997, the Federal Trade Commission (FTC) obtained consent decrees against two consumer finance companies for violations of the ECOA. In one case, the decree addressed allegations that the finance company discriminated against applicants on the basis of age and the fact that their income derived from public assistance. In the other case, the finance company failed to provide applicants who were denied credit a written notice of adverse action. The FTC is continuing its work with other government agencies and with creditor

9. The financial regulatory agencies use different methods to compile data on compliance, which are presented here in terms of percentages of financial institutions supervised or examined. Consequently, the data support only general conclusions.

and consumer organizations to increase awareness of, and compliance with, the ECOA.

The other agencies that enforce the ECOA—the Farm Credit Administration (FCA), the Department of Transportation, the Securities and Exchange Commission (SEC), the Small Business Administration, and the Grain Inspection, Packers and Stockyards Administration of the Department of Agriculture—reported substantial compliance among the entities they supervise. The FCA's examination and enforcement activities revealed certain violations of the ECOA, most of them due to creditors' failure to collect monitoring information and to comply with rules regarding adverse action notices; however, no formal actions were initiated. The SEC reported that no violations of Regulation B were detected during examinations of registered broker–dealers conducted by self-regulatory organizations, the agency's principal method of reviewing for compliance.

Electronic Fund Transfer Act (Regulation E)

The five financial regulatory agencies reported that approximately 94 percent of the institutions examined during the 1997 reporting period were in compliance with Regulation E, the same percentage as in 1996. Financial institutions most frequently failed to comply with the following provisions:

- Provide, at least once each calendar year, a notice of the procedures for resolving alleged errors
- After receiving notice of an error, investigate the alleged error promptly, determine whether an error was actually made, and transmit the results of the investigation and determination to the consumer within ten business days
- Provide an adequate initial disclosure at the time a consumer contracts for an EFT service or before the first transfer is made
- Provide customers with a periodic statement of all required information at least quarterly, or monthly if EFT activity occurred.

The OTS issued one formal enforcement action addressing violations of Regulation E during the 1997 reporting period. The FTC issued a final decision and order that was incorporated into a consent decree, settling charges against a telemarketing company for failing to obtain written authorization from consumers for preauthorized transfers. In addition, the FTC accepted for public comment consent agreements in three cases alleging violations of the EFTA; the cases involved free trial offers that resulted in unexpected charges for many consumers. The FDIC issued two formal enforcement actions addressing violations of consumer protection regulations, including Regulation E.

The SEC reported that no violations of Regulation E were detected during examinations of registered broker–dealers conducted by self-regulatory organizations.

Consumer Leasing Act (Regulation M)

The five financial regulatory agencies reported substantial compliance with Regulation M for the 1997 reporting period. As in 1996, more than 99 percent of the institutions examined were in full compliance with the regulation. The few violations involved failure to adhere to specific disclosure requirements.

In 1997 the FTC issued five final decisions and orders against major automobile manufacturers to address violations of the Consumer Leasing Act

(CLA) and the Truth in Lending Act (TILA). The orders settled charges that the five companies had violated the CLA in lease promotions that featured low monthly payments or low amounts down in large, bold print but hid additional costs and sometimes contradictory information in ‘‘mouse print’’ that was difficult or impossible to read. The complaints in these cases also charged the companies with violating the CLA by failing to clearly and conspicuously disclose various lease costs and terms as required.

In two other cases, the FTC issued final decisions and orders against automobile dealerships for deceptive credit and lease agreements in violation of the CLA and TILA. The FTC also issued for public comment consent agreements with two major automobile manufacturers, and with five dealerships and their chief executive officers in the St. Louis area, for violations of the CLA and TILA involving misrepresentation and hiding or failing to disclose adequately the terms of advertised automobile lease deals.

In 1997 the FTC continued its education efforts among consumers and businesses and published a new brochure for businesses giving information about the advertising requirements of revised Regulation M.

Truth in Lending Act (Regulation Z)

The five financial regulatory agencies reported that 75 percent of the institutions examined during the 1997 reporting period were in full compliance with Regulation Z, compared with 70 percent in 1996. The Board reported a decrease in compliance, the FDIC and the OTS reported an increase, and the OCC and the NCUA reported an unchanged level of compliance. The five agencies indicated that of the institutions not in compliance, 62 percent were in the lowest-frequency category (one to five violations), compared with 63 percent in 1996.

The violations of Regulation Z most often observed were failure to accurately disclose the finance charge, payment schedule, annual percentage rate, and amount financed and failure to provide a disclosure reflecting the terms of the legal obligation between the parties.

The OTS issued five formal enforcement actions addressing violations of Regulation Z, and the FDIC issued two formal enforcement actions addressing violations of consumer protection regulations, including Regulation Z.

A total of 261 institutions supervised by the Board, the FDIC, or the OTS were required, under the Interagency Enforcement Policy on Regulation Z, to refund $2.6 million to consumers in 1997 because of improper disclosures.

The Department of Transportation continued during 1997 to prosecute a cease-and-desist consent order issued in 1993 against a travel agency and a charter operator. The complaint alleged that the two organizations had violated Regulation Z by routinely failing to send credit statements for refund requests to credit card issuers within seven days of receiving fully documented credit refund requests from customers. A motion for a summary judgment is pending before an administrative law judge.

The FTC during the year issued two final decisions and orders in cases alleging deceptive disclosures and understated credit terms, including the annual percentage rate, in violation of Regulation Z and TILA. Another final decision and order included civil penalties and consumer redress for alleged violations of a prior FTC order relating to failure to include mandatory credit insurance and other costs in credit disclosures to consumers. The agency also issued seven final decisions and orders and accepted for public comment consent agreements in seven other cases involving lease and credit advertising. These cases alleged deceptive lease and credit advertising, in violation of the CLA or TILA—specifically, failure to clearly and conspicuously or accurately provide required lease or credit advertising disclosures.

During the year the FTC also continued its consumer and business education efforts through training seminars in several regions of the country.

Expedited Funds Availability Act (Regulation CC)

The five financial regulatory agencies reported that 87 percent of institutions examined during the 1997 reporting period were in full compliance with Regulation CC, the same percentage as in 1996. Of the institutions not in full compliance, 66 percent had one to five violations (the lowest-frequency category). Institutions most frequently failed to comply with the following provisions:

- Follow special procedures for large deposits
- Adequately train employees and provide procedures to ensure compliance
- For deposits not subject to next-day availability, provide immediate availability to $100
- Make funds from certain checks, both local and nonlocal, available for withdrawal within the times prescribed by the regulation
- Provide disclosures of the institution's availability policy.

The OTS issued two formal enforcement actions addressing violations of Regulation CC, and the FDIC issued two formal enforcement actions addressing violations of consumer protection regulations, including Regulation CC.

Unfair and Deceptive Acts or Practices (Regulation AA)

The three financial regulatory agencies with responsibility for enforcing Regulation AA's Credit Practices Rule reported that 97 percent of the institutions examined during the 1997 reporting period were in full compliance with the regulation. The most frequent violation was failure to provide a clear, conspicuous disclosure regarding a cosigner's liability. No formal enforcement actions for violations of Regulation AA were issued during the period.

Applications

In February, the Board adopted amendments to Regulation Y (Bank Holding Companies and Change in Bank Control) that streamlined the applications process for mergers and acquisitions. Bank acquisition proposals from well-capitalized and well-managed bank holding companies having "satisfactory" or better CRA examination records are now eligible for consideration using an expedited review process. Also, comments submitted after the close of the public comment period are no longer routinely considered by the System.

In 1997 the Federal Reserve System acted on twenty-four bank and bank holding company applications that involved CRA protests and six that involved adverse CRA ratings. The System reviewed another twenty applications involving fair lending and other issues related to compliance with consumer protection laws.[10] Among the applications processed were several related to major bank acquisitions that were protested on CRA grounds. The Board approved these applications, finding in each case that convenience and needs considerations, including CRA performance records, were consistent with approval, as described below.

In February, the Board approved the application by Marine Midland Bank (Buffalo) to merge with First Federal Savings and Loan of Rochester (Rochester). Commenters expressed concern that the closing of certain branches operated by the two companies would adversely affect low- and moderate-income neighborhoods. In its order approving the application, the Board directed Marine Midland to submit its plan for branch closures, consolidations, and relocations to the New York Reserve Bank. For each branch being closed in a low- or moderate-income or predominantly minority census tract, Marine Midland will indicate how it plans to help meet the convenience and needs of the affected community. Marine Midland will also notify the Reserve Bank of any changes to the plan for a period of two years or until the Reserve Bank conducts its next CRA performance examination.

In April, the Board approved the application of Banc One Corporation (Columbus), at that time the nation's tenth largest banking organization, to acquire Liberty Bancorp, Inc. (Oklahoma City). The order noted that each of Banc One's thirty subsidiary banks had received "outstanding" or "satisfactory" ratings at their most recent CRA examinations. The Board also considered certain preliminary information developed in the course of its supervision of Banc One that raised questions about fair lending oversight, procedures, and practices at Banc One Mortgage Corporation, a nonbank subsidiary of the bank holding company. In its order, the Board noted that the Federal Reserve was conducting an examination of Banc One Mortgage Corporation to resolve these issues and to ensure compliance with the law. If the examination were to reveal a problem, the Board has the supervisory authority to require the bank holding company and the nonbank subsidiary to address the deficiencies.

In October, the Board approved the application by First Union Corporation (Charlotte), the nation's sixth largest banking organization, to acquire Signet Banking Corporation (Richmond). The two organizations competed directly in Virginia, Maryland, and the District of Columbia, and some commenters expressed concern that branch closings resulting from the merger would disproportionately disadvantage communities with predominantly low- and moderate-income and minority residents. In light of these concerns, the Board reviewed preliminary, confidential information from First Union on branches slated for closure as well as the company's branch closure policy. The Board also reviewed the OCC's most recent publicly available CRA performance evaluations for First Union's subsidiary banks; these reports indicated that the banks have satisfactory records of opening and closing branches and that they provide reasonable access to services for all segments of their communities. In addition, the Board reviewed data on First Union's lending record in its communities and in low- and moderate-income

10. Two applications were withdrawn in 1997—one involving an adverse CRA rating and the other, a fair lending issue. The System also reviewed comments submitted in three other cases (not reflected in the above figures) that were deemed to be more in the nature of individual consumer complaints than protests.

areas. The Board concluded that convenience and needs considerations, including CRA performance records, were consistent with approval.

In December, the Board approved the application by NationsBank Corporation (Charlotte), the nation's fifth largest banking organization, to acquire Barnett Banks, Inc. (Jacksonville). The two organizations competed directly in a large number of banking markets in Florida, as well as in a few markets in Georgia. Several commenters expressed concern that branch closures resulting from the merger would adversely affect senior citizens and low- and moderate-income neighborhoods and would result in a reduction in community development and home mortgage lending. In its order approving the application, the Board noted that it had considered NationsBank's record of opening and closing branches in other acquisitions, in particular, its acquisition of Boatmen's Bancshares, Inc. (St. Louis), in December 1996. In that case the Board found that, to date, NationsBank had followed its branch closure policy by assessing the effect of closings in low- and moderate-income areas. Given the extensive overlap of the two organizations' branches in Florida markets, the Board directed NationsBank, as part of any subsequent application to acquire a depository institution, to report to the Federal Reserve its branch closures in Florida and Georgia during the two-year period following its acquisition of Barnett.

Consumer Complaints

The Federal Reserve investigates complaints against state member banks and forwards to the appropriate enforcement agencies complaints involving other creditors and businesses (see accompanying table). The Federal Reserve also monitors and analyzes complaints about unregulated practices.

Complaints about State Member Banks

The Federal Reserve received 3,318 complaints about financial institutions in 1997: 2,673 by mail, 634 by telephone, and 11 in person. Fewer than half of the complaints (1,524) were against state member banks; of these,

Consumer Complaints to the Federal Reserve System Regarding State Member Banks and Other Institutions, by Subject, 1997

Subject	State member banks	Other institutions	Total
Regulation B (Equal Credit Opportunity)	69	39	108
Regulation E (Electronic Fund Transfers)	62	52	114
Regulation Z (Truth in Lending)	194	299	493
Regulation BB (Community Reinvestment)	1	3	4
Regulation CC (Expedited Funds Availability)	30	31	61
Regulation DD (Truth in Savings)	50	44	94
Fair Credit Reporting Act	56	113	169
Fair Debt Collection Practices Act	13	18	31
Flood insurance	2	1	3
Regulations G, T, U and X	0	1	1
Real Estate Settlement Procedures Act	0	13	13
Unregulated practices [1]	1,047	1,180	2,227
Total	**1,524**	**1,794**	**3,318**

1. Complaints against these institutions were referred to the appropriate enforcement agencies.

almost two-thirds involved unregulated practices. Of the complaints against state member banks, about 61 percent concerned lending: 5 percent alleged discrimination on a prohibited basis; and 56 percent raised a variety of issues, most of them involving lending practices, including credit denial on a basis not prohibited by law (such as credit history or length of residence) and miscellaneous other practices (such as release or use of credit information). Another 25 percent of the complaints against state member banks involved disputes about interest on deposits and general deposit account practices; the remaining 14 percent concerned disputes about electronic fund transfers, trust services, and other miscellaneous bank practices (see accompanying table).

The System also received 2,209 inquiries about consumer credit and banking policies and practices. In responding to these inquiries, the Board and the Reserve Banks give specific explanations of laws, regulations, and banking practices and provide relevant printed materials on consumer issues.

Unregulated Practices

Under section 18(f) of the Federal Trade Commission Act, the Board monitors complaints about banking practices not subject to existing regulations and focuses on complaints involving practices that may be unfair or deceptive. Of the 2,227 complaints about unregulated practices, the top five categories related to credit cards: miscelleneous problems involving credit cards (135), interest rates and terms (127), customer service problems (93), pre-approved solicitations (78), and penalty charges on accounts (69). The specific complaints about credit cards represented by these categories concerned such matters as failure to close accounts as requested, increased interest rates on accounts, changed credit terms on pre-approved

Consumer Complaints Received by the Federal Reserve System, by Type and Function, 1997

Complaint	Complaints against state member banks					
	Total		Not investigated		Investigated	
					Bank legally correct	
	Number	Percent	Unable to obtain sufficient information	Explanation of law provided to consumer	No reimbursement or other accommodation	Goodwill reimbursement or other accommodation
Loans						
Discrimination alleged						
Real estate loans	11	1	0	0	1	1
Credit cards	26	2	1	5	12	1
Other loans	32	2	1	2	13	1
Discrimination not alleged						
Real estate loans	70	5	2	4	28	14
Credit cards	617	40	11	57	184	168
Other loans	172	11	6	27	64	30
Deposits	379	25	14	31	162	52
Electronic fund transfers	52	3	2	2	18	14
Trust services	12	1	1	1	3	2
Other	153	10	13	27	43	23
Total	**1,524**	**100**	**51**	**156**	**528**	**306**

accounts, and penalty charges such as over-limit fees.

Each of these five complaint categories accounts for a small portion (4 percent or less) of all consumer complaints received by the System. All other complaint categories involving unregulated practices registered fewer than fifty complaints in 1997.

Complaint Referrals to HUD

In 1997, in accordance with a memorandum of understanding between HUD and the federal bank regulatory agencies, the Federal Reserve referred to HUD five complaints about state member banks alleging violations of the Fair Housing Act. Investigations completed for two of the five complaints (and five others that were pending at year-end 1996) revealed no evidence of unlawful discrimination; the other three were pending at year-end.

During 1997 HUD referred four complaints involving state member banks to the Federal Reserve. By year-end the Federal Reserve had completed investigations into two of the four complaints; the investigations revealed no evidence of unlawful discrimination.

Complaint Program Activities

In 1997 the Consumer Complaints Section at the Board continued work on implementing a comprehensive system designed to replace and consolidate the complaint program's analysis tools. Along with other management tools, the Board's new system for collecting complaint data—Complaint Analysis Evaluation System and Reports (CAESAR)—provides the capability to automatically generate response letters to individual complaints; analyze the type of discrimination complaints received by the Federal Reserve; and analyze data to deter-

Consumer Complaints Received—Continued

Complaints against state member banks						Referred to other agencies	Total complaints
Investigated					Pending, December 31		
Customer error	Bank error	Factual or contractual dispute—resolvable only by courts	Possible bank violation—bank took corrective action	Matter in litigation			
0	0	0	0	0	9	10	21
0	2	0	0	0	5	6	32
0	1	1	0	0	13	23	55
0	13	3	0	2	4	245	315
18	79	18	6	0	76	488	1,105
4	13	4	1	4	19	274	446
6	50	12	1	4	47	427	806
0	10	0	0	0	6	62	114
0	1	2	0	0	2	15	27
1	26	2	0	2	16	244	397
29	**195**	**42**	**8**	**12**	**197**	**1,794**	**3,318**

mine patterns and trends. As part of this initiative, the Board is converting the mainframe-based Consumer Complaint and Inquiry Tracking System and querying systems to the PC-based CAESAR; implementation throughout the Federal Reserve is expected by early 1999.

In 1997, individual staff members from the Reserve Banks' consumer complaint sections continued to work at the Board for several weeks at a time to gain familiarity with operations in Washington. Nine Reserve Banks participated in the program.

Consumer Policies

The Consumer Policies program explores alternatives to regulation for protecting consumers in retail financial services and brings research information to bear more directly on policymaking. During 1997, Consumer Policies staff members provided research analysis for reports on finance charges, home equity lines of credit, characteristics of households without bank accounts, and the TILA–RESPA streamlining initiative. The Consumer Policies Section and the Consumer Complaints Section worked to improve the analysis of data from the Consumer Satisfaction Questionnaire, which is distributed to consumers who lodge complaints about state member banks. This analysis assesses the level of consumers' satisfaction with the handling of their complaints, as a measure of the complaint program's performance, and is used to identify possible improvements.

The Consumer Policies program also conducted a major educational initiative that targeted automobile leasing disclosures and complemented the implementation of the revised Regulation M. The educational program, discussed earlier in the section "Leasing Education and Regulatory Changes," included preparation of a new brochure and creation of a public Web site.

Consumer Advisory Council

The Consumer Advisory Council convened in April, July, and October to advise the Board on matters concerning laws that the Board administers and other issues related to consumer financial services. The council's thirty members come from consumer and community organizations, financial and academic institutions, and state governments. Council meetings are open to the public.

The streamlining of the Truth in Lending Act and the Real Estate Settlement Procedures Act was a major topic during 1997. In April, the council's consumer credit committee reported broad agreement for providing meaningful disclosures as early as possible and for combining disclosures and eliminating duplication. Several possibilities were discussed: a "lender pay all" approach for disclosing the amount the borrower needs at loan closing, with the lender assuming the risk for any higher costs; a consolidated disclosure approach covering both TILA and RESPA, with the disclosure delivered before formal application so that consumers can comparison shop; and rolling all loan costs into a finance charge that is disclosed as an annual percentage rate. Council members also talked about enforcement strategies, education for homebuyers, and the need to reduce paperwork not required by either TILA or RESPA.

In October, the council considered concepts related to rate disclosures: improving the current annual percentage rate (APR) disclosure (which is the percentage equivalent of the finance charge) by incorporating some costs that are currently not included in the finance charge; replacing the APR with a disclosure of the note rate and total of all closing costs; and consolidating all costs paid at closing into a single dollar figure and converting that figure into a ‘‘premium rate’’ to facilitate comparison shopping. Council members had differing views on the APR. Some believed that it is not useful, pointing to findings of a Michigan Research Center survey that consumers do not really understand the APR. An APR that does not work well now, they said, will not be improved by adding other cost items. Others disagreed. They noted that consumers in the Michigan survey frequently mentioned the APR as a shopping tool. They also observed that the APR was initially developed because no other rate proved to be an effective or accurate way of describing the cost of credit to consumers.

The council also discussed issues related to the HOEPA provisions of Truth in Lending, which seek to protect homeowners against abusive mortgage lending practices. Some members continued to believe that it may be too early to measure the success of a law that has been in place for only two years. But they also noted that it was evident from the testimony presented at the Board’s hearings in June 1997 that HOEPA has not stopped all fraudulent activity in the high-cost mortgage area. Some suggested that if HOEPA could be changed to prevent fraudulent activity, it should be changed now, but they expressed doubt about finding effective means to eliminate abusive practices such as the entry of inflated income on applications completed by the lender for the borrower. Some members suggested substantive restrictions—such as requiring refunds on ‘‘points’’ charged on the earlier loan or prohibiting new closing costs—for HOEPA loans refinanced by the lender within, say, one year. Members also posed the idea of extending the ban on balloon payments, which currently applies only to loans for terms of less than five years.

Community development and reinvestment was a topic at all three council meetings in 1997. In April, members discussed the effects of bank mergers and acquisitions on local communities. Some members see mergers as giving the resulting institution greater flexibility, increased capacity to take risks, and a more focused ability to work with and provide technical assistance to groups in local communities. Others believe that larger institutions sometimes lack the flexibility to meet local needs because their programs focus on the statewide potential, and they worry that consolidation reduces access to loan officers and key decisionmakers, who may be located out of state.

At the April meeting the council discussed proposed interagency regulations that would prohibit a bank from establishing branches outside its home state primarily for deposit production and focused on how the loan-to-deposit ratio for the host state should be determined. Council members suggested using a statewide test, in light of the difficulty of determining which branch deposits are local. The council also discussed the service and investment tests under the revised CRA rules and the need for institutions to publish specific goals (such as goals for small business loans or low-income housing) when they issue strategic plans for public comment.

At the July and October meetings, the council’s discussion of the CRA rules addressed such matters as whether financial institutions should receive CRA credit under the service test for providing free or low-cost checking accounts to facilitate the government’s electronic delivery of federal payments; the application of the service and investment tests in regard to the performance of large banks, as reflected in CRA public evaluations by the Federal Reserve; and the clarification of terms—such as *innovation, complexity, size,* and *impact on the community*—used to define the weight given to ''qualified investments'' and to successful, long-term investments made previously and still outstanding.

In October, the council discussed findings from newly released data on small business, small farm, and community development lending collected and reported under the revised CRA regulations by large commercial banks and savings associations. In light of certain limitations of these data, the council urged that the Board continue to explore methodologies for further analysis and for measuring loan demand in local communities, to provide a context for the lending reported. The council also suggested that the Board consider partnership projects that focus on improving small business lending, modeled on the Federal Reserve's mortgage partnership projects, which have identified obstacles in mortgage lending and strategies for removing them. In addition, council members suggested that banks disclose, on a voluntary basis, information about their community development loans, such as the kinds and locations of projects, as the single number currently disclosed is not helpful.

During 1997 a working group of the council considered the effects of appraisals on community development lending. In July, members discussed some of the negative consequences when a property is undervalued by an appraiser unfamiliar with the community or a particular community development initiative: The insurer may not want to insure the loan, or the lender may decide not to close the deal. If the low valuation becomes a ''comparable value'' for other properties, property values in a community are very quickly driven down. Discriminatory practices, such as an appraisal that bases the valuation on a foreclosure sale miles from the property instead of market values around the block, can add to problems. In rural areas, the variability of property types, uses, and size further complicates appraisals. In the case of a property's ''over-improvement,'' the difficulty of finding valuations on comparable properties in the local market adds to the difficulty for a developer and a bank seeking to finance a community development project; either the developer invests more in equity or the bank underwrites a loan with a higher loan-to-value ratio (causing concern for the bank's regulator).

In October, the council heard recommendations from the working group on such matters as training and licensing of appraisers; providing incentives for banks to direct resources to the appraisal process; educating consumers and appraisers about the importance of accurate, unbiased appraisals; and the need for further research into the appraisal process.

The council considered a wide array of other topics during the year, including

- Options for delivering disclosures electronically under a variety of federal regulations
- The federal mandate to convert most federal payments to electronic deposit, and whether special rules are needed under the Board's Regulation E for new accounts offered to about 10 million recipients who have no banking relationship
- The circumstances under which financial institutions ought to receive credit in the assessment of their performance under the CRA rule's service test
- The Board's reports to the Congress on stored-value products and on the

public availability of identifying information about consumers, such as social security numbers
- A Board-initiated study, headed by the Board's Vice Chair, of the Federal Reserve's role in the payments system.

Testimony and Legislative Recommendations

In July, the Board testified before the Senate Banking Committee on ways to improve the disclosures required for home mortgage loans under TILA and to unify them with the disclosures required under RESPA. The Board's testimony discussed how the two statutes regulate home mortgage lending, described the Board's and HUD's efforts to simplify and streamline the information given to consumers, and outlined the agencies' plans to develop legislative recommendations.

In September, the Board testified before the Subcommittee on Financial Institutions and Consumer Credit of the House Banking Committee on debit cards that can be used without security codes, requiring only a signature. (These cards are often referred to as check cards or off-line debit cards.) Some observers have expressed concern that consumers may not be aware of the risk of unauthorized use associated with these products.

The Board noted its inclination, given that the industry has voluntarily acted to limit consumer liability in many instances to $50 or less, to see how well these voluntary efforts work before recommending that the Congress amend the Electronic Fund Transfer Act. It is also in everyone's interest, the Board said, to ensure that consumers understand the risks associated with these cards and are able to make an informed choice about whether to assume the risk.

The subcommittee hearing also addressed a legislative proposal to bar creditors from mailing unsolicited loan checks to consumers. The Board suggested a better course would be to let the market work without the interference of new laws. The Truth in Lending Act requires that full disclosure of credit terms be included in any mailing so that consumers can make informed decisions about whether to accept the loans; the primary concern with unsolicited loan checks is not disclosure, but the potential for theft and fraud by persons other than the intended recipient.

Recommendations of Other Agencies

Each year the Board asks for recommendations from the other federal supervisory agencies for amending the financial services laws or the implementing regulations.

The FDIC suggested addressing solicitation and marketing practices related to credit cards, through legislative or regulatory change, to permit enforcement agencies to more adequately supervise trade practices. It noted some practices that may technically comply with the law but that in the opinion of many consumers constitute deceptive marketing. It also endorsed efforts by the Board and HUD to streamline TILA–RESPA requirements to facilitate comparison shopping for consumers before they submit an application for credit.

The OCC recommended that the Congress review current consumer disclosures, which may unnecessarily burden banks and insufficiently benefit consumers, and that it consider disclosures that are less burdensome to depository institutions and more useful to consumers. The FTC expressed its support for updating and clarifying the requirements of Regulation B and Regulation Z, scheduled for review soon under the Board's Regulatory Planning and Review program. ■