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The *Federal Reserve Bulletin* is issued quarterly under the direction of the staff publications committee. This committee is responsible for opinions expressed except in official statements and signed articles. It is assisted by the Publications Department under the direction of Lucretia M. Boyer.

Change in Publishing Format of the *Federal Reserve Bulletin*

In response to the increased use of the Internet to access information and in the interest of publishing on a timely basis, beginning in 2006 the content of the *Federal Reserve Bulletin* will only be available on the Federal Reserve Board's public web site (www.federalreserve.gov). Publishing articles on the web as they are released will allow the more timely introduction of research and information to the public as topics are relevant to current economic conditions and useful to our readers.

The online version of the *Bulletin* will continue to include topical research articles, the Board's semiannual Monetary Policy Reports, Reports on the Condition of the U.S. Banking Industry, Legal Developments, and links to other features such as lists of advisory councils, committees, and maps of the Federal Reserve Districts.

Online access to the *Bulletin* will continue to be free of charge. A free e-mail notification service will be available to alert subscribers to new articles as they are released. Information about ways to subscribe to the e-mail notification service will follow.

If you have any questions, you may contact the Publications Fulfillment staff by phone at 202-452-3245, by fax at 202-728-5886, or you may mail your inquiries to Publications Fulfillment, MS 127, Board of Governors of the Federal Reserve System, Washington DC 20551.

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growth, particularly at the fifty large bank holding companies as these large companies added mortgage-backed securities and adjusted their interest rate risk exposures. Loans and unused commitments to lend grew less robustly, rising 1.4 percent and 1.7 percent respectively. Residential mortgage loans, including home-equity lines of credit, contributed significantly to this increase, as did commercial loans and commercial real estate loans. Weakness was evident in credit card balances, attributable to a seasonal slowdown in credit card spending and significantly accelerated repayments by which, in effect, households have transferred some credit card balances to the rapidly growing home-equity loan category.

Nondeposit borrowings increased sharply, rising 6.8 percent, as strong asset growth exceeded deposit increases. The increase in borrowings was mostly in short-maturity instruments. Regulatory capital ratios remained strong but tightened slightly during the quarter. Problem assets continued to decline from already low levels, reaching 0.76 percent of loans and related assets. Net charge-offs and provisions for loan losses also declined. Fueled by asset growth and improved asset quality, net income rose to $32.9 billion. Net interest margins narrowed significantly and non-interest income surged, supported by strong trading revenues and mortgage servicing income.

Monetary Policy Report to the Congress

Report submitted to the Congress on July 20, 2005, pursuant to section 2B of the Federal Reserve Act

MONETARY POLICY AND THE ECONOMIC OUTLOOK

The U.S. economy continued to expand at a solid pace over the first half of 2005 despite the restraint imposed on aggregate demand by a further rise in crude oil prices. Household spending trended up, propelled by rising wealth and income and by low interest rates, and business outlays received ongoing support from favorable financial conditions, rising sales, and increased profitability. Moreover, the earlier declines in the foreign exchange value of the dollar shifted some domestic and foreign demand toward U.S. producers. Overall, the economic expansion was sufficient to create jobs at roughly the same pace as in late 2004 and to lower the unemployment rate further over the first half of this year.

Higher oil prices boosted retail prices of a broad range of consumer energy products and, as a result, continued to hold up the rate of overall consumer price inflation in the first half of 2005. In addition, the rise in energy prices this year, coupled with increases in the prices of some other commodities, imported goods, and industrial materials, put upward pressure on the costs of many businesses. A portion of these costs was passed on to consumers, which contributed to a higher rate of inflation in core consumer prices (that is, total prices excluding the food and energy components, which are volatile). As measured by the price index for personal consumption expenditures excluding food and energy, core inflation increased from an annual rate of 1½ percent in 2004 to about 2 percent between the fourth quarter of 2004 and May 2005. While survey measures of near-term inflation expectations have edged up this year, surveys, as well as readings from financial markets, suggest that expected inflation at longer horizons has remained contained.

With financial conditions advantageous for households and firms, a solid economic expansion in train, and some upward pressure on inflation, the Federal Open Market Committee (FOMC) continued to remove policy accommodation at a measured pace over the first half of the year, raising the intended federal funds rate an additional 1 percentage point, to 3¼ percent, by the end of June. At the most recent FOMC meeting, the Committee judged that policy remained accommodative. With appropriate monetary policy, however, the upside and downside risks to output and inflation were viewed as balanced, and the Committee underscored its commitment to respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

The fundamental factors that supported the U.S. economy in the first half of 2005 should continue to do so over the remainder of 2005 and in 2006. In the household sector, the combination of further gains in employment, favorable borrowing terms, and generally healthy balance sheets should keep consumer spending and residential investment on an upward path. In the business sector, expanding sales, the low cost of capital, and the replacement or upgrade of aging equipment and software should help to maintain increases in capital spending. And, although economic performance has been uneven across countries, continued growth overall in the economies of U.S. trading partners should sustain the demand for U.S. exports. In contrast, ongoing increases in imports will likely continue to subtract from the growth of U.S. gross domestic product. In addition, high energy prices remain a drag on aggregate demand both here and abroad, though this drag should lessen over time if prices for crude oil level out in line with quotes in futures markets.

Despite the upward pressure on costs and prices over the past year or so, core consumer price inflation is likely to remain contained in 2005 and 2006. Longer-run inflation expectations are still well anchored, and because businesses are adding to their stocks of capital and are continuing to find ways to use their capital and work forces more effectively, structural productivity will likely rise at a solid pace over the foreseeable future. In addition, barring a further increase in oil prices, the boost that higher energy costs have given to core inflation should wane in coming quarters, while the recent appreciation of the dollar, as well as the deceleration in global materials prices, will likely reduce the impetus to inflation from rising import prices.

Of course, substantial uncertainties surround this economic outlook. A further sharp rise in crude oil prices would have undesirable consequences for both economic activity and inflation, and the possibility that housing prices, at least in some locales, have moved above levels that can be supported by fundamentals remains a concern. As another example, if the recent surge in measured unit labor costs were to prove more persistent than currently appears likely, the outlook for inflation would be adversely affected. Economic growth and inflation will also be shaped importantly by the evolution of the imbalance in the U.S. current account.

The Conduct of Monetary Policy over the First Half of 2005

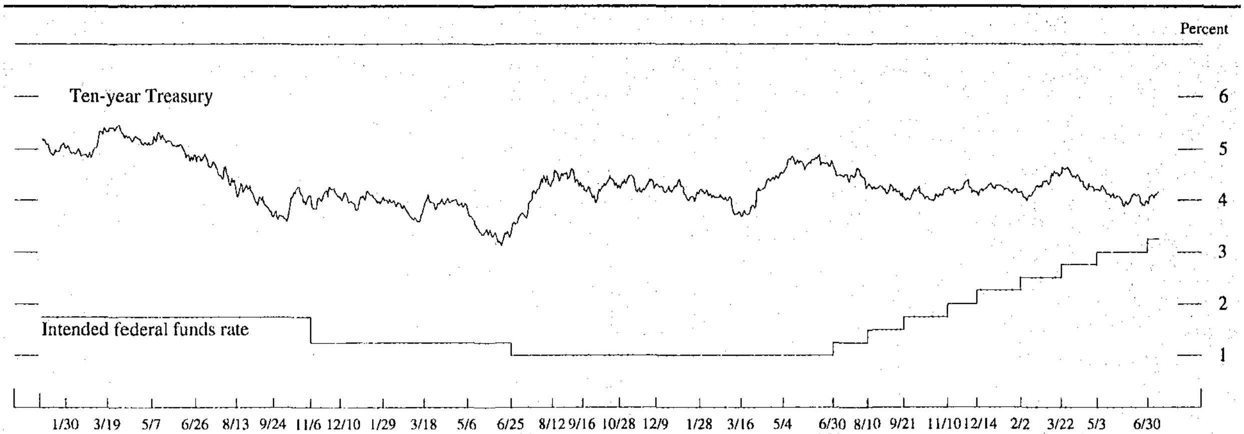
Despite increases in the federal funds rate totaling 1¼ percentage points in 2004, monetary policy was still judged to be accommodative at the start of 2005. At the time of the February FOMC meeting, the available information indicated that the economy had expanded at a robust pace through the end of 2004 and retained considerable momentum. Accordingly, the Committee voted to raise its target for the federal funds rate from 2¼ percent to 2½ percent and to make minimal changes to the text of the accompanying statement. The statement reiterated that "the Committee believes that policy accommodation can be removed at a pace that is likely to be measured." Members noted, however, that this forward-looking language was clearly conditioned on economic developments and therefore would not stand in the way of either a pause or a step-up in policy firming depending on events.

By March, the data were pointing to a further solid gain in activity during the first quarter, fueled especially by continued increases in consumption expenditures and residential investment. In addition, private nonfarm payrolls were posting widespread advances, and slack in resource utilization appeared to be diminishing. The Committee voted at its March meeting to raise the federal funds rate another 25 basis points, to 2¾ percent. In view of the rise in prices of energy and other commodities and recent elevated readings on inflation in core consumer prices, the Committee altered the text of the policy statement to note the pickup in inflationary pressures. The Committee also decided to modify the assessment of the balance of risks to make it explicitly conditional on an assumption of "appropriate" monetary policy, so as to underscore that maintaining balanced risks would likely require continued removal of policy accommodation.

The evidence that had accumulated by the spring pointed to some moderation in the pace of activity. Retail spending flattened out for a time, likely in response to higher energy prices, and the growth of capital spending dropped back from its elevated pace of late last year. Nonetheless, with long-term interest rates still quite low and with employment and profits continuing to rise, economic activity appeared to retain considerable momentum, suggesting that the softness would be short lived. Against this backdrop, the FOMC decided to raise the federal funds rate another 25 basis points at its May meeting and to make few changes to the text of the accompanying statement.

In the weeks after the May meeting, incoming indicators supported the view that the underlying

Selected interest rates



NOTE: The data are daily and extend through July 13, 2005. The ten-year Treasury rate is the constant-maturity yield based on the most actively traded securities. The dates on the horizontal axis are those of FOMC meetings.
SOURCE: Department of the Treasury and the Federal Reserve.

pace of activity was not faltering. The information that the Committee reviewed at the time of the June FOMC meeting showed that consumer spending and business investment had turned up, on balance, and that demand for housing continued to be strong. With economic activity remaining firm and crude oil prices ratcheting higher, the FOMC voted to raise the funds rate an additional 25 basis points, to 3¼ percent, and to make only minimal changes to the text of the accompanying statement. This action brought the cumulative increase in the target federal funds rate since June 2004 to 2¼ percentage points.

Economic Projections for 2005 and 2006

In conjunction with the FOMC meeting at the end of June, the members of the Board of Governors and the Federal Reserve Bank presidents, all of whom participate in the deliberations of the FOMC, were asked to provide economic projections for 2005 and 2006. In general, Federal Reserve policymakers expect the economy to continue to expand at a moderate pace and core inflation to remain roughly stable over this period. The central tendency of the FOMC participants' forecasts for the increase in real (that is, inflation adjusted) GDP is 3½ percent over the four quarters of 2005 and 3¼ percent to 3½ percent in 2006. The civilian unemployment rate is expected to average 5 percent in both the fourth quarter of 2005 and the fourth quarter of 2006. FOMC participants project that the chain-type price index for personal consumption expenditures excluding food and energy will increase between 1¾ percent and 2 percent both this year and next.

Economic projections for 2005 and 2006
Percent

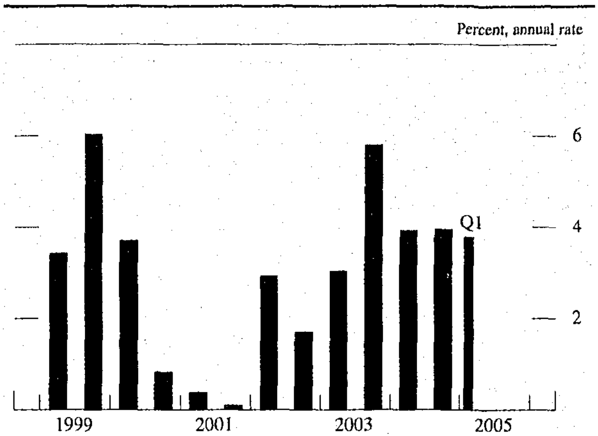
Indicator	Federal Reserve Governors and Reserve Bank presidents	
	Range	Central tendency
	2005	
Change, fourth quarter to fourth quarter[1]		
Nominal GDP	5–6¼	5½–5¾
Real GDP	3–3¾	3½
PCE price index excluding food and energy	1½–2¼	1¾–2
Average level, fourth quarter		
Civilian unemployment rate	5–5¼	5
	2006	
Change, fourth quarter to fourth quarter[1]		
Nominal GDP	5–6	5¼–5½
Real GDP	3¼–3¾	3¼–3½
PCE price index excluding food and energy	1½–2½	1¾–2
Average level, fourth quarter		
Civilian unemployment rate	5	5

1. Change from average for fourth quarter of previous year to average for fourth quarter of year indicated.

ECONOMIC AND FINANCIAL DEVELOPMENTS IN 2005

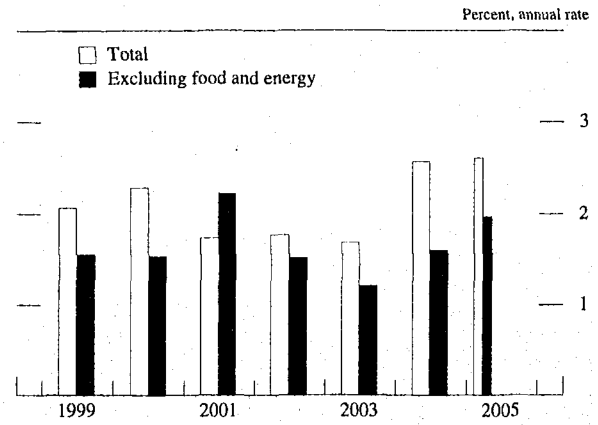
The economic expansion entered 2005 on a solid footing and was led by ongoing increases in consumption, residential investment, and business spending on equipment and software. Although the pace of expansion slowed somewhat in the early spring, activity has picked up again more recently. On average, real GDP appears to have increased a little less rapidly over the first half of 2005 than in the second half of 2004, a reflection in part of reduced fiscal stimulus and the drag on economic activity from higher energy prices. Industrial production has also risen more slowly so far this year than in 2004: The increase totaled 3 percent at an annual rate between December 2004 and June 2005, down from 5 percent during the previous six months. Nevertheless, the economic expansion has been sufficient to gradually absorb slack in labor and product markets. Nonfarm payroll employment has continued to increase, and the unemployment rate has moved down further since the beginning of the year, to 5 percent in June. Similarly, the rate of capacity utilization in the manufacturing sector stood at 78.4 percent in June, up from 77.9 percent at the end of 2004 and just a little below its long-term historical average.

Change in real GDP



NOTE: Here and in subsequent charts, except as noted, change for a given period is measured to its final quarter from the final quarter of the preceding period.
SOURCE: Department of Commerce, Bureau of Economic Analysis.

Change in PCE chain-type price index



NOTE: The data are for personal consumption expenditures (PCE). The changes for 2005 are from 2004:Q4 to May 2005.
SOURCE: Department of Commerce, Bureau of Economic Analysis.

Rising energy prices continued to boost consumer price inflation in the first half of 2005. With consumer energy prices having climbed more than 13 percent at an annual rate so far this year, the price index for personal consumption expenditures (PCE) increased at an annual rate of about 2½ percent between the fourth quarter of 2004 and May 2005, the same pace as in 2004. Meanwhile, the core PCE price index rose at an annual rate of about 2 percent in the first half of 2005, up from 1½ percent in 2004.

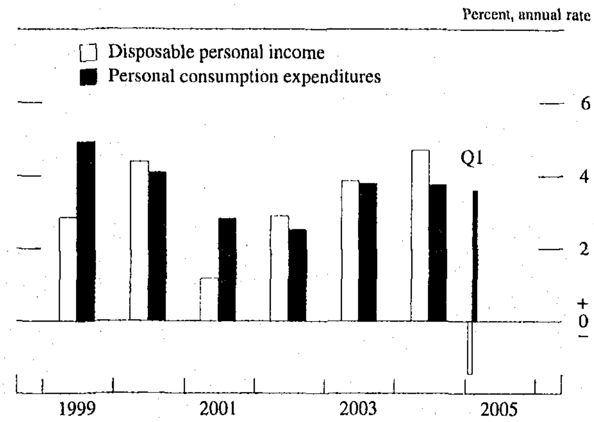
The Household Sector

Consumer Spending

Consumer spending continued to move higher in the first half of this year, though not as rapidly as in the second half of 2004. After increasing at an average annual rate of 4½ percent in the third and fourth quarters of last year, real personal consumption expenditures rose at a 3½ percent rate in the first quarter and appear to have advanced at a roughly similar pace in the second quarter. Household spending this year has been supported by rising employment and household wealth as well as by the low level of interest rates. However, higher costs for consumer energy products have eroded households' purchasing power.

Sales of light motor vehicles, which had been buoyed in the second half of last year by a variety of sales inducements, dropped back in the first quarter after many of the inducements expired. However, sales firmed again in the second quarter to an average annual pace of more than 17 million units, a level similar to that in the fourth quarter of last year.

Change in real income and consumption



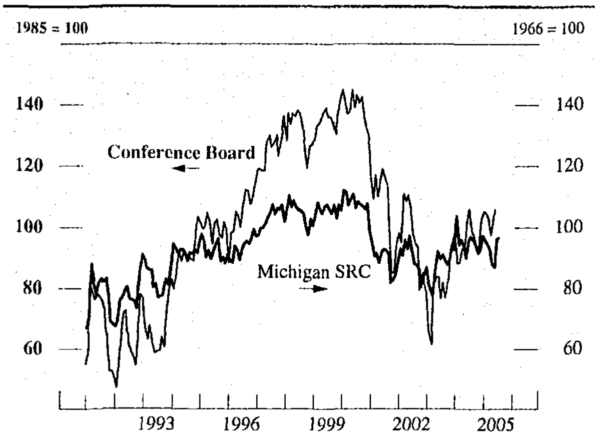
SOURCE: Department of Commerce, Bureau of Economic Analysis.

Underlying demand for light motor vehicles has remained relatively strong, though sales likely have also been boosted recently by sizable price discounts.

Excluding motor vehicles, consumer spending posted strong gains in early 2005, flattened out in March, and picked up again in the spring. On a quarterly average basis, the rate of increase in non-auto spending appears to have stepped down in the second quarter, largely because of a deceleration in outlays for consumer goods. Meanwhile, real outlays for services rose at an annual rate of about 3 percent in the first quarter, and the available data point to an increase of about the same magnitude in the second quarter.

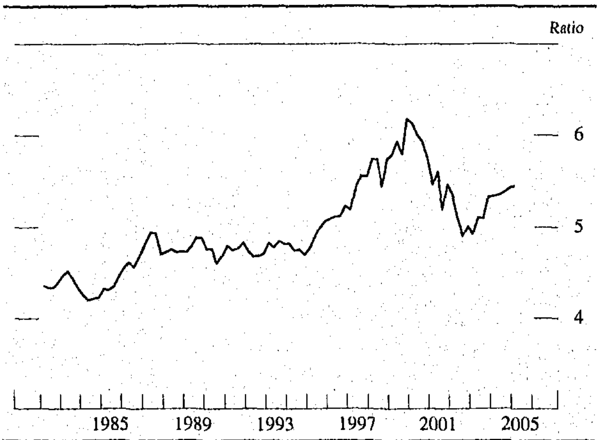
If the effect of Microsoft's $32 billion special dividend payment in December 2004 is excluded from the calculation, real disposable personal income

Consumer sentiment



NOTE: The Conference Board data are monthly and extend through June 2005. The Michigan SRC data are monthly and extend through a preliminary estimate for July 2005.
SOURCE: The Conference Board and University of Michigan Survey Research Center.

Wealth-to-income ratio



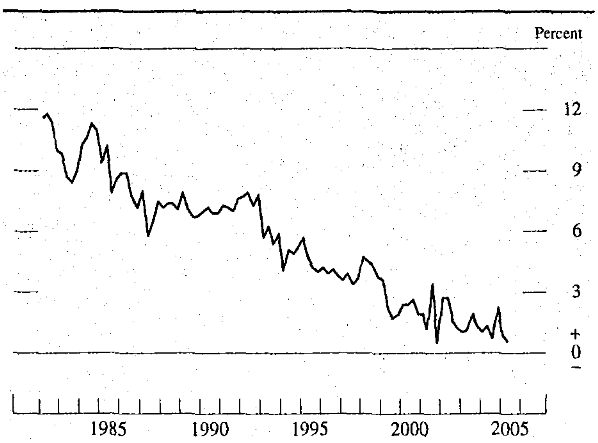
NOTE: The data are quarterly and extend through 2005:Q1. The wealth-to-income ratio is the ratio of household net worth to disposable personal income.

SOURCE: For net worth, Federal Reserve Board, flow of funds data; for income, Department of Commerce, Bureau of Economic Analysis.

(that is, after-tax income adjusted for inflation) rose at an annual rate of about 2 percent between the fourth quarter of 2004 and May 2005, a slower pace than in 2004. Although increases in employment and earnings pushed up wage and salary income over the first half of 2005, the rise in real income was damped to some degree by the energy-driven increase in consumer prices. Higher energy prices also appear to have weighed on consumer confidence for much of this year. Surveys by both the Michigan Survey Research Center (SRC) and the Conference Board indicate that household sentiment edged down through the early spring, though readings from these surveys turned up again more recently.

Household wealth appears to have increased a bit faster than nominal disposable income over the first half of this year; the small increase in the wealth-to-income ratio comes on the heels of substantial increases in 2003 and 2004. Although stock prices have changed little, on net, thus far this year, home prices have continued to rise sharply. Because changes in wealth influence consumer spending with a lag, both the earlier and the more-recent increases in household net worth have supported consumption this year. As wealth increased and interest rates remained quite low, the personal saving rate edged down to just ½ percent of disposable income in April and May. Over the previous two decades, the personal saving rate averaged close to 5 percent.

Personal saving rate



NOTE: The data are quarterly; the reading for 2005:Q2 is the average of April and May.

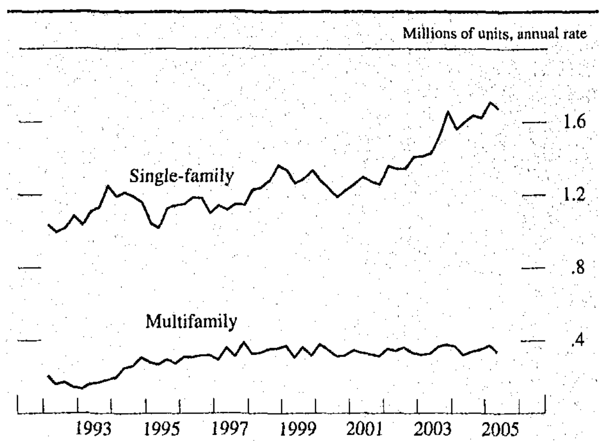
SOURCE: Department of Commerce, Bureau of Economic Analysis.

Residential Investment

Activity in the housing market continued at a strong pace in the first half of 2005. Real expenditures on residential structures increased at an annual rate of 11½ percent in the first quarter and appear to have posted another gain in the second quarter. In the single-family sector, starts of new units averaged 1.69 million at an annual rate between January and June—nearly 4 percent above the pace posted over the second half of 2004. Similarly, starts of multifamily units averaged 360,000 over the first six months of 2005, about 3¼ percent higher than in the previous six months.

As in 2004, the demand for housing during the first half of 2005 was supported by rising employment and income and by low mortgage rates. Rates on thirty-year fixed-rate mortgages have fluctuated between 5½ percent and 6 percent in recent months and are currently near the low end of that range. In addition, demand reportedly has been boosted

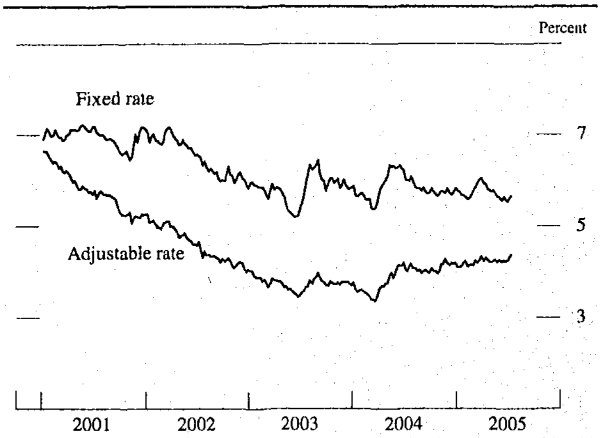
Private housing starts



NOTE: The data are quarterly and extend through 2005:Q2.

SOURCE: Department of Commerce, Bureau of the Census.

Mortgage rates

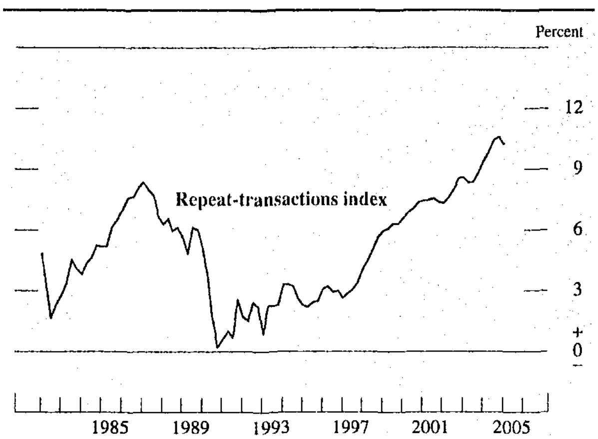


NOTE: The data, which are weekly and extend through July 13, 2005, are contract rates on thirty-year mortgages.
SOURCE: Federal Home Loan Mortgage Corporation.

by a rise in purchases of second homes—either as vacation units or as investments—and by the greater availability of less-conventional financing instruments. These financing instruments, including interest-only mortgages and adjustable-rate mortgages that allow borrowers a degree of flexibility in the size of their monthly payments, have enabled some households to buy homes that would otherwise have been unaffordable. As a result, both new and existing home sales have remained remarkably robust this year, and both were at or near record levels in May.

The strong demand for housing has continued to push up home prices this year. Although rates of house price appreciation were a little slower in the first quarter of this year than in 2004, the repeat-transactions price index for existing homes (limited to purchase-transactions only), which is published by the Office of Federal Housing Enterprise Oversight and partially adjusts for changes in the quality of homes sold, was nonetheless up 10 percent relative to its year-earlier level. Price appreciation has been especially sharp over the past year in some large metropolitan areas, including Las Vegas, Miami, San Francisco, and New York, but rapid increases in home prices have been observed in other areas as well. In many of these locales, recent price increases have far exceeded the increases in rents and household incomes.

Change in house prices



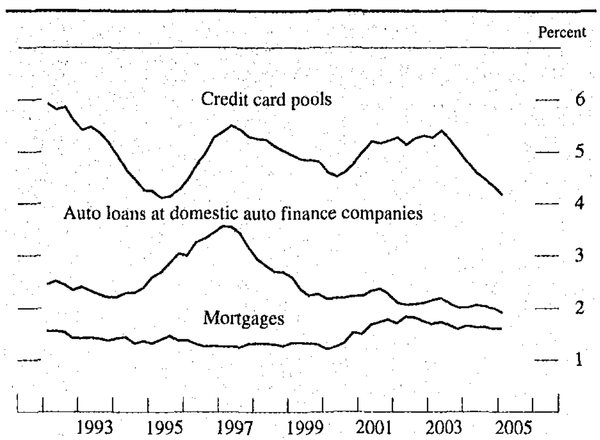
NOTE: The data are quarterly and extend through 2005:Q1. Change is over four quarters. For the years preceding 1991, changes are based on an index that includes appraisals associated with mortgage refinancings. Beginning in 1991, changes are based on an index that includes purchase transactions only.
SOURCE: Office of Federal Housing Enterprise Oversight.

Household Finance

Supported by rising house prices and continued economic expansion, household debt increased at an annual rate of about 9¼ percent in the first quarter of 2005. This advance was paced by a rise in mortgage debt of 10½ percent at an annual rate. However, even that rapid rise in mortgage debt represented a slight deceleration from the torrid pace in 2004, a development in line with the small slowdown in the pace of house price appreciation. Despite the increase in mortgage debt, net housing wealth rose. Refinancing activity has remained subdued, as rates on fixed-rate mortgages are a little above levels at which many households would currently find refinancing to be attractive.

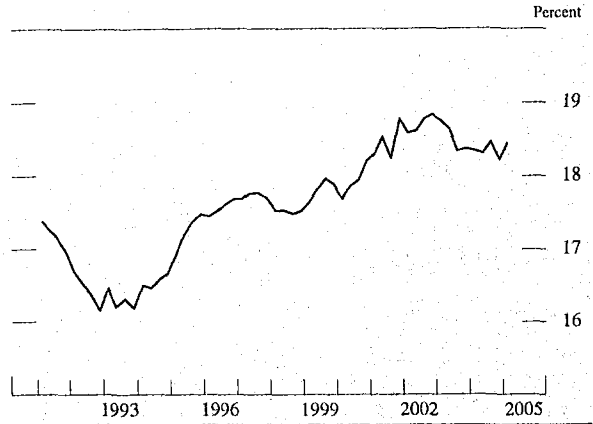
Consumer credit expanded at an annual rate of about 4½ percent over the first quarter of the year and was about unchanged in April and May. The growth of consumer credit has continued to be

Delinquency rates on selected types of household loans



NOTE: The data are quarterly and extend through 2005:Q1.
SOURCE: For credit cards, Moody's Investors Service; for auto loans, the financing subsidiaries of the three major U.S. automobile manufacturers; for mortgages, Mortgage Bankers Association.

Household financial obligations ratio



NOTE: The data are quarterly and extend through 2005:Q1. The financial obligations ratio equals the sum of required payments on mortgage and consumer debt, automobile leases, rent on tenant-occupied property, homeowners' insurance, and property taxes, all divided by disposable personal income.
SOURCE: Federal Reserve Board.

restrained by substitution toward home equity debt as a means to finance household expenditures.

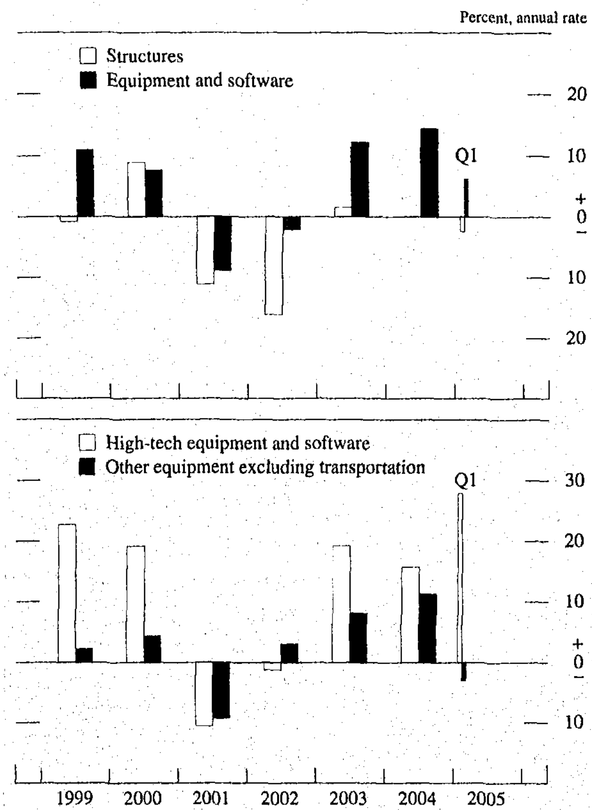
Measures of household credit quality have remained favorable. Delinquency rates on credit card debt and auto loans have continued to decline from already low levels. The pace of bankruptcy filings has run a little higher than at the same time last year; however, that pace has probably been boosted by a rush to file before the new rules in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 take effect in October. Reflecting the rapid pace of household debt growth, the ratio of household financial obligations to disposable personal income has edged up from a year earlier, though this ratio remains a bit below the peak level reached in late 2002.

The Business Sector

Fixed Investment

After posting a robust gain in the second half of 2004, real business fixed investment rose at a more moderate pace over the first half of 2005, as the rate of increase in expenditures on equipment and software (E&S) dropped back and outlays for nonresidential structures remained lackluster. Nonetheless, economic and financial conditions appear to be supportive of capital spending: Sales and corporate profits have continued to increase, businesses have ample liquid assets at their disposal, and financial market participants appear willing to finance new investment projects at favorable terms.

Change in real business fixed investment



NOTE: High-tech equipment consists of computers and peripheral equipment and communications equipment.
SOURCE: Department of Commerce, Bureau of Economic Analysis.

Real E&S spending rose at an annual rate of 6 percent in the first quarter after having advanced at an 18 percent pace in the second half of 2004. Led by large increases in purchases of computers and communications equipment, spending on high-tech equipment posted a sizable gain in the first quarter. In contrast, outlays for transportation equipment dropped back early in the year because of a small decline in business expenditures on motor vehicles and a sharp drop in aircraft purchases after a surge in the fourth quarter of 2004. Investment in equipment other than high-tech and transportation goods, a category that accounts for about 40 percent of E&S in nominal terms, also edged down in the first quarter after registering a sizable gain in the second half of last year. The types of equipment in this category of investment tend to be sensitive to trends in business sales, but the timing of business spending may have been influenced by the provisions of the partial-expensing tax incentive, which encouraged capital spending to be pulled forward in advance of the incentive's expiration at the end of 2004.

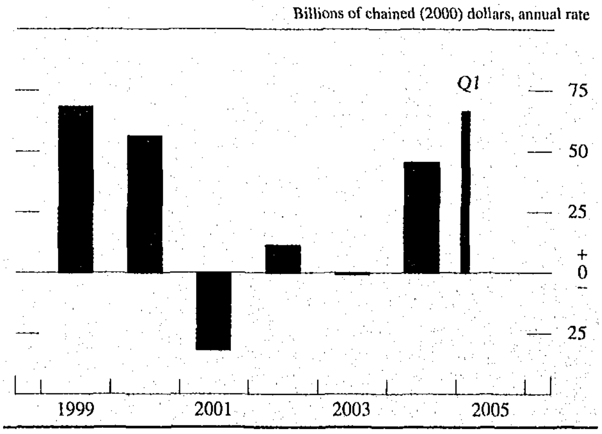
More-recent indicators of E&S spending point to another moderate rise in investment in the second quarter. In particular, outlays for transportation equipment appear to have turned up, on net, as a step-up in purchases of aircraft more than offset a further decline in business spending on motor vehicles. At the same time, the evidence on high-tech spending has been mixed: Real spending on computers appears to have registered another large gain in the second quarter, while the rate of increase in outlays for communications equipment apparently fell back. Indicators of spending on equipment other than transportation and high tech have looked more favorable recently, as shipments and imports for this broad category increased noticeably, on balance, in April and May. In addition, unfilled orders for such equipment remain at high levels.

Real nonresidential construction continued at a low level in the first half of this year, but fundamentals are starting to show signs of improvement. The construction of office buildings and industrial facilities has been restrained for some time by elevated vacancy rates, weak demand, and higher costs for construction materials. However, vacancy rates in these sectors have recently turned down, and construction outlays for these types of buildings appear to have edged higher, on net, so far this year. Commercial building—which includes retail outlets and warehouses—also appears to have increased this year, in part because of strong growth in the construction of large retail stores. Meanwhile, investment in the drilling and mining sector has trended up, on balance, over the past year, as higher prices for natural gas boosted the demand for new drilling rigs.

Inventory Investment

As in 2004, businesses accumulated inventories at an appreciable pace early this year. Outside the motor vehicle industry, nonfarm inventories increased at an annual rate of $66 billion in real terms in the first quarter of 2005. The rapid rate of inventory accumulation late last year and early in 2005 appears primarily to have been the result of efforts by firms to replenish stocks that had been depleted by the strong pace of sales in 2003 and 2004; apart from firms in a limited number of sectors, such as steel and paper, most businesses do not appear to be holding excess stocks, even taking into account the downward trend in inventory–sales ratios that has resulted from the improvement in supply-chain management capabilities. The rebuilding of inventories in most industries appears to have been largely completed, and the available data for April and May point to a noticeable step-down in the pace of stockbuilding. Indeed, in recent surveys, businesses have been reporting that they and their customers are increasingly comfortable with current levels of stocks, whereas in 2004 and early 2005, many were still characterizing inventory positions as too lean.

Change in real business inventories



SOURCE: Department of Commerce, Bureau of Economic Analysis.

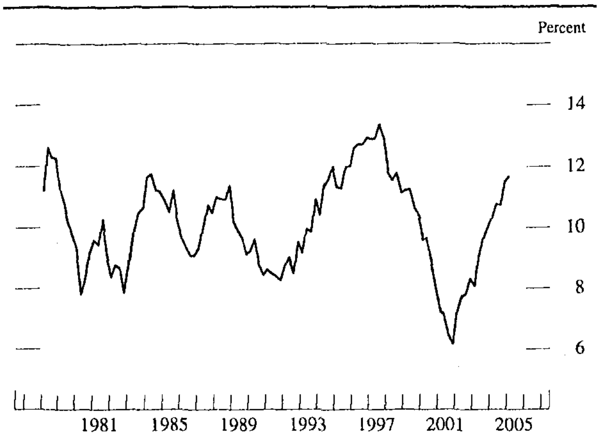
One important exception to this characterization is the motor vehicle industry, for which dealer stocks—especially of light trucks—were high by historical standards in recent months. In response, several major motor vehicle manufacturers reduced production in the second quarter, and, more recently, some have introduced price discounts on many 2005 models. These efforts appear to have helped, in that inventories of light vehicles at the end of June fell to sixty-five days of supply, a level more in line with historical norms.

Corporate Profits and Business Finance

Corporate profits have continued to rise so far this year, though at a slower pace than in 2003 and 2004. Earnings per share for S&P 500 firms in the first quarter of 2005 were up about 13 percent since the same time last year, a pace in line with the profit figures reported in the national income and product accounts (NIPA). The ratio of before-tax profits of nonfinancial corporations to that sector's gross value added was about flat in the first quarter after having moved up in 2003 and 2004. In the first half of this year, the petroleum and gas industries benefited from higher oil prices, but corporate earnings in the automobile sector declined sharply.

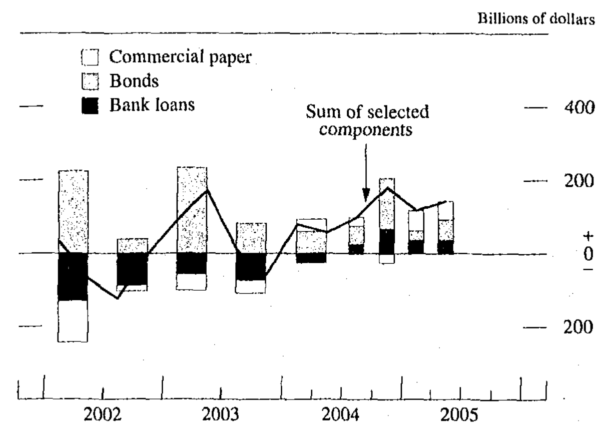
Given continued strong corporate profits and the accompanying strength in cash flow, nonfinancial firms' demand for external financing to fund capital expenditures has remained somewhat subdued. Net

Before-tax profits of nonfinancial corporations as a percent of sector GDP



NOTE: The data are quarterly and extend through 2005:Q1. Profits are from domestic operations of nonfinancial corporations, with inventory valuation and capital consumption adjustments.
SOURCE: Department of Commerce, Bureau of Economic Analysis.

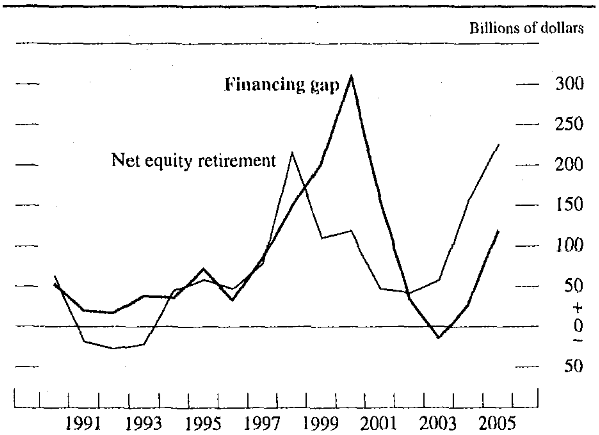
Selected components of net business financing



NOTE: Seasonally adjusted annual rate for nonfinancial corporate business. The data for the sum of selected components are quarterly. The data for 2005:Q2 are estimated.
SOURCE: Federal Reserve Board; Securities Data Company; and Federal Financial Institutions Examination Council, Consolidated Reports of Condition and Income (Call Report).

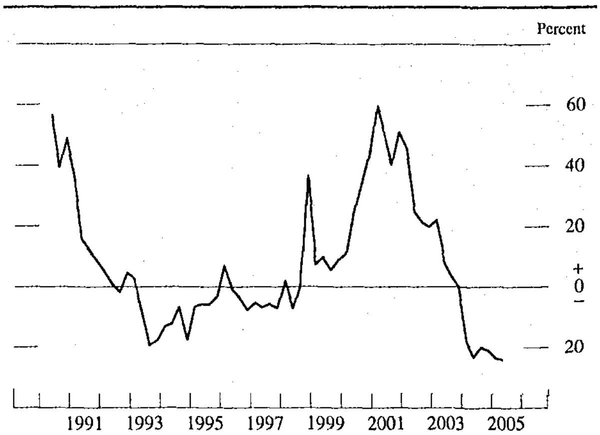
equity issuance has stayed negative so far this year, and share retirements have been boosted by considerable stock buybacks and cash-financed merger and acquisition activity. Gross corporate bond issuance has been limited, and the proceeds have been used mainly to pay down existing debt. Short-term debt financing, however, continued to pick up in the first half of 2005. Both commercial and industrial loans and commercial paper expanded at a brisk pace that was likely in part the result of firms' need to fund the rapid rate of inventory accumulation earlier in the year. The Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices conducted in April 2005 indicated that demand for business loans had strengthened over the previous three months and that substantial fractions of banks had eased standards and terms on these loans. In response to special questions regarding longer-term changes in lending practices, most banks reported that standards on business loans were somewhat tighter, but that terms were somewhat easier, than they had been in 1996 and 1997.

Financing gap and net equity retirement at nonfinancial corporations



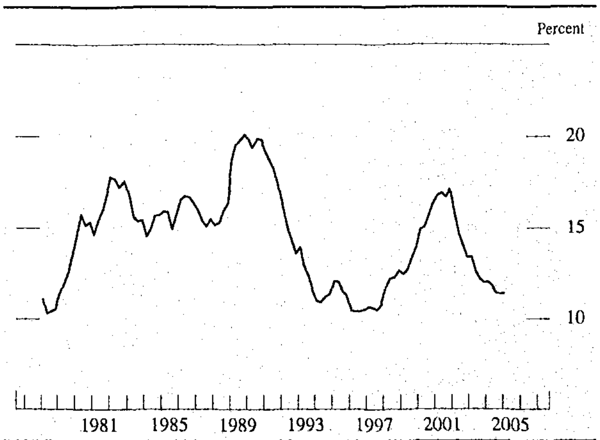
NOTE: The data are annual through 2004; for 2005, they are estimates based on data from 2005:Q1. The financing gap is the difference between capital expenditures and internally generated funds. Net equity retirement is the difference between equity retired through share repurchases, domestic cash-financed mergers, or foreign takeovers of U.S. firms and equity issued in public or private markets, including funds invested by venture capital partnerships.
SOURCE: Federal Reserve Board, flow of funds data.

Net percentage of domestic banks tightening standards on commercial and industrial loans to large and medium-sized borrowers



NOTE: The data are drawn from a survey generally conducted four times per year; the last observation is for the April (Q2) 2005 survey. Net percentage is the percentage of banks reporting a tightening of standards less the percentage reporting an easing. The definition for firm size suggested for, and generally used by, survey respondents is that large and medium-sized firms have sales of $50 million or more.
SOURCE: Federal Reserve, Senior Loan Officer Opinion Survey on Bank Lending Practices.

Net interest payments of nonfinancial corporations as a percent of cash flow



NOTE: The data are quarterly and extend through 2005:Q1.
SOURCE: Department of Commerce, Bureau of Economic Analysis.

Indicators of credit quality in the nonfinancial business sector have stayed generally very strong amid continued growth of profits and corporate balance sheets that remain flush with liquid assets. Both the default rate on outstanding corporate bonds and the delinquency rate on business loans stand at the low end of their historical ranges. However, the automobile sector has been an exception to the pattern of solid corporate credit quality. All three major credit rating agencies downgraded the debt of both Ford and General Motors this year in response to disappointing earnings news. General Motors' debt now has a below-investment-grade rating from both Standard & Poor's and Fitch, though it is still rated as investment-grade by Moody's. Ford retains an investment-grade rating with all the rating agencies except Standard & Poor's.

Expansion of commercial-mortgage debt continued apace in the first half of the year and was accompanied by record issuance of commercial-mortgage-backed securities. Likely because of that heavy issuance, spreads of yields on commercial-mortgage-backed securities over those on comparable-maturity Treasuries have turned up recently, but these spreads remain relatively low. The credit quality of commercial-mortgage debt remains quite strong, as delinquency rates on holdings of commercial mortgages at banks and insurance companies and on loans that back mortgage securities have been declining from already low levels.

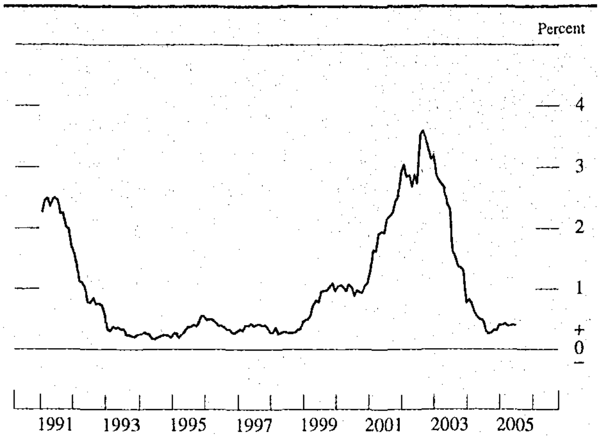
The Government Sector

Federal Government

The deficit in the federal unified budget narrowed over the past year. Over the twelve months ending in June, the unified budget recorded a deficit of \$336 billion, \$99 billion less than during the comparable period last year. Both revenues and outlays rose faster than did nominal GDP over this period, but the rise in receipts was especially strong. Even at its lower level, the deficit was still equal to about 2¾ percent of nominal GDP.

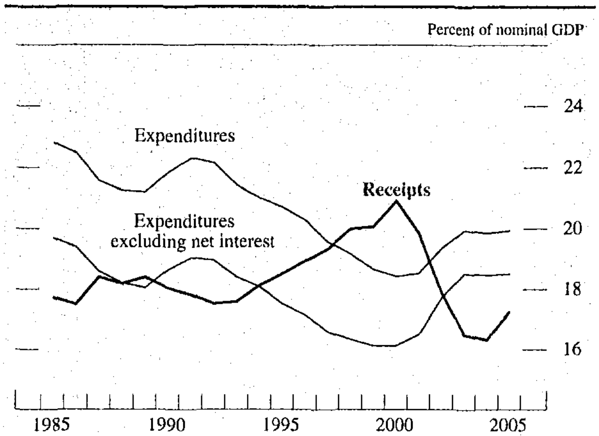
Nominal federal receipts during the twelve months ending in June were 14 percent higher than during the same period a year earlier and reached 17 percent of nominal GDP. Revenues were boosted by a large

Default rate on outstanding corporate bonds



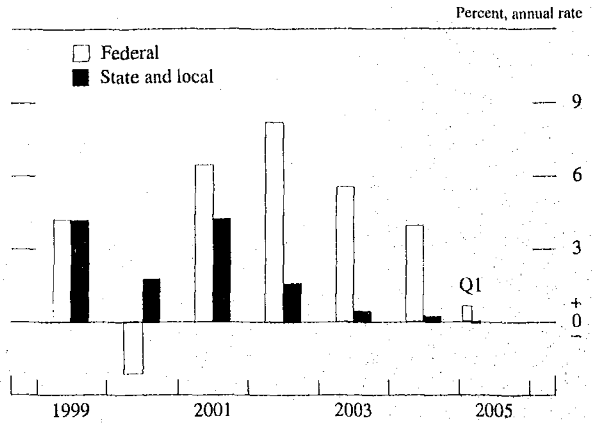
NOTE: The data are monthly and extend through June 2005. The rate for a given month is the face value of bonds that defaulted in the twelve months ending in that month divided by the face value of all bonds outstanding at the end of the calendar quarter immediately preceding the twelve-month period.
SOURCE: Moody's Investors Service.

Federal receipts and expenditures



NOTE: The budget data are from the unified budget through 2004 and are for fiscal years (October through September), and GDP is for Q4 to Q3. For 2005, the budget data are for the twelve months ending in June, and GDP is for 2004:Q4 to 2005:Q1.
SOURCE: Office of Management and Budget.

Change in real government expenditures on consumption and investment

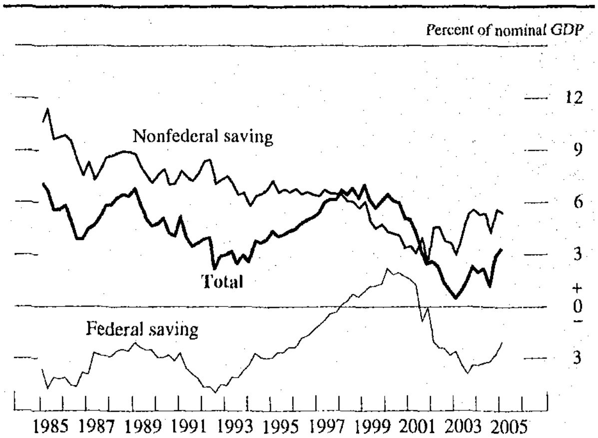


SOURCE: Department of Commerce, Bureau of Economic Analysis.

increase in corporate receipts that was driven by the strength of corporate profits. In addition, individual income and payroll taxes rose nearly 12 percent, twice as fast as the growth of household income. However, some of this rise was due to the features of the Jobs and Growth Tax Relief Reconciliation Act of 2003 that altered the timing of tax payments in a way that temporarily reduced the level of tax collections last year.

Nominal federal outlays during the twelve months ending in June were 7 percent higher than during the same period a year ago and stood at 20 percent of nominal GDP. Spending for national defense continued to trend up at a rapid clip, and outlays for Medicare also posted a sizable increase. In addition, federal net interest payments, boosted both by higher interest rates and by the higher level of federal debt, rose more than 13 percent over this period. Real federal expenditures for consumption and investment—the part of government spending that is a component of real GDP—increased at an annual rate of just ½ percent in the first calendar quarter of 2005 after having risen 4 percent in 2004. Although defense spending changed little in real terms in the first quarter, it has risen considerably in recent years and is likely to increase further in coming quarters. Nondefense spending in the first quarter edged up in line with its recent trend, and enacted legislation is consistent with its continuing to rise at a subdued pace.

Net saving



NOTE: The data are quarterly and extend through 2005:Q1. Nonfederal saving is the sum of personal and net business saving and the net saving of state and local governments.

SOURCE: Department of Commerce, Bureau of Economic Analysis.

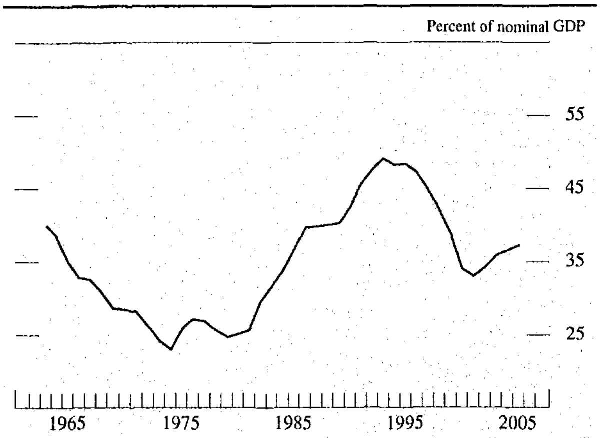
The deficit in the federal budget has depressed national saving in the past few years. The narrowing of the deficit of late has lessened this reduction in national saving from a little more than 3 percent of nominal GDP in 2003 and 2004 to roughly 2 percent in the first quarter of 2005. Even so, as business and personal saving rates changed little, on average, over the past year, net national saving rose to just 3¼ percent of nominal GDP in the first quarter, well below the long-term historical average of about 7 percent and below recent levels of net domestic investment. If not reversed, such a low level of net national saving will necessitate either slower capital formation or continued heavy borrowing from abroad. The pressures on national saving will intensify greatly with the retirement of the baby-boom generation and the associated increases in Social Security and Medicare benefit payments.

Federal Borrowing

Because of the need to finance the sizable federal budget deficit, federal debt held by the public expanded at a seasonally adjusted annual rate of 13¾ percent in the first quarter of the year. The ratio of this debt to nominal GDP increased to more than 37 percent for the first time since 2000. The average maturity of outstanding marketable Treasury debt has been declining for several years and reached fifty-three months at the end of the first quarter of 2005, down from about seventy months in 2000. However, in the May mid-quarter refunding statement, the Treasury announced that it was considering reintroducing regular issuance of a thirty-year nominal bond in February 2006, a move that would presumably slow or arrest this downtrend.

Indicators of demand for Treasury securities by foreign investors have been mixed so far this year; demand by foreign official institutions seems to have moderated, but demand by foreign private investors

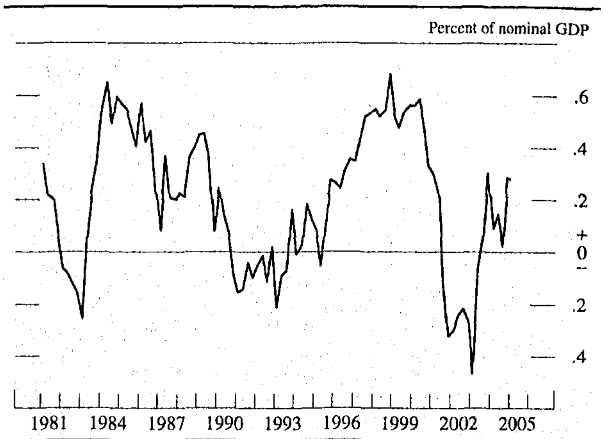
Federal government debt held by the public



Note: The final observation is for 2005:Q1. For previous years, the data for debt are as of year-end, and the corresponding values for GDP are for Q4 at an annual rate. Excludes securities held as investments of federal government accounts.

Source: Federal Reserve Board, flow of funds data.

State and local government net saving



Note: The data, which are quarterly, are on a national income and product account basis and extend through 2005:Q1. Net saving excludes social insurance funds.

Source: Department of Commerce, Bureau of Economic Analysis.

appears to have remained robust. Indirect bidders at Treasury auctions—which include foreign official institutions that place bids through the Federal Reserve Bank of New York—have been awarded an average of 33 percent of coupon securities issued at auctions held so far this year, down from 42 percent in 2004. Treasury securities held in custody at the Federal Reserve Bank of New York on behalf of foreign official institutions have grown only about $25 billion so far this year after an increase of more than $200 billion in 2004. Data from the Treasury International Capital System also suggest an ebbing of demand for Treasury securities from foreign official investors during the first five months of the year. These data, however, indicate that foreign private investors have continued to accumulate Treasury securities at a rapid pace.

State and Local Governments

The fiscal positions of states and localities have improved this year. Ongoing gains in income and consumer spending, along with sharp increases in property values, have continued to boost tax receipts. Although many jurisdictions have increased their spending moderately, some are also using the additional revenues to rebuild reserve funds. On a NIPA basis, net saving by state and local governments equaled $34 billion at an annual rate in the first quarter (roughly ¼ percent of nominal GDP), double the 2004 average. In addition, virtually all states registered surpluses in their general fund budgets in fiscal year 2005, which ended on June 30 for all but four states. Nevertheless, lingering fiscal concerns are still evident in some jurisdictions; these concerns are related primarily to rising Medicaid costs, the termination of temporary federal grants that were appropriated in fiscal year 2004, and pressures to restore funding to programs—such as elementary and secondary education—that were cut back earlier in the decade.

Real consumption and investment spending by state and local governments edged down in the first quarter of 2005 after having changed little in 2004. Real outlays for consumption items increased at an annual rate of less than ½ percent, a reflection of some slowing in the pace of hiring. Nominal spending on investment rose at a moderate rate in the first quarter, but because construction costs escalated, investment spending declined a little in real terms.

State and Local Government Borrowing

State and local government debt held by the public expanded at a rapid pace in the first quarter of the year, rising at a seasonally adjusted annual rate of 16¼ percent, up from 5½ percent in the fourth quarter of last year. However, much of this borrowing was for the advance refunding of existing debt, as state and local governments continued to take advantage of low long-term interest rates. A significant portion of the proceeds of these advance refundings were invested in U.S. Treasury instruments tailored to meet the cash management needs of municipal governments. In addition, financing of transportation- and education-related projects boosted issuance of long-term municipal bonds for new capital.

The credit quality of municipal borrowers improved last year, and this trend has generally continued so far in 2005, as upgrades of municipal bonds by Standard & Poor's continued to outpace downgrades.

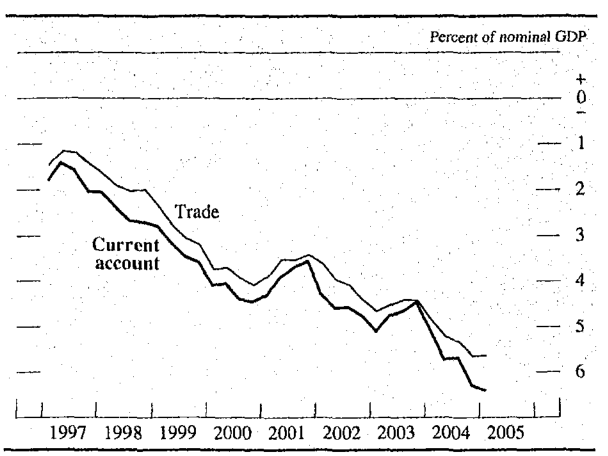
The External Sector

The U.S. current account deficit expanded in the first quarter of 2005 to $780 billion at an annual rate, or about 6.4 percent of nominal GDP. The deficit in trade in goods continued to widen, increasing $17 billion from the previous quarter. The deficit on net unilateral transfers also widened in the first quarter, largely because of an increase in government grants. In contrast, the surplus on trade in services rose $7 billion, and the surplus on net investment income rose $2 billion.

International Trade

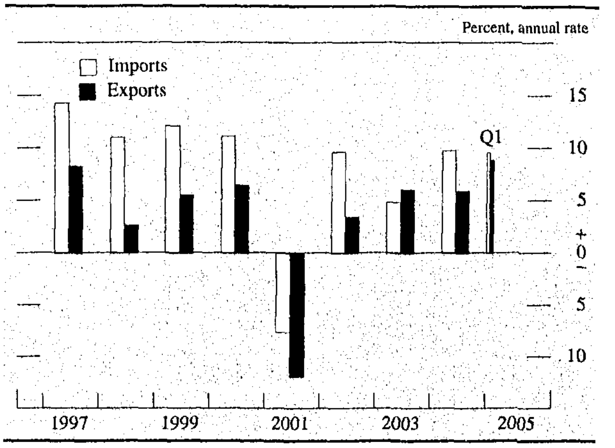
Real exports of goods and services accelerated in the first quarter of 2005 to an annual rate of about 9 percent, roughly twice as fast as the rate in the second half of last year. The dollar's decline in recent years has raised the competitiveness of U.S. relative prices and has continued to provide a mounting boost to exports. Support from foreign economic activity, though still substantial, moderated after the first half of 2004 as growth abroad slowed. Increases in exports of U.S. goods were widespread across major U.S. trading partners, with the exception of Japan, and were concentrated in capital goods and consumer goods. Real exports of services rose at an annual rate of about 13¼ percent.

U.S. trade and current account balances



NOTE: The data are quarterly and extend through 2005:Q1.
SOURCE: Department of Commerce.

Change in real imports and exports of goods and services



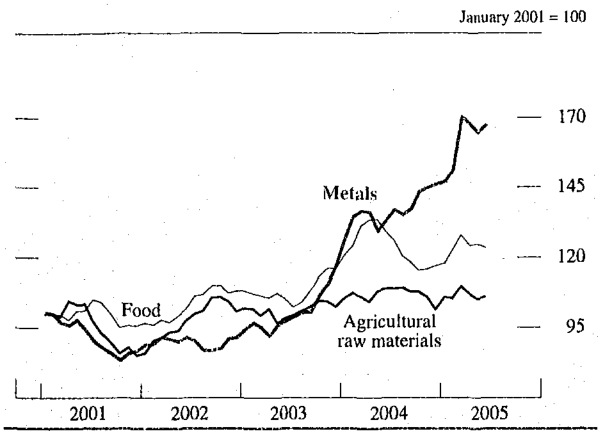
SOURCE: Department of Commerce.

Real imports of goods and services rose at an annual rate of about 9½ percent in the first quarter, a pace similar to the average in 2004. The growth of real oil imports ebbed after surging late last year. Increases in imports of non-oil goods were widespread across categories. The expiration of the Multifibre Arrangement and the resulting elimination of quotas shifted the source of some U.S. textile and apparel imports among U.S. trading partners, but these events appear to have had a limited effect on the overall level of imports of these goods. Real imports of services reversed their fourth-quarter decline, posting a gain of 7 percent at an annual rate, as some travel-related expenditures and also royalties and license fees recovered from a very weak fourth quarter.

Boosted by substantial increases in the prices of primary commodities and industrial supplies, prices of total exports rose at an annual rate of 4¼ percent in the first quarter. Prices of U.S. agricultural exports rebounded in the first quarter after good harvests in the second half of 2004 had caused prices to fall sharply. The available data for the second quarter point to continued increases in export prices.

Prices of imported non-oil goods rose at an annual rate of 3¾ percent in the first quarter, almost 1½ percentage points faster than in the second half of 2004. Prices of material-intensive items, such as industrial supplies and foods, steadily increased in the last quarter of 2004 and in the first quarter of 2005. In part, this rise reflected higher prices for nonfuel primary commodities, as strength in global demand for many commodities outstripped a slow expansion of supply. Prices for finished goods, such as consumer goods and many kinds of capital goods, also turned noticeably higher. Available data for the second quar-

Prices of major nonfuel commodities

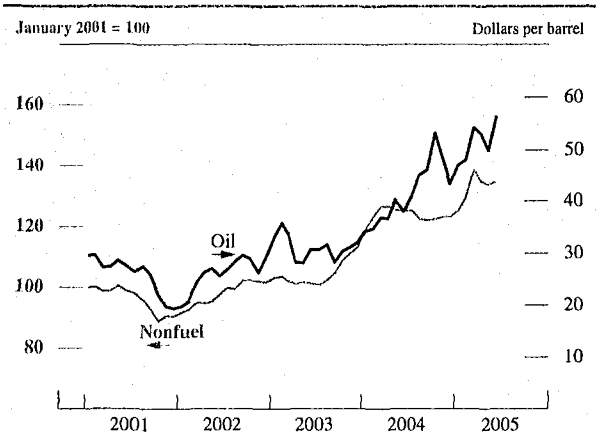


NOTE: The data are monthly and extend through June 2005. The category of agricultural raw materials consists of timber, cotton, wool, rubber, and hides; food includes cereals, vegetable oils and protein meals, seafood, and meat; and metals includes aluminum, copper, and iron ore.
SOURCE: International Monetary Fund.

ter show that the increases in prices of both material-intensive and finished goods have slowed.

The spot price of West Texas intermediate (WTI) crude oil began 2005 near $43 per barrel, but it climbed above $50 per barrel in late February and breached $60 per barrel in late June. The increase in the spot price of WTI largely reflects several global factors: continued strong demand for oil, limited spare production capacity, and concerns about the reliability of supply from some foreign sources. In contrast to the market outlook during last October's peak in oil prices, futures contracts indicate that market participants now expect oil prices to remain near their current high levels, a view consistent with

Prices of oil and of nonfuel commodities



NOTE: The data are monthly and extend through June 2005. The oil price is the spot price of West Texas intermediate crude oil. The price of nonfuel commodities is an index of forty-five primary-commodity prices.
SOURCE: For oil, *Wall Street Journal;* for nonfuel commodities, International Monetary Fund.

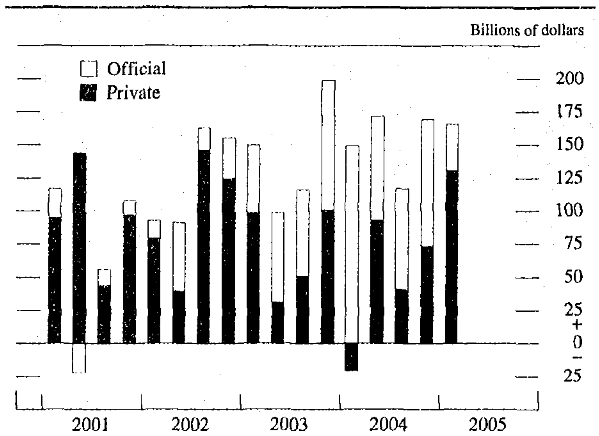
the belief that demand will remain strong and production will have difficulty keeping pace. The price of the far-dated NYMEX oil futures contract (currently for delivery in December 2011) rose from about $38 per barrel as of last October to about $56 per barrel in late June.

OPEC spare production capacity appears to be near historical lows, with only Saudi Arabia able to increase production substantially. Many other OPEC producers are either pumping close to capacity or encountering production problems. Venezuela and Indonesia cannot meet their production quotas, and Iraqi production this year has averaged less than in 2004. In addition, several governments have moved to increase their control of the energy industry as oil prices have risen. Russian oil production, which had provided most of the growth in non-OPEC supply over the previous five years, has stagnated since last September amid the partial nationalization of Yukos, formerly Russia's largest oil company. Venezuela has also increased the taxes and royalty payments of foreign oil firms.

The Financial Account

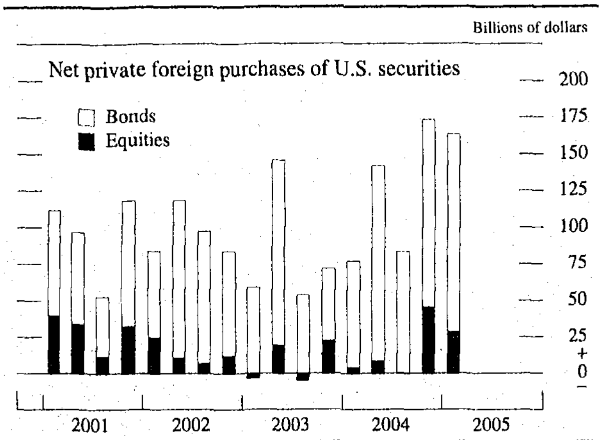
Foreign official inflows, which accounted for more than half of all net financial inflows to the United States in 2004, slowed significantly in the first quarter but showed signs of renewed strength in April and May. In contrast, private inflows moderated in April and May after having increased substantially in the preceding six months. As has been the case for several years, the U.S. current account has been financed primarily by foreign purchases of U.S. debt securities. U.S. residents' purchases of foreign securities increased after a temporary lull in the fourth quarter

U.S. net financial inflows



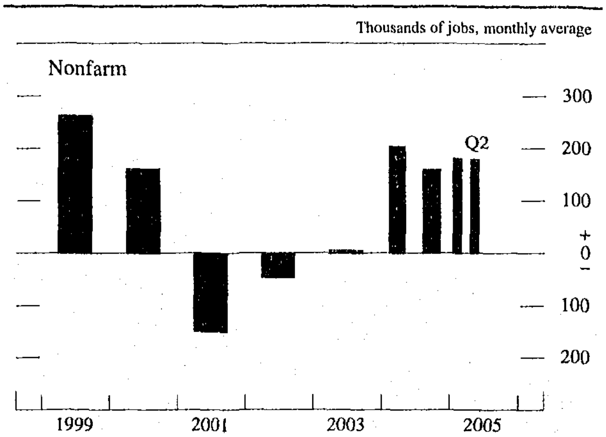
SOURCE: Department of Commerce.

U.S. net international securities transactions



SOURCE: Department of Commerce and the Federal Reserve Bank of New York.

Net change in payroll employment



SOURCE: Department of Labor, Bureau of Labor Statistics.

and have been more heavily weighted toward purchases of equities.

Net direct investment outflows in the first quarter were well below their levels in the fourth quarter; direct investment into the United States was roughly unchanged, but U.S. direct investment abroad fell back after a surge in new equity late last year. There is little evidence to date that U.S. companies have repatriated earnings from their foreign subsidiaries using the temporarily reduced tax rate available under the American Jobs Creation Act of 2004. However, there are indications that these remittances may pick up in the second half of this year.

The Labor Market

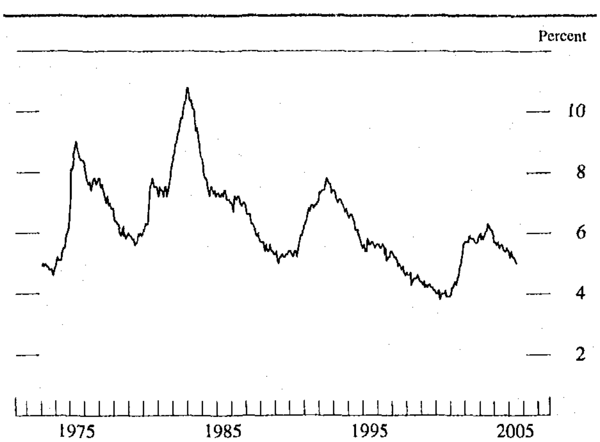
Employment and Unemployment

Labor markets have continued to improve this year, albeit at an uneven pace from month to month. On average, nonfarm payroll employment expanded roughly 180,000 per month over the first half of 2005, about the same pace as in the fourth quarter of 2004. At the same time, the civilian unemployment rate, which had declined from 5¾ percent to just below 5½ percent over 2004, continued to move down. The jobless rate stood at 5 percent in June, the lowest level since September 2001.

The increases in payrolls over the first half of 2005 were relatively widespread across industries. Particularly sizable gains were registered at providers of health-care services and leisure and hospitality services and at establishments that provide business services, such as professional and technical assistance and administrative and support services (a category that includes temporary help). In addition, construction employment continued to climb at a steady pace, a reflection of the buoyant residential housing market and increased spending on infrastructure by state and local governments. In contrast, manufacturing employment continued to trend down, as cutbacks in industries that produce wood products, furniture, and a variety of nondurable goods more than offset hiring at producers of fabricated metals and machinery. Employment in retail trade has advanced at a moderate pace this year. Increases in employment at state and local governments slowed somewhat in the first half of this year from the pace in the second half of last year, and federal civilian employment changed little.

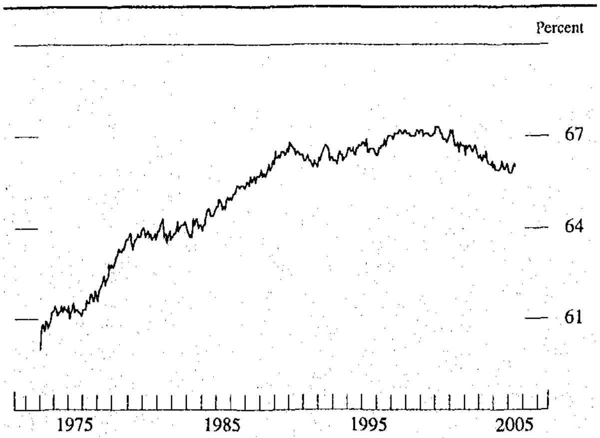
The gradual rise in job opportunities appears to be attracting some potential workers back into the labor market. The labor force participation rate, which had declined noticeably between 2000 and 2004, edged up over the first half of 2005. Nevertheless, the

Civilian unemployment rate



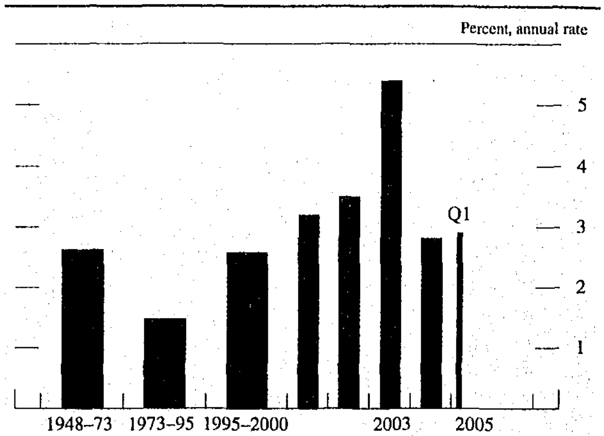
NOTE: The data are monthly and extend through June 2005.
SOURCE: Department of Labor, Bureau of Labor Statistics.

Labor force participation rate



NOTE: The data are monthly and extend through June 2005.
SOURCE: Department of Labor, Bureau of Labor Statistics.

Change in output per hour



NOTE: Nonfarm business sector.
SOURCE: Department of Labor, Bureau of Labor Statistics.

participation rate in June, at 66 percent, remained well below the high of 67¼ percent reached in early 2000. To some extent, both the high level of the participation rate in 2000 and the more recent decline are likely related to cyclical developments in the economy: The tight labor markets of the late 1990s, perhaps coupled with the introduction of work requirements for many welfare recipients, undoubtedly drew additional people into the labor force at that time, while the subsequent recession and slow recovery in the labor market have discouraged many job seekers in recent years. However, the downtrend in the aggregate participation rate also appears to be associated with structural developments that seem likely to limit future increases. For example, the large baby-boom cohorts are now entering ages at which labor force participation rates typically drop off sharply. And, in contrast to patterns observed in previous decades, participation rates for women between 25 and 54 years of age no longer appear to be trending up.

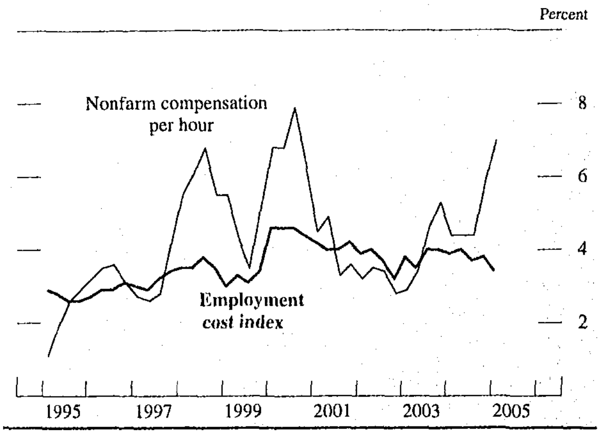
Productivity and Labor Costs

Gains in labor productivity have slowed, on balance, in recent quarters. According to currently published data, output per hour in the nonfarm business sector rose 2½ percent over the year ending in the first quarter of 2005, down from the 5½ percent pace registered in the comparable period a year earlier. A deceleration in productivity is not unusual as an economic expansion matures and as businesses—which become increasingly confident about future prospects for sales—step up their pace of hiring. In addition, the recent slowdown in productivity growth was from the unusually rapid average rate that prevailed between 2002 and early 2004. That elevated rate likely reflected both an atypical reluctance to hire—as employers reacted to a succession of economic and geopolitical shocks—and newfound efficiencies brought about by the better use of high-tech capital purchased by businesses in earlier years and by organizational changes implemented to maintain profitability when the economy was relatively weak. As the impetus from these influences has waned, productivity growth has fallen back.

Measures of labor compensation for recent quarters suggest that the remaining slack in labor markets continued to restrain increases in base wage rates but that large increases in some of the more flexible components of worker pay and for some types of employer-provided benefits added to labor costs. In particular, compensation per hour in the nonfarm business sector, which is based on the data from the national income and product accounts, rose 7 percent over the four quarters ending in the first quarter of this year, having registered a particularly large bulge in the final quarter of 2004. Much of this sharp rise may be the result of the exercise of a large number of stock options late last year, a development perhaps induced by an increase in equity prices that boosted the number of options that were "in the money" and by a proposed change in accounting regulations that led some companies to accelerate the vesting of options that had been previously granted. In addition, the strong performance of profits in 2004 may have been associated with sizable nonproduction bonus payments at the end of last year.

A more modest rate of increase in hourly compensation is indicated by the employment cost index (ECI), which is based on a quarterly survey of private

Measures of change in hourly compensation

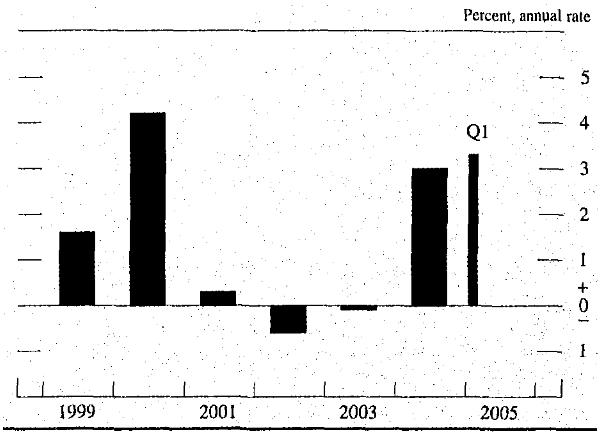


NOTE: The data are quarterly and extend through 2005:Q1. For nonfarm compensation, change is over four quarters; for the employment cost index (ECI), change is over the twelve months ending in the last month of each quarter. Nonfarm compensation is for the nonfarm business sector; the ECI is for private industry excluding farm and household workers.
SOURCE: Department of Labor, Bureau of Labor Statistics.

nonfarm establishments conducted by the Bureau of Labor Statistics and which excludes income received from the exercise of stock options. In particular, the ECI measure of hourly compensation rose 3½ percent over the twelve months ending in March 2005, about ½ percentage point less than the increases over the preceding two years. The wages and salaries component of the ECI was up just 2½ percent over the twelve months ending in March, a pace similar to that in the preceding year, while employer costs for benefits increased 5¾ percent, a bit below the pace of the previous year but a sizable gain nonetheless. Part of the outsized rise in benefit costs stemmed from the need by many companies to rebuild their defined-benefit pension assets to make up for earlier losses in those plans. In addition, health insurance costs have continued to rise more rapidly than wages, although the 7½ percent increase in these costs over the year ending in March of this year was down from the double-digit rates of growth in 2002 and 2003.

The acceleration in the nonfarm business measure of hourly compensation, coupled with the deceleration in productivity, has contributed to a noticeable pickup in unit labor costs in recent quarters. In particular, unit labor costs rose 4¼ percent over the four quarters ending in the first quarter of 2005 after having declined 1 percent over the preceding four quarters. However, to the extent that the acceleration in compensation was the result of a temporary bulge in stock option exercises in late 2004, unit labor costs should moderate significantly this year. Moreover, the implications of such a spike in unit labor costs for price inflation are probably minimal, at least as

Change in unit labor costs



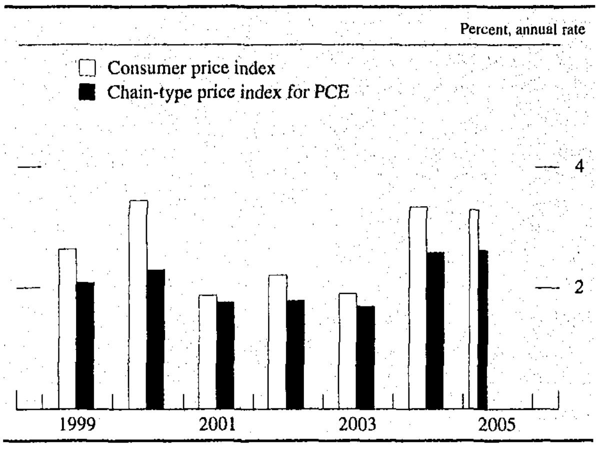
NOTE: Nonfarm business sector. The change in unit labor costs is defined as the increase in nonfarm compensation per hour less the growth in labor productivity.
SOURCE: Department of Labor, Bureau of Labor Statistics.

judged by previous spikes of this nature. For example, the sharp rise in unit labor costs in 2000 had little or no subsequent effect on price inflation.

Prices

Higher energy prices continued to show through to overall consumer price inflation this year. The chain-type price index for personal consumption expenditures rose at an annual rate of about 2½ percent between the fourth quarter of 2004 and May 2005, a rate of increase similar to that over the four quarters of 2004. Within that total, core PCE prices accelerated over that period to an annual rate of about

Change in consumer prices



NOTE: For 2005, the change for the PCE price index is from 2004:Q4 to May 2005; for the consumer price index, it is from 2004:Q4 to 2005:Q2.
SOURCE: For consumer price index, Department of Labor, Bureau of Labor Statistics; for chain-type measure, Department of Commerce, Bureau of Economic Analysis.

Alternative measures of price change
Percent

Price measure	2003 to 2004	2004 to 2005
Chain-type (Q1 to Q1)		
Gross domestic product (GDP)	1.7	2.4
Gross domestic purchases	1.7	2.8
Personal consumption expenditures (PCE)	1.7	2.2
Excluding food and energy	1.4	1.6
Market-based PCE excluding food and energy	1.3	1.7
Fixed-weight (Q2 to Q2)		
Consumer price index	2.9	2.9
Excluding food and energy	1.8	2.2

NOTE: Changes are based on quarterly averages of seasonally adjusted data.
SOURCE: For chain-type measures, Department of Commerce, Bureau of Economic Analysis; for fixed-weight measures, Department of Labor, Bureau of Labor Statistics.

2 percent, from 1½ percent in 2004. However, data for the consumer price index (CPI), which are available through June, suggest that core inflation has moderated in recent months; the core CPI rose at an annual rate of 1¼ percent in the three months ending in June after having increased at a 3¼ percent pace over the first three months of this year.

The PCE price index for energy, which moved up more than 18 percent in 2004, increased at an annual rate of nearly 14 percent between the fourth quarter of 2004 and May 2005, having been pushed higher by a further run-up in crude oil prices. Gasoline prices climbed especially rapidly between February and April, when higher crude costs were accompanied by a significant widening in retail margins. Although these margins subsequently dropped back, retail gasoline prices in June were still nearly 10 percent above their level at the end of last year, and they moved up further in early July. Electricity prices also rose sharply over the first half of 2005 because of higher input costs for electricity generation.

Consumer food prices increased at an annual rate of about 2½ percent over the first half of 2005, a bit less than in 2004. Prices for fruits and vegetables dropped back early in the year, as supplies recovered from the damage associated with last year's succession of hurricanes. Although these prices turned up a little in the spring, they remain below their fourth-quarter levels. In contrast, meat prices rose at an annual rate of 3 percent over the first half of the year; relatively strong domestic demand has lifted prices despite increases in the number of cattle being fed for slaughter and ample supplies of other meats and poultry. Prices for beef were also influenced by a variety of trade restrictions associated with concerns about mad cow disease: Both the full resumption of imports from Canada (which would tend to push down prices) and the resumption of exports to other important trading partners (which would tend to push up prices) were delayed. Prices of food away from home, for which labor costs are more important than raw food costs, rose at an annual rate of about 3½ percent over the first half of this year, a little higher than the recent trend.

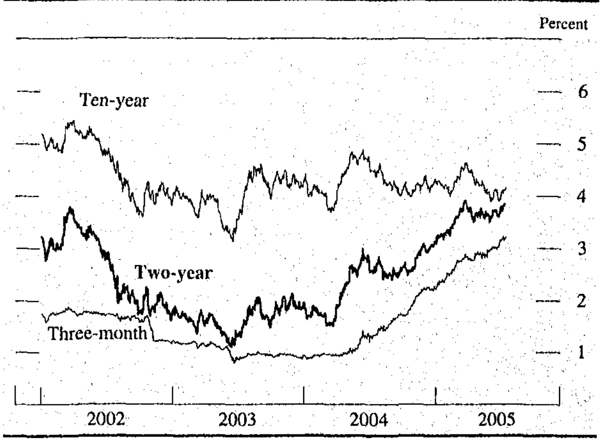
The pickup in core PCE inflation this year is due both to the sharp run-up in energy prices and to higher prices for other intermediate materials; these developments have raised production and distribution costs for a wide range of domestically produced goods and services. In addition, the decline in the exchange value of the dollar into early 2005 continued to push up prices of core nonfuel imports this year, both for items used in the domestic production of other goods and services and for items sold directly to consumers. Partially offsetting these influences have been the gains in productivity, which have enabled firms to absorb a portion of the higher costs. Moreover, although the price of crude oil remains high, prices for some other industrial materials have decelerated or edged down of late: The *Journal of Commerce* industrial price index—which excludes energy items—has fallen 6 percent since the beginning of April, while the producer price index for core intermediate materials rose at an annual rate of just 1¼ percent in the second quarter of this year after having increased at roughly a 7 percent pace, on average, in the preceding few quarters.

Measures of shorter-term inflation expectations have edged higher this year, while those of longer-term expectations have held steady or moved lower. Most notably, the Michigan SRC survey indicates that households' median expectations for inflation over the next twelve months have ranged between 3 percent and 3¼ percent in recent months, up from just under 3 percent at the beginning of the year. In contrast, households' median expectations for inflation over the next five to ten years, at a little under 3 percent, are similar to readings in recent years. The latest Survey of Professional Forecasters likewise shows that inflation is expected to average 2½ percent over the next ten years, a figure unchanged since 2001. Readings of longer-term inflation compensation from financial markets show a more pronounced decline: Inflation compensation as measured by the spread of the yield on nominal Treasury securities over their indexed counterparts for the period five to ten years ahead has fallen about 50 basis points since the end of 2004.

U.S. Financial Markets

Financial market conditions remained generally accommodative during the first half of 2005, as Treasury and private interest rates stayed low. Risk spreads on speculative-grade debt had become very tight by the end of the first quarter, but they subsequently rose, on balance, after the downgrades of Ford and General Motors; current levels suggest more-typical compensation for default risk. Banks continued easing terms and standards on lending to businesses. The pace of business borrowing, which had been sluggish, picked up last year and remained fairly robust in the first half of 2005. Nevertheless, strong corporate profits and the large stockpile of liquid assets already on firms' balance sheets continued to limit their demand for external financing. Debt of the federal government, of state and local governments, and of households continued to expand briskly. Broad equity price indexes were little changed on net; higher oil prices boosted share prices in the energy sector but weighed on other stocks.

Interest rates on selected Treasury securities



NOTE: The data are daily and extend through July 13, 2005.
SOURCE: Department of the Treasury.

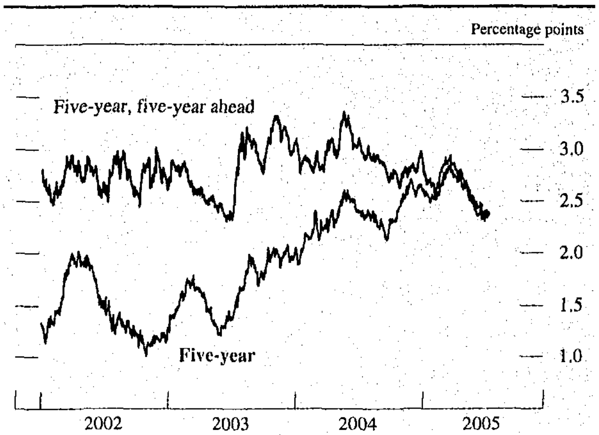
Interest Rates

The FOMC boosted the intended federal funds rate 25 basis points at each of its four meetings in the first half of the year. Judging from federal funds futures quotes, these policy actions had all been widely anticipated by investors for some time before each meeting. Since the start of the year, rates on interest rate futures contracts that will expire at the end of 2005 have moved up about 60 basis points in response to evidence of robust economic growth and concerns about the possible emergence of inflationary pressures. Two-year nominal Treasury yields have risen about 80 basis points over that period, reflecting both the firming of policy expectations and actual monetary policy tightening.

Nevertheless, ten-year nominal Treasury yields have edged down so far this year and are now about 60 basis points below their level just before the FOMC meeting in June 2004. Moreover, this fall in long-term yields is a global phenomenon: Long-term yields have declined in most foreign industrialized economies, in several cases by more than in the United States. From the term structure of interest rates, the ten-year Treasury yield can be decomposed into a series of ten consecutive one-year forward rates. The last of these—the one-year forward rate ending ten years hence—now stands about 160 basis points below its level just before the June 2004 FOMC meeting.

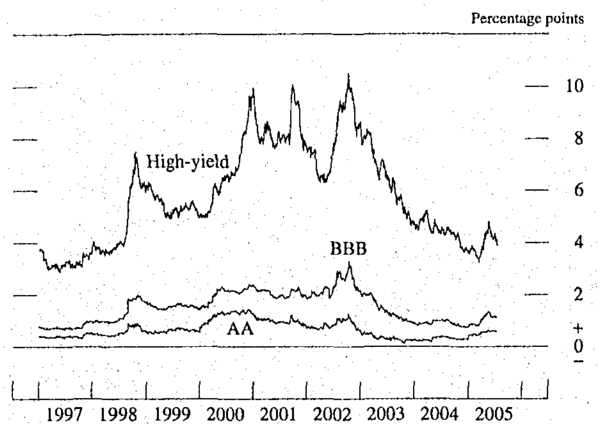
Several potential explanations have been offered for the decline in long-term yields and distant-horizon forward rates in the United States since mid-2004. Among these is the possibility that long-term inflation expectations have fallen and become more firmly anchored. Indeed, longer-term inflation compensation, measured by the spread between the yields on ten-year Treasury inflation-protected securities and their nominal counterparts, has fallen about 30 basis points over this period. A second possible explanation is investors' willingness to accept smaller risk premiums on long-term securities amid declining macroeconomic and interest rate uncertainty. The volatility of short-term interest rates and Treasury yields implied by option prices has indeed declined to historically low levels. A third possibility is that several factors have spurred an excess of global saving over planned investment, such as rising incomes in countries with high saving rates, the desire by the aging citizens of many industrialized countries to

TIPS-based inflation compensation



NOTE: The data are daily and extend through July 13, 2005. Based on a comparison of the yield curve for Treasury inflation-protected securities (TIPS) to the nominal off-the-run Treasury yield curve.
SOURCE: Federal Reserve Board calculations based on data provided by the Federal Reserve Bank of New York and Barclays.

Spreads of corporate bond yields over comparable off-the-run Treasury yields



NOTE: The data are daily and extend through July 13, 2005. The high-yield index is compared with the five-year Treasury yield, and the BBB and AA indexes are compared with the ten-year Treasury yield.

SOURCE: Merrill Lynch AA and BBB indexes and Merrill Lynch Master II high-yield index.

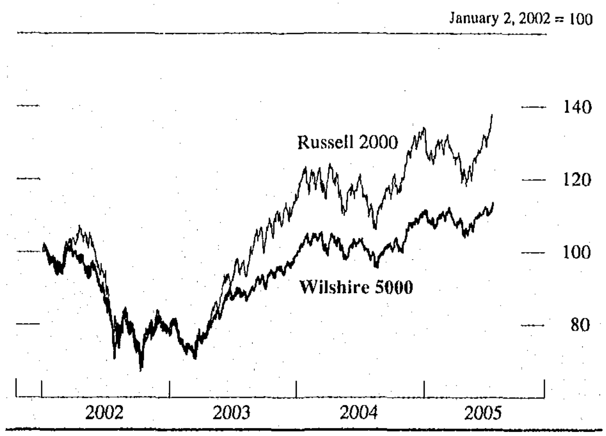
save for retirement, and apparently diminished investment prospects in many industrialized and developing economies.

Spreads of yields on investment-grade corporate debt over those on comparable-maturity Treasury securities fell during the first quarter of 2005, and risk spreads on high-yield corporate debt reached very low levels. However, in March, news about difficulties in the domestic motor vehicle industry apparently became a focal point for a revision of investors' assessment of risks. Further revelations of accounting irregularities in the insurance industry also seem to have made investors somewhat charier of risk. As a result, risk spreads on corporate bonds and credit default swaps have widened; speculative-grade bond spreads are now about 50 basis points higher than at the start of the year.

Equity Markets

Broad equity price indexes fell modestly in the first quarter, but they rebounded and are now little changed, on net, since the start of 2005. Thus far this year, stock prices have been buoyed by continued strong profits and low long-term interest rates, but higher oil prices and a few high-profile earnings disappointments have weighed on share prices outside the energy sector. The forward earnings–price ratio held about steady despite the fall in real interest rates. Equity price volatility implied by quotes on stock options declined, as the implied volatility on the S&P 500 index dropped to a record low level of less than 11 percent.

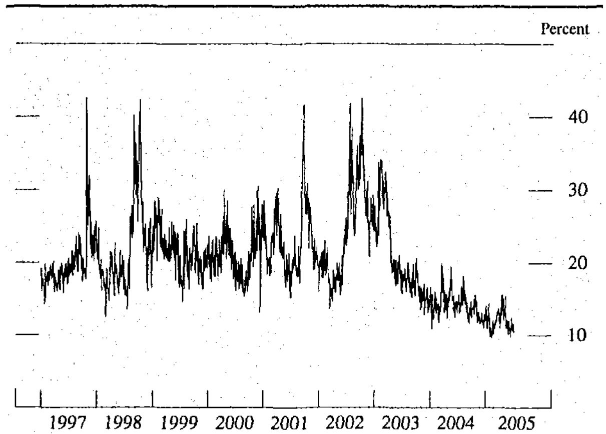
Stock price indexes



NOTE: The data are daily and extend through July 13, 2005.

SOURCE: Frank Russell Company; Dow Jones Indexes.

Implied S&P 500 volatility



NOTE: The data are daily and extend through July 13, 2005. The series shown is the implied thirty-day volatility of the S&P 500 stock price index as calculated from a weighted average of options prices.

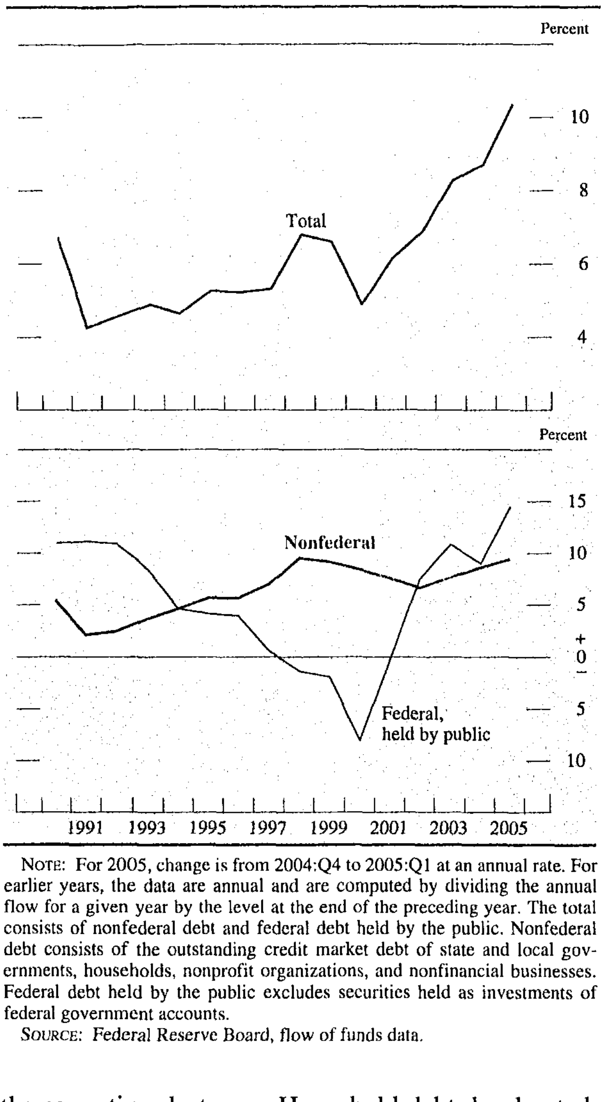
SOURCE: Chicago Board Options Exchange.

Net inflows into equity mutual funds were moderate in the first half of 2005, down from the rapid pace during the same period last year. These flows likely followed the pattern set by share prices, which surged about 30 percent in 2003, rose about 10 percent in 2004, and have been flat so far this year.

Debt and Financial Intermediation

The aggregate debt of the domestic nonfinancial sectors expanded at an annual rate of about 10 percent in the first quarter of 2005, up from an 8¼ percent pace in the fourth quarter of 2004, mainly because of faster growth of federal government debt and state and local government debt. The mix of household and business debt growth has shifted modestly since

Change in domestic nonfinancial debt



NOTE: For 2005, change is from 2004:Q4 to 2005:Q1 at an annual rate. For earlier years, the data are annual and are computed by dividing the annual flow for a given year by the level at the end of the preceding year. The total consists of nonfederal debt and federal debt held by the public. Nonfederal debt consists of the outstanding credit market debt of state and local governments, households, nonprofit organizations, and nonfinancial businesses. Federal debt held by the public excludes securities held as investments of federal government accounts.

SOURCE: Federal Reserve Board, flow of funds data.

the same time last year. Household debt decelerated, though it continued expanding at a rapid pace, and the growth of business-sector debt picked up even though ample internal funding continued to limit firms' need for external financing.

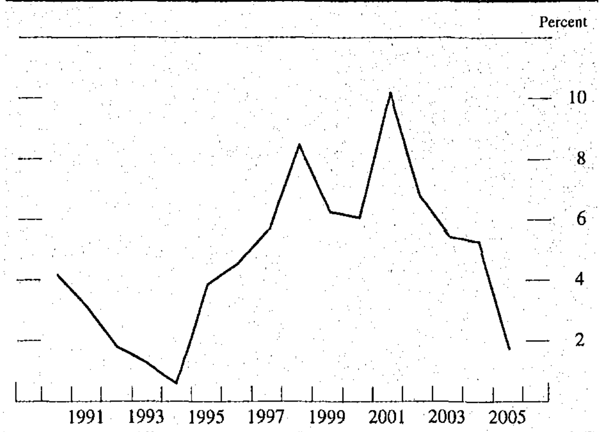
Commercial bank credit expanded at an annual rate of 13 percent in the first quarter of 2005. Financing secured by residential real estate, including home mortgages, home equity loans, and mortgage-backed securities, extended its long, robust expansion. In May, the Federal Reserve Board and other federal agencies that regulate depository institutions issued guidance on sound underwriting and effective credit-risk-management practices for home equity lending. Recently there has been increased use of potentially riskier types of mortgages, including adjustable-rate and interest-only loans, which could pose challenges to both lenders and borrowers. Business loans, which had begun to grow in 2004 after several years of runoffs, accelerated to a 15 percent annual rate of growth in the first quarter of 2005, supported in part by strong demand for short-term financing to fund rising accounts receivable, inventories, and merger and acquisition activity.

Credit market assets held by government-sponsored enterprises declined in the first quarter of this year, as Freddie Mac and Fannie Mae reduced their outright holdings of mortgage-backed securities.

The M2 Monetary Aggregate

In the first half of 2005, M2 grew at a 2½ percent annual rate—probably slower than nominal GDP and down from a 5¼ percent pace last year. Slower growth in liquid deposits—likely a consequence of their rising opportunity cost—accounted for most of this deceleration. Yields on retail money market mutual funds rose noticeably in the first half but continued to lag interest rates on market instruments, and assets in these funds continued their prolonged runoff. Small time deposits, whose yields have better kept pace with rising market interest rates, rose briskly during the same period. Currency expanded at a slow rate, apparently a reflection in large measure of weak demand from abroad. On net, the velocity of M2 is estimated to have moved up in the first half at a somewhat slower pace than would be expected from the historical relationship between money, income, and opportunity cost.

M2 growth rate



NOTE: For 2005, growth is estimated using monthly data through May; for earlier years, the data are annual averages. M2 consists of currency, traveler's checks, demand deposits, other checkable deposits, savings deposits (including money market deposit accounts), small-denomination time deposits, and balances in retail money market funds.

SOURCE: Federal Reserve Statistical Release H.6, "Money Stock Measures."

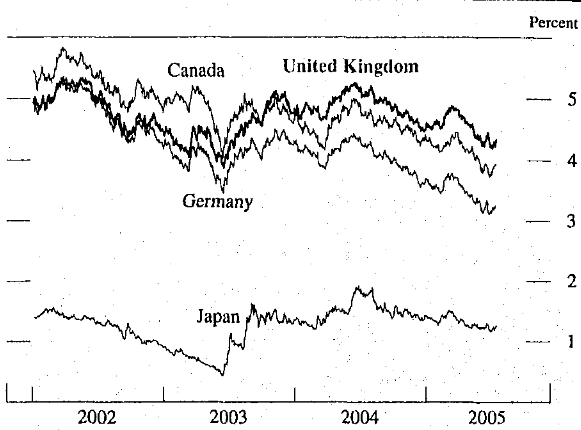
International Developments

Foreign economic activity has expanded a bit less rapidly this year than in the second half of 2004, as measured by an export-weighted average of growth among U.S. trading partners. The pace of expansion in the industrial economies has generally increased, but, with the important exception of China, this increase has been offset by moderating growth in many developing economies. Inflation has remained well contained in most countries.

The stance of monetary policy has not changed this year in most major foreign economies. The European Central Bank has held its policy rate constant since June 2003, and both the Bank of England and the Bank of Canada have kept policy rates unchanged after having raised them in the latter half of 2004. The Bank of Japan has maintained its commitment to a policy of quantitative easing until deflation ends, but in late May it made what it described as a technical change to allow temporary deviations below the target range for reserve accounts if banks' demand for funds is too weak to satisfy the target. Reserve account balances temporarily fell below ¥30 trillion, the lower end of the target, in early June. Monetary policy has also remained unchanged in most emerging Asian economies; however, several Latin American monetary authorities have continued tightening cycles that began last year in efforts to restrain inflationary pressures.

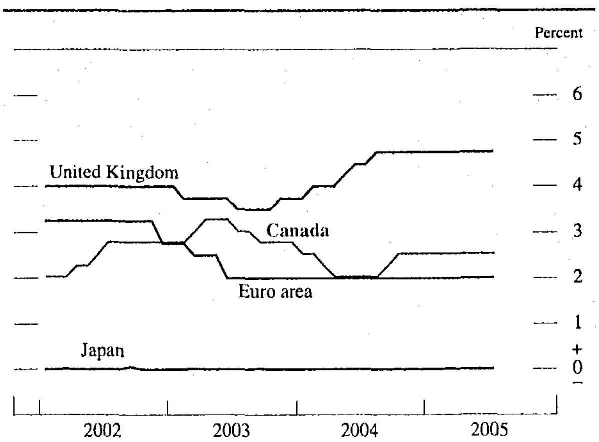
After having edged up during the first three months of this year, long-term interest rates in the major foreign industrial economies have fallen and now stand below their levels at the start of the year. As in the United States, the decline in foreign long-term interest rates continues a trend that began in mid-2004. However, long-term rates in the major foreign industrial economies have fallen more than rates in the United States this year. The decline in European long-term rates occurred amid weak economic news and a shift away from market expectations of a policy rate increase. In contrast, long-term rates in Canada and the United Kingdom have trended down despite policy rate increases in the second half of last year by both countries' central banks, though market perceptions that the Bank of England may cut rates have recently increased. Although the decline in Japanese rates last year was consistent with both the weak

Yields on benchmark goverment bonds in selected foreign industrial countries



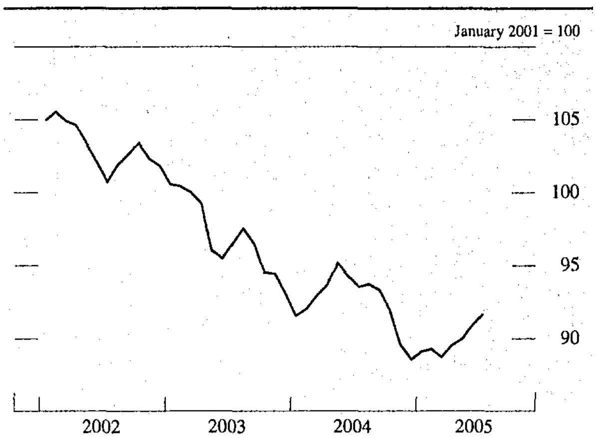
NOTE: The data are for ten-year bonds and are daily. The last observation is for July 13, 2005.
SOURCE: Bloomberg L.P.

Official interest rates in selected foreign industrial countries



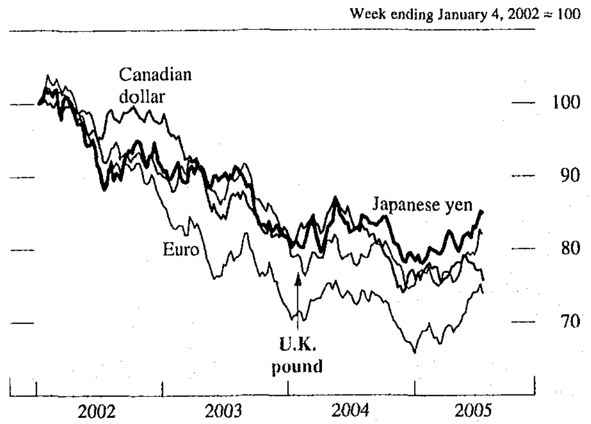
NOTE: The data are as of month-end; the last observation for each series is for July 13, 2005. The data shown are the call money rate for Japan, the overnight rate for Canada, the refinancing rate for the euro area, and the repurchase rate for the United Kingdom.

U.S. dollar nominal exchange rate, broad index



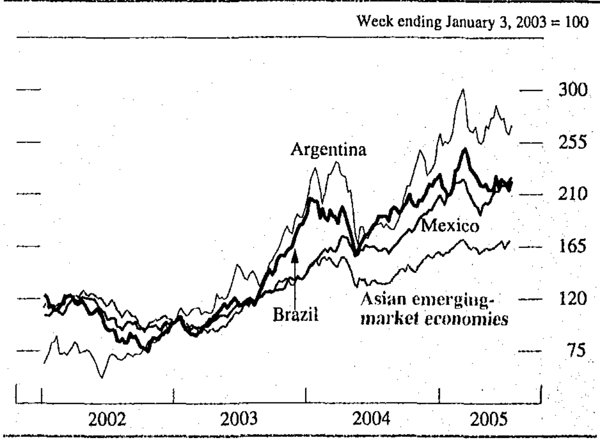
NOTE: The data are monthly and are in foreign currency units per dollar. The last observation is the average of trading days from July 1, 2005, through July 13, 2005. The broad index is a weighted average of the foreign exchange values of the U.S. dollar against the currencies of a large group of major U.S. trading partners. The index weights, which change over time, are derived from U.S. export shares and from U.S. and foreign import shares.
SOURCE: Federal Reserve Board.

U.S. dollar exchange rate against selected major currencies



NOTE: The data are weekly and are in foreign currency units per dollar. The last observation for each series is the average of July 11, 2005, through July 13, 2005.
SOURCE: Bloomberg L.P.

Equity indexes in selected emerging-market economies



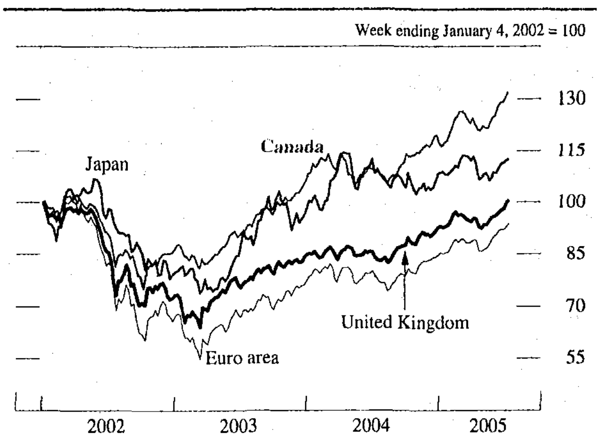
NOTE: The data are weekly. The last observation for each series is the average of July 11, 2005, through July 13, 2005. The Asian emerging-market economies are China, Hong Kong, India, Indonesia, Malaysia, Pakistan, the Philippines, Singapore, South Korea, Taiwan, and Thailand; the index weight for each of these economies is its market capitalization as a share of the group's total.
SOURCE: For Asian emerging-market economies, Morgan Stanley Capital International (MSCI) index; for others, Bloomberg L.P.

performance of the economy and the persistence of deflation, long-term rates fell further this year despite solid growth in the first quarter.

As foreign interest rates have fallen in recent months, the value of the dollar has risen. Most of this rise has been against the currencies of the major industrial countries; the dollar is largely unchanged against the currencies of the United States' other important trading partners. The dollar has appreciated about 12 percent against the euro and about 9 percent against the yen and sterling since the start of the year. Some of the appreciation against the euro occurred after voters in France and the Netherlands rejected the proposed constitution for the European Union by unexpectedly large margins in May.

European, British, and Canadian stock indexes have risen more than 8 percent since the start of the year. The rise in European stock prices is notable because indicators of economic activity have been fairly weak. In contrast, Japanese stock prices are now little changed after having reversed first-quarter gains. Equity prices in the majority of emerging markets began the year on a strong note but reversed course late in the first quarter and currently stand close to their January levels. Despite these swings, intraday volatility has remained subdued in most equity markets.

Equity indexes in selected foreign industrial countries



NOTE: The data are weekly. The last observation for each series is the average of July 11, 2005, through July 13, 2005.
SOURCE: Bloomberg L.P.

Industrial Economies

Real GDP in Japan increased at an annual rate of nearly 5 percent in the first quarter of 2005, bouncing back from last year's recession. Personal consumption spending reversed its recent declines, pushing the household saving rate down further. Private investment also rose sharply after having grown tepidly in the second half of 2004. In contrast, the external sector made a small negative contribution to GDP, as imports rose modestly but exports fell. While Japanese manufacturers of high-tech goods reduced their levels of inventories from last year's peak, inventory stocks of firms outside the high-tech sector increased, perhaps because of the slowdown in exports. The labor market has steadily improved: The unemployment rate has reached a seven-year low, and the ratio of job offers to job applicants is at a twelve-year high. Despite the pickup in economic activity and continuing inflation in wholesale prices, consumer price deflation has worsened slightly. The GDP price deflator returned to a year-over-year rate of deflation of more than 1 percent after having temporarily registered a more modest decline in the fourth quarter of 2004.

The pace of activity in the euro area appears to have slowed after a stronger start to the year. Real GDP grew at a 2 percent annual rate in the first quarter, as private consumption rose moderately and both households and firms switched expenditures away from imports and toward domestically produced goods. Both Germany and Spain grew at rates above the area average in the first quarter. In contrast, real GDP in both Italy and the Netherlands declined, while French growth was slower than in most of 2004. Measures of activity point toward slower growth in the euro area in the second quarter. Retail sales, which had risen in the first quarter, were roughly flat, on average, in April and May. The trade balance fell in April, threatening a main engine of growth, though the recent rise in the dollar against the euro should help stimulate export demand going forward. Twelve-month consumer price inflation edged up in June to just above the European Central Bank's target ceiling of 2 percent for inflation over the medium term. The European Central Bank's measure of core inflation, which excludes energy and unprocessed foods, has eased since January to an annual rate comfortably below 2 percent.

Consumer spending in the United Kingdom increased only modestly in the first quarter, slowing real GDP growth to 1½ percent. Nevertheless, the labor market remains tight, as unemployment is at its lowest levels since the mid-1970s and real earnings continue to trend up. The twelve-month rate of consumer price inflation ticked up in June to the Bank of England's target of 2 percent. In its May *Inflation Report*, the Bank of England forecast that inflation would temporarily rise but stay near the target over a two-year period. House prices have been fairly stable this year, and household net mortgage borrowing has also been subdued.

Growth in Canada remains moderate. Continuing a pattern that has largely held for the past two years, private consumption and investment demand rose in the first quarter while net exports fell. Activity in the second quarter appears to have been solid. Data on housing starts indicate that construction spending grew further, and the merchandise trade surplus improved in April, as exports rose and imports decreased slightly. Twelve-month consumer price inflation fell in May to about 1½ percent after having averaged slightly above 2 percent in the first quarter. The Bank of Canada's measure of core inflation has stayed below 2 percent throughout this year.

Emerging-Market Economies

Chinese real GDP continues to rise rapidly following strong growth in 2004. Economic expansion has been led by investment, exports, and, more recently, a surge in domestic production of goods that had previously been imported. Investment expenditure has remained vigorous despite the government's attempts early last year to slow its rate of increase. Import growth slowed in the first quarter, but the rise of exports was unabated, leading to a significant widening of the trade surplus. Although recent attention has focused on China's exports of textiles, export growth has remained strong across most major categories of goods. The slowdown in imports has also been broadly based. Despite China's strong rate of economic expansion, consumer price inflation fell to less than 3 percent in the first quarter and has remained low, as declining food prices have offset modest increases in nonfood prices.

Economic developments in other Asian emerging-market economies have varied. Hong Kong maintained its strong performance. As in China, growth in Hong Kong has been driven by both investment and exports. Export growth has also played an important role in supporting growth in most of the other countries in this region, but domestic demand, particularly inventory investment, has declined in many economies so far this year. Inflation has risen slightly, reflecting higher food and energy prices, but remains well contained and under 3 percent in most countries.

The Mexican economy has slowed so far this year, as demand for its manufacturing exports has weakened and monetary tightening has tempered investment and consumption demand. The Bank of Mexico has left monetary policy unchanged since March, but its tightening over the preceding twelve months raised short-term interest rates 500 basis points. Twelve-month consumer price inflation has fallen from its levels of late last year but still stands above the Bank of Mexico's target range of 2 percent to 4 percent. After having risen in the second half of last year, core inflation has also trended down in recent months.

Economic growth in most South American economies has also slowed compared with the pace of activity at the end of 2004. Brazil's real GDP rose at only a 1¼ percent annual rate in the first quarter, as both private consumption and investment declined in the wake of the Brazilian central bank's decision to begin raising its policy rate in the second half of 2004 to counter inflationary pressures. Exports, which rose rapidly and outpaced imports, provided the only bright spot. Twelve-month inflation has remained above 7 percent, and the central bank has continued to raise its policy rate this year. Argentina has gradually recovered from its 2001 crisis, but real GDP sharply decelerated in the first quarter. The unemployment rate, which had steadily fallen over the past few years, also edged up slightly. Twelve-month consumer price inflation appears to have stabilized after having been pushed up by food price increases earlier in the year, but it still lies above the central bank's unofficial target range of 5 percent to 8 percent. The Argentine government recently completed the final settlement of its debt exchange but has not yet resolved the treatment of the remaining investors (holders of roughly one-fourth of all defaulted government bonds) who rejected the agreement. □

New Information Reported under HMDA and Its Application in Fair Lending Enforcement

Robert B. Avery and Glenn B. Canner, of the Division of Research and Statistics, and Robert E. Cook, of the Division of Consumer and Community Affairs, prepared this article. Shannon C. Mok and Caitlin G. Coslett provided research assistance. Patricia J. Dykes and Sylvia A. Freeland assisted in preparing the 2004 HMDA data for analysis.

Most lending institutions with offices in metropolitan statistical areas are required by the Home Mortgage Disclosure Act of 1975 (HMDA) to disclose information to the public about applications for home loans and the home loans that they originate or purchase during each calendar year. The law's requirements arose from concerns that, in some cases, lenders were contributing to the decline of certain neighborhoods by failing to provide adequate home financing to qualified applicants on reasonable terms and conditions. The disclosure of lending activity is intended to help determine whether lenders are adequately serving their communities' housing finance needs, to facilitate enforcement of the nation's fair lending laws, and to guide investment activities in both the public and the private sectors. HMDA is implemented by the Federal Reserve Board's Regulation C.

Underlying HMDA's disclosure requirements is a presumption that more publicly available information will improve market performance and help prevent market failures. The data reported under HMDA are certainly extensive: Taken together, the 8,853 lenders covered by the law as of the end of 2004 are estimated to have accounted for about 80 percent of home loans extended that year.

The Congress has amended HMDA on several occasions to extend the reach of the law to more lenders and to expand the types of information that must be disclosed. Amendments passed in 1989 have been the most sweeping to date. They require that lenders disclose the disposition of each application they process for home loans and the income, race, ethnicity, and sex of the individuals applying for the loans. As this new information became available, it revealed wide differences in rates of approval of loan applications across racial and ethnic lines and thereby heightened concerns about whether lending decisions complied with the nation's fair lending laws. The disclosures triggered a continuing debate about the proper interpretation of the data and the significance of the differences in lending decisions. Many lending institutions have responded to the concerns raised in the debate by adopting new loan-underwriting procedures to help ensure fair treatment of all applicants and by initiating a wide variety of community outreach and affordable lending programs intended to benefit minority borrowers and lower-income individuals and neighborhoods.

In 2002, in its most recent review of Regulation C, the Federal Reserve Board made a number of important changes to the disclosure requirements that substantially increase the types and amount of information made available through HMDA.[1] The revisions are intended to better advance the purposes of the law by keeping the regulation in step with recent developments in home-loan markets and by incorporating the revised standards of classification for the collection of information on race and ethnicity as established by the Office of Management and Budget (OMB).

Most of the recent changes in the information that is required to be reported under HMDA apply to data relating to loans extended in 2004. Individual lenders covered by HMDA were required to make their 2004 data available to the public beginning on March 31, 2005. However, only the September 2005 release of the data will have been comprehensively checked by the supervisory agencies for the errors and omissions that are detectable from a review of the data.

Perhaps the most important change to Regulation C is the requirement that lenders now disclose pricing (interest rates and fees) for loans with prices

NOTE: Gregory Elliehausen, of the Credit Research Center of Georgetown University, prepared a special analysis for this article.

1. See Home Mortgage Disclosure Act (12 U.S.C. 2801), Regulation C (12 C.F.R. pt. 203), and the staff commentary accompanying Regulation C (12 C.F.R. pt. 203, Supp. I). The Board's revisions to Regulation C that are the focus of this article were issued in 2002. See the following issues of *Federal Register* (2002), vol. 67: February 15, p. 7222; May 8, p. 30771; and June 27, p. 43218; and *Federal Register* (2003), vol. 68 (May 28), p. 31589.

above designated thresholds. Loans with prices above the thresholds are referred to here as "higher-priced loans." Other important new information being reported under the revised regulation is whether the loan is a first lien, a junior lien, or unsecured (characteristics referred to here as a loan's lien status), whether it is secured by a manufactured home, and whether it is subject to the protections of the Home Ownership and Equity Protection Act of 1994 (HOEPA). These new pieces of information allow for a better understanding of lending activity in the higher-priced segment of the home-loan market, a segment that was virtually nonexistent a decade or so ago and is now a substantial part of the market. The growth of this market segment, while affording some consumers greater access to credit, has been accompanied by concerns about abusive lending practices, often referred to as "predatory lending."[2] These concerns lend importance to a better understanding of the higher-priced segment of the market and a greater ability to monitor the activities of the individual lenders involved in it.

This article presents a first look at the greatly expanded 2004 HMDA data and considers some of their implications for the continuing concerns about fair lending.[3] The analysis highlights some key relationships revealed in an initial review of the types of data that are new for 2004. Some parts of the analysis focus on nationwide statistics, and others examine patterns across groups of lenders, loan products, and various groupings of applicants, borrowers, and neighborhoods. The authors explore, in particular and in some depth, the strengths and limitations of the information on loan pricing.

We also describe how the Federal Reserve uses the HMDA data as part of a screening tool to facilitate the enforcement of the fair lending laws. In this regard, we discuss the way the expanded HMDA data, particularly the information on loan pricing, enhance the utility of the screening tool. At the same time, we emphasize that, although these data present valuable new opportunities for researchers and others to learn more about the home-loan market and for the regulatory agencies to improve the enforcement of fair lending laws, the data are not sufficient by themselves for drawing conclusions about the fairness of the lending process or the activities of any individual lender. For example, credit history scores and other factors not included in the HMDA data can be critical in determining loan prices. With regard to this issue, we collaborated with researchers at the Credit Research Center of Georgetown University, which has data on credit history scores and other loan-level factors relevant to loan pricing. The loan-level data were supplied to the Credit Research Center by a small group of lenders that are covered by HMDA and are active originators of loans in the higher-priced segment of the home-loan market.

Our examination of the 2004 data also focuses on the newly reported information about loans on manufactured homes. The disposition of applications for loans to buy, refinance, or improve such units has an important influence on the pattern of denial rates of all loans reported under HMDA. We also discuss the new information on HOEPA-related lending and certain requests for pre-approvals of home-purchase loans and assess their overall significance in the market. Finally, in the article's summary and conclusions, we review our key findings and emphasize that users of the data should exercise particular caution in drawing conclusions about lending patterns from HMDA data alone.

The Requirements of Regulation C

The Federal Reserve Board's Regulation C, which implements HMDA, applies to most depository institutions (commercial banks, savings institutions, and credit unions—hereafter, "banks") with a home or branch office in a metropolitan area. Banks that are exempt from Regulation C are small (currently those with assets of less than $34 million), or are not in the home-lending business, or have offices exclusively in rural (nonmetropolitan) areas.[4] Regula-

2. The Federal Reserve has adopted no specific definition of predatory lending, but the term is often considered to encompass a variety of lending practices involving fraud, deception, or unfairness. Some predatory lending practices are illegal; others, although legal, are still considered abusive in certain circumstances. Some of the practices considered questionable or in some cases illegal include (1) making loans that are based on the asset value of the collateral but are unaffordable given the consumer's ability to pay the obligation; (2) inducing repeated refinancing accompanied by high fees that provide no material benefit to the consumer (sometimes referred to as "loan flipping"); (3) inducing the consumer, through deception or fraud, to accept loan add-ons, such as single-premium credit insurance; (4) "steering" borrowers qualified for lower-rate loans into higher-priced loans; and (5) purposely overestimating the value of the collateral to overstate available equity or induce a consumer to pay an inflated price for a home.

3. For additional information, see Board of Governors of the Federal Reserve System, Department of Housing and Urban Development, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision (2005), "Agencies Announce Answers to Frequently Asked Questions about New HMDA Data," press release, March 31, www.federalreserve.gov/boarddocs/press/all/2005/.

4. Although coverage of financial institutions under HMDA is limited to those with offices in metropolitan statistical areas, covered institutions must report on all their home-lending activities whether the properties involved in the loan are located in a metropolitan or nonmetropolitan area.

tion C also extends to mortgage and consumer finance companies—hereafter, "mortgage companies"—whether such companies are independent or are subsidiaries of banks or affiliates of bank holding companies. Coverage of mortgage companies applies mainly to those that are active in the home-loan market—that is, those that extend 100 or more home-purchase or home-refinancing loans per year and operate in at least one metropolitan area.[5]

The HMDA data include information about applicants and borrowers, the home-loan products they seek, the disposition of their requests for credit, and details about the location of the property that relate to the application. For information about the channels through which the HMDA data are released and for a description of the data that were required of lenders before the 2002 revisions, see box "Distribution of HMDA Data and Pre-2004 Requirements of Regulation C."

The New Reporting Requirements

The 2002 revisions to Regulation C are intended to improve the quality, consistency, and utility of the data reported under HMDA; they are also intended to ease regulatory burden, primarily by clarifying and simplifying parts of the regulation. The new requirements

- expand coverage to more nondepository lenders
- streamline the definitions of *refinancing* and *home-improvement loan*
- revise the definition of *application* to include certain requests for pre-approvals (however, in this article, applications are defined as being for a loan on a specific property; they are thus distinct in our analyses from requests for pre-approval, which are unrelated to a specific property)
- mandate for the first time the collection of lien status; property code (to distinguish between one- to four-family dwellings that are site-built and those that are manufactured homes); loan pricing; and HOEPA status
- incorporate changes to the rules on collecting and reporting information on race and ethnicity to conform to guidance issued by the OMB
- require lenders to request the race, ethnicity, and sex of prospective borrowers who apply by mail, Internet, or telephone
- revise the categories that identify the type of institution to which loans are sold

The disclosure of additional data and the revised definitions for some currently reported items serve several purposes. For example, the revised definition of *refinancing* is intended to reduce inconsistency in the data and to simplify reporting.[6] Some of the new data items—such as lien status and identification of loans for manufactured homes—allow more-precise differentiation among loan products and consequently reduce the possible analytical biases that arise when dissimilar loan products are grouped together. To ensure that nondepository institutions that are active home lenders are subject to the same reporting regime as are other lenders, coverage rules were changed by adding an annual dollar-volume threshold of $25 million of home-loan originations to the current criterion of 10 percent of total loan originations measured in dollars.

Pricing information increases the scope of analysis of HMDA data in support of fair lending enforcement and makes possible an assessment of pricing patterns in the higher-priced segment of the home-loan market. In addition, designation of HOEPA status can be used to identify lenders involved in that type of lending, to measure its incidence in the market, and to aid in fair lending evaluations and HOEPA compliance. Finally, the new information on requests for pre-approvals provides more data on consumers' experiences in the early stages of shopping for a loan to buy a home, a phase of the loan process that has heretofore gone largely unreported, and thus should also facilitate fair lending enforcement.

Transition Rules

To minimize reporting burden and to help ensure the quality and usefulness of the expanded data, the Federal Reserve established transition rules for HMDA compliance that generally did not require lenders to collect some of the new information for requests for pre-approval and applications submitted before January 1, 2004. Among the new information

5. For the details of the coverage rules and for additional information about the data collection and reporting requirements, see *A Guide to HMDA Reporting: Getting It Right!* published annually by the Federal Financial Institutions Examination Council (www.ffiec.gov/hmda/guide.htm).

6. Reporting institutions had been allowed to choose from four scenarios in deciding which refinancings to report. The new rules define a refinancing simply as a secured home loan that satisfies and replaces another secured home loan by the same borrower. The reporting of home equity lines of credit (extended for any purpose) is voluntary.

Distribution of HMDA Data and Pre-2004 Requirements of Regulation C

Under the Home Mortgage Disclosure Act (HMDA), lenders use a "loan/application register" (HMDA/LAR) to report information annually to their federal supervisory agencies for each application and loan acted on during the calendar year. Lenders must make their HMDA/LARs available to the public by March 31 following the year to which the data relate, and they must remove the two date-related fields to help preserve applicants' privacy.[1]

The Federal Financial Institutions Examination Council (FFIEC), acting on behalf of the federal supervisory agencies, compiles the reported information and prepares an individual disclosure statement for each institution—one for each metropolitan statistical area (MSA) and metropolitan division (MD) in which it has offices—as well as aggregate reports for all covered lenders in each MSA and other reports.[2] The disclosure and aggregate reports are detailed tables of data on individual loans and applications.

The disclosure statements and reports are available to the public at the FFIEC website for HMDA (www.ffiec.gov/hmda), from the covered lenders themselves, and from depositories (such as public libraries and other government offices) in each MSA.[3] In addition, a copy of the HMDA/LAR for each institution is available to the public on CD-ROM for a nominal charge. The FFIEC also makes available a copy of the file of population characteristics of each census tract covered by the tables on individual institutions and by the aggregate tables. The 2004 census tract file is derived from the 2000 decennial census. MSA and MD identifiers included on that file are based on the designations of MSAs issued by the Office of Management and Budget.[4]

1. Lenders must make their date-modified register available to the public for a period of three years.

2. MSAs that have a single core with a population of 2.5 million or more and meet certain other requirements contain MDs. Of the 370 MSAs in the United States, 11 have a population of at least 2.5 million and have a total of 29 MDs. Starting with the release of the 2004 HMDA data, disclosure reports will follow the guidance provided by the Office of Management and Budget (OMB) regarding the appropriate use of statistical-area definitions; see Office of Management and Budget (2003), *OMB Bulletin*, no. 03-04 (June), www.whitehouse.gov/omb/bulletins/b03-04.html. In conformance with OMB guidance, the FFIEC will prepare disclosure reports for each MSA and MD.

3. The FFIEC maintains the most recent three years of HMDA data. Data for earlier years can be obtained from the National Technical Information Center, Springfield, Virginia, www.ntis.gov.

4. See Office of Management and Budget, *OMB Bulletin*.

Before the most recent revisions, in 2002, the Federal Reserve Board's Regulation C required lenders to report the following information on home-purchase and home-improvement loans and on the refinancing of such loans:

For each application or loan
- application date and the date an action was taken on the application
- action taken on the application
  - — approved and originated
  - — approved but not accepted by the applicant
  - — denied (with the reasons for denial—voluntary for some lenders)
  - — withdrawn by the applicant
  - — file closed for incompleteness
- loan amount
- income relied on in loan underwriting
- loan type
  - — conventional
  - — insured by the Federal Housing Administration
  - — guaranteed by the Veterans Administration
  - — backed by the Farm Service Agency or Rural Housing Service
- loan purpose
  - — home purchase
  - — refinance
  - — home improvement
- type of purchaser (if the lender subsequently sold the loan)

For each applicant or co-applicant
- race or ethnicity
- sex

For each property
- location, by state, county, and census tract
- type (one- to four-family dwelling or dwelling with five or more units)
- occupancy status (owner-occupied or nonowner-occupied)

Information is also reported on home loans purchased by an institution during a calendar year. Under the 2002 revisions to Regulation C, additional items became required beginning in 2004.

items affected by the transition rules were the data on pricing; the information on whether an application or loan involved a request for pre-approval and on whether the dwelling involved was a manufactured home; and the classifications of race and ethnicity.

Of all applications involving one- to four-family units in the 2004 HMDA data, about 2 million, or 7 percent, were filed before 2004, and thus the data reported on those applications (pertaining to about 1 million loans) might not reflect the new reporting rules. Users of the 2004 data should be aware of this limitation.

To help users of the HMDA data better distinguish loans subject to the transition rules, the Federal Financial Institutions Examination Council (FFIEC) has added a data item to the 2004 CD-ROM that contains a copy of the HMDA/LAR for each institution that indicates whether or not an application was filed before January 1, 2004 (see box "Distribution of HMDA Data and Pre-2004 Requirements of Regulation C"). Users of the 2004 data can make assumptions or restrict their analysis in various ways to address problems created by the transition rules. For example, in preparing the institution and aggregate MSA disclosure reports for 2004, the FFIEC excluded applications filed before January 1, 2004, from all tables reporting pricing (but not other) information.

The transition rules should have little effect on the data in future HMDA filings. However, because some applications have application filing dates that precede a decision on the application by more than a year, a few applications subject to the transition rules may be included when the 2005 HMDA data are reported in 2006.

Lien Status

Information on lien status differentiates home loans secured by a first lien, those secured by a junior (second or third) lien, and those not secured. (The last category arises only among home-improvement loans, for which a security interest in a property may or may not be taken.) Knowledge of lien status is basic to credit underwriting because loans secured by first liens have a lower incidence of default than loans secured by junior liens or unsecured loans; consequently, loans secured by a first lien are generally offered at the lowest rates of interest.

The information on lien status serves a number of public policy interests. First, the information improves the measurement of the overall size of the home-loan market and particular segments within that market, such as home-purchase lending. Although HMDA data have always included information about the purpose of a loan, recent market developments have made that information less useful for measuring lending. Today, many home purchases involve both first- and junior-lien loans. The junior-lien loan in such transactions is often used to avoid requirements to purchase private mortgage insurance (PMI) or to avoid exceeding the loan-size limits used by some secondary-market purchasers, especially Fannie Mae and Freddie Mac (see the appendix for more information about PMI and the availability of data on loans backed by PMI). In the past, a loan backed by a junior lien could not be distinguished directly in the home-purchase loan data from one backed by a first lien and was therefore often assumed to represent a separate home-purchase loan rather than to be one of two used to purchase a single property.[7] The expanded HMDA data allow such distinctions to be made and consequently help avoid the double counting of loans in the home-purchase market.

Second, lien status is essential for interpreting loan-pricing information and in conducting fair lending investigations. Regarding fair lending reviews, the historical lack of information on lien status in the HMDA data has hampered analyses focusing on potential differences in the pattern of the disposition of applications because distinguishing properly among loan products using only HMDA data has been difficult or impossible.[8] Because the use of various loan products and patterns of application disposition can vary across racial and ethnic groups, an inability to distinguish products can lead to spurious correlations and potentially inappropriate conclusions about the fairness of the application of credit-underwriting policies.

Manufactured-Home Status

Available evidence indicates that the credit profiles of individuals seeking loans backed by manufactured homes differ from those of individuals borrowing for site-built homes.[9] On the whole, loans to purchase manufactured homes involve relatively high credit risk, in part because the buyers of such homes tend to have weaker financial profiles than do those purchasing other single-family properties. This evidence has important implications for denial rates and pricing.

Analysis of past HMDA data implied that lenders denied about 60 percent of all applications for conventional home-purchase loans for manufactured homes, whereas they denied only about 12 percent of

7. One technique used to identify loans backed by junior liens was to assume that all loans below a given amount were junior-lien loans. This approach is flawed because some homes, including many manufactured homes, have low prices and purchasers of these properties often need only a small loan. Similarly, some borrowers make substantial down payments when they buy a home, and in such circumstances, the amount of the first-lien loan may be small.

8. During some fair lending reviews, lenders have provided examiners with information that has allowed the separation of first and junior liens.

9. A manufactured home is a single-family house constructed under a federal building code administered by the U.S. Department of Housing and Urban Development (HUD). The Federal Manufactured Home Construction and Safety Standards (commonly known as the HUD code) took effect on June 15, 1976. The result of federal regulation was to more clearly define mobile homes as buildings rather than vehicles—although the HUD code imposes standards to make sure the units can be transported by truck to the placement site. The Housing Act of 1980 officially adopted this change, mandating that, for homes built under the HUD code, the term *manufactured housing* (factory-built homes) replace the term *mobile homes* in all federal law and literature.

applications for other conventional home-purchase loans.[10] Until now, the general inability to accurately distinguish manufactured-home loans from loans related to site-built homes complicated the determination of whether differences in denial rates across groups of applicants arose from differences in underwriting practices across the groups or simply from different mixes of loan products sought by the groups. Identification of applications and loans involving manufactured homes in the expanded HMDA data allows for more-refined analysis of the sources of different denial rate patterns and for greater understanding of financing activities in this important market segment.

Loan Pricing

The home-loan market has evolved in a number of important respects over the past decade or so. Traditionally, lenders offered consumers a relatively limited array of products at prices that varied according to the characteristics of the loan and property but not according to the creditworthiness of the borrower. Effectively, borrowers either did or did not meet the underwriting criteria for a particular product, and those who met the criteria paid about the same price. This market characterization may explain why the congressional revisions to HMDA in 1989 focused on the disclosure of data on the disposition of applications rather than on loan prices.

Since then, improvements in information processing and the maturation of a robust secondary market for loans have spurred changes in the home-loan market. Prominent among these changes has been an evolution toward an explicitly risk-based pricing of credit. Now the creditworthiness of individual borrowers can lead to different prices for the same product. Less-creditworthy applicants, or those either unwilling or unable to document their creditworthiness or income, are increasingly less likely to be turned down for a loan; rather, they are offered credit at higher prices.

Borrowers in the higher-priced market generally fall into one of two market segments, "near prime" and "subprime," with individuals in the latter category paying the highest prices because they pose the greatest risk of default. In practice, the dividing line between these two "nonprime" markets is becoming increasingly amorphous, as is the line between the prime (lower-price) and nonprime markets.

Estimates of the annual volume of subprime lending vary, but all sources agree that this market has grown substantially in recent years.[11] One industry source estimates that over the period 1994–2004, the annual dollar volume of subprime home loans increased from about $35 billion to more than $530 billion. Consequently, subprime lending is no longer a minor segment of the market. Subprime loans are estimated to have accounted for about 19 percent of all home-loan originations in 2004, up from less than 5 percent in 1994.[12]

As significant pricing variability has emerged in the market, so have concerns about the fairness of creditor decisions in this regard. Little information has been available to assess the merits of these concerns, and only a few fair lending investigations focusing on pricing issues have been pursued by the federal banking agencies or the Department of Justice. In its review of Regulation C that led to the 2002 revisions, the Federal Reserve Board averred the importance of gathering information to facilitate assessments of the fairness of loan-pricing decisions, particularly for nondepository institutions, which are less likely to be subject to periodic fair lending examinations. Recognizing the costs incurred by lenders to comply with such a reporting and disclosure requirement, the Board limited the scope of the regulation to the disclosure of pricing on loan originations (not loans purchased from other entities or applications that did not result in a loan origination) in the higher-priced segment of the loan market and to focus within that segment only on dwelling-secured loans subject to Regulation Z (which does not cover "business purpose" loans—including some loans to individuals who do not intend to occupy the dwelling being financed).[13]

Specifically, the 2002 revisions to Regulation C require the reporting of the spread between the annual percentage rate (APR) on a loan and the rate on

10. In the past, loans on manufactured homes were identified using information about the lender's main line of business. This proxy is helpful only for lenders focused mainly on manufactured-home lending. A large number of other lenders also extend such credit, but because manufactured-home lending does not constitute their main line of business, determining which of their loans involve manufactured homes has been impossible. See www.huduser.org/datasets/manu.html.

11. One method of estimating the annual volume of subprime loans is based on a list of subprime lenders that was developed by HUD and has been released each year since 1993. The number of loans in the HMDA data originated by lenders on the HUD list has been used as an estimate of subprime lending volume. The list has also been used to support other analyses of subprime lending activity. Of the 224 lenders on the list for 2003, 191 appear under the same name and identification number as reported in the HMDA filings for 2004.

12. Estimates pertain to home loans backed by one- to four-family homes; see Inside Mortgage Finance Publications (2005), *Mortgage Market Statistical Annual 2005*, 2 vols. (Bethesda, Md.: IMFP).

13. Regulation Z, 226.3(a). The Federal Reserve Board's Regulation Z (12 C.F.R. pt. 226) implements the Truth in Lending Act.

Treasury securities of comparable maturity for loans with spreads above designated thresholds. The APR was selected as the measure of the loan's pricing because it was regarded as the best single measure of the "true" cost of a loan. The thresholds for reporting differ by lien status: 3 percentage points for first liens and 5 percentage points for junior liens. To calculate the rate spread, the lender uses the yield on Treasury securities as of the fifteenth day of a given month depending on when the interest rate was set on the loan.[14]

In establishing this disclosure rule, the Federal Reserve sought to select thresholds that would exclude the vast majority of prime rate loans and include the vast majority of subprime loans. The selection of specific thresholds was based on loan-price data from several sources.[15] The analysis revealed that roughly 98 percent of prime first-lien loans have APRs that would likely fall below the threshold of 3 percentage points for reporting first liens.[16] The analysis also indicated that this threshold would require reporting for about 98 percent of the subprime loans backed by first liens and that the 5 percentage point threshold would capture about 95 percent of the subprime loans backed by junior liens. Overall, data from the Annual Housing Survey covering prime, near-prime, and subprime loans suggested that, in a typical year, the thresholds would fall somewhere in the near-prime range and would require the reporting of about 10 percent of all home loans backed by first liens and about 22 percent of all loans backed by junior liens.

In a given year, various factors may influence the proportion of loans that have prices placing them above or below the pricing thresholds. A change in interest rates can influence the volume and types of loans that exceed the pricing thresholds. With generally rising interest rates, for example, refinancing activity will be reduced, and consequently a larger proportion of loans reported above the thresholds will involve home purchases. Moreover, borrowers who refinance during a period of rising interest rates are likely to differ from those who borrow when rates are falling. When rates are rising, borrowers seeking to refinance their outstanding loans are likely to have more-urgent needs for additional funds that can be raised by a cash-out refinancing or are seeking to lower their total monthly payment obligations by lengthening the terms of their outstanding debt.

Changing interest rates also may affect the proportion of adjustable-rate versus fixed-rate loans originated over the course of a year and thus the mix of loans reported with rates above the threshold. To compensate borrowers for bearing the additional interest rate risk associated with adjustable-rate loans, such loans typically have lower initial APRs than do fixed-rate loans with the same term to maturity. If market participants expect interest rates to rise, these expectations tend to be built into the term structure of interest rates (the "yield curve") and to widen the difference between the initial rates on adjustable-rate and fixed-rate loans. This widening can increase the proportion of fixed-rate loans with APRs above the threshold because the APRs for longer-term adjustable-rate loans will not rise as much in such a market as will those for fixed-rate longer-term loans.

HOEPA Status

Long-standing concerns about predatory lending led the Congress to enact the Home Ownership and Equity Protection Act of 1994, the first federal statute to explicitly target such lending practices. HOEPA, which amends the Truth in Lending Act, applies to closed-end home loans (excluding home-purchase loans) bearing an APR or dollar-amount fees above specified thresholds.[17] The act imposes restrictions on certain loan features, including balloon payments and prepayment penalties, and requires improved disclosures for consumers. HOEPA, like most other federal consumer protection statutes, overrides weaker state laws but permits states to enact stricter rules.

14. For such calculation, the rule directs creditors to use the fifteenth day of a given month for any loan on which the interest rate was set on or after that day through the fourteenth day of the next month. The relevant date is when the interest rate on the loan was determined, which is often, but not always, set pursuant to a lock-in agreement between the borrower and the lender. The APR used in the calculations is the one determined and disclosed to the consumer under section 226.6 or section 226.18 of Regulation Z. To ease reporting burdens and to help ensure high-quality data, the FFIEC makes available a "Rate Spread Calculator" that lenders can use to determine whether they must report the spread on a given loan and, if so, what the spread is; see www.ffiec.gov/ratespread/default.aspx.

15. See the U.S. Census Bureau's 1998 and 1999 Annual Housing Surveys, the Federal Reserve Board's 2001 Survey of Consumer Finances, the Federal Housing Finance Board's 1999 Mortgage Interest Rate Survey, and data on subprime lending from the Credit Research Center of Georgetown University.

16. See Board of Governors of the Federal Reserve System (2002), "Regulatory Analysis of Proposed Amendments to Regulation C," staff memorandum, Division of Research and Statistics, January 15.

17. Unlike lines of credit, closed-end loans are amortizing—they require fixed monthly payments against both principal and interest—and are thus scheduled to close at the end of a given term to maturity, when the balance will reach zero. A balloon payment might be involved if the amortization schedule leaves a relatively large balance owed at the end of the loan's term. In contrast, a home equity line of credit (HELOC) is a revolving account that permits borrowing from time to time at the account holder's discretion, up to the amount of the credit line. Under a HELOC, a consumer may repeatedly pay the balance down to zero and then redraw against the line.

The Federal Reserve Board, which has authority to modify some of the requirements of HOEPA (implemented by the Board's Regulation Z), made such a modification in 2001. The 2001 revisions to the regulation lowered the APR trigger for coverage of first-lien loans from 10 percentage points above the comparable-maturity Treasury security to 8 percentage points (the threshold for junior liens was left at 10 percentage points), adjusted the calculation of the dollar-amount trigger for fees to include amounts paid at closing for optional credit insurance products, prohibited or restricted certain practices, and required improved disclosures.[18] Although these amendments addressed some concerns, predatory lending continues to some degree. Since 1999, about thirty states and numerous local governments have enacted laws regarding predatory lending to address certain practices and contract terms. The Congress has also considered amendments to HOEPA to broaden its scope and to preempt state laws, but to date, no final action has been taken.

In its 2002 amendments to Regulation C (the HMDA regulation), the Board required lenders to report whether a loan is subject to HOEPA. In so doing, the Board recognized that obtaining information on the volume and pattern of lending covered under HOEPA would be useful for a better understanding of the size of the HOEPA-related segment of the market and would allow regulators to focus examinations on the loans and creditors posing the greatest concern. The HOEPA status of loans at banks could always be obtained through on-site examinations; but nondepository lenders are not subject to regular examinations, and thus the extent of their HOEPA-related lending has been largely unknown. Moreover, although banks are examined regularly, the collection of data on HOEPA status on the HMDA/LAR is a much more efficient way for the enforcement agencies to obtain the data and allows for some types of analysis to precede an on-site compliance examination.

Requests for Pre-Approvals

Prospective homebuyers are often asked by sellers to demonstrate that they are likely to qualify for financing. In recent years, many lending institutions have developed pre-approval programs to respond to that request. Such programs typically provide qualified prospective homebuyers with a binding written commitment to finance their purchase, subject to certain conditions related primarily to the property to be purchased and any changes in their financial circumstances. The request for a pre-approval does not generally identify a specific property so that, if granted, it can be used by the prospective buyer with more than one prospective seller. In the past, the HMDA records did not include data on requests for pre-approvals unless they ultimately resulted in an application related to a specific property. Under the expanded reporting requirements, lenders must also report requests for pre-approval that were denied. Disclosure of denials of pre-approval requests is intended to provide more-complete information on the availability of home financing and to facilitate fair lending enforcement. Lenders have the option of reporting pre-approvals that were granted but not acted on by the consumer.[19]

Changes in the Collection of Data Regarding Race and Ethnicity

The 2004 HMDA data incorporate the revised standards of classification for government collection of information on race and ethnicity as established by the OMB.[20] Perhaps the most important OMB revision allows individuals to select multiple racial and ethnic identifications, and HMDA reporting rules were modified to conform to these changes. For HMDA data collected before 2004, applicants for credit had no opportunity to designate both race and ethnicity but had to categorize themselves as being of Hispanic origin *or* as being in one of five racial categories (American Indian or Alaskan Native, Asian or Pacific Islander, black, white, or other). As of 2004, applicants may designate more than one racial category (American Indian or Alaska Native, Asian, black or African American, Native Hawaiian or other Pacific Islander, or white) *and* may designate one of two ethnicities (either "Hispanic or Latino" or

18. For further details, see section 226.32 of Regulation Z.

19. The only pre-approval programs covered by HMDA are those in which the decision to grant or deny the request is based on a comprehensive credit underwriting process in which a lender collects and reviews the information it typically considers in making credit decisions in a traditional application (that is, an application for a specific property). For a pre-approval program to be covered, the lender must issue binding written commitments (subject only to very limited conditions) for consumers whose requests were granted. Because requests for pre-approval typically do not identify a specific home for purchase, the HMDA data do not show the property location for pre-approvals that do not ultimately result in an application for credit related to a specific property.

20. See Office of Management and Budget (1997), "Revisions to the Standards for the Classification of Federal Data on Race and Ethnicity," *Federal Register*, vol. 62 (October 30), pp. 58782–90.

"not Hispanic or Latino"). (Hereafter, for concision, we refer to the category "black or African American" as *black* and to the category "Hispanic or Latino" as *Hispanic.*)

The changes regarding race and ethnicity will make it difficult to align the HMDA data for 2004 with those for earlier years. Most important, applicants who in 2003 were classified as Hispanic were not also classified by their race. Consequently, a comparison of lending activity by race between 2004 and earlier years might lead some to conclude that lending to certain racial groups may have changed when, in fact, the only change was in the classification system.

1. Distribution of home lenders covered by HMDA, by type of institution, 2004

Type	Number	Percent
Depository institution		
Commercial bank	3,946	44.6
Savings institution	1,017	11.5
Credit union	2,030	22.9
All	6,993	79.0
Mortgage company		
Independent	1,464	16.5
Affiliated[1]	396	4.5
All	1,860	21.0
All institutions	**8,853**	**100**

1. Subsidiary of a depository institution or an affiliate of a bank holding company.

SOURCE: In this and subsequent tables except as noted, Federal Financial Institutions Examination Council, data reported under the Home Mortgage Disclosure Act (www.ffiec.gov/hmda).

Changes in the Data-Collection Requirements for Sales in the Secondary Market

The secondary market for home loans is the arena in which loans already originated are bought and sold. HMDA requires that, for a given year, covered institutions report the sales of loans that they originated in that year as well the sales of loans that they purchased in that year. For each sale, the institution must also report the type of purchaser.

HMDA data have long been one of the few sources of loan-level information describing secondary-market activities. The 2004 data are reported using codes that represent revised categories for identifying the secondary-market purchasers. For the first time, the HMDA data identify loans placed in private securitizations, which represent a growing segment of the secondary market. The revisions in the reporting categories are intended to improve the utility of the data.

SUMMARY OF RESULTS FROM THE 2004 HMDA DATA

For 2004, the FFIEC prepared disclosure statements for 8,853 HMDA-reporting lenders—3,946 commercial banks, 1,017 savings institutions, 2,030 credit unions, and 1,860 mortgage companies. Of the mortgage companies, most (1,464) were independent entities—that is, institutions that were neither subsidiaries of banks nor affiliates of bank holding companies (table 1). The disclosure statements consisted of 72,246 distinct reports, each covering the lending activity of a particular institution in each metropolitan statistical area (MSA) in which it had a home or branch office (table 2). The number of reporting institutions was up 9 percent from 2003, in part because OMB's revision of MSA boundaries added, on net, 242 previously rural counties to MSAs.[21]

The number of lenders covered by HMDA is large; however, most of these institutions, whether measured by number of reported applications or loans or by asset size, are small. For 2004, 60 percent of reporting institutions provided information on fewer than 250 loans or applications, accounting for 1.7 percent of the reported data (table 3). Sixty-three percent of the reporting banks had assets of less than $250 million, and they accounted for only 2.2 percent of the applications and loans in the 2004 HMDA data.[22]

At the other end of the spectrum, the twenty-five lenders reporting the largest number of applications accounted for about 42 percent of all the applications reported in the 2004 data (data not shown in table). If HMDA reporters are further aggregated to their highest level of corporate organization (such as a bank holding company), lending is even more concentrated. The twenty-five largest organizations reporting the largest number of applications accounted for 55 percent of the applications in the 2004 data (data not shown in table).

Volume of Applications and Loans

For 2004, lenders covered by HMDA reported on roughly 28.1 million home-loan applications (table 2)—9.8 million for purchasing one- to four-family homes, 16.1 million for refinancing existing

21. The OMB changed MSA boundaries to encompass 288 previously rural counties and to exclude 46 counties previously in MSAs.

22. Because of the reporting rules, asset size is generally a meaningful measure of size only for depository institutions. Assets are measured as of December 31, 2004.

2. Home loan and reporting activity of home lenders covered under HMDA, 1990–2004
Number

Year	Applications received for home loans, and home loans purchased from other lenders (millions)						Reporters	Disclosure reports[2]
	Applications				Loans purchased	Total		
	Home purchase	Refinance	Home improvement	Total[1]				
1990	3.27	1.07	1.16	5.51	1.15	6.66	9,332	24,041
1991	3.26	2.11	1.18	6.55	1.36	7.91	9,358	25,934
1992	3.54	5.24	1.23	10.01	1.98	12.00	9,073	28,782
1993	4.52	7.72	1.40	13.64	1.80	15.44	9,650	35,976
1994	5.20	3.80	1.69	10.69	1.48	12.17	9,858	38,750
1995	5.51	2.70	1.75	9.96	1.28	11.24	9,539	36,611
1996	6.33	4.54	2.14	13.01	1.82	14.83	9,328	42,946
1997	6.75	5.39	2.16	14.30	2.08	16.38	7,925	47,416
1998	7.96	11.42	2.04	21.43	3.23	24.65	7,836	57,294
1999	8.43	9.37	2.05	19.85	3.01	22.86	7,832	56,966
2000	8.28	6.54	1.99	16.81	2.40	19.21	7,713	52,776
2001	7.69	14.29	1.85	23.83	3.77	27.59	7,631	53,066
2002	7.40	17.48	1.53	26.41	4.83	31.24	7,771	56,506
2003	8.15	24.60	1.51	34.26	7.23	41.49	8,121	65,808
2004	9.79	16.10	2.20	28.13	5.14	33.27	8,853	72,246

NOTE: Here and in all subsequent tables except tables 3 and 8, applications exclude requests for pre-approval that were denied by the lender or were accepted by the lender but not acted upon by the borrower.

In this article, applications are defined as being for a loan on a specific property; they are thus distinct from requests for pre-approval, which are not related to a specific property.

1. Applications for multifamily homes are included only in the "total" column; for 2004 these applications numbered about 62,000.

2. A report covers the mortgage lending activity of a lender in a single metropolitan statistical area in which it had an office during the year.

home loans, 2.2 million for improving one- to four-family dwellings, and 62,000 related to multifamily dwellings (structures for five or more families). Lenders also reported on about 5.1 million loans they purchased from other institutions. In addition, lenders reported on roughly 330,000 requests for pre-approvals of home-purchase loans that were either turned down by the lender at the time the pre-approval was sought or granted but not acted on by the applicant (data not shown in table). In either case, those 330,000 requests for pre-approval did not reach the stage of an application for a loan for a specific property.[23] The 2004 volume of applications for refinancing fell about one-third from 2003, primarily because of a rise in interest rates.

Conventional and Government-Backed Loans

Among the reported applications for loans to purchase owner-occupied one- to four-family homes (both site-built and manufactured), about 90 percent were for conventional loans—that is, loans not involving a government backing for the lender—most of which involve first liens; the remainder were for government-backed forms of credit, mostly involving the Federal Housing Administration (FHA) (table 4). An even higher share of applications for refinancings (and home-improvement loans) were for conventional loans, an indication that borrowers with government-backed loans either tend to refinance into a conventional loan or tend not to refinance.

The share of HMDA-reported loans backed by the FHA has been declining over the past several years, from about 16 percent in 2000 to about 8 percent in 2004 (data not shown in tables). New, more flexibly underwritten conventional loan products are likely attracting borrowers that would otherwise seek FHA backing. Among these products are interest-only loans, adjustable-rate products that offer flexible payment options, and products that allow smaller down payments, a wider range of credit histories, and reduced documentation of incomes.

Lien Status

The 2004 data, which include for the first time information on the lien status of a loan, indicate that a significant minority of reported loans involve junior liens, particularly loans for home purchases. Among the loans to purchase owner-occupied homes, 13 percent involved junior (subordinate) liens (data not shown in tables).[24]

23. Among the loan originations in the 2004 data, about 470,000 were reported as being initiated through a pre-approval program. This figure likely understates the number of originations that began in pre-approval programs because the transition rules did not require the reporting of this item on applications taken before January 1, 2004.

24. The HMDA data do not include a code indicating whether the junior-lien home-purchase loan reported in the data is associated

3. Distribution of home lenders covered by HMDA, by type of lender and the number of applications they receive, 2004

Type of lender, and subcategory (asset size in millions of dollars, or affiliation)	Number of applications					
	1–99		100–249		250–999	
	Percent of type[1]	Percent of subcategory[2]	Percent of type[1]	Percent of subcategory[2]	Percent of type[1]	Percent of subcategory[2]
Depository institution						
Commercial bank						
Less than 250	80.2	56.7	71.4	31.6	31.3	11.0
250–999	16.4	24.5	25.9	24.2	57.2	42.4
1,000 or more	3.4	13.4	2.7	6.6	11.5	22.6
All	100	42.8	100	26.8	100	21.2
Savings institution						
Less than 250	85.1	40.9	71.2	35.7	30.6	20.4
250–999	10.7	7.2	25.3	17.8	60.8	57.1
1,000 or more	4.1	6.5	3.6	5.8	8.6	18.8
All	100	23.8	100	24.9	100	33.1
Credit union						
Less than 250	96.9	62.9	84.7	27.5	35.9	9.3
250–999	3.0	7.6	14.7	18.4	58.0	58.3
1,000 or more	.1	1.0	.6	3.0	6.0	24.0
All	100	49.1	100	24.5	100	19.6
All depository institutions						
Less than 250	86.3	57.1	75.1	30.6	32.3	11.5
250–999	11.4	17.7	22.7	21.8	58.2	48.5
1,000 or more	2.3	10.0	2.2	5.9	9.5	22.0
All	100	41.9	100	25.9	100	22.5
Mortgage company						
Independent	78.9	21.5	75.0	10.7	83.3	26.2
Affiliated	21.1	21.2	13.1	13.1	16.7	19.4
All	100	21.4	88.1	11.2	100	24.8
All lenders	...	37.6	...	22.8	...	23.0
MEMO						
All applications, by number reported by lender	...	.5	...	1.2	...	3.6

NOTE: See table 1, note 1, and general note to table 2.
1. Distribution sums vertically.
2. Distribution sums horizontally.
. . . Not applicable.

Homebuyers have various reasons for taking out subordinate loans when they purchase their homes. Some are seeking to raise funds to cover the down payments and closing costs of the first-lien loans used to buy their homes. In some cases, funds raised through the subordinate liens allow homebuyers to avoid the requirement to purchase PMI for first-lien loans with high loan-to-value ratios. In other cases, borrowers take out junior-lien loans to keep the amounts borrowed on their first-lien loans within the loan-size limits used by Fannie Mae and Freddie Mac (discussed below).

Owner Occupancy

Some commentators have attributed part of the strength in housing markets for the past several years to a growing number and share of home sales to investors or individuals purchasing second homes as distinct from those who intend to reside in the units being purchased. HMDA reports help document the role of investors in the housing market because the data indicate whether the property to which an application or loan relates is intended as the borrower's principal dwelling (that is, as an owner-occupied unit).[25] The HMDA data indicate that the share of reported lending for nonowner-occupied purposes remained steady from 1990 through 1995, primarily in the 4.5 percent to 5.5 percent range (whether measured in number of loans or dollar amount of loans), and then began rising. In 2004, the nonowner-occupied share of the home-purchase market in terms of number of loans was about 15 percent and in terms of dollar amount was roughly 13 percent (data not shown in tables).

with any particular first-lien loan. The junior-lien loan may be in the reported data, but the first-lien loan may not be. This distinction can arise if, for example, the lender extending the first-lien loan is not covered by HMDA. We estimate that about 62 percent of the junior-lien home loans used to purchase owner-occupied homes in the reported data are likely associated with a reported first-lien home loan of the same lender—these "paired loans" were extended by the same lender in the same census tract to borrowers of the same sex, race, and ethnicity, and the actions taken on each loan in the loan pair were within a couple of days of each other.

25. An investment property is a nonowner-occupied dwelling that is intended to be continuously rented. Some nonowner-occupied units—vacation homes and second homes—are for the primary use of the owner and would thus not be considered investment properties. The HMDA data do not, however, distinguish between these two types of nonowner-occupied dwellings.

3.—Continued

Type of lender, and subcategory (*asset size in millions of dollars, or affiliation*)	Number of applications						Memo	
	1,000–4,999		5,000 or more		Any		Number of lenders	Percent of applications
	Percent of type[1]	Percent of subcategory[2]	Percent of type[1]	Percent of subcategory[2]	Percent of type[1]	Percent of subcategory[2]		
Depository institution								
Commercial bank								
Less than 250	6.3	.7	1.1	.0	60.6	100	2,391	1.1
250–999	35.7	8.6	4.4	.4	28.7	100	1,131	1.8
1,000 or more	58.1	37.3	94.4	20.1	10.8	100	424	19.6
All	100	6.9	100	2.3	100	100	3,946	22.5
Savings institution								
Less than 250	11.0	2.8	1.7	.2	49.6	100	504	.4
250–999	48.0	17.0	5.2	.8	35.3	100	359	.9
1,000 or more	40.9	33.8	93.1	35.1	15.1	100	154	11.9
All	100	12.5	100	5.7	100	100	1,017	13.2
Credit union								
Less than 250	3.1	.3	.0	.0	75.6	100	1,534	.6
250–999	47.7	15.4	10.0	.3	19.5	100	396	.9
1,000 or more	49.2	63.0	90.0	9.0	4.9	100	100	1.1
All	100	6.3	100	.5	100	100	2,030	2.5
All depository institutions								
Less than 250	6.6	.8	1.3	.1	63.3	100	4,429	2.2
250–999	41.6	11.6	5.1	.4	27.0	100	1,886	3.5
1,000 or more	51.8	40.3	93.7	21.8	9.7	100	678	32.6
All	100	7.5	100	2.3	100	100	6,993	38.3
Mortgage company								
Independent	81.8	27.3	69.2	14.4	78.7	100	1,464	44.2
Affiliated	18.2	22.5	30.8	23.7	21.3	100	396	17.6
All	100	26.2	100	16.4	100	100	1,860	61.7
All lenders	. . .	11.5	. . .	5.2	. . .	100	8,853	100
Memo								
All applications, by number reported by lender	. . .	7.6	. . .	87.1	. . .	100	. . .	100

Lender Specialization

Different types of lending institutions tend to specialize in different types of home loans. Mortgage companies, which extended 54 percent of all the home loans reported in 2004, accounted for roughly 67 percent of government-backed originations. Depository institutions extended 71 percent of reported home-improvement loans and about 89 percent of multifamily loans. Commercial banks and mortgage companies together accounted for about 90 percent of loans on manufactured homes in 2004.

Secondary-Market Activity

HMDA data document the importance of the secondary market for home loans. Of the 20.2 million home loans originated or purchased in 2004 by lenders covered by HMDA, 14.1 million, or roughly 70 percent, were sold in 2004 (data not shown in tables).[26]

Prominent in the secondary market are government-sponsored enterprises (GSEs)—in particular, Fannie Mae and Freddie Mac.[27] For the most part, the purchases of Fannie Mae and Freddie Mac in 2004 consisted of conventional loans originated to purchase homes or to refinance existing loans. These two institutions accounted for nearly 35 percent of the loans purchased by secondary-market institutions. Other types of purchasing institutions active in the secondary market include banks (8 percent of loans sold), private securitization pools (5 percent), and mortgage and insurance companies (9 percent). In some cases, the purchasing institution is affiliated with the originating lender—directly, as a subsidiary, or indirectly, as an affiliate of the holding company that owns the lender. Affiliated institutions accounted for 11 percent of loans sold in the secondary market.

Loans for Manufactured Homes

In the past, users of HMDA data had no certain way to identify which applications and loans involved

26. The HMDA data tend to undercount the volume of secondary-market sales somewhat. One reason is that, for example, some loans originated in 2004 will be sold to a secondary-market institution in 2005 or later and thus will never be reported as a sale. Another is that, as with other HMDA data, about 20 percent of home loans originated in 2004 were extended by lenders not covered by HMDA.

27. GSEs are privately owned institutions that blend the characteristics of public and private institutions. They receive certain benefits from government sponsorship in exchange for their advancement of certain public policy goals such as homeownership among lower-income households and in targeted communities.

4. Distribution of home loan applications and home loans, by purpose, lien status, and type of loan and by type and occupancy status of home, 2004

Loan category (purpose and lien status) and loan type (government-backed or conventional)	Applications									
	One- to four-family home									Multifamily home, percent of loan category[1]
	Site built			Manufactured			Total			
	Owner occupied		Nonowner occupied, percent of loan category[1]	Owner occupied		Nonowner occupied, percent of loan category[1]	Owner occupied		Nonowner occupied, percent of loan category[1]	
	Percent of loan category[1]	Percent of loan type[2]		Percent of loan category[1]	Percent of loan type[2]		Percent of loan category[1]	Percent of loan type[2]		
Home purchase										
First lien										
Government backed										
FHA	8.3	94.2	.1	8.6	5.8	.1	8.3	100	.1	.5
VA	2.3	97.8	*	.9	2.2	*	2.2	100	*	*
FSA/RHS	.4	98.9	*	.1	1.2	*	.4	100	*	*
Conventional	89.0	94.3	99.9	90.5	5.7	99.9	89.1	100	99.9	99.5
Total	100	94.4	100	100	5.6	100	100	100	100	100
MEMO: Number	6,899,878		1,156,788	411,500		26,640	7,311,378		1,183,428	28,345
Junior lien										
Government backed										
FHA	.1	96.1	*	1.5	3.9	.2	.1	100	*	.1
VA	*	99.4	*	*	.6	*	*	100	*	*
FSA/RHS	*	100	*	*	*	*	*	100	*	*
Conventional	99.8	99.6	100	98.5	.4	99.8	99.8	100	100	99.9
Total	100	99.6	100	100	.4	100	100	100	100	100
MEMO: Number	1,134,740		83,626	4,126		450	1,138,866		84,076	795
Refinance										
First lien										
Government backed										
FHA	2.5	97.2	.6	3.7	2.8	.3	2.6	100	.6	.8
VA	1.0	98.8	.6	.6	1.2	.3	1.0	100	.6	*
FSA/RHS	*	96.4	*	*	3.6	*	*	100	*	*
Conventional	96.5	98.1	98.8	95.7	1.9	99.4	96.4	100	98.8	99.2
Total	100	98.1	100	100	1.9	100	100	100	100	100
MEMO: Number	13,695,847		975,583	266,184		10,020	13,962,031		985,603	27,558
Junior lien										
Government backed										
FHA	.1	98.2	.1	.2	1.9	1.1	.1	100	.1	.2
VA	*	100	*	*	*	*	*	100	*	*
FSA/RHS	*	100	*	*	*	*	*	100	*	*
Conventional	99.9	99.1	99.9	99.9	.9	98.9	99.9	100	99.9	99.8
Total	100	99.1	100	100	.9	100	100	100	100	100
MEMO: Number	1,003,316		24,991	8,703		267	1,012,019		25,258	887
Home improvement										
First lien										
Government backed										
FHA	.5	95.2	.1	1.0	4.9	.4	.6	100	.1	*
VA	.1	97.8	*	.1	2.2	*	.1	100	*	*
FSA/RHS	*	100	*	*	*	*	*	100	*	*
Conventional	99.4	97.4	99.9	98.9	2.6	99.6	99.4	100	99.9	100
Total	100	97.4	100	100	2.7	100	100	100	100	100
MEMO: Number	727,677		58,664	19,784		1,275	747,461		59,939	2,751
Junior lien										
Government backed										
FHA	.6	99.7	.9	.1	.3	1.1	.6	100	.9	.1
VA	*	100	*	*	*	*	*	100	*	*
FSA/RHS	*	100	*	*	*	*	*	100	*	*
Conventional	99.4	98.7	99.1	99.9	1.3	99.0	99.4	100	99.1	99.9
Total	100	98.7	100	100	1.3	100	100	100	100	100
MEMO: Number	950,082		17,049	12,702		191	962,784		17,240	1,070
Unsecured										
Government backed										
FHA	.4	96.0	.1	.6	4.0	.3	.4	100	.1	*
VA	*	100	*	*	*	*	*	100	*	*
FSA/RHS	*	100	*	*	*	*	*	100	*	*
Conventional	99.6	97.2	99.9	99.5	2.8	99.7	99.6	100	99.9	100
Total	100	97.2	100	100	2.8	100	100	100	100	100
MEMO: Number	372,385		21,780	10,785		713	383,170		22,493	489
MEMO: Total number	24,783,925		2,338,481	733,784		39,556	25,517,709		2,378,037	61,895

NOTE: For one- to four-family homes, excludes applications for which occupancy status was missing.

FHA Federal Housing Administration VA Veterans Administration FSA/RHS Farm Service Agency and Rural Housing Service

1. Distribution sums verticaly.

2. Distribution sums horizontally.

* Less than 0.05 percent.

4.—Continued

Loan category (purpose and lien status) and loan type (government-backed or conventional)	Loans									
	One- to four-family home									Multifamily home, percent of loan category[1]
	Site built			Manufactured			Total			
	Owner occupied		Nonowner occupied, percent of loan category[1]	Owner occupied		Nonowner occupied, percent of loan category[1]	Owner occupied		Nonowner occupied, percent of loan category[1]	
	Percent of loan category[1]	Percent of loan type[2]		Percent of loan category[1]	Percent of loan type[2]		Percent of loan category[1]	Percent of loan type		
Home purchase										
First lien										
Government backed										
FHA	8.8	95.1	.1	16.4	4.9	.1	9.0	100	.1	.5
VA	2.6	97.9	*	2.0	2.1	*	2.5	100	*	*
FSA/RHS	.5	99.0	*	.2	1.0	*	.4	100	*	*
Conventional	88.2	97.5	99.9	81.5	2.5	99.9	88.0	100	99.9	99.5
Total	100	97.3	100	100	2.7	100	100	100	100	100
MEMO: Number	4,654,243		811,816	129,150		15,272	4,783,393		827,088	22,247
Junior lien										
Government backed										
FHA	.1	96.8	*	1.4	3.2	*	0.2	100	*	.2
VA	*	99.1	*	*	.9	*	*	100	*	*
FSA/RHS	*	100	*	*	*	*	*	100	*	*
Conventional	99.8	99.7	100	98.6	.3	100	99.8	100	100	99.8
Total	100	99.7	100	100	.3	100	100	100	100	100
MEMO: Number	735,361		50,362	2,510		285	737,871		50,647	625
Refinance										
First lien										
Government backed										
FHA	3.2	97.3	.5	6.7	2.7	.2	3.2	100	.5	.8
VA	1.5	98.7	.7	1.5	1.3	.4	1.5	100	.7	*
FSA/RHS	*	96.8	*	*	3.2	*	*	100	*	*
Conventional	95.4	98.8	98.8	91.8	1.2	99.5	95.3	100	98.8	99.2
Total	100	98.7	100	100	1.3	100	100	100	100	100
MEMO: Number	6,405,770		578,753	83,946		5,980	6,489,716		584,733	21,703
Junior lien										
Government backed										
FHA	*	98.0	*	.1	2.0	.7	*	100	*	.3
VA	*	100	*	*	*	*	*	100	*	*
FSA/RHS	*	100	*	*	*	*	*	100	*	*
Conventional	99.9	99.4	100	99.9	.6	99.3	99.9	100	99.9	99.7
Total	100	99.4	100	100	.6	100	100	100	100	100
MEMO: Number	461,649		11,430	2,814		138	464,463		11,568	580
Home improvement										
First lien										
Government backed										
FHA	.7	96.4	.1	1.1	3.6	.4	.7	100	.1	*
VA	.1	98.5	*	.1	1.5	*	.1	100	*	*
FSA/RHS	*	100	*	*	*	*	*	100	*	*
Conventional	99.3	97.7	99.9	98.9	2.3	99.6	99.3	100	99.9	100
Total	100	97.7	100	100	2.3	100	100	100	100	100
MEMO: Number	352,066		35,835	8,249		787	360,315		36,622	2,058
Junior lien										
Government backed										
FHA	.6	99.6	.6	.2	.4	2.7	.6	100	.7	.2
VA	*	100	*	*	*	*	*	100	*	*
FSA/RHS	*	100	*	*	*	*	*	100	*	*
Conventional	99.4	98.8	99.3	99.8	1.2	97.3	99.4	100	99.3	99.9
Total	100	98.8	100	100	1.2	100	100	100	100	100
MEMO: Number	393,226		7,058	4,599		75	397,825		7,133	653
Unsecured										
Government backed										
FHA	.4	95.4	.1	.6	4.6	*	.4	100	.1	*
VA	*	100	*	*	*	*	*	100	*	*
FSA/RHS	*	100	*	*	*	*	*	100	*	*
Conventional	99.6	97.1	99.9	99.4	2.9	100	99.6	100	99.9	100
Total	100	97.1	100	100	2.9	100	100	100	100	100
MEMO: Number	147,510		6,302	4,399		267	151,909		6,569	284
MEMO: Total number	13,149,825		1,501,556	235,667		22,804	13,385,492		1,524,360	48,150

manufactured homes. To help overcome this limitation, the Department of Housing and Urban Development (HUD) produced annually a list of reporting institutions (typically about twenty) that it believed were primarily in the business of extending such credit.[28] Users of the HMDA data often relied on the HUD list to identify, albeit imperfectly, loans and applications related to manufactured homes. This practice had its own limitations—it could not be used to identify applications and loans related to manufactured homes reported by lenders not on the HUD list, and users often assumed that all loans by the lenders on the list were for manufactured homes when some were not. The expanded HMDA data resolve this problem by explicitly including a code to identify applications and loans for manufactured homes. For background information on manufactured homes, see box "Manufactured Homes in the U.S. Housing Market."

Loans for manufactured homes entail more credit risk than do most other forms of credit extended to consumers.[29] For example, the proportion of loans for manufactured homes that are thirty days or more past due is far higher than for most other consumer credit products and is about twice the rate for conventional loans secured by one- to four-family homes.[30] In part, the elevated credit risk arises from more uncertainty about whether the collateral backing the loan will retain its original value. Much of the credit risk arises from the poorer credit history profiles of the typical borrowers in the manufactured-home loan market compared with those in the site-built home-loan market.

An individual's credit history score (a statistical characterization of an individual's creditworthiness based exclusively on information in a credit record maintained by a credit-reporting agency) is a common metric of credit risk.[31] Among individuals who have manufactured-home loans (whether home loans or, as is the case for most manufactured homes, personal-property loans), the average credit history score as of June 30, 2003, was 666, a score nearly 70 points lower than the average among individuals with loans secured by one- to four-family site-built homes. Moreover, nearly 25 percent of the individuals with loans secured by manufactured homes had credit history scores below 600, a threshold that is often associated with high-risk lending, compared with only about 5 percent of the individuals with loans backed by site-built units.

Lenders recognize the elevated risks related to loans backed by manufactured homes and factor these risks into the interest rates they charge borrowers.[32] Lender caution is also reflected in the very high denial rates on applications for loans backed by manufactured homes.

Manufactured Homes in the U.S. Housing Market

More than 23 million individuals, or roughly 8 percent of the U.S. population, live in manufactured housing. Typically, about 10 percent to 20 percent of all construction starts for single-family housing each year are for manufactured homes. Most manufactured homes are assembled in factories, shipped to a home site, and never moved once installed. Nearly 80 percent of all the manufactured homes are owner occupied, a rate more than 10 percentage points higher than that for site-built homes.

Manufactured housing is a significant source of affordable housing. The average new unit cost about $55,000 in 2003, although prices varied, averaging about $32,000 for single-section homes and nearly $60,000 for multi-section ("double wide") units (excluding land costs). Because the price of a manufactured home is generally lower per square foot than that of a site-built home, the manufactured home is particularly attractive to households with lower incomes. The average annual income of households owning manufactured homes is less than half that of those owning site-built homes and about the same as that of households that rent their homes.

28. See www.huduser.org/datasets/manu.html.

29. Unless otherwise indicated, information in this section is derived from the following sources: U.S. Bureau of the Census (for HUD), American Housing Survey (formerly the Annual Housing Survey) and the Residential Finance Survey www.huduser.org/datasets/pdrdatas.html; Manufactured Housing Institute 2004, www.manufacturedhousing.org; and U.S. Census Bureau 2000 census, www.census.gov/main/www/cen2000.html. Information on the default experience regarding loans secured by manufactured homes and on the credit history scores of individuals were derived from the June 30, 2003, credit records of a nationally representative sample of approximately 300,000 individuals (with all personal identifying information removed); the sample was obtained by the Federal Reserve Board from one of the three national credit-reporting agencies. See Robert B. Avery, Paul S. Calem, and Glenn B. Canner (2004), "Credit Report Accuracy and Access to Credit," *Federal Reserve Bulletin*, vol. 90 (Summer), pp. 297–322.

30. See American Bankers Association, *Consumer Credit Delinquency Bulletin*, www.aba.com.

31. To facilitate this discussion, we have adjusted the credit history scores assigned to the individuals in the Federal Reserve sample of 300,000 credit records (see text note 30) to match the distribution of the more-familiar FICO credit history scores developed by Fair Isaac Corporation, for which information is publicly available. See www.myfico.com/myfico/CreditCentral/ScoringWorks.asp.

32. In recent years, the manufactured-home lending industry has been adversely affected by the excessive production of units in the late 1990s and the reliance on the relaxed credit underwriting that accompanied the sales of these units. See Neil J. Morse (2004), "Manufacturing the Dream," *Mortgage Banking* (August), pp. 50–56.

The 2004 HMDA Data on Manufactured Housing

The 2004 HMDA data indicate that, on the basis of applications that lenders received after January 1, 2004, nearly 4,400 lenders extended more than 242,000 manufactured-home loans.[33] About 57 percent of these loans were for home purchases; most of the rest were for refinancing an earlier loan (data derived from table 5). Commercial banks, the largest source of loans on manufactured homes, extended 46 percent of the total number; mortgage companies extended 44 percent.

The data indicate further that manufactured-home lending is a relatively concentrated business. The ten lenders that extended the largest number of manufactured-home loans in 2004 accounted for one-third of all such loans that year, and the top twenty such lenders accounted for 42 percent (data not shown in tables). Likewise, 60 percent of the lenders that extended manufactured-home loans in 2004 extended ten or fewer such loans. The 2004 data indicate that thirty-five lenders could reasonably be considered to have specialized in manufactured-home lending that year (see box "The HUD List of Specialists in Manufactured-Home Lending and the 2004 HMDA Data").

For a number of the largest lenders that extended manufactured-home loans (measured by the number of such loans), that business segment was only a very small portion of their lending activity, according to the 2004 data. In fact, among the twenty-five firms that extended the largest number of manufactured-home loans, only three could be characterized as focused primarily on that business segment. For virtually all the rest, manufactured-home lending amounted to 5 percent or less of their total lending activity.

Of those obtaining loans to purchase manufactured homes, 41 percent were of lower income, whereas of those borrowing to purchase site-built homes, about 24 percent had lower incomes (table 6).[34] On average, minority borrowers have lower incomes than do non-Hispanic white borrowers, but only about 18 percent of manufactured-home purchasers were members of a racial or ethnic minority group, whereas about 30 percent of purchasers of site-built homes were minorities (data derived from table 6).[35]

The HUD List of Specialists in Manufactured-Home Lending and the 2004 HMDA Data

Before 2004, HMDA reporters were not required to identify which of their applications and loans involved manufactured homes, and identifying all of the lenders offering such credit was impossible. For 2003, HUD's list of manufactured-home loan specialists who are also HMDA reporters identified 19 such lenders. Only 13 of the 19 lenders that reported 2003 HMDA data provided 2004 HMDA data under the same name and identification number. These 13 lenders accounted for 15 percent of all the manufactured-home loans reported in the 2004 data. Among the 6 manufactured-home lenders on the 2003 HUD list that did not report in 2004 under the same name or identification number, 2 reported under different names and identification numbers. These 2 lenders reported information on only about 950 loans related to manufactured homes (about 0.4 percent of the total). Of the 15 manufactured-home loan specialists on the HUD list that reported data for 2004, only 11 were in fact primarily involved in extending loans on manufactured homes.

For 35 lenders that supplied 2004 data (including the 11 on the 2003 HUD list), lending for manufactured homes constituted at least 80 percent of their reported lending activity, and so they may reasonably warrant consideration as specialists in manufactured-home lending. Among the rest of the approximately 4,400 reporting lenders that had extended at least one manufactured-home loan in 2004, about 500 indicated that the proportion of their originations related to manufactured homes was at least 20 percent but less than 80 percent, and the remaining 3,900 indicated that the proportion was less than 20 percent.

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33. As noted, the transition rules regarding the reporting of data pose difficulties for evaluating the 2004 HMDA data for manufactured homes. Consequently, applications governed by the transition rules are excluded from tables 5 and 6. Despite the reporting exceptions created by the rules, some lenders chose to report information on manufactured-home status for applications submitted before January 1, 2004. However, it is not clear whether these lenders identified all, or only some, of the pre-2004 applications for loans on manufactured homes, and so we exclude these additional data from the analysis.

The 2004 data include information on applications or loans related to manufactured homes from an additional 400 or so lenders—about 4,800 in all—which indicates that some institutions chose to identify manufactured homes on applications taken during the transition period (before January 1, 2004).

34. The income category of a purchaser is relative to the median family income of the area (MSA or statewide non-MSA) in which the property being purchased is located, and the income category of a census tract is the median family income of the tract relative to that of the area (MSA or statewide non-MSA) in which the tract is located: "Low" is less than 50 percent of the median; "moderate" is 50 percent to 79 percent (in this article, "lower income" encompasses the low and moderate categories); "middle" is 80 percent to 119 percent; and "higher" is 120 percent or more.

35. For loans with two or more applicants, HMDA-covered lenders report data on only two. Income for two applicants is reported jointly.

5. Distribution of loans on manufactured homes, by type of loan and type of home lender, 2004

Type of lender	Home purchase				Refinance				Home improvement					
	First lien		Junior lien		First lien		Junior lien		First lien		Junior lien		Unsecured	
	Percent of loan type[1]	Percent of lender type[2]	Percent of loan type[1]	Percent of lender type[2]	Percent of loan type[1]	Percent of lender type[2]	Percent of loan type[1]	Percent of lender type[2]	Percent of loan type[1]	Percent of lender type[2]	Percent of loan type[1]	Percent of lender type[2]	Percent of loan type[1]	Percent of lender type[2]
	Government backed													
Depository institution														
Commercial bank	28.1	5.2	18.8	*	22.5	1.2	*	*	45.5	*	50.0	*	92.9	*
Savings institution	7.5	10.1	12.5	*	7.9	3.1	25.0	*	4.6	*	30.0	*	*	*
Credit union	.1	.3	*	*	.2	.1	25.0	*	*	*	20.0	*	3.6	*
Mortgage company														
Independent	45.6	11.2	59.4	*	55.3	3.9	50.0	*	18.2	*	*	*	3.6	*
Affiliated	18.8	18.0	9.4	*	14.1	3.8	*	*	31.8	.1	*	*	*	*
All lenders	100	8.6	100	*	100	2.5	100	*	100	*	100	*	100	*
MEMO														
Number of loans	20,909		32		5,940		4		88		10		28	

NOTE: Excludes transition-period loans (those for which the application was submitted before 2004). For definition of manufactured home, see text note 9. See also table 1, note 1.

1. Distribution sums vertically.
2. Distribution sums horizontally.
* Less than 0.05 percent.

Requests for Pre-Approval

The 2004 data for the first time include information on certain types of requests for pre-approval of home-purchase loans. Since pre-approval programs pertain only to requests for loans to purchase a home, the HMDA data do not include pre-approval information for applications involving a refinancing or home-improvement loan. Although all requests for pre-approval that are turned down must be reported, lenders have the option of reporting requests for pre-approval that were approved but not acted on by the consumer. Because many lenders apparently chose not to report any optionally reportable requests for pre-approval, the new data do not account completely for pre-approval activity. Nonetheless, the new reporting scheme is sufficiently comprehensive to identify which individuals were denied at the pre-approval stage and which successful borrowers initiated the borrowing process through a pre-approval program.

Nearly half of all lenders reported some pre-approval activity, although the volume of such activity varied greatly across lenders.[36] The five lenders that reported the greatest number of requests for pre-approval accounted for one-third of all such requests. Some differences in the propensity to offer pre-approval programs were found by type of institution; more than half of the reporting credit unions, savings institutions, and mortgage companies reported requests for pre-approval, but only about one-third of the commercial banks reported such information.

Although requests for pre-approval are far fewer in number than home-purchase loan applications that do not begin through this channel, they are not rare events. The 2004 data include information about 1 million requests for pre-approval for first-lien loans to buy homes and about 100,000 for junior liens. Of those institutions with pre-approval programs, 82 percent did not report any pre-approval requests that were approved but not acted on by the consumer, an indication that these institutions chose not to report all their requests for pre-approval.

Denials and Pricing in the 2004 Data

A central element of the 1989 revisions to HMDA was the collection of loan-level data on the disposition of home-loan applications, and the 2002 revisions to Regulation C expanded this concept to include loan-level information on pricing. This

Although, as of 2004, applicants may choose more than one race as well as one of two ethnicities, applications are placed for the purposes of table 6 and tables 9 through 13 under only one category for race and ethnicity, generally according to the race and ethnicity of the person listed first on the application. However, under race, the application is designated as *joint* if one applicant reported the single designation of white and the other reported one or more minority races. If the application is not joint but more than one race is reported, the following designations are made: If at least two minority races are reported, the application is designated as *two or more minority races*; if the first person listed on an application reports two races, and one is white, the application is categorized under the minority race.

36. Pre-approvals were subject to the transition rules; consequently, these numbers and the others in this section exclude applications submitted before 2004.

5.—Continued

Type of lender	Home purchase				Refinance				Home improvement						Memo Number of loans
	First lien		Junior lien		First lien		Junior lien		First lien		Junior lien		Unsecured		
	Percent of loan type[1]	Percent of lender type[2]	Percent of loan type[1]	Percent of lender type[2]	Percent of loan type[1]	Percent of lender type[2]	Percent of loan type[1]	Percent of lender type[2]	Percent of loan type[1]	Percent of lender type[2]	Percent of loan type[1]	Percent of lender type[2]	Percent of loan type[1]	Percent of lender type[2]	
	Conventional														
Depository institution															
Commercial bank	48.4	49.1	24.2	.6	45.8	31.6	41.9	1.1	61.6	4.8	63.9	2.6	89.7	3.7	112,385
Savings institution	6.9	50.9	3.4	.6	5.8	29.0	6.2	1.2	5.5	3.1	3.9	1.2	2.5	.8	15,391
Credit union	3.0	44.6	17.8	6.2	3.5	35.9	7.0	2.7	3.5	4.0	6.2	3.8	4.0	2.5	7,632
Mortgage company															
Independent	35.9	48.2	51.2	1.6	33.4	30.5	36.6	1.3	21.2	2.2	19.0	1.0	.3	*	84,940
Affiliated	5.8	30.2	3.4	.4	11.5	40.9	8.3	1.1	8.2	3.3	7.0	1.5	3.5	.8	21,849
All lenders	100	47.1	100	1.1	100	32.0	100	1.2	100	3.6	100	1.9	100	1.9	242,197
Memo Number of loans	114,021		2,653		77,571		2,908		8,739		4,633		4,661		242,197

section summarizes the aggregate outcomes on both points. Because the transition rules regarding the reporting of data create problems for assessing some of the 2004 data regarding loan pricing, as they do for manufactured homes and pre-approvals, the analysis that follows excludes "transition" applications—those submitted before January 1, 2004 (data on these applications are shown as memo items in tables 7 and 8). Otherwise, information is given on all applications reported under HMDA. For presentation, applications were grouped into twenty-five product categories based on loan and property type, purpose of the loan, and lien and owner-occupancy status.[37] For each product category, information is provided on the number of total and pre-approval applications, application denials, originated loans, loans with prices above the thresholds, loans covered by HOEPA, and the mean and median spreads for loans priced above certain thresholds.

Denial Rates

For the past fifteen years or so, the HMDA data have been the primary source of publicly available data on the disposition of applications for home loans. The expanded HMDA data for 2004 provide new opportunities to assess patterns in the disposition of applications at different stages of the lending process and across product lines and applicant groups.

Denial Rates across Products

The incidence of denials differs substantially across loan products. Lenders deny only about 15 percent of the applications for home-purchase loans on one- to four-family site-built homes, whether the loans are secured as a first lien or a junior lien and whether they are conventional or government backed (table 7). In contrast, about 30 percent to 36 percent of refinancings and home-improvement loan applications involving first liens are denied, as are about 50 percent of the applications for manufactured homes. The main exception to this pattern is applications for government-backed first-lien loans for refinancings, which have a denial rate similar to that of home-purchase loans.

Of particular importance are the disposition patterns for applications for manufactured homes. As noted, past HMDA data did not distinguish applications for manufactured homes from those for site-built properties. Analysis of the HUD list of manufactured-home loan specialists suggested that such lenders had very high denial rates, and that for lenders offering both manufactured-home loans and other home loans a distorted picture of their propensity to deny credit could easily be drawn. The 2004 data confirm the importance of distinguishing applications for manufactured homes from those for site-built properties. For example, adding the applications for conventional home-purchase first liens for manufactured homes to those for one- to four-family site-built homes would increase the number of total lender actions on applications only 7 percent but the number of denials more than 25 percent. The denial rate for the category "conventional

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37. Applications in which the lender reported that the race, ethnicity, and sex of the applicant or co-applicant were "not applicable" were assumed to have been made by businesses (including trusts) rather than by individuals.

6. Distribution of home-purchase loans for one- to four-family owner-occupied homes, by characteristic of borrower and of census tract and by type of home, 2004

Characteristic and status	Site built		Manufactured		Total		MEMO Number
	Percent of characteristic[1]	Percent of status[2]	Percent of characteristic[1]	Percent of status[2]	Percent of characteristic[1]	Percent of status	
BORROWER[3]							
Income ratio (percent of area median)							
Less than 50	4.7	93.3	12.2	6.8	4.9	100	205,771
50–79	18.9	95.8	29.1	4.2	19.2	100	798,602
80–119	29.4	97.2	30.1	2.8	29.5	100	1,227,091
120 or more	46.9	98.3	28.7	1.7	46.4	100	1,933,772
Total[4]	100	97.3	100	2.8	100	100	4,165,236
Race							
American Indian or Alaska Native	.8	96.1	1.2	3.9	.8	100	36,650
Asian	4.9	99.7	.5	.3	4.7	100	206,716
Black or African American	7.1	97.9	5.4	2.1	7.0	100	305,432
Native Hawaiian or other Pacific Islander	.5	98.3	.3	1.7	.5	100	23,246
White	74.9	96.9	84.4	3.1	75.2	100	3,280,354
Two or more minority races	.1	97.9	.1	2.1	.1	100	3,282
Joint	1.4	98.0	1.0	2.0	1.4	100	59,524
Missing[5]	10.4	98.1	7.2	1.9	10.3	100	447,970
Total	100	97.3	100	2.8	100	100	4,363,174
Ethnicity							
Hispanic or Latino	11.2	98.2	7.4	1.8	11.1	100	483,253
Not Hispanic or Latino	76.4	97.1	82.1	2.9	76.6	100	3,341,979
Joint[6]	1.3	97.9	1.0	2.1	1.3	100	55,914
Missing[5]	11.1	97.7	9.5	2.4	11.1	100	482,028
Total	100	97.3	100	2.8	100	100	4,363,174
Minority status							
Minority	26.0	98.3	15.9	1.7	25.7	100	1,120,646
Non-Hispanic white	62.6	96.8	73.7	3.2	62.9	100	2,745,937
Missing[5]	11.4	97.5	10.3	2.5	11.4	100	496,591
Total	100	97.3	100	2.8	100	100	4,363,174
CENSUS TRACT OF PROPERTY							
Income ratio (percent of area median)							
Less than 50	1.6	99.1	.5	.9	1.5	100	65,777
50–79	13.2	96.7	16.8	3.4	13.3	100	575,070
80–119	49.2	96.2	71.4	3.8	49.8	100	2,149,842
120 or more	36.0	99.1	11.4	.9	35.3	100	1,524,643
Total[4]	100	97.3	100	2.7	100	100	4,315,332
Racial or ethnic composition (minorities as percentage of population)							
Less than 10	32.5	96.5	43.4	3.5	32.8	100	1,417,201
10–19	22.9	97.6	21.1	2.5	22.9	100	988,062
20–49	27.7	97.5	25.7	2.5	27.7	100	1,193,394
50–79	10.2	98.0	7.6	2.0	10.2	100	438,175
80–100	6.6	99.1	2.2	0.9	6.5	100	279,509
Total[4]	100	97.3	100	2.7	100	100	4,316,341
Location							
Central city	38.5	98.8	17.1	1.2	38.0	100	1,642,184
Noncentral city	52.7	97.6	47.3	2.4	52.5	100	2,272,738
Rural or only state known	8.8	90.0	35.6	10.0	9.5	100	411,822
Total[4]	100	97.3	100	2.7	100	100	4,326,744

NOTE: Excludes transition-period loans (those for which the application was submitted before 2004). For definition of income categories for borrower and census tract, see text note 34. Census tract is for the property securing the loan. Categories for race and ethnicity reflect the revised standards established in 1997 by the Office of Management and Budget (OMB); for details, see text discussion. The term *minority* means Hispanic or Latino ethnicity or any race other than white. Census-tract data reflect the 2000 decennial census; they also reflect definitions for metropolitan statistical areas established by the OMB in June 2003 and used in HMDA for the first time in the 2004 data (see note 2 in main-text box "Distribution of HMDA Data and Pre-2004 Requirements of Regulation C").

1. Distribution sums vertically.
2. Distribution sums horizontally.
3. For details on the identification of borrower income, race, and ethnicity, see text note 35.
4. Excludes loans for the information for the characteristic was missing on the application.
5. Information for the characteristic was missing on the application.
6. On the applications for these loans, one applicant reported "Hispanic or Latino," and the other reported "not Hispanic or Latino."

home-purchase first liens" would increase from 14.9 percent to 17 percent (data derived from table). Although this change might not appear large in the aggregate, for some lenders it could create a major distortion.

Denials of Requests for Pre-Approval

Denial rates for applications that begin with requests for pre-approval can be computed in different ways, especially since lenders need not report approved requests for pre-approval not acted on by the borrowers. One way to assess the disposition of applications received through the pre-approval process is to compute denial rates for requests for pre-approval separately from the denial rates for subsequent applications related to a specific property. Another way of assessing denial rates is to combine the two stages (pre-approval requests and subsequent applications for a specific property) and to treat a denial at either stage as a denial.

The denial rates for pre-approval requests (column 3 of table 8) are similar to the denial rates for all applications for home loans on specific properties (column 4 of table 7). Not surprisingly, the denial rates on applications for a specific property that began as requests for pre-approval (derived from columns 5 and 6 of table 8) are lower than the denial rates on pre-approval requests and on applications for a specific property that did not come through the pre-approval process. But although they are relatively low, the denial rates for pre-approved borrowers are not zero: More than 8 percent of pre-approved applicants for conventional first-lien home-purchase loans are turned down when they apply for a loan on a specific property.

If we view requests for pre-approval and applications for loans to purchase a specific property as elements of a single process, the data suggest that the overall denial rates for applicants for home loans on specific properties who came through the pre-approval process are about the same as for applicants who did not first request a pre-approval. Seventeen percent of the applicants for conventional first-lien home-purchase loans who came through the pre-approval process were denied versus 15 percent of those who did not first request a pre-approval (data derived from tables 7 and 8).

However, origination rates for the two groups were very different. Only 49 percent of the applicants for conventional first-lien home-purchase loans who began the process with a request for a pre-approval ended up with a loan, compared with 67 percent of other applicants. This difference appears to stem not from lender actions but from markedly different rates of withdrawal from the process by applicants. Thirty-four percent of applications for conventional first-lien home-purchase loans that started at the pre-approval stage are withdrawn by the applicant at some point (or not acted on by the lender). The withdrawal rate for other applications is much lower (19 percent).

Reported Reasons for Denial

The HMDA data include information from lenders on why they turned down an application. Lenders generally provide the information voluntarily; however, two federal bank supervisory agencies, the Office of Thrift Supervision and the Office of the Comptroller of the Currency, require the institutions they supervise to report this information.[38]

Institutions are allowed to cite up to three reasons (from a list of nine) that an application was turned down. Overall, one or more reasons for denial were provided for about 81 percent of the denials across all loan products and for about 75 percent of the denials for home-purchase loans (data not shown in tables). Poor or no credit history was the most frequently cited reason for denying applications: Credit-related issues were cited in about 26 percent of the denials of applications for conventional first-lien loans to purchase one- to four-family site-built homes and in about 52 percent of the denials of applications for such loans to purchase manufactured homes. Other reasons often cited for credit denials involved excessive debt-to-income ratios, issues related to collateral, and unverifiable or incomplete information on applications; a catch-all category in the HMDA data labeled "other" was also frequently cited.

Loan Pricing

Because of the transition rules, some unknown proportion of higher-priced loans was reported in the same way as loans that did not meet the threshold requirements.[39] The inability to identify higher-priced loans that were originated in 2004 but had application dates preceding that year means that users of the data need to take special account of these applications when conducting analyses.

Reasons for Loan-Price Variation

The HMDA data on loans in the higher-priced segment of the home-loan market do not include much

38. Reasons for denial are not provided for requests for pre-approvals that are denied.

39. Analysis of the data is further complicated because loans not subject to the Federal Reserve's Regulation Z—that is, business loans—are reported with the same code as loans with spreads below the threshold. Some, perhaps most, of these loans are identifiable, however, because, as explained in text note 37, an application can be identified as being from a trust or other organization rather than from a person.

7. Disposition of applications for home loans, and origination and pricing of loans, by type of home and type of loan, 2004

Type of home and loan	Applications				Loans originated				
	Number submitted	Acted upon by lender			Number	Loans with annual percentage rate (APR) spread above the threshold[1]			
		Number	Number denied	Percent denied		Number	Percent	Percent distribution, by percentage points of APR spread	
								3–3.99	4–4.99
ONE- TO FOUR-FAMILY									
NONBUSINESS RELATED[4]									
Owner occupied									
Site built									
Home purchase									
Conventional									
First lien	5,559,099	4,938,892	737,756	14.9	3,745,490	432,364	11.5	58.0	27.5
Junior lien	1,072,726	964,662	164,750	17.1	701,078	270,688	38.6	. . .	. . .
Government backed									
First lien	652,281	583,299	79,253	13.6	479,498	6,298	1.3	58.3	24.4
Junior lien	1,563	1,254	171	13.6	1,036	29	2.8	. . .	. . .
Refinance									
Conventional									
First lien	12,261,720	9,641,212	2,973,609	30.8	5,708,965	884,108	15.5	53.9	28.1
Junior lien	954,842	785,067	270,594	34.5	439,495	120,500	27.4	. . .	. . .
Government backed									
First lien	427,105	347,785	51,661	14.9	269,349	4,084	1.5	69.5	19.8
Junior lien	766	451	172	38.1	268	12	4.5	. . .	. . .
Home improvement									
Conventional									
First lien	706,594	619,012	224,727	36.3	339,836	74,584	21.9	49.0	25.9
Junior lien	915,901	784,857	332,508	42.4	376,785	65,185	17.3	. . .	. . .
Government backed									
First lien	3,876	3,361	820	24.4	2,350	90	3.8	48.9	21.1
Junior lien	5,505	4,899	2,372	48.4	2,142	1,133	52.9	. . .	. . .
Conventional or government-backed, unsecured	364,947	348,629	182,505	52.3	143,856	. . .	. . .	. . .	. . .
Manufactured									
Conventional, first lien									
Home purchase	359,129	347,524	186,618	53.7	98,864	56,498	57.1	22.9	21.8
Refinance	239,999	201,876	104,276	51.7	71,508	34,171	47.8	32.9	27.3
Other	99,144	88,765	33,661	37.9	48,565	9,807	20.2	24.3	13.4
Nonowner occupied[5]									
Conventional, first lien									
Home purchase	1,112,330	1,003,071	156,925	15.6	760,796	92,715	12.2	59.0	26.8
Refinance	937,424	808,515	193,158	23.9	539,758	75,537	14.0	53.4	27.4
Other	234,450	208,729	70,590	33.8	122,321	36,442	29.8	10.7	5.9
BUSINESS RELATED[4]									
Conventional, first lien									
Home purchase	54,944	50,213	3,062	6.1	45,339	4,244	9.4	49.9	24.7
Refinance	55,051	47,590	5,952	12.5	38,922	3,997	10.3	45.7	29.0
Other	29,115	26,444	3,638	13.8	21,427	1,952	9.1	6.3	4.7
MULTIFAMILY[6]									
Conventional, first lien									
Home purchase	24,593	22,599	2,372	10.5	19,294	861	4.5	60.2	23.2
Refinance	23,424	21,619	2,306	10.7	18,468	886	4.8	58.8	23.5
Other	5,662	5,067	954	18.8	3,942	279	7.1	14.0	10.8
Total	**26,102,190**	**21,855,392**	**5,784,410**	**26.5**	**13,999,352**	**2,176,464**	**15.5**	**41.4**	**21.3**

NOTE: Excludes transition-period applications (those submitted before 2004) and transition-period loans (those for which the application was submitted before 2004).

1. APR spread is the difference between the APR on the loan and the yield on a comparable-maturity Treasury security. The threshold for first-lien loans is a spread of 3 percentage points; for junior-lien loans, it is a spread of 5 percentage points.

2. Loans covered by the Home Ownership and Equity Protection Act of 1994, which does not apply to home-purchase loans (for details, see text).

3. Number denied divided by number (not shown) acted upon.

4. Business-related applications and loans are those for which the lender reported that the race, ethnicity, and sex of the applicant or co-applicant are "not applicable"; all other applications and loans are nonbusiness related.

5. Includes applications and loans for which occupancy status was missing.

6. Includes business-related and nonbusiness-related applications and loans for owner-occupied and nonowner-occupied properties.

. . . Not applicable.

7.—Continued

Loans originated						Memo Transition-period applications (those submitted before 2004)					
Loans with annual percentage rate (APR) spread above the threshold[1]											
Percent distribution, by percentage points of APR spread			APR spread (percentage points)		Number of HOEPA-covered loans[2]	Number submitted	Number denied	Percent denied[3]	Loans originated		Number of HOEPA-covered loans[2]
5-6.99	7-8.99	9 or more	Mean	Median					Number	Percent with APR spread above threshold	
13.2	1.2	.2	4.1	3.8	...	490,846	41,115	9.9	303,881	5.1	...
76.2	21.7	2.1	6.4	6.2	...	47,351	5,230	13.4	26,475	23.1	...
12.7	4.3	.3	4.2	3.9	...	85,896	8,172	11.5	56,693	.7	...
69.0	17.2	13.8	7.1	6.0	...	226	16	9.8	134	2.2	...
15.7	2.2	.2	4.2	3.9	7,249	813,761	106,316	18.5	333,550	10.7	322
58.3	28.9	12.9	7.3	6.7	3,987	36,965	6,184	21.6	16,479	23.7	177
9.4	1.0	.3	3.9	3.6	496	49,849	6,008	15.9	23,485	.8	106
58.3	41.7	0	6.7	6.6	2	63	6	21.4	19	0	...
19.4	4.5	1.1	4.4	4.0	1,965	13,773	1,733	14.6	7,912	14.6	63
41.5	27.9	30.7	8.0	7.6	5,046	21,962	4,342	24.0	10,646	13.0	158
21.1	7.8	1.1	4.7	4.0	4	391	74	25.0	189	3.7	...
23.1	29.3	47.6	9.2	8.9	1,002	273	67	30.9	88	43.2	17
...	...	...	...	...	...	4,881	1,209	27.1	2,132	...	...
32.4	16.8	6.0	5.7	5.2	...	9,595	1,177	13.8	5,003	22.2	...
28.9	8.2	2.8	5.0	4.6	1,830	12,252	2,370	25.0	4,590	21.2	41
30.5	16.4	15.4	6.4	5.5	904	6,679	722	12.5	4,308	4.9	24
11.6	1.8	.8	4.1	3.8	...	84,952	7,864	10.8	53,019	7.8	...
16.4	2.4	.5	4.2	3.9	612	82,569	11,682	17.3	42,145	9.1	34
50.9	25.6	6.8	6.4	6.1	218	8,684	1,120	15.7	4,739	24.9	6
20.7	3.5	1.2	4.4	4.0	...	87,425	11,520	14.9	50,885	5.7	...
21.6	3.2	.5	4.4	4.1	104	117,852	25,941	25.4	54,936	10.5	36
64.3	20.9	3.8	6.2	6.1	29	42,414	7,973	22.0	21,444	9.8	121
13.9	2.1	.6	4.1	3.7	...	3,607	169	5.2	2,838	3.1	...
16.0	1.4	.3	4.1	3.8	29	3,920	262	7.3	3,060	3.0	3
57.7	15.1	2.5	5.9	5.8	7	689	35	5.6	548	2.7	2
27.2	**7.7**	**2.5**	**4.8**	**4.3**	**23,484**	**2,026,875**	**251,307**	**15.7**	**1,029,198**	**8.4**	**1,110**

8. Home-purchase lending that began with a request for pre-approval: Disposition and pricing, by type of home, 2004

Type of home	Requests for pre-approval			Applications preceded by requests for pre-approval[1]			Loan originations whose applications were preceded by requests for pre-approval		
	Number submitted	Number denied	Percent denied[2]	Number submitted	Acted upon by lender		Number	Loans with annual percentage rate (APR) spread above the threshold[3]	
					Number	Number denied		Number	Percent
ONE- TO FOUR-FAMILY									
NONBUSINESS RELATED									
Owner occupied									
Site built									
Conventional									
First lien	684,306	153,773	22.5	448,771	396,998	34,665	332,804	27,340	8.2
Junior lien	88,793	15,423	17.4	67,757	61,771	4,728	52,671	14,865	28.2
Government backed									
First lien	100,118	26,682	26.7	71,632	64,214	7,218	53,527	662	1.2
Junior lien	147	35	23.8	118	99	13	83	7	8.4
Manufactured									
Conventional, first lien	39,791	23,838	59.9	37,592	35,700	22,039	7,430	4,735	63.7
Other	3,714	935	25.2	2,912	2,351	419	1,787	94	5.3
Nonowner occupied									
Conventional, first lien	84,763	15,252	18.0	58,101	51,548	5,457	41,564	3,478	8.4
Other	7,003	1,067	15.2	5,953	5,040	487	4,000	1,307	32.7
BUSINESS RELATED									
Conventional, first lien	3,667	350	9.5	3,317	2,791	244	2,417	364	15.1
Other	1,540	117	7.6	1,419	1,208	90	1,079	149	13.8
MULTIFAMILY									
Conventional, first lien	226	29	12.8	207	186	14	167	19	11.4
Other	16	4	25.0	14	13	2	11	6	54.5
Total	**1,014,084**	**237,505**	**23.4**	**697,793**	**621,919**	**75,376**	**497,540**	**53,026**	**10.7**

NOTE: Excludes transition-period requests for pre-approval (those submitted before 2004). See also notes 4, 5, and 6 of table 7 for details on business-related, nonowner-occupied, and multifamily properties and general note to table 2.

1. These applications are included in the total of 26,102,190 reported in table 7.

2. Number denied divided by number (not shown) acted upon.

3. See table 7, note 1.

. . . Not applicable.

of the information that might explain variations in the prices of reported loans. Among the factors reflected in loan pricing are the cost of the funds to be lent, credit risk, prepayment risk, overhead expenses, loan-servicing costs, the negotiating abilities and inclinations of the creditor and borrower, the possibility of discriminatory pricing, and variations in the channels through which a loan application at a given lender may be processed (see box "Reasons for Loan Price Variation").

Issues Raised by Expanding the Disclosure of Pricing-Related Items

Although disclosures that are more comprehensive could improve the understanding of loan pricing, it would impose new costs on lenders to collect and report the additional data, raise difficult reporting issues, and might pose privacy concerns for consumers and reveal otherwise nonpublic information about lenders' business strategies. Adding new data elements to mandated disclosures would require institutions to train staff, modify data collection and reporting software, and expand controls to ensure the reporting of correct data.

Further, the fact that lenders differ in the factors they consider in setting loan prices makes it difficult to select additional data elements that would allow a complete understanding of the determinants of a particular lender's pricing method. Also, some loan-pricing items that might be added to the HMDA data raise technical issues about what, precisely, to report. For example, if lenders were required to report credit scores, getting consistent data across lenders would be difficult because institutions rely on different types of credit scores in underwriting—for example, some lenders rely on generic FICO credit history scores (see text note 31), whereas others use proprietary credit scores developed from information on their own experience with lending.

8.—Continued

Loan originations whose applications were preceded by requests for pre-approval							MEMO Applications with transition-period requests for pre-approval (request submitted before 2004)				
Loans with annual percentage rate (APR) spread above the threshold[3]											
Percent distribution, by percentage points of APR spread					APR spread (percentage points)		Number	Number denied	Percent denied[2]	Loans originated	
3–3.99	4–4.99	5–6.99	7–8.99	9 or more	Mean	Median				Number	Percent with APR spread above threshold
49.2	28.4	20.0	2.0	.5	4.3	4.0	20,444	731	4.3	13,382	3.8
. . .	. . .	81.3	16.7	2.0	6.2	6.0	1,269	37	3.4	919	9.6
34.1	7.4	29.5	28.5	.5	5.6	6.3	5,866	351	7.2	3,770	1.4
. . .	. . .	71.4	14.3	14.3	6.4	5.3	11	1	10.0	9	0
19.6	23.4	33.5	15.2	8.3	5.8	5.3	172	23	18.4	91	22.0
20.2	0	77.7	2.1	0	5.0	5.3	508	26	6.5	335	0
48.0	21.8	17.0	7.7	5.4	4.8	4.0	2,406	107	5.4	1,493	4.8
0	0	53.8	38.5	7.7	7.0	6.8	184	8	5.8	81	18.5
36.8	19.8	31.0	8.2	4.1	5.1	4.6	1,800	75	4.6	1,393	3.2
.7	0	82.6	11.4	5.4	6.4	6.3	570	21	4.2	450	4.7
47.4	31.6	10.5	0	10.5	5.1	4.1	16	0	0	15	6.7
0	0	50.0	50.0	0	6.8	6.9	1	0	0	1	0
31.0	**18.4**	**39.5**	**9.0**	**2.1**	**5.1**	**5.0**	**33,247**	**1,380**	**5.0**	**21,939**	**3.8**

The potential for compromising consumer privacy is also a consideration. More than 90 percent of the loan records in a given year's HMDA data are unique—that is, an individual lender reported only one loan in a given census tract for a specific loan amount. These unique loan records can be matched with other publicly available information, such as property deed records, to determine the identities of individual borrowers. With such a match, any data item in the HMDA database, such as loan pricing, becomes publicly known. During the Board's review of Regulation C, some commenters cited this circumstance as a reason not to require the reporting of price information. Expanding HMDA to include data items such as credit scores that may be considered highly personal would likely also raise privacy concerns.

Finally, requiring lenders to disclose additional information about their lending activities may result in the disclosure of otherwise nonpublic information about lenders' business strategies. HMDA now requires disclosure of information about lending patterns—for example, pricing patterns—that otherwise would not be public. In general, such disclosure is pro-competitive because it helps possible entrants to the market identify business opportunities and lowers the information advantage of market incumbents. An argument could be made that disclosing detailed information about lenders' business strategies through HMDA might discourage lenders from testing new products or entering new markets by creating a risk that, because of such disclosure, a lender would lose its competitive advantage before it had recouped the fixed costs of entry. The likelihood of such discouragement would depend critically on whether potential competitors could discern the essential elements of a lender's business strategy (a discernment that would depend, in part, on which data items had to be disclosed) and, further, distinguish successful business strategies from unsuccessful ones (a distinction that could not be made on the basis of HMDA data alone). Ultimately, any decision to add data items to the reporting requirements of HMDA should be based on a careful weighing of the costs and benefits of such additional reporting.

Reasons for Loan Price Variation

As in credit underwriting, loan pricing reflects a wide variety of factors.

Cost of funds. The cost of funds is the largest element in the overall cost of extending prime-market home loans and a significant factor for loans in the higher-priced segment of the market. Funding costs vary with the expected duration of the debt and the creditworthiness of the borrower. Also, many creditors originate loans for subsequent sale in the secondary market; consequently, the prices offered by secondary-market participants for home loans bear heavily on the pricing decisions for such loans.

Credit risk. Credit risk is the probability that a loan will go into default. Loans that involve greater credit risk carry higher prices. On average, loans in the prime market entail substantially lower credit risk than do those in the subprime market.[1] Interest rates on loans increase with the rate of serious delinquency, even for subprime loans, an indication that loans that pose greater credit risk carry higher rates of interest (chart A).

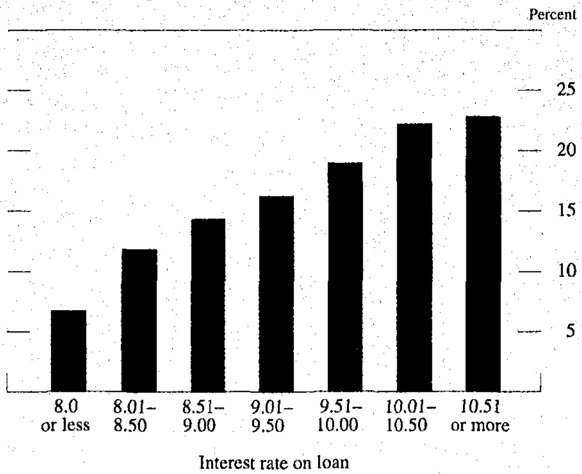
Credit risk is a function of the creditworthiness of the borrower, the equity in the home securing the loan, and the likelihood that proceeds of a foreclosure sale of the home will satisfy the obligation if default occurs. In general, the creditworthiness of borrowers is related to their income and employment prospects; available assets if financial problems arise; claims on their income from servicing other debts; and credit history, which, in part, reflects their willingness and ability to repay credit. As noted, in underwriting loans, credit history is often summarized and measured by a credit history score. Equity in a home is measured at the time of loan origination by a loan-to-value ratio (LTV).

The importance of credit history in loan pricing is illustrated by the fact that interest rates are higher for loans with lower credit history scores (chart B). For the most part, borrowers in the prime segment of the market have credit history scores that indicate they pose relatively little credit risk. Borrowers in the higher-priced segment of the market typically have weaker credit history profiles for one or more of several reasons: previous failures to make loan payments as scheduled, collection agency actions, bankruptcy or adverse court judgments, or little or no previous experience with credit.

Prepayment risk. Prepayment risk measures the possibility that a loan will be repaid before the end of the loan term. Most early payoffs of home loans are attributable either to the sale of the home or the refinancing of the loan, typically when rates have fallen sufficiently from the rate on the existing loan. Because a prepayment results in payment of the principal ahead of schedule, the lender (or secondary-market investor) must reinvest the funds at the new market rate, which may be lower than the old rate, particularly in the case of a refinancing.

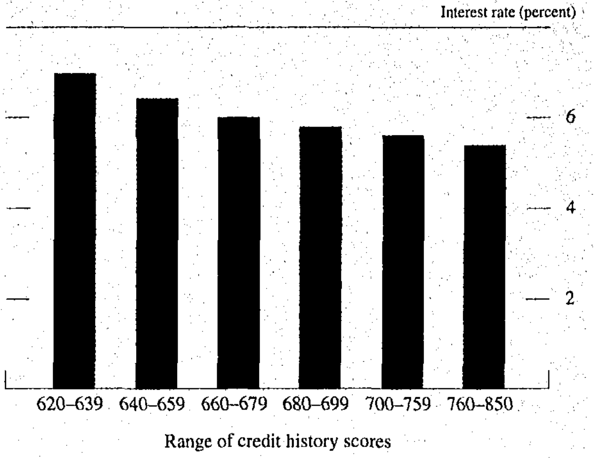
1. See Amy Crews Cutts and Robert Van Order (2004), "On the Economics of Subprime Lending," Freddie Mac Working Paper 04-01 (Washington: Freddie Mac, January), www.freddiemac.com/corporate/reports.

A. Percentage of selected subprime loans delinquent ninety days or more or in foreclosure, by interest rate on loan, May 2005



NOTE: The loans, which consist of 1.5 million home loans from among twenty-five active subprime lenders, are first- and second-lien home-purchase and home-refinancing loans originated in the second quarter of 2001. Performance is as of May 2005.
SOURCE: LoanPerformance database (www.loanperformance.com).

B. Interest rates offered on thirty-year fixed-rate mortgages, by credit history score of borrower, July 2005



NOTE: Based on a nationwide tabulation of lenders; loan amount is $150,000.
SOURCE: Fair Isaac Corporation (www.myfico.com, accessed on July 18, 2005).

Reasons for Loan Price Variation—Continued

Although the possibility of prepayment is well understood, estimating when it will happen is quite difficult. For this reason, lenders compensate for the risk either by including prepayment penalties in their loan contracts or by pricing the risk in their calculation of the interest rate on the loan. The first of these options, the prepayment penalty, is rare in the prime segment of the market but is more common in the subprime segment.

Borrowers in the higher-priced segment of the home-loan market have higher prepayment rates than others because many of them improve their credit profiles over time as they make regular payments, and this improvement in turn allows them to qualify for a lower-rate loan. Our review of depersonalized credit record information from one of the three national credit-reporting agencies indicates that, as of June 30, 2003, almost one-fourth of those with outstanding home-loan debt and with credit history scores between 580 and 620 (a credit score range associated with individuals with subprime credit quality) increased their credit scores 40 points or more over the ensuing eighteen-month period. A change in credit score of this magnitude would typically be sufficient to move their credit risk profiles into the near-prime or prime segment of the market.[2]

The effect of even a small improvement in the credit history score is much larger for borrowers in the higher-priced segment of the home-loan market than for those in the prime segment. For a higher-priced loan, a small improvement in the borrower's credit history score may translate into a substantial reduction in interest rates and may encourage prepayment (chart B).[3] Because pricing in the prime segment varies little by credit score, borrowers in the prime market are less likely to obtain a lower-priced loan if their credit scores improve.

Another factor that may result in elevated rates of prepayment in the higher-priced portion of the market is the practice referred to as "loan flipping." Flipping is inducing a borrower to refinance a loan repeatedly—even though the refinancing may not be in the borrower's interest—and charging high fees with each refinancing.

Overhead expenses. Overhead expenses represent a fairly small component of the cost of lending for most home loans. However, borrowers who have experienced payment problems in the past, or who have little or no credit history, or who are unable or unwilling to document their employment histories or income are likely to require more time to underwrite. The higher cost of underwriting may be passed on to such borrowers and can result in prices that place their loans in the higher-priced segment of the market. Marketing and other expenses incurred to identify market opportunities and solicit customers may also differ across segments of the home-loan market.

Servicing costs. Servicing costs are expenses incurred to process and distribute loan payments, monitor accounts, and deal with borrowers who fall behind in their payments. Servicing costs can be particularly high if the loan involves a foreclosure—that is, a forced sale. Because the higher-priced segment of the market has high rates of serious delinquency, servicing costs are higher than in the prime market. And because higher-priced loans tend to be smaller than prime loans, the costs of servicing and the costs of extra underwriting efforts (noted earlier) must be spread over a smaller dollar volume of loans. Borrowing a relatively small amount increases the possibility that elevated costs will lead to a higher-priced loan because any given amount of fixed costs passed on to the borrower increases the APR more on a smaller loan than on a larger loan. Hence, these costs have a larger effect on loan prices in the higher-priced segment of the market than in the prime segment.

In general, the cost and risk-related factors noted earlier may be measured in an objective way and are demonstrably related to the costs, and hence the prices established, for credit. Two additional, and related, pricing factors are not necessarily objective and, moreover, are more likely than others to raise fair lending concerns: discretionary pricing by loan officers and price negotiations between creditor and applicant.

Discretionary pricing. Many creditors provide their loan officers and agents working on their behalf (for example, mortgage brokers) with rate sheets that indicate the creditors' minimum prices by product (for example, for conventional loans of various types or with various types of government backing), loan characteristics (for example, term to maturity and LTV ratio), and borrower creditworthiness (for example, credit history score and debt-to-income ratio). In some cases, loan officers and brokers are allowed to deviate from these prices as market conditions warrant or allow. A loan officer may quote a prospective borrower a price above the rate sheet (sometimes referred to as an "overage"), and if the consumer accepts the price without demanding cash back to offset loan fees or other closing costs, the contract interest rate or loan fees on such "overaged loans" will be higher than they might otherwise have been.

Discretionary pricing can be a legitimate business practice and can help ensure that markets allocate resources in the most efficient way. However, when loan officers are permitted latitude in establishing prices, the lender runs the risk that differential treatment on a basis prohibited by law may arise. Obtaining overages more often, or in higher

2. The three national credit-reporting agencies are Equifax (www.equifax.com), Experian (www.experian.com), and Trans Union Corporation (www.transunion.com).

3. Of course, prepayment penalties may deter prepayment among some borrowers in the higher-priced segment of the market even when their credit scores improve.

Reasons for Loan Price Variation—Continued

amounts, from minority borrowers or targeting only minorities for overaging may constitute a fair lending violation unless some legitimate, nondiscriminatory reason exists for the result.

Price negotiations. Price variation can also arise because less sophisticated or less knowledgeable borrowers are not as likely to shop for credit or to realize that they may negotiate with the lender over the interest rate and fees. Moreover, lower-income borrowers may be disproportionately represented in the category of less sophisticated borrowers. Given that minority borrowers have disproportionately lower incomes, there is some likelihood that they will be overrepresented among borrowers with overaged loans. Such results may be interpreted by some as demonstrating unlawful discriminatory pricing by lenders.

Differences in the extent to which borrowers negotiate or shop for the best deal may result in a pattern of overage loans that is not illegal but that nonetheless may be difficult for a lender to document and explain. Moreover, instances of different negotiating strengths among borrowers can be difficult to distinguish from illegal discriminatory treatment in which loan officers quote loan rates or provide information or assistance that varies according to the race, ethnicity, sex, or other prohibited characteristic of the borrower.

Variations in loan-processing channels. The delivery channels through which borrowers obtain loans vary widely across lenders. On the one hand, underwriting and pricing may be centrally controlled even though the application may begin on the Internet or with a mailed solicitation or at a bank branch. On the other hand, in complex financial organizations with bank branches, multiple affiliates, decentralized loan production offices, indirect brokerage operations, and nonbank subsidiaries, each application may be subject to a different underwriting and pricing regime depending on its point of initiation. The 2004 HMDA pricing data suggest that the delivery channel through which a borrower obtains a loan may matter. As discussed elsewhere in this article (see section "Incidence of Higher-Priced Lending for Selected Subgroups"), the incidence of higher-priced lending is higher for borrowers who live outside the assessment areas of lenders covered by the Community Reinvestment Act of 1977 (CRA) than for those who live inside these areas.[4] This difference may be due to a reliance on different delivery channels for loans within and outside these lenders' assessment areas.

4. The assessment areas of lenders covered by the CRA include principally the locales in which a lender has its main or branch offices and its deposit-taking automated teller machines. For a more complete definition of CRA assessment areas, see the Federal Reserve Board's Regulation BB, section 228.41. See also Robert B. Avery, Glenn B. Canner, Shannon C. Mok, and Dan S. Sokolov (2005), "Community Banks and Rural Development: Research Relating to Proposals to Revise the Regulations That Implement the Community Reinvestment Act," *Federal Reserve Bulletin*, vol. 91 (Spring), pp. 202–35.

The Interest Rate Situation in 2004

The interest rates prevailing in a given year can significantly affect the proportion of loans that exceed the thresholds established by the Federal Reserve for determining whether a loan is "higher-priced." For 2004, the rate on Treasury securities used to calculate the spread for home loans with thirty-year terms varied from 4.67 percent to 5.54 percent. This variation implies that the threshold for reporting a first-lien loan as higher-priced ranged from 7.67 percent to 8.54 percent over the year. For junior liens, which typically have a shorter term to maturity than do first liens, the reporting threshold ranged from about 8.78 percent to 9.79 percent for a fifteen-year loan (different terms to maturity would yield somewhat different ranges).

Data derived by Freddie Mac from its Primary Mortgage Market Survey show that the spread for average interest rates for first-lien conforming mortgages extended in 2004 imply a typical gap between the thirty-year Treasury rate and an estimated APR for prime-rate loans of between 1 percent and 1.25 percent.[40] This gap implies that a thirty-year first-lien home loan would have to have been priced between 1.75 percentage points and 2 percentage points above a prime-rate home loan to exceed the HMDA price-reporting threshold. Such a price spread was around the upper end of the near-prime market, but it was probably still below the levels associated with most subprime loans. In future years, the thresholds may cover a greater proportion of the near-prime segment of the market.

Results: The Incidence of Higher-Priced Lending

Several patterns are revealed in the 2004 HMDA pricing data (table 7). First, in almost all cases, government-backed loan products show lower incidences of higher-priced lending than do comparable conventional loan products. For example, among first-lien home-purchase loans for site-built homes, 11.5 percent of conventional loans have APRs above

40. See www.freddiemac.com.

the pricing threshold versus only 1.3 percent of government-backed loans. Second, with few exceptions, first-lien loans have a substantially lower incidence of higher-priced lending than do junior-lien loans for the same purposes. For example, nationally the incidence of higher-priced lending for conventional first-lien refinance loans was 15.5 percent whereas for comparable junior-lien loans it was 27.4 percent. Third, manufactured-home loans exhibit the greatest incidence of higher pricing across all loan products, a result consistent with the elevated credit risk associated with such lending. For example, 57.1 percent of conventional first-lien loans used to purchase manufactured homes were higher priced, in sharp contrast to the 11.5 percent rate for comparable loans for site-built homes. Finally, the lower incidence of higher-priced lending (shown in the memo item in table 7) for loans initiated in the transition period reinforces the decision to exclude such loans from the pricing analysis.

Rate spreads for higher-priced loans. Variation in mean and median spreads across products for loans with rates above the threshold is much smaller than variation in the incidence of higher-priced lending. Because the threshold for reporting is set higher for junior liens than for first liens, higher-priced junior-lien products have higher mean and median spreads. Once again, manufactured-home loans stand out in that they have the highest average spreads among all the loan products with comparable lien status.

Except for loans backed by manufactured homes, the vast majority of higher-priced loans have prices within 1 or 2 percentage points of the pricing thresholds. Only a very small proportion of higher-priced first-lien loans have spreads that exceed 7 percentage points. Similarly, only a small proportion of junior-lien loans have spreads of 9 percentage points or more. But home-improvement loans provide two exceptions—30.7 percent of conventional junior-lien home-improvement loans and 47.6 percent of government-backed junior-lien home-improvement loans have spreads of 9 percentage points or more. Reflecting these distributions, the mean and median spreads for most loan products fall within 2 percentage points of the reporting thresholds. The exceptions include loans backed by manufactured homes and junior-lien home-improvement loans, for which the distribution of prices is more even.

Lenders of higher-priced loans. Most lenders covered by HMDA reported extending few if any higher-priced loans for 2004 (data not shown in tables). Nearly 3,300 lenders reported making no such loans, and an additional 2,300 reported making between one and nine such loans. Nearly 500 lenders reported making more than 100 higher-priced loans; these more-active lenders accounted for 96 percent of all reported higher-priced lending of this type. Moreover, the 10 lenders with the largest volume extended 38 percent of all higher-priced loans.

Variation across metropolitan areas. The analysis of separate geographic markets shows that higher-priced lending varies considerably across MSAs.[41] For this exercise, the focus is on the incidence of higher-priced lending among conventional first-lien home-purchase loans for site-built, owner-occupied homes. The MSA with the lowest incidence of higher-priced lending for this product is the San Francisco–San Mateo–Redwood City area in California, at 2 percent; the MSA with the highest incidence is the McAllen–Edinburg–Pharr area in Texas, at 42 percent.[42] A review of the full list of MSAs indicates that most of the areas with the highest incidence are in the southern region of the country, whereas those with the lowest incidence are much more dispersed.

Although a comprehensive analysis of the reasons for such wide variation in the incidence of higher-priced lending is beyond the scope of this article, a review of data from one of the three national credit-reporting agencies finds a close association between the proportion of individuals in an MSA county with a low credit score and the incidence of higher-priced lending in that area.

Loans Covered by HOEPA

The 2004 HMDA data indicate whether a loan is subject to the Home Ownership and Equity Protection Act of 1994. Before 2004, little information was publicly available about the extent of such lending or the number or type of institutions involved in such activities. However, HMDA data do not capture all HOEPA-related lending. Some HOEPA loans are extended by institutions not covered by HMDA, and some HOEPA loans that are made by HMDA-covered institutions are not reported under the Federal

41. Reporting institutions are required to report all their lending in MSAs as well as in the nonmetropolitan portions of states. However, because institutions operating exclusively in nonmetropolitan areas are not covered by HMDA, loans in nonmetropolitan areas are underrepresented in the data. For this reason, the geographic analysis here is focused on MSAs.

42. In November 2004, the OMB redesignated this Texas MSA as McAllen–Edinburg–Mission (see www.whitehouse.gov/omb/bulletins/fy05/b05-02_attachment.pdf).

Reserve Board's Regulation C, which implements HMDA. In particular, if the proceeds of a home-secured loan are not used to refinance an existing home loan or to finance home improvement, then the loan may be covered by HOEPA but is not reportable under Regulation C.[43]

Incidence of HOEPA-Related Lending

For 2004, 1,948 lenders reported extending 24,594 loans covered by HOEPA (table 7). The HOEPA loans accounted for only 0.003 percent of all the originations of home-secured refinance or home-improvement loans reported for 2004 (derived from the table).[44]

HOEPA lending is relatively concentrated: The ten lenders that reported the largest number of HOEPA originations accounted for 37 percent of all reported HOEPA loans (data not shown in tables). At the other extreme, 801 institutions reported only one HOEPA loan, and 327 reported only two such loans. Most HOEPA loans were extended by banks (50 percent of the total) or by bank subsidiaries or affiliates of bank holding companies (14 percent of the total); independent mortgage companies extended the rest.

Characteristics of HOEPA-Related Lending

As noted, HOEPA applies only to closed-end home loans (whether for refinancing or home improvement) and not to home-purchase loans or home equity lines of credit. The vast majority of HOEPA loans reported in the 2004 data involved conventional products: Only 7 percent of reported HOEPA loans were government backed (derived from table 7). About 50 percent of the reported HOEPA loans involved first-lien conventional loans (more than 80 percent of these were for refinancings, and the rest were for home improvement), and about 40 percent involved junior-lien conventional loans (more than half of these were for home improvement).

On average, reported HOEPA loans are not large (data not shown in tables). For example, for conventional refinancing loans covered by HOEPA, the average size of a first-lien loan was $98,650, and the average size of a junior-lien loan was $31,705. In contrast, the average sizes of such loans not covered by HOEPA were $173,125 for a first-lien loan and $54,581 for a junior-lien loan.

Reported HOEPA lending varies among borrowers sorted by borrower income, race, and ethnicity and among census tracts sorted by census tract income, population, and location. However, the data do not indicate that HMDA-reportable HOEPA lending is focused primarily on lower-income or minority individuals or on those residing in lower-income neighborhoods or neighborhoods with high concentrations of minority individuals. For example, although reported HOEPA loans were extended to borrowers in all income groups, about three-fourths were extended to middle- and higher-income borrowers (data not shown in tables). Similarly, most reported HOEPA loans were extended to non-Hispanic white borrowers. Most of the homes secured by reported HOEPA loans were in middle- or higher-income areas and in areas with a minority population that was less than 20 percent of the total population.

Lending Outcomes by Race, Ethnicity, and Sex

One of the primary purposes of the HMDA data is to allow comparison of the outcomes of the lending process for applicants and borrowers grouped along many dimensions, including by race, ethnicity, and sex. Outcomes reported in the HMDA data include the disposition of applications (denial rates) and, as of 2004, the pricing of loans. Gross outcomes for different groups of borrowers can be compared, but HMDA data include information on a number of items whose presence or absence for borrowers can be made consistent ("controlled for") in conducting the comparisons. Clearly the HMDA data do not include all the factors that are involved in credit underwriting and pricing. However, by controlling for variations so as to make borrowers as similar as possible on the dimensions of the data that are available, one can account for some of the factors that may explain differences in the outcomes of the lending process among groups.

The HMDA data allow individuals to be matched by loan type and purpose, type of property securing the loan, lien status, owner-occupancy status, property location (for example, same MSA or even same census tract), income relied on for underwriting, loan amount, and time of year when the loan was made as well as by whether the loan involved a co-applicant.

43. For example, if a homeowner takes out a HOEPA-covered loan to pay off outstanding credit card debt or some other type of consumer credit, and the loan does not involve the refinancing of an existing home loan or home improvement, then the loan is not covered by Regulation C and is thus not required to be part of an institution's HMDA reporting.

44. The HMDA data also include information on loans purchased by covered institutions during 2004: Among purchased loans, about 2,700 were designated as HOEPA loans.

In comparing lending outcomes across racial and ethnic groups, one can match for the sex of the applicant and co-applicant, and in comparing outcomes by sex, one can match for race and ethnicity.

Comparisons in outcomes across groups can be conducted at the level of an individual institution, groups of institutions (for example, manufactured-home lending specialists), geographic market, or populations as a whole. Further, a variety of statistical methodologies can be used to control for the effects of the credit-related or other factors in HMDA noted above. The full range of these comparisons is beyond the scope of this article. However, to gain an understanding of the differences that are likely to be important, we analyzed the 2004 data using statistical matching criteria similar to those used in the Federal Reserve's statistical analysis program (described in the section "Using the Expanded HMDA Data as a Screening Tool for Fair Lending Enforcement").

We restrict the analysis to denial rates, the incidence of higher-priced lending, and the mean spreads paid by borrowers with higher-priced loans, and we compare these outcomes across eleven groups—nine racial or ethnic groups and the two sexes. We conduct the analysis for thirteen of the twenty-five loan products covered in table 7.[45]

We present the comparisons at three levels, one unadjusted and two adjusted. The first level for each group is the raw, or unadjusted, average outcome. The second level is the average outcome as adjusted for the borrower-related factors reported in the HMDA data—income, loan amount, location (MSA) of the property, presence of a co-applicant, and (in the comparisons by race and ethnicity) sex or (in the comparisons by sex) race and ethnicity; applying this adjustment is hereafter termed "adjusting (or controlling or accounting) for borrower-related factors." The third level is the average outcome as adjusted for all the items in the second level (the borrower-related factors) plus the lending institution—applying this adjustment is hereafter termed "adjusting (or controlling, or accounting) for borrower-related factors plus lender."

Applications subject to the transition rules were excluded from the pricing comparisons; however, they were *included* for the denial-rate comparisons.[46] Also excluded from the sample are applicants residing outside the fifty states and the District of Columbia, applications deemed to be business-related, and requests for pre-approval that were denied by the lender or that were granted by the lender but not acted upon by the borrower. Otherwise, the sample includes all 2004 HMDA applications acted upon by the lender in the thirteen product areas.

Unadjusted and adjusted comparisons for lending outcomes across groups are discussed in the sections below. For purposes of presentation, the adjusted outcomes shown in the tables are normalized so that, *for the base comparison group* (non-Hispanic whites in the case of comparison by race and ethnicity, and males in the case of comparison by sex), the adjusted mean at each adjustment level is the same as the unadjusted mean. Consequently, the adjusted outcomes for any other group represent the expected average outcome if the members of that group had the same distribution of control factors as that of the base comparison group.

Denial Rates across Groups

Unadjusted mean denial rates vary across loan categories for all groups of borrowers (table 9). For example, the mean unadjusted denial rate for Asians is lowest for government-backed first-lien home-purchase loans (12.4 percent) and highest for conventional junior liens for home improvements (46.1 percent).

For every loan category, American Indians, blacks, Hispanic whites, and the group for which race was missing have higher unadjusted mean denial rates than non-Hispanic whites, with the highest rates generally for blacks and the rates for Hispanic whites lying about halfway between those for blacks and those for non-Hispanic whites. The denial rates for each of the other minority groups vary in their relationship with the rates for non-Hispanic whites.

With few exceptions, controlling for borrower-related factors reduces the differences among racial and ethnic groups. (Although the effect of controlling for borrower-related factors can widen the racial and ethnic differences in denial rates.) Accounting for

45. The analysis was not conducted for unsecured loans because pricing data were not collected for these loans. Eleven other product areas were not used because they accounted for so few loans that matching was difficult.

46. The action date on an application is used to determine the reporting year for HMDA data. The gap between the application date and the action date is generally shorter for denied applications than for originated loans. For example, applications received and acted upon in December (and therefore reported in HMDA for that year) are more likely to be denials than acceptances. Similarly, applications acted upon in January but received in the previous year are more likely to be acceptances. In analyzing denial rates for 2004, excluding applications covered by the transition period (that is, applications received before 2004) is therefore likely to disproportionately exclude acceptances. This can be seen in the memo item in table 7, where the denial rates are lower for applications filed during the transition period. For this reason, transition-period applications are included in the denial-rate analysis in tables 9 and 14.

9. Unadjusted and adjusted denial rates on applications for loans on one- to four-family homes, by type of loan and by race and ethnicity and sex of applicant, 2004

A. Home purchase, owner-occupied site-built home

Percent except as noted

Race and ethnicity and sex	Conventional								Government backed, first lien			
	First lien				Junior lien							
	Number of applications	Unadjusted denial rate	Adjusted denial rate, by adjustment factor		Number of applications	Unadjusted denial rate	Adjusted denial rate, by adjustment factor		Number of applications	Unadjusted denial rate	Adjusted denial rate, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race and ethnicity												
American Indian or Alaska Native	42,460	21.1	20.4	15.7	11,211	22.7	22.6	18.3	6,425	15.5	14.4	14.7
Asian	288,060	13.5	12.7	12.9	48,970	18.6	17.4	16.3	7,645	12.4	12.2	13.2
Black or African American	402,090	24.7	22.3	18.2	96,741	21.9	21.2	18.8	85,845	17.2	16.9	16.0
Native Hawaiian or other Pacific Islander	30,866	17.5	15.3	15.4	9,312	18.3	17.2	15.6	3,629	13.8	12.9	11.7
Two or more minority races	3,768	13.8	12.3	15.7	975	12.5	11.8	15.5	534	15.4	15.8	12.1
Joint	64,744	12.0	15.0	12.4	12,224	13.1	15.3	13.8	12,807	9.6	12.5	11.8
Race missing	696,276	21.8	20.1	15.1	156,504	20.4	19.6	17.7	63,179	20.0	17.0	16.6
Hispanic white	423,395	18.4	15.8	14.8	124,483	20.0	18.0	16.0	59,172	15.6	13.8	13.5
Non-Hispanic white	3,309,353	10.9	10.9	10.9	532,260	13.7	13.7	13.7	396,856	10.4	10.4	10.4
Sex												
One male	1,636,413	16.8	16.8	16.8	344,552	18.7	18.7	18.7	195,671	14.0	14.0	14.0
One female	1,217,287	16.0	15.3	15.8	235,350	18.3	18.2	18.4	133,456	14.4	13.2	13.5
Two males	55,264	15.6	15.6	15.6	11,311	18.3	18.3	18.3	13,409	11.2	11.2	11.2
Two females	45,100	15.2	14.0	14.4	8,591	17.5	16.4	16.1	9,121	12.1	10.9	11.8

NOTE: Includes transition-period applications (those submitted before 2004); for explanation, see text note 46. For explanation of adjustment factors, see text. For method of allocation into racial and ethnic categories and definitions of categories, see general note to table 6 and text note 35. Applications made jointly by a male and female are not tabulated here because they would not be directly comparable with applications made by one applicant or by two applicants of the same sex.

9.—Continued

B. Refinance, owner-occupied site-built home

Percent except as noted

Race and ethnicity and sex	Conventional								Government backed, first lien			
	First lien				Junior lien							
	Number of applications	Unadjusted denial rate	Adjusted denial rate, by adjustment factor		Number of applications	Unadjusted denial rate	Adjusted denial rate, by adjustment factor		Number of applications	Unadjusted denial rate	Adjusted denial rate, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race and ethnicity												
American Indian or Alaska Native	93,068	38.2	40.1	32.3	6,529	40.8	38.6	34.9	3,222	15.7	13.8	13.3
Asian	321,978	18.7	25.7	27.3	20,194	33.1	36.1	35.2	3,698	15.0	15.4	16.1
Black or African American	897,836	41.9	39.8	32.4	54,132	44.5	42.2	37.3	69,607	17.6	18.5	17.2
Native Hawaiian or other Pacific Islander	55,859	29.7	33.5	31.2	4,518	36.3	36.3	37.3	2,204	12.2	12.0	14.1
Two or more minority races	8,340	28.2	32.9	31.3	704	31.5	37.3	39.8	442	13.6	13.6	14.3
Joint	108,225	25.7	33.0	27.3	9,382	28.9	33.9	31.7	7,857	11.0	13.8	14.0
Race missing	2,084,368	43.9	47.3	32.3	193,182	43.8	41.1	35.2	55,907	21.4	17.8	17.1
Hispanic white	639,075	29.6	31.3	28.6	38,892	37.9	37.0	33.8	29,182	15.8	15.1	16.2
Non-Hispanic white	5,916,294	24.3	24.3	24.3	475,471	28.4	28.4	28.4	206,851	12.4	12.4	12.4
Sex												
One male	2,683,328	35.1	35.1	35.1	179,812	37.4	37.4	37.4	91,609	16.1	16.1	16.1
One female	2,161,057	32.2	31.0	32.8	131,172	37.9	35.5	36.0	71,666	16.1	15.2	16.3
Two males	69,113	26.9	26.9	26.9	5,471	32.7	32.7	32.7	4,995	17.4	17.4	17.4
Two females	78,731	30.1	27.0	26.1	5,370	34.4	32.8	34.2	4,740	15.5	14.6	14.7

NOTE: See note to table 9.A.

9. Unadjusted and adjusted denial rates on applications for loans on one- to four-family homes, by type of loan and by race and ethnicity and sex of applicant, 2004—Continued

C. Home improvement, conventional loan, owner-occupied site-built home

Percent except as noted

Race and ethnicity and sex	First lien				Junior lien			
	Number of applications	Unadjusted denial rate	Adjusted denial rate, by adjustment factor		Number of applications	Unadjusted denial rate	Adjusted denial rate, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race and ethnicity								
American Indian or Alaska Native	8,843	47.1	47.1	40.3	7,712	54.7	48.2	47.3
Asian	15,204	27.8	34.8	33.4	16,276	46.1	45.7	44.3
Black or African American	67,098	49.1	47.2	41.7	62,045	60.1	55.6	52.0
Native Hawaiian or other Pacific Islander	4,402	38.3	42.7	38.9	4,538	50.1	46.4	43.8
Two or more minority races	677	41.5	43.0	40.7	656	62.0	57.0	48.8
Joint	6,832	32.6	40.2	34.1	10,842	40.6	47.1	42.2
Race missing	102,716	53.0	56.0	39.5	159,984	49.6	48.4	42.1
Hispanic white	54,319	37.5	37.7	36.2	39,529	51.4	46.4	45.1
Non-Hispanic white	360,959	28.6	28.6	28.6	494,636	36.3	36.3	36.3
Sex								
One male	159,817	43.4	43.4	43.4	189,244	51.1	51.1	51.1
One female	143,959	38.4	37.0	39.9	143,026	50.0	47.3	49.4
Two males	5,024	39.1	39.1	39.1	5,588	46.3	46.3	46.3
Two females	5,788	38.4	37.5	34.6	6,261	44.3	42.9	44.9

NOTE: See note to table 9.A.

9.—Continued

D. Manufactured housing, conventional loan, first lien, owner-occupied home

Percent except as noted

Race and ethnicity and sex	Home purchase				Refinance			
	Number of applications	Unadjusted denial rate	Adjusted denial rate, by adjustment factor		Number of applications	Unadjusted denial rate	Adjusted denial rate, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race and ethnicity								
American Indian or Alaska Native	4,785	57.3	55.9	52.7	1,670	58.0	57.9	51.5
Asian	1,736	44.4	44.1	40.2	641	49.5	48.4	51.6
Black or African American	28,363	64.2	62.4	57.7	9,535	63.9	61.6	53.8
Native Hawaiian or other Pacific Islander	1,351	57.3	55.2	50.2	346	59.8	60.3	56.5
Two or more minority races	121	68.6	63.5	74.7	73	56.2	68.4	50.2
Joint	3,398	53.5	58.3	57.5	1,549	50.7	50.4	47.9
Race missing	33,385	60.9	58.4	54.7	39,237	64.2	68.5	52.7
Hispanic white	20,820	55.1	55.9	52.5	6,760	51.0	51.3	49.3
Non-Hispanic white	238,698	48.0	48.0	48.0	149,366	46.2	46.2	46.2
Sex								
One male	101,964	52.7	52.7	52.7	54,294	52.8	52.8	52.8
One female	82,536	54.9	52.3	52.1	39,726	52.7	52.1	52.9
Two males	4,483	50.3	50.3	50.3	1,271	43.2	43.2	43.2
Two females	5,766	56.7	53.4	49.9	1,792	50.0	51.4	43.3

NOTE: See note to table 9.A.

9. Unadjusted and adjusted denial rates on applications for loans on one- to four-family homes, by type of loan and by race and ethnicity and sex of applicant, 2004—Continued

E. Nonowner-occupied site-built home

Percent except as noted

Race and ethnicity and sex	Conventional, first lien								Other[1]			
	Home purchase				Refinance							
	Number of applications	Unadjusted denial rate	Adjusted denial rate, by adjustment factor		Number of applications	Unadjusted denial rate	Adjusted denial rate, by adjustment factor		Number of applications	Unadjusted denial rate	Adjusted denial rate, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race and ethnicity												
American Indian or Alaska Native	6,881	37.5	28.5	16.2	5,674	30.5	30.5	27.0	2,183	49.7	44.5	38.9
Asian	48,246	15.0	13.3	12.9	30,317	20.4	22.3	22.2	6,716	30.0	32.1	28.4
Black or African American	80,051	24.1	19.6	17.1	87,234	30.6	28.6	25.4	26,017	44.8	38.4	34.1
Native Hawaiian or other Pacific Islander	5,127	18.2	15.6	13.3	4,401	24.8	25.2	26.4	1,611	40.5	33.7	32.4
Two or more minority races	600	14.8	13.1	10.8	661	24.4	28.3	30.6	214	42.1	33.5	46.2
Joint	11,839	11.1	13.4	12.6	7,957	18.1	23.0	20.1	2,293	24.7	31.9	27.5
Race missing	123,905	18.2	17.2	14.2	132,928	32.5	30.9	26.2	31,499	40.3	37.6	31.5
Hispanic white	56,912	18.7	14.9	14.2	44,640	26.8	24.4	22.7	14,508	37.9	34.9	31.8
Non-Hispanic white	659,022	11.0	11.0	11.0	484,333	17.8	17.8	17.8	133,098	25.5	25.5	25.5
Sex												
One male	318,461	17.2	17.2	17.2	264,494	24.5	24.5	24.5	74,353	33.6	33.6	33.6
One female	164,107	17.5	16.3	16.3	143,972	25.5	24.0	23.8	43,267	39.3	34.6	33.6
Two males	25,564	10.7	10.7	10.7	13,387	16.2	16.2	16.2	4,006	24.0	24.0	24.0
Two females	8,813	12.2	9.6	10.8	5,283	21.5	17.6	14.9	1,881	35.3	29.5	24.6

NOTE: See note to table 9.A.

1. "Other" consists of government-backed loans of all types, junior liens, home-improvement loans, and unsecured loans.

lender almost always reduces differences further, although statistically significant differences remain between non-Hispanic whites and most of the other racial and ethnic groups.

For example, for conventional first-lien home-purchase loans, the unadjusted mean denial rate for blacks was 24.7 percent and for non-Hispanic whites 10.9 percent, a difference of 13.8 percentage points. Accounting for income, loan amount, and other borrower-related factors in the HMDA data reduces the difference 2.4 percentage points. Controlling for borrower-related factors plus lender significantly reduces the gap further, to 7.3 percentage points.

The reduction for conventional first-lien refinancing is even more dramatic. The unadjusted difference between black and non-Hispanic white denial rates is 17.6 percentage points, a difference cut by more than half, to 8.1 percentage points, when adjusted for borrower-related factors plus lender.

Differences in denial rates exhibit no consistent pattern with regard to the sex of the applicant. For some products, males have higher denial rates, and for others, females do; but in general, the size of the difference by sex is small. Furthermore, controlling for borrower-related factors plus lender has an inconsistent (but generally small) effect. In fact, in some cases adjustment reverses the sign of the difference—that is, for example, some denial rates that were higher for females than for males before adjustment become higher for males than for females after adjustment.

Incidence of Higher-Priced Lending across Racial and Ethnic Groups

Although most borrowers do not have higher-priced loans, the incidence of higher-priced lending varies substantially across racial and ethnic groups (table 10). Moreover, both the overall incidence of higher-priced lending and the differences across groups varies substantially across loan product categories. For government-backed loan products, small proportions of borrowers have higher-priced loans, and no meaningful differences appear across racial and ethnic groups. At the other extreme, the majority of borrowers for manufactured homes have higher-priced loans; and for this product, significant differences appear across racial and ethnic groups (although these differences are smaller than for some other products).

Differences in the incidence of higher-priced lending across loan products make it difficult to identify

10. Unadjusted and adjusted incidence of higher-priced lending for loans on one- to four-family homes, by type of loan and by race and ethnicity and sex of borrower, 2004

A. Home purchase, owner-occupied site-built home

Percent except as noted

Race and ethnicity and sex	Conventional								Government backed, first lien			
	First lien				Junior lien							
	Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor		Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor		Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race and ethnicity												
American Indian or Alaska Native	28,107	18.1	17.2	11.8	7,618	50.2	47.5	33.6	4,751	4.9	4.1	1.1
Asian	199,359	5.9	7.4	8.1	32,444	34.4	30.8	29.9	5,402	2.5	1.7	.8
Black or African American	232,688	32.4	26.7	15.7	62,434	61.9	58.3	37.1	59,275	1.5	1.3	1.1
Native Hawaiian or other Pacific Islander	20,293	15.7	16.3	11.1	6,195	49.6	44.9	33.5	2,373	2.3	1.6	1.4
Two or more minority races	2,613	22.9	22.2	12.2	699	43.2	44.3	26.6	400	20.5	17.0	1.2
Joint	47,299	6.9	10.8	9.4	9,090	29.3	36.7	31.3	10,035	1.1	1.1	1.4
Race missing	390,136	13.4	16.8	11.1	96,140	40.7	43.5	33.2	35,547	1.4	1.3	.9
Hispanic white	301,915	20.3	16.6	11.6	87,612	58.0	49.9	35.1	47,055	2.1	1.1	1.1
Non-Hispanic white	2,476,255	8.7	8.7	8.7	394,357	30.4	30.4	30.4	304,809	1.1	1.1	1.1
Sex												
One male	1,129,781	15.3	15.3	15.3	237,097	46.1	46.1	46.1	145,275	1.3	1.3	1.3
One female	850,213	15.3	14.4	15.0	162,680	47.8	46.9	46.7	98,428	1.6	1.5	1.3
Two males	38,170	9.5	9.5	9.5	7,879	34.4	34.4	34.4	10,094	1.2	1.2	1.2
Two females	31,083	10.4	9.0	9.8	6,064	37.3	34.5	35.2	6,716	1.2	1.3	1.1

NOTE: Excludes transition-period loans (those for which the application was submitted before 2004). For definition of higher-priced lending and explanation of adjustment factors, see text. For method of allocation into racial and ethnic categories and definitions of categories, see general note to table 6 and text note 35. Loans taken out jointly by a male and female are not tabulated here because they would not be directly comparable with loans taken out by one borrower or by two borrowers of the same sex.

10.—Continued

B. Refinance, owner-occupied site-built home

Percent except as noted

Race and ethnicity and sex	Conventional								Government backed, first lien			
	First lien				Junior lien							
	Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor		Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor		Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race and ethnicity												
American Indian or Alaska Native	44,503	20.2	21.0	14.7	2,981	26.8	24.4	26.1	2,216	4.4	4.2	1.0
Asian	207,114	5.9	9.7	12.1	10,519	25.4	24.9	24.3	2,348	3.9	2.0	1.0
Black or African American	391,524	34.6	29.5	17.6	24,292	45.2	41.3	26.4	46,603	1.0	1.2	1.5
Native Hawaiian or other Pacific Islander	31,381	16.4	18.6	14.5	2,267	35.8	33.2	24.6	1,547	6.1	4.1	1.4
Two or more minority races	5,089	21.1	22.4	15.0	394	19.3	25.4	24.7	347	18.7	19.6	2.3
Joint	67,199	10.4	14.7	13.5	5,609	23.3	26.5	24.8	6,100	.9	1.1	1.2
Race missing	827,590	19.3	25.4	15.3	82,329	32.7	42.1	24.8	30,603	2.0	2.0	1.3
Hispanic white	378,826	19.3	18.5	14.3	20,687	35.1	28.7	25.2	21,804	1.9	1.2	1.4
Non-Hispanic white	3,698,309	12.9	12.9	12.9	285,505	23.9	23.9	23.9	152,619	1.3	1.3	1.3
Sex												
One male	1,360,350	18.6	18.6	18.6	90,991	34.0	34.0	34.0	63,536	1.4	1.4	1.4
One female	1,173,835	19.8	18.5	18.7	67,266	32.6	32.6	33.9	49,282	1.7	1.6	1.4
Two males	40,012	12.1	12.1	12.1	3,024	23.6	23.6	23.6	3,103	2.2	2.2	2.2
Two females	43,208	17.3	14.5	13.4	2,887	31.7	26.6	22.6	3,053	1.8	1.5	1.6

NOTE: See note to table 10.A.

10. Unadjusted and adjusted incidence of higher-priced lending for loans on one- to four-family homes, by type of loan and by race and ethnicity and sex of borrower, 2004—Continued

C. Home improvement, conventional loan, owner-occupied site-built home

Percent except as noted

Race and ethnicity and sex	First lien				Junior lien			
	Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor		Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race and ethnicity								
American Indian or Alaska Native	3,775	23.4	25.8	22.5	2,628	18.8	17.4	17.5
Asian	8,907	8.4	16.3	18.8	6,467	13.5	15.1	16.6
Black or African American	27,677	42.5	39.2	24.6	19,520	37.9	31.3	18.0
Native Hawaiian or other Pacific Islander	2,237	17.7	22.4	21.9	1,749	26.5	22.6	16.9
Two or more minority races	341	22.3	22.6	18.6	193	16.6	15.1	14.1
Joint	3,894	15.5	20.7	19.2	5,280	15.2	18.3	16.3
Race missing	36,877	21.5	32.2	21.4	61,005	17.4	23.1	15.9
Hispanic white	28,395	26.7	27.6	21.0	15,464	21.0	20.0	16.5
Non-Hispanic white	221,213	19.5	19.5	19.5	259,771	15.6	15.6	15.6
Sex								
One male	74,062	26.1	26.1	26.1	71,519	24.4	24.4	24.4
One female	74,479	27.0	25.8	26.5	57,771	22.3	21.4	23.6
Two males	2,545	17.2	17.2	17.2	2,390	19.1	19.1	19.1
Two females	3,053	23.9	18.5	21.2	2,807	19.0	18.1	19.2

NOTE: See note to table 10.A.

10.—Continued

D. Manufactured housing, conventional loan, first lien, owner-occupied home

Percent except as noted

Race and ethnicity and sex	Home purchase				Refinance			
	Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor		Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race and ethnicity								
American Indian or Alaska Native	1,168	68.2	58.3	54.8	513	51.9	53.5	50.6
Asian	537	62.8	62.6	61.9	210	42.9	47.8	56.0
Black or African American	5,175	78.5	64.8	60.0	2,316	67.7	56.1	50.1
Native Hawaiian or other Pacific Islander	315	70.8	69.2	65.3	102	48.0	44.5	45.5
Two or more minority races	21	47.6	51.2	57.0	26	42.3	54.3	–9.8
Joint	918	58.3	56.8	60.3	568	41.2	49.3	48.7
Race missing	6,535	57.2	56.6	55.4	7,420	59.0	51.6	46.3
Hispanic white	5,598	67.5	65.2	60.7	2,274	46.2	56.7	50.0
Non-Hispanic white	76,324	54.7	54.7	54.7	56,713	46.0	46.0	46.0
Sex								
One male	28,100	61.0	61.0	61.0	17,181	48.6	48.6	48.6
One female	22,177	60.5	60.2	59.8	12,772	49.8	49.0	49.2
Two males	1,566	65.1	65.1	65.1	560	56.3	56.3	56.3
Two females	1,547	65.0	64.6	65.1	622	47.3	50.8	53.6

NOTE: See note to table 10.A.

10. Unadjusted and adjusted incidence of higher-priced lending for loans on one- to four-family homes, by type of loan and by race and ethnicity and sex of borrower, 2004—Continued

E. Nonowner-occupied site-built home

Percent except as noted

Race and ethnicity and sex	Conventional, first lien								Other[1]			
	Home purchase				Refinance							
	Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor		Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor		Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race and ethnicity												
American Indian or Alaska Native	3,576	16.9	15.6	11.1	3,166	19.7	21.5	14.1	828	34.8	25.2	31.2
Asian	33,592	7.4	8.5	8.6	18,809	7.0	10.9	11.3	3,785	37.5	32.1	30.4
Black or African American	46,260	38.6	24.2	14.7	46,900	33.5	27.7	16.7	11,099	46.8	43.2	33.6
Native Hawaiian or other Pacific Islander	3,407	15.8	14.6	11.2	2,666	14.6	17.3	13.0	731	40.8	33.5	29.5
Two or more minority races	424	25.7	23.5	11.4	424	24.8	27.5	15.9	97	38.1	19.9	55.4
Joint	8,971	7.1	11.0	9.9	5,421	8.2	13.5	11.3	1,466	27.2	31.8	28.6
Race missing	76,434	11.5	14.1	10.6	64,341	15.5	22.2	13.5	13,877	41.1	40.0	32.0
Hispanic white	40,643	16.8	15.4	10.9	28,011	17.9	18.1	13.3	7,522	49.4	40.1	34.5
Non-Hispanic white	502,030	9.4	9.4	9.4	330,979	10.9	10.9	10.9	81,408	30.2	30.2	30.2
Sex												
One male	219,700	17.7	17.7	17.7	161,011	17.9	17.9	17.9	39,283	42.5	42.5	42.5
One female	111,338	17.4	16.9	16.9	85,278	19.8	19.8	18.4	20,416	43.0	42.5	43.1
Two males	19,437	8.3	8.3	8.3	9,083	7.9	7.9	7.9	2,526	27.2	27.2	27.2
Two females	6,428	7.6	6.8	7.9	3,307	12.0	9.3	10.2	984	35.6	33.5	32.0

NOTE: See note to table 10.A.

1. "Other" consists of government-backed loans of all types, junior liens, home-improvement loans, and unsecured loans.

consistent patterns across all types of lending. Conventional home-purchase lending and conventional refinance lending include most of the borrowers covered by the HMDA data, and consequently those loan types are the main focus of the discussion of higher-priced lending that follows. In general, unadjusted differences in the incidence of higher-priced lending between non-Hispanic whites, on the one hand, and blacks, on the other, are large, but these differences are substantially reduced after controlling for borrower-related factors plus lender.

Most of the reduction in the difference in the incidence of higher-priced lending across groups comes from adding the control for lender to the control for borrower-related factors. For conventional first-lien home-purchase loans, the mean unadjusted incidence of higher-priced lending was 32.4 percent for blacks and 8.7 percent for non-Hispanic whites, a difference of 23.7 percentage points. Borrower-related factors account for about one-fourth of the difference. Adding to this adjustment the control for lender reduces the remaining gap markedly, to 7 percentage points. For conventional first-lien refinancings, the unadjusted difference between blacks and non-Hispanic whites is 21.7 percentage points; this difference is reduced to 4.7 percentage points after controlling borrower-related factors plus lender, and about two-thirds of that reduction comes from the addition of the control for lender. Similar patterns for differences between black and non-Hispanic white borrowers are found for the junior-lien products.

The picture for Asians differs greatly from that for blacks. Asians have a lower unadjusted mean incidence of higher-priced lending for first-lien conventional home-purchase and refinance loans than do non-Hispanic whites. The gap is narrowed by controlling for borrower-related factors plus lender, although the incidence of higher-priced lending remains lower for Asians than for non-Hispanic whites. Hispanic whites show a pattern similar to that of blacks, but with smaller differences relative to non-Hispanic whites. For first-lien conventional loan products, the adjusted differences for Hispanic whites are less than one-half those for blacks; for conventional home-purchase junior liens, the differences for Hispanic whites are close to those for blacks.

The foregoing analysis indicates that the information in the HMDA data—that is, adjusting the HMDA data for borrower-related factors plus lender—is insufficient to account fully for racial or ethnic differences in the incidence of higher-priced lending; significant differences remain unexplained. Explaining

11. Unadjusted and adjusted incidence of higher-priced lending for conventional, first-lien loans on site-built, owner-occupied, one- to four-family homes, by selected race and ethnicity for selected characteristics of borrower, property, and lender, 2004

Percent except as noted

Selected characteristic, by race and ethnicity of borrower	Home purchase				Refinance			
	Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor		Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
INCOME OF BORROWER								
Lower								
Black or African American	87,841	39.2	35.2	21.7	161,762	42.1	39.6	25.9
Hispanic white	83,642	23.6	21.2	16.3	120,253	22.5	24.2	20.4
Non-Hispanic white	637,019	12.9	12.9	12.9	961,571	19.3	19.3	19.3
Middle								
Black or African American	66,997	33.9	31.1	18.1	112,007	34.8	33.8	20.1
Hispanic white	84,988	22.1	19.5	13.3	118,699	20.8	21.5	16.6
Non-Hispanic white	648,853	9.9	9.9	9.9	989,420	14.9	14.9	14.9
Higher								
Black or African American	70,247	23.9	19.8	10.9	104,662	26.0	22.8	12.7
Hispanic white	118,728	17.4	12.5	7.8	123,101	16.9	14.6	10.4
Non-Hispanic white	1,099,544	5.8	5.8	5.8	1,539,336	9.0	9.0	9.0
INCOME OF CENSUS TRACT								
Lower								
Black or African American	69,713	40.9	34.7	22.7	141,851	42.5	37.5	27.4
Hispanic white	85,791	26.0	25.0	18.8	126,577	23.3	25.6	22.9
Non-Hispanic white	254,231	15.0	15.0	15.0	383,904	21.7	21.7	21.7
Middle								
Black or African American	107,177	32.0	29.0	17.8	175,784	33.4	31.2	19.5
Hispanic white	137,291	20.5	17.7	13.0	167,456	19.2	19.6	16.0
Non-Hispanic white	1,229,899	10.3	10.3	10.3	1,936,163	15.0	15.0	15.0
Higher								
Black or African American	55,401	22.7	18.2	9.8	73,571	22.2	18.1	10.2
Hispanic white	78,431	13.6	10.5	7.0	84,151	13.6	11.2	8.2
Non-Hispanic white	984,982	5.2	5.2	5.2	1,370,653	7.4	7.4	7.4
CRA ASSESSMENT AREA								
Property not in assessment area								
Black or African American	78,331	31.9	25.5	17.7	121,253	28.3	23.3	14.8
Hispanic white	100,290	16.7	14.3	11.1	105,634	13.6	12.6	10.3
Non-Hispanic white	1,010,824	7.4	7.4	7.4	1,419,662	8.8	8.8	8.8
Property in assessment area								
Black or African American	43,680	12.7	9.9	6.6	79,403	13.3	10.9	6.4
Hispanic white	68,101	9.6	5.6	4.0	113,714	7.7	5.3	4.6
Non-Hispanic white	620,870	2.8	2.8	2.8	964,166	3.9	3.9	3.9

Notes appear at end of table.

the remaining differences is likely to require more details about such factors as the specific credit circumstances of each borrower, the specific loan products they seek, and the business practices of the institutions they approach for credit.

Understanding the patterns within the HMDA data is also likely to require more information. Two somewhat offsetting patterns are shown in the data. On the one hand, minority borrowers (except for Asians) tend to disproportionately use government-backed products, which show a much lower incidence of higher-priced loans. The implication is that the difference in the incidence of higher-priced lending between minorities and non-Hispanic whites is lower for the combined loan product, conventional and government-backed loans, than for each product separately. On the other hand, for a given loan type, whether government-backed or conventional, non-Asian minorities tend to disproportionately borrow from lenders that have higher incidences of higher-priced loans, a tendency on the part of minority borrowers that accounts for much of the aggregate difference in outcomes between them and non-Hispanic white borrowers.

The disproportionate borrowing by non-Asian minorities from higher-priced lenders could occur because of often benign factors such as a "segmented" marketplace in which different lenders offer different products and borrower groups self-select the product-lender combination that best matches their credit or other circumstances. Such a marketplace does not necessarily raise public-policy concerns regarding fair lending: For example, compared with non-Hispanic whites, minority groups on average

11.—Continued

Percent except as noted

Selected characteristic, by race and ethnicity of borrower	Home purchase				Refinance			
	Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor		Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
DISPOSITION								
Sold to GSE[1]								
Black or African American	43,683	9.0	6.7	5.2	71,439	1.1	1.0	.7
Hispanic white	67,768	3.9	3.2	2.9	87,929	.4	.4	.4
Non-Hispanic white	808,454	1.6	1.6	1.6	1,200,878	.4	.4	.4
Sold to others								
Black or African American	137,679	40.5	33.3	20.6	196,055	43.6	36.7	25.9
Hispanic white	160,188	26.3	24.0	17.5	179,549	27.3	27.9	22.1
Non-Hispanic white	1,065,255	13.8	13.8	13.8	1,427,539	20.0	20.0	20.0
Retained								
Black or African American	51,326	30.7	25.6	13.2	124,030	39.6	34.3	21.0
Hispanic white	73,959	22.2	17.5	10.5	111,348	21.4	21.7	18.5
Non-Hispanic white	602,546	9.3	9.3	9.3	1,069,892	17.4	17.4	17.4
TYPE OF LENDER, BY PERCENTAGE OF LENDER'S LOANS TO NON-HISPANIC WHITES THAT ARE HIGHER PRICED								
Less than 10								
Black or African American	121,500	10.6	8.5	8.4	171,423	6.6	5.1	4.3
Hispanic white	182,503	5.7	4.8	4.5	212,021	2.6	2.5	2.3
Non-Hispanic white	1,993,900	2.3	2.3	2.3	2,589,887	1.8	1.8	1.8
10–49								
Black or African American	69,894	44.3	40.9	35.9	139,090	46.1	42.2	36.9
Hispanic white	78,695	31.0	33.0	31.2	111,898	32.1	32.9	30.6
Non-Hispanic white	366,709	25.3	25.3	25.3	763,119	27.3	27.3	27.3
50 or more								
Black or African American	41,189	76.6	75.6	74.8	80,743	74.4	71.8	71.7
Hispanic white	40,393	65.4	70.7	71.6	54,639	58.2	65.8	67.1
Non-Hispanic white	115,646	66.5	66.5	66.5	345,303	64.2	64.2	64.2

NOTE: For discussion of CRA assessment areas and the identification of higher-priced lenders, see text note 47. See also general note to table 10.A.

1. Government-sponsored enterprise; virtually all were to Fannie Mae and Freddie Mac.

may seek loans with higher loan-to-value ratios (perhaps because on average they may have less savings to meet down-payment and closing cost requirements), which are typically higher priced and which are the specialty of certain lenders. This explanation could account for differences in lender choice, but demonstrating it requires loan-specific information—such as loan-to-value ratios—as well as other information that is not in the HMDA data.

However, a situation that might suggest an inadequately functioning marketplace—and that could trigger fair lending concerns—would occur if minority borrowers are incurring prices on their loans that are higher than is warranted by their credit characteristics. Such a problem could arise in one or both of the following circumstances: (1) neighborhoods with high proportions of minority residents may be less well served by lenders offering prime products, a circumstance that would make obtaining lower-priced loans more difficult for well-qualified minorities, or (2) some minority borrowers may be steered to lenders who typically charge higher prices than the credit characteristics of these borrowers warrant. The data reported under HMDA are insufficient to tell us whether either explanation (or any other) is correct, nor do they tell us why minorities disproportionately use government-backed products.

Incidence of Higher-Priced Lending for Selected Subgroups

Although, for reasons discussed above, we cannot definitively explain the racial and ethnic pricing differences that remain after adjusting for borrower-related factors plus lender or the reasons that minorities may disproportionately obtain credit from higher-priced lenders, some additional insights may be gained by analyzing subgroups of lenders and borrowers (table 11). We present data only for blacks and Hispanic whites because they are the two minority groups whose outcomes differ most from those of non-Hispanic whites in the incidence of higher-priced lending. We also restrict the comparison to the two loan-products that account for the largest number of loans—conventional home-purchase loans and refinancings. We analyze these two minority groups and the two loan products with regard to five factors: (1) the borrower's relative income; (2) the relative income of the census tract in which the property related to the loan is located; (3) the location of the property relative to the lender's assessment area as defined under the Community Reinvestment Act of 1977 (CRA); (4) the disposition of the loan—that is, whether the loan was retained or sold and, if it was sold, to whom; and (5) the proportion of the lender's loans that are higher priced (less than 10 percent, 10–49 percent, or 50 percent or more—the last proportion being taken to indicate that the lender specializes in higher-priced lending).[47]

Results for borrowers grouped by their relative income and their census tract income classification offer little evidence that unexplained racial differences in pricing or lender choice vary by income. Although the incidence of higher-priced loans is higher for lower-income borrowers and those who live in lower-income census tracts, the same is true for all three racial groups. Thus, although unexplained price differences are somewhat lower for higher-income borrowers, price patterns are generally similar to those of the overall decompositions.

The decompositions for CRA assessment area and loan sales provide evidence on whether the channel through which a loan was obtained and the subsequent disposition of the loan affect racial or ethnic groups differently. Although the overall incidence of higher-priced loans reported in the 2004 HMDA data is much lower for loans sold to the GSEs, the data offer scant evidence that the disposition (sold or retained) is related to unexplained racial differences.

However, whether the loan was originated by an institution in its CRA assessment area does matter. Differences across groups for lending within an assessment area are about one-third of those for lending outside the assessment area. Moreover, for all racial and ethnic groups, lending within an assessment area exhibits a much lower incidence of higher-priced lending.

One possible explanation for the assessment-area effect may be that the channel through which loans are originated matters. Loans extended to borrowers outside an institution's assessment area may be more likely to have come through mortgage brokers, who may price differently or who operate in areas with different market conditions than do institutions that originate loans directly. Although this pattern may suggest that brokers charge higher prices, particularly to minorities, it is not necessarily evidence of unfair treatment or that the existence of the broker channel adversely affects minorities. It may indicate that brokers serve markets or individuals who are more costly to serve, or whose credit profiles are weaker, and price accordingly. If so, then were it not for broker activity, some of these borrowers might not be served at all or might pay higher prices. Determining whether brokers treat minority borrowers fairly is a complex undertaking and requires information unavailable in the HMDA data. The same can be said about lenders that originate loans through different channels.

Finally, although the aggregate lending patterns of specialists in higher-priced lending exhibit unexplained racial or ethnic differences, so do the aggregate patterns of other lenders to approximately the same degree. And for the higher-priced specialists with the highest incidence of higher-priced lending, differences across racial and ethnic groups are, in some instances, lower than for other lenders. Regarding the racial and ethnic differences in the lending patterns that do exist among higher-priced lending specialists, the analysis shows that income, loan amount, and other HMDA factors appear to explain little of those differences.

Differences in Mean Price Spreads across Racial and Ethnic Groups

Patterns across racial and ethnic groups for the mean spreads paid by those with higher-priced loans are quite different from patterns across such groups for the incidence of higher-priced lending (table 12). For the loan products with the largest numbers of borrowers, the unadjusted mean spreads are lower for all minority groups except blacks than they are for non-Hispanic whites. Typically, Asian borrowers have the

47. Larger depository institutions covered by the CRA (generally those with assets of $250 million or more) are required to identify the census tracts in their CRA assessment areas as of the end of each calendar year. That information was used to determine which loans in the HMDA data were for properties within the lenders' CRA assessment areas. When lenders were part of a bank holding company, the combined assessment areas of all banks in the holding company were used for the analysis. For a definition of "assessment area," see note 4 to box "Reasons for Loan Price Variation."

The identification of specialists in high-priced lending was based solely on the incidence of higher-priced loans for non-Hispanic whites. This restriction prevented the identification from being affected by differences between the pricing outcomes of blacks and Hispanics, on the one hand, and those of non-Hispanic whites, on the other.

12. Unadjusted and adjusted mean APR spreads for higher-priced loans on one- to four-family homes, by type of loan and by race and ethnicity and sex of borrower, 2004

A. Home purchase, owner-occupied site-built home

Percent except as noted

Race and ethnicity and sex	Conventional								Government backed, first lien			
	First lien				Junior lien							
	Number of higher-priced loans	Unadjusted mean spread	Adjusted mean spread, by adjustment factor		Number of higher-priced loans	Unadjusted mean spread	Adjusted mean spread, by adjustment factor		Number of higher-priced loans	Unadjusted mean spread	Adjusted mean spread, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race and ethnicity												
American Indian or Alaska Native	5,101	4.0	4.1	4.1	3,828	6.3	6.4	6.4	235	4.2	4.0	4.1
Asian	11,771	3.8	4.0	4.0	11,164	6.2	6.4	6.4	137	4.3	4.2	4.2
Black or African American	75,427	4.2	4.2	4.2	38,657	6.6	6.5	6.5	911	4.1	4.0	4.2
Native Hawaiian or other Pacific Islander	3,186	4.0	4.1	4.1	3,070	6.3	6.5	6.5	55	4.3	4.3	4.5
Two or more minority races	598	4.1	4.3	4.1	302	6.4	6.5	6.5	82	3.9	3.6	4.1
Joint	3,242	4.0	4.1	4.1	2,662	6.4	6.5	6.5	114	4.2	4.1	4.2
Race missing	52,094	4.1	4.1	4.1	39,130	6.4	6.5	6.5	515	4.2	4.2	4.1
Hispanic white	61,248	3.9	4.0	4.1	50,817	6.3	6.4	6.4	973	4.7	4.2	4.2
Non-Hispanic white	216,409	4.1	4.1	4.1	119,879	6.4	6.4	6.4	3,214	4.1	4.1	4.1
Sex												
One male	173,166	4.0	4.0	4.0	109,257	6.4	6.4	6.4	1,924	4.2	4.2	4.2
One female	130,250	4.1	4.0	4.0	77,785	6.4	6.4	6.4	1,555	4.2	4.3	4.3
Two males	3,632	4.1	4.1	4.1	2,711	6.3	6.3	6.3	126	4.1	4.1	4.1
Two females	3,246	4.1	4.0	4.1	2,261	6.4	6.3	6.3	83	4.0	3.8	3.9

NOTE: For definition of APR spread, see table 7, note 1. See also note to table 10.A.

12.—Continued

B. Refinance, owner-occupied site-built home

Percent except as noted

Race and ethnicity and sex	Conventional								Government backed, first lien			
	First lien				Junior lien							
	Number of higher-priced loans	Unadjusted mean spread	Adjusted mean spread, by adjustment factor		Number of higher-priced loans	Unadjusted mean spread	Adjusted mean spread, by adjustment factor		Number of higher-priced loans	Unadjusted mean spread	Adjusted mean spread, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race and ethnicity												
American Indian or Alaska Native	8,977	4.1	4.2	4.1	800	7.2	6.8	7.1	98	4.1	4.0	3.8
Asian	12,250	3.9	4.1	4.1	2,675	6.5	6.9	7.1	91	4.4	3.7	3.8
Black or African American	135,467	4.3	4.3	4.3	10,974	7.5	7.2	7.2	456	3.7	3.8	3.8
Native Hawaiian or other Pacific Islander	5,153	4.1	4.2	4.2	811	6.8	7.1	7.1	94	5.1	3.7	3.6
Two or more minority races	1,072	4.0	4.1	4.1	76	6.8	7.0	7.3	65	3.9	3.9	3.9
Joint	6,973	4.1	4.2	4.2	1,308	7.0	7.1	7.1	56	3.9	3.8	3.6
Race missing	159,741	4.2	4.2	4.2	26,915	7.6	7.3	7.2	603	3.8	3.9	3.9
Hispanic white	73,181	4.0	4.1	4.2	7,255	6.9	7.0	7.1	408	4.4	4.0	3.9
Non-Hispanic white	476,034	4.2	4.2	4.2	68,211	7.1	7.1	7.1	2,002	3.8	3.8	3.8
Sex												
One male	252,618	4.1	4.1	4.1	30,905	7.1	7.1	7.1	895	3.9	3.9	3.9
One female	232,583	4.2	4.2	4.1	21,919	7.1	7.1	7.1	823	3.9	3.9	3.8
Two males	4,833	4.2	4.2	4.2	714	7.0	7.0	7.0	68	4.1	4.1	4.1
Two females	7,479	4.3	4.2	4.2	914	7.2	6.9	7.0	55	3.9	4.0	4.3

NOTE: See note to table 12.A.

12. Unadjusted and adjusted mean APR spreads for higher-priced loans on one- to four-family homes, by type of loan and by race and ethnicity and sex of borrower, 2004—Continued

C. Home improvement, conventional loan, owner-occupied site-built home

Percent except as noted

Race and ethnicity and sex	First lien: Number of higher-priced loans	First lien: Unadjusted mean spread	First lien: Adjusted mean spread, by adjustment factor: Borrower-related	First lien: Adjusted mean spread, by adjustment factor: Borrower-related plus lender	Junior lien: Number of higher-priced loans	Junior lien: Unadjusted mean spread	Junior lien: Adjusted mean spread, by adjustment factor: Borrower-related	Junior lien: Adjusted mean spread, by adjustment factor: Borrower-related plus lender
Race and ethnicity								
American Indian or Alaska Native	883	4.5	4.6	4.4	493	7.7	7.6	7.8
Asian	752	3.9	4.3	4.4	875	7.5	7.8	7.9
Black or African American	11,770	4.6	4.6	4.5	7,389	8.4	8.3	8.1
Native Hawaiian or other Pacific Islander	397	4.2	4.4	4.5	463	7.9	8.0	7.7
Two or more minority races	76	4.4	4.3	4.3	32	7.7	7.9	6.6
Joint	605	4.4	4.5	4.4	800	7.8	8.1	8.2
Race missing	7,920	4.5	4.6	4.5	10,633	7.9	8.2	8.0
Hispanic white	7,572	4.3	4.3	4.4	3,255	7.7	8.1	8.0
Non-Hispanic white	43,209	4.4	4.4	4.4	40,410	7.9	7.9	7.9
Sex								
One male	19,340	4.4	4.4	4.4	17,425	8.2	8.2	8.2
One female	20,104	4.4	4.4	4.4	12,873	8.1	8.1	8.1
Two males	438	4.3	4.3	4.3	457	7.9	7.9	7.9
Two females	729	4.6	4.4	4.1	532	8.0	8.0	7.9

NOTE: See note to table 12.A.

12.—Continued

D. Manufactured housing, conventional loan, first lien, owner-occupied home

Percent except as noted

Race and ethnicity and sex	Home purchase: Number of higher-priced loans	Home purchase: Unadjusted mean spread	Home purchase: Adjusted mean spread, by adjustment factor: Borrower-related	Home purchase: Adjusted mean spread, by adjustment factor: Borrower-related plus lender	Refinance: Number of higher-priced loans	Refinance: Unadjusted mean spread	Refinance: Adjusted mean spread, by adjustment factor: Borrower-related	Refinance: Adjusted mean spread, by adjustment factor: Borrower-related plus lender
Race and ethnicity								
American Indian or Alaska Native	796	6.0	6.0	5.9	266	5.4	5.3	4.9
Asian	337	5.4	5.5	5.5	90	4.9	5.7	5.7
Black or African American	4,060	6.0	5.9	5.9	1,567	5.4	5.3	5.3
Native Hawaiian or other Pacific Islander	223	5.8	6.1	6.6	49	4.8	5.0	5.1
Two or more minority races	10	5.6	6.8	5.3	11	3.9	4.0	3.2
Joint	535	5.6	5.8	5.7	234	4.9	5.1	5.1
Race missing	3,738	5.9	5.9	5.7	4,379	4.8	4.7	4.9
Hispanic white	3,777	6.0	6.1	6.0	1,051	5.0	5.0	5.1
Non-Hispanic white	41,725	5.6	5.6	5.6	26,104	5.0	5.0	5.0
Sex								
One male	17,145	5.8	5.8	5.8	8,350	5.0	5.0	5.0
One female	13,413	5.7	5.7	5.7	6,363	5.1	5.0	5.0
Two males	1,019	5.9	5.9	5.9	315	5.4	5.4	5.4
Two females	1,005	5.7	5.6	6.0	294	5.4	5.3	5.7

NOTE: See note to table 12.A.

lowest mean spreads. Furthermore, adjusting for differences in loan amounts, incomes, and other HMDA factors plus lender either does little to the average spreads or changes them in different directions for different groups. One consistent difference that persists after adjustment is the difference between blacks and non-Hispanic whites. After adjustment, the gap in the mean spreads between these groups for the most common loan products is between 0.10 and 0.15 percentage points.

Differences in Pricing by Sex of Borrower

As with denial rates, there is little evidence of systematic differences in pricing when borrowers are

12. Unadjusted and adjusted mean APR spreads for higher-priced loans on one- to four-family homes, by type of loan and by race and ethnicity and sex of borrower, 2004—Continued

E. Nonowner-occupied site-built home

Percent except as noted

Race and ethnicity and sex	Conventional, first lien								Other[1]			
	Home purchase				Refinance							
	Number of higher-priced loans	Unadjusted mean spread	Adjusted mean spread, by adjustment factor		Number of higher-priced loans	Unadjusted mean spread	Adjusted mean spread, by adjustment factor		Number of higher-priced loans	Unadjusted mean spread	Adjusted mean spread, by adjustment factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race and ethnicity												
American Indian or Alaska Native ...	603	3.9	4.1	4.1	623	4.1	4.3	4.3	288	6.5	6.2	6.3
Asian ...	2,476	3.9	3.9	4.0	1,319	3.9	4.0	4.1	1,419	6.5	6.2	6.1
Black or African American ...	17,841	4.2	4.1	4.1	15,731	4.3	4.3	4.3	5,197	6.5	6.3	6.2
Native Hawaiian or other Pacific Islander ...	539	4.0	4.0	3.9	388	4.2	4.4	4.8	298	6.7	6.3	6.2
Two or more minority races ...	109	4.1	4.4	4.1	105	3.9	3.9	3.7	37	6.7	6.2	6.7
Joint ...	637	4.0	4.0	3.9	444	4.2	4.2	4.0	399	6.5	6.4	6.0
Race missing ...	8,816	4.1	4.1	4.1	9,995	4.2	4.3	4.2	5,698	6.7	6.3	6.3
Hispanic white ...	6,831	3.9	4.0	4.0	5,002	4.1	4.2	4.2	3,718	6.3	6.2	6.1
Non-Hispanic white ...	47,211	4.0	4.0	4.0	35,920	4.1	4.1	4.1	24,622	6.1	6.1	6.1
Sex												
One male ...	38,917	4.0	4.0	4.0	28,824	4.2	4.2	4.2	16,711	6.4	6.4	6.4
One female ...	19,349	4.0	4.0	4.0	16,904	4.2	4.2	4.2	8,774	6.3	6.3	6.4
Two males ...	1,605	4.1	4.1	4.1	718	4.1	4.1	4.1	688	6.3	6.3	6.3
Two females ...	489	4.1	4.2	5.4	396	4.4	4.1	4.0	350	6.5	6.2	6.4

NOTE: See note to table 12.A.

1. See table 10.E., note 1.

distinguished by sex (table 10). The differences in the unadjusted incidence of higher-priced lending are almost always small across loan products and generally narrow when HMDA factors plus lender are taken into account. Of the nineteen loan product comparisons with evidence of some pricing difference by sex, males have a higher incidence of higher-priced loans in nine cases, while females do in ten cases. Nearly identical patterns are exhibited for mean spreads, and there is no evidence that one sex consistently pays more than the other (table 12).

The Role of Factors Not Included in HMDA

An important limitation of the decompositions reported earlier is that controls were possible only for borrower-related factors included in the HMDA data plus lender when assessing differences in loan pricing among racial, ethnic, or other groups. As noted, many factors relevant to underwriting and pricing are not included in the HMDA data and thus cannot be accounted for in analyses that rely exclusively on the data. To provide some insight into how important controlling for these other factors might be in accounting for pricing differences across borrower groups, we collaborated with Georgetown University's Credit Research Center (CRC) to perform additional analyses using a CRC database. The CRC data consist of both HMDA data and a wide range of other loan-level factors not in the HMDA data that may relate to credit underwriting and pricing.

The CRC data, which were provided by eight lenders that specialize in subprime lending, are equivalent to the 2004 HMDA filings of those lenders (for the loans they originated) plus non-HMDA information on many other characteristics of the loans and borrowers.[48] The non-HMDA information consists of credit history scores (in this instance, FICO scores), loan-to-value ratios for first-lien loans, the appraised value of property, and information on whether the interest rate on the loan was adjustable or fixed, whether underwriting for the loan waived certain certifications by the borrower (that is, whether the loan was a "low documentation" product), whether the loan carried a prepayment penalty, and whether the loan was originated through a broker. Unlike the HMDA data, the CRC data are not disaggregated

48. The eight subprime mortgage lenders are subsidiaries of large financial institutions. The 2004 data from these lenders consist of about 626,000 loans that they originated; more than 60 percent of the loans in that group are higher-priced. The data from these subprime lenders have been used in various research initiatives and public policy deliberations.

13. Loan pricing by eight subprime specialists, conventional first-lien loans on owner-occupied one- to four-family homes, by type of loan and by selected race and ethnicity of borrower, 2004

A. Unadjusted and adjusted incidence of higher-priced lending

Percent except as noted

Race and ethnicity	Home purchase				Refinance			
	Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor		Number of loans	Unadjusted incidence	Adjusted incidence, by adjustment factor	
			Borrower-related	Borrower-related plus non-HMDA credit factors			Borrower-related	Borrower-related plus non-HMDA credit factors
Black or African American	6,369	85.8	84.4	83.9	37,354	82.9	81.9	80.7
Hispanic white	6,110	72.6	83.2	83.1	12,800	71.7	78.8	80.9
Non-Hispanic white	30,224	82.9	82.9	82.9	135,667	80.7	80.7	80.7

NOTE: Includes transition-period loans (those for which the application was submitted before 2004). For details on higher-priced lending, the subprime lenders, and the adjustment factors, see text and text note 49. For method of allocation into racial and ethnic categories and definitions of categories, see general note to table 6 and text note 35.

SOURCE: Credit Research Center, Georgetown University.

13.—Continued

B. Unadjusted and adjusted mean APR spreads for higher-priced loans

Percentage points except as noted

Race and ethnicity	Home purchase				Refinance			
	Number of higher-priced loans	Unadjusted spread	Adjusted spread, by adjustment factor		Number of higher-priced loans	Unadjusted spread	Adjusted spread, by adjustment factor	
			Borrower-related	Borrower-related plus non-HMDA credit factors			Borrower-related	Borrower-related plus non-HMDA credit factors
Black or African American	5,463	5.1	5.1	5.0	30,959	5.1	5.1	5.0
Hispanic white	4,437	4.7	4.9	4.9	9,183	4.7	4.8	4.9
Non-Hispanic white	25,053	4.9	4.9	4.9	109,524	5.0	5.0	5.0

NOTE: For definition of APR spread, see table 7, note 1. See also notes to table 13.A.

by individual lender; consequently, the analysis of the data could not control for lender. Together, the eight lenders accounted for about 22 percent of the higher-priced conventional first- or junior-lien home-purchase or refinance loans related to owner-occupied properties reported by HMDA filers for 2004.

The CRC analyzed pricing differences among the combined filings of the eight lenders in a manner identical to that used to prepare table 10—that is, using only data reported in HMDA—and then it extended the adjustment of differences by using the non-HMDA items in its database.[49] The number of loans in the CRC database was sufficient to allow meaningful analysis of conventional home-purchase and refinance loans on one- to four-family, site-built, owner-occupied homes for two minority groups—blacks and Hispanic whites—and for non-Hispanic whites.

For pricing outcomes for conventional first-lien home-purchase loans from the eight lenders, as adjusted for borrower-related factors (that is, using only the HMDA data), the incidence of higher-priced lending differs between black and non-Hispanic white borrowers by 1.5 percentage points and between Hispanic white and non-Hispanic white borrowers by 0.3 percentage point (table 13). When additional factors available only in the CRC data are taken into account, the differences between black and non-Hispanic white borrowers and between Hispanic white and non-Hispanic white borrowers falls about one-third. For refinance loans, the 1.2 percentage point gap between black and non-Hispanic white borrowers that remains after controlling for HMDA data items is removed when additional factors in the CRC database are controlled for. With respect to mean APR spreads for these loan products, gross

49. Only loans with complete information on all relevent factors were used in the analysis. Loans with missing information for any factor had a somewhat lower incidence of higher-priced lending than did the loans used in the analysis.

differences across racial or ethnic groups (that is, differences that exist in the raw, or unadjusted, data) are de minimus, a fact little changed by adding more controls from either the HMDA or the CRC data.

These results suggest that an analysis employing comprehensive information on specific loan products (for example, different types of adjustable-rate loans) from specific lenders—information unavailable in the HMDA or CRC data—would be required to draw firm conclusions about racial or ethnic differences in pricing.

Using the Expanded HMDA Data as a Screening Tool for Fair Lending Enforcement

Ensuring compliance with the nation's fair lending laws is one of the responsibilities of the federal and state agencies that regulate financial institutions. For some time, the Federal Reserve has been using a statistical analysis system that relies on the HMDA data to help assess fair lending compliance by high-volume mortgage lenders. The system identifies which supervised institutions and which loan products and geographic markets show meaningful differences in the denial rates of loan applications by the race, ethnicity, or sex of the borrower and thus warrant greater supervisory attention. The statistical analysis system measures differences in denial rates by comparing applications for a specific loan product filed by applicants who *differ* by race, ethnicity, or sex but who are *matched* on the basis of the limited set of items in the HMDA data. For example, the analysis can focus on denial rates of whites, Hispanic whites, and blacks by comparing the denials of applicants from each of those groups who sought the same loan product for about the same loan amount, are from the same metropolitan area, and have similar incomes, dates of application, and number of applicants in the transaction. The statistical analysis system also provides compliance examiners with a specific list of matched application files to review during the on-site part of an examination.

The expanded data provide opportunities to improve the statistical analysis system in two ways. First, some of the new data items can be used to refine the existing system of analyzing denial rates of loan applications by allowing more precise differentiation among loan products. Lien status and manufactured-home designation are prominent examples because both typically have significant roles in loan underwriting. Second, the new loan-pricing information provides opportunities to expand the statistical analysis beyond the disposition of applications to differences in loan pricing. The data can be reviewed for differences across groups in the incidence of higher-priced lending and in average spreads paid by borrowers with loans priced above the thresholds. The pricing data can also be reviewed for broader patterns that may indicate fair lending issues. For example, an institution's overall lending activity can be reviewed to identify geographic variations in pricing that may be associated with neighborhood racial or ethnic population characteristics. Each of these approaches will improve the fair lending analyses conducted by examiners.

Screening Using the 2004 HMDA Data

As of this writing, the Federal Reserve has modified its statistical analysis system for fair lending examinations to incorporate the new information available in the expanded HMDA data. To examine the potential utility of the enhanced system, we used a streamlined version of the system to conduct a review of the lending activity of the 8,853 institutions reporting 2004 HMDA data. The approach here and in the earlier sections of this article are related, but unlike the earlier sections, which involved an analysis of *aggregate* patterns that included a control for lender, this exercise uses the data to identify patterns in the lending of *individual* institutions.

The streamlined analysis starts by evaluating the statistical significance of differences across racial or ethnic lines in the unadjusted (or gross) incidence of denial rates, incidence of higher-priced lending, and average spreads paid by those with higher-priced loans for each lender separately. This procedure produces a series of lender–product combinations. For each lender–product combination, further analysis matches each minority applicant (or borrower) with nonminority applicants (or borrowers) on the basis of a variety of factors available in the HMDA data, including loan product, borrower income and loan amount, geographic market (for example, specific MSA), and number of applicants (one or more than one).

Adjusted differences are computed by comparing the denial rates, incidence of higher-priced lending, and average APR spreads of minorities with those of the nonminorities matched to them. This procedure is designed to remove the effects of these other factors from the calculations of the differences. The adjusted differences are an estimate of the expected differences in outcomes if a minority and a nonminority with the same income, loan amount, and number of applicants applied for the same loan product, at the same institution, in the same market.

The streamlined analysis used for purposes of this article relies on publicly available data as well as data filed under HMDA that are not subject to public disclosure (the dates an application was filed and acted on). A picture of the outcomes of the statistical analysis system with regard to the analysis of denial rates or pricing can be conveyed by reviewing the number of loan products for which the system indicates a statistically significant difference between blacks and Hispanics (as a group) and non-Hispanic whites in denial rates, in the incidence of higher-priced lending, or in the mean differences in pricing for those with higher-priced loans.[50] The focus of the streamlined analysis is on the eight owner-occupied product areas that account for the vast majority of owner-occupied loans in the 2004 HMDA data.[51]

In total, there are 13,260 lender–product combinations for the 8,853 HMDA reporting institutions that have at least one black or Hispanic borrower who can be matched (for comparison) to at least one non-Hispanic white borrower. Of the 13,260 lender–product combinations, 2,418 have at least fifty black or Hispanic borrowers and at least fifty non-Hispanic white borrowers, numbers that provide a more meaningful basis for comparison.

For the black and Hispanic group and the non-Hispanic white group, we have calculated, for the 13,260 lender–product combinations, the distribution across the categories of the statistical significance of three indicators—the difference in denial rates (table 14), in the incidence of higher-priced lending (table 15), and in the mean spreads for loans above the threshold (table 16). We differentiate between situations in which the black and Hispanic group has an indicator (denial rate, incidence of higher-priced loans, or mean spread) that is greater than that for the non-Hispanic white group and situations in which an indicator is lower for the black and Hispanic group than for the non-Hispanic white group. Differences are presented in two ways: (1) as the distribution of the statistical significance of the unadjusted rate or incidence and (2) for each unadjusted category, as the distribution of the statistical significance that remains *after* the statistical analysis system has been applied. The categories of statistical significance are, from highest to lowest level of significance, 1 percent, 5 percent, 10 percent, and not statistically significant.

Denial Rates

Of the 13,260 lender–product combinations, 3,075, or 23 percent, are those in which the minority group has an unadjusted denial rate that is different from that of the non-Hispanic white group by a statistically significant amount. In almost all of these cases, the black and Hispanic denial rate is higher, although the reverse holds in 4 percent of the cases. Eleven percent of the lender–product combinations show a statistically significant difference in denial rates after the matching procedure is employed (6 percent at the 1 percent significance level), and only 2 percent of the 11 percent show a lower denial rate for blacks and Hispanics.

Incidence of Higher-Priced Loans

Of the 13,260 lender–product combinations, 1,148, or 9 percent, have a statistically significant difference between the minority and nonminority groups in the unadjusted incidence of higher-priced lending. Most of the significant differences show a higher incidence for the black and Hispanic group, although about 8 percent show a lower incidence. Employing the matching process to control for differences in income, loan amount, and other HMDA factors reduces the number of statistically significant differences by more than one-half. Of the lender–product combinations that are statistically significant at the 1 percent level when unadjusted differences are evaluated, fewer than one-half (2 percent of the total number of lender–product combinations) are statistically significant at the 1 percent level after adjustment. A similar reduction occurs in the number of lenders with at least one loan product with a statistically significant minority–nonminority difference—the matching procedure reduces the number of lenders almost 50 percent (data not shown in tables).

50. Black and Hispanic borrowers were selected for this review because these groups generally showed the greatest differences from non-Hispanic whites. The groups were combined to have sufficient numbers for a meaningful statistical comparison. The "Hispanic" category used here includes all borrowers designated as Hispanic regardless of their race. This definition differs from that used in the previous section, which restricted the category of "Hispanics" to white Hispanics.

51. The eight products are virtually the same as those portrayed in table 9 with the modifications of (1) adding refinance and home-improvement first liens to the manufactured-housing product area and (2) combining the home-improvement and junior-lien refinancing products and expanding the category to include government-backed loans. Combining products for this exercise was done purely for the purpose of paralleling the way products are grouped in the Federal Reserve's statistical analysis system. The key product areas are identical to those used for tables 7 and 8. The product groupings do not affect the actual matching procedure because minority borrowers are always matched with non-Hispanic white borrowers with exactly the same product as defined using all the information available in HMDA. Transition-period applications were used in the denial-rate comparison but not in the comparisons for pricing.

14. Distribution of the difference between denial rates on applications by black and Hispanic applicants as a group and such denial rates for non-Hispanic white applicants, by lender–product combination, 2004

Percent except as noted

Type of unadjusted difference	Number of lender–product combinations before adjustment	Distribution of percentage of lender–product combinations after adjustment					
		Black and Hispanic denial rate is higher and difference is statistically significant, by degree of significance			Difference is not statistically significant	Non-Hispanic white denial rate is higher and difference is statistically significant at least at the 10 percent level	Total
		1 percent	5 percent	10 percent			
Black and Hispanic denial rate is higher and difference is statistically significant, by degree of significance							
1 percent	1,642	43.8	16.4	8.6	31.1	0	100
5 percent	758	4.1	12.4	9.5	74.0	0	100
10 percent	557	.7	5.7	8.8	84.7	0	100
Difference is not statistically significant	10,185	.3	48.0	1.0	98.1	.4	100
Non-Hispanic white denial rate is higher and difference is statistically significant, by degree of significance							
1 percent	48	2.1	2.1	0	45.8	50.0	100
5 percent	34	0	0	0	94.1	5.9	100
10 percent	36	0	0	0	80.6	19.4	100

NOTE: Includes transition-period applications (those submitted before 2004); for explanation, see text note 46. The adjustment factors and the racial and ethnic categories differ from those in tables 9 through 13. For explanation of adjustment factors and for method of allocation into racial and ethnic categories and definitions of categories, see text and text notes 50 and 51.

The effect of employing the statistical procedures is particularly dramatic for those products for which the black and Hispanic group shows an unadjusted incidence that is lower by a statistically significant amount. Only 7 percent of such cases remain statistically significant after the matching procedures are employed—and none are at the 1 percent significance level.

The reduction in the number of statistically significant differences results primarily from a reduction in the magnitude of the differences. For example, on average, the minority–nonminority difference in the incidence of higher-priced loans for those lender–product combinations in which the unadjusted difference is positive and statistically significant falls 4.5 percent, or about one-fourth, after matching.

Mean Pricing Spreads

The matching procedure yields a similar reduction in the number of lender–product combinations showing a statistically significant difference in the mean spreads for blacks and Hispanics versus those for non-Hispanic whites. Of the 13,260 lender–product combinations, 5 percent show a statistically significant minority–nonminority difference in the mean spread; about one-third of these show a lower spread for blacks and Hispanics. The number of statistically significant differences for lender–product combinations is reduced 60 percent after the matching procedure is employed, and about one-sixth of those show a lower spread for blacks and Hispanics. The number of lenders with a statistically significant difference in mean spread for at least one product also falls about 60 percent when adjustments are made.

Overall Patterns

A high degree of overlap exists among lenders with statistically significant adjusted differences between the minority and nonminority groups in denial rates, the incidence of higher-priced lending, and mean spreads. For example, 60 percent of the lenders with a difference in the adjusted mean spread that is statistically significant at the 1 percent level also have a statistically significant difference in the incidence of higher-priced lending for at least one product. Almost 80 percent of the lenders with an adjusted difference in the incidence of higher-priced lending that is statistically significant at the 1 percent level also have a statistically significant difference in the denial rates for at least one product. However, the presence of statistically significant differences in multiple outcome measures does not necessarily imply a more serious fair lending concern; it may simply reflect differences in the distribution of credit characteristics of the minority and nonminority populations served by the lender.

We emphasize that the Federal Reserve's statistical analysis system is only a screening tool. The HMDA

15. Distribution of the difference between incidence of higher-priced loans for black and Hispanic borrowers as a group and the incidence for non-Hispanic white borrowers, by lender–product combination, 2004

Percent except as noted

Type of unadjusted difference	Number of lender–product combinations before adjustment	Distribution of percentage of lender–product combinations after adjustment					
		Black and Hispanic incidence is higher and difference is statistically significant, by degree of significance			Difference is not statistically significant	Non-Hispanic white incidence is higher and difference is statistically significant at least at the 10 percent level	Total
		1 percent	5 percent	10 percent			
Black and Hispanic incidence is higher and difference is statistically significant, by degree of significance							
1 percent	532	43.0	15.4	7.5	34.0	0	100
5 percent	285	4.9	11.9	8.4	74.7	0	100
10 percent	241	1.2	4.6	9.1	85.1	0	100
Difference is not statistically significant	12,112	.1	.3	.4	99.0	.2	100
Non-Hispanic white incidence is higher and difference is statistically significant, by degree of significance							
1 percent	33	0	0	0	93.9	6.1	100
5 percent	26	0	0	0	96.2	3.8	100
10 percent	31	0	0	0	90.3	9.7	100

NOTE: Excludes transition-period loans (those for which the application was submitted before 2004). The adjustment factors and the racial and ethnic categories differ from those in tables 9 through 13. For explanation of adjustment factors and for method of allocation into racial and ethnic categories and definitions of categories, see text and text notes 50 and 51.

data alone, no matter how much they are manipulated, cannot be used to conclude whether a particular applicant was treated adversely on the basis of a prohibited factor regarding either the disposition of the application or the pricing of the loan. The data reveal little about an individual's financial circumstances and nothing about the condition or value of the property offered as collateral. Furthermore, the data reveal nothing about the underwriting standards used by a lender to assess the creditworthiness of an individual or to set loan price. Moreover, the data do not reveal how a lender's credit decisions relate to its overall business strategy. For example, the data do not account for the possibility that an institution's outreach efforts may attract a larger proportion of applicants with weaker credit profiles than do other institutions. Consequently, the data do not provide a final basis on which to draw conclusions regarding either the existence or the absence of fair lending violations.

The Use of Screening in the Enforcement Process

As implemented in the Federal Reserve's bank supervisory process, the statistical analysis system is used as a screening procedure to identify those institutions and their specific products that warrant closer review for fair lending concerns. Examiners familiar with the procedures and products of a given institution conduct the analysis and tailor it to the specific circumstances relevant to the institution in ways that reflect the institution's product offerings, its compliance risk-management systems, and the Federal Reserve's overall supervisory experience with the institution. Thus, the system used as a screening tool to analyze fair lending compliance for a particular institution is more complex than the streamlined analysis used in this article.

If an institution is targeted for more-intensive review, follow-up procedures can take one or more forms, including soliciting more information from the institution regarding its lending and underwriting procedures; gathering additional loan-level data, such as credit scores and loan-to-value ratios; performing detailed reviews of loan-file data; and conducting interviews with current or past bank personnel or borrowers. The follow-up can be integrated into the normal consumer examination cycle or can become a special review of fair lending compliance. The Federal Reserve has already applied the expanded statistical management system that includes the 2004 HMDA data to many of the institutions it supervises and has contacted those that exhibited relatively large pricing differences by race, ethnicity, or sex to learn more about their lending practices and to improve compliance oversight.

In addition, a review of the 2004 data by other agencies is under way. The Federal Reserve is sharing the screening procedures with other agencies so that, if they wish, they may integrate them into their

16. Distribution of the difference between mean APR spread of prices for loans above the threshold for black and Hispanic borrowers as a group and the mean spread for non-Hispanic white borrowers, by lender–product combination, 2004

Percent except as noted

Type of unadjusted difference	Number of lender–product combinations before adjustment	Distribution of percentage of lender–product combinations after adjustment					
		Black and Hispanic mean spread is higher and difference is statistically significant, by degree of significance			Difference is not statistically significant	Non-Hispanic white mean spread is higher and difference is statistically significant at least at the 10 percent level	Total
		1 percent	5 percent	10 percent			
Black and Hispanic mean spread is higher and difference is statistically significant, by degree of significance							
1 percent	172	28.5	18.6	6.4	40.7	0	100
5 percent	145	5.5	8.3	9.0	77.2	0	100
10 percent	127	4.7	6.3	7.1	81.9	0	100
Difference is not statistically significant	12,611	.1	.2	.3	99.3	.2	100
Non-Hispanic white mean spread is higher and difference is statistically significant, by degree of significance							
1 percent	75	1.3	1.3	0	84.0	13.3	100
5 percent	57	1.8	1.8	0	91.2	5.3	100
10 percent	73	0	0	1.4	97.3	1.4	100

NOTE: For definition of APR spread, see table 7, note 1. See also note to table 15.

supervisory programs. It is also responding to agency requests for additional, more detailed analysis of individual institutions that may be of concern to the agencies.

Follow-Up Procedures When Unexplained Differences Are Found

Experience with fair lending reviews indicates that widely used and largely noncontroversial, objective underwriting factors, such as credit scores and loan-to-value ratios, can often account for some or perhaps all of the pricing differences by race, ethnicity, and sex that are not explained by the HMDA data. Thus, generally the first step in a compliance examination in which pricing differences are at issue is to gather additional information on the factors that are used in underwriting and pricing but that are not included in the HMDA data. These factors can vary from institution to institution and from product to product. This step is generally taken after consultation with the lending institution and after a review of its underwriting policies and procedures. If accounting for these objective factors explains all racial or ethnic pricing differences remaining after controlling for HMDA-related factors, the examination will typically be closed unless other pricing issues remain. If, however, not all differences can be explained by controlling for these factors, further steps will typically be taken.

Ordinarily examiners will ask the institution to provide any evidence it has for the remaining differences. Supervisory experience shows that these differences frequently arise in institutions that employ discretionary pricing programs. Lenders who indicate to examiners that pricing differences are the result of either (1) the use of discretionary pricing to adjust for varied market factors, such as a competitor's pricing or individualized credit-risk or pricing-related factors not encompassed in a rate sheet, or (2) differences in the extent to which borrowers negotiate for the best available pricing on their loans should expect to be asked to provide credible evidence to support such explanations. Such evidence could include contemporaneous documentation from loan files, credible statements by participating loan personnel, and nondiscriminatory underwriting policies and procedures, such as internal audits of discretionary pricing patterns or training that focuses on a loan officer's responsibility to avoid setting pricing overages according to the perceived susceptibility of a given group to such pricing.

A particularly complex arena in which evidence of pricing differences may arise involves institutions having multiple loan origination channels, particularly channels that involve indirect loans (for example, those supplied by brokers or wholesalers). These channels can include multiple origination sources within a particular institution, including the institution's own loan officers along with those of its affiliates or subsidiaries, as well as indirect lending in which an institution originates loans referred to it by brokers or loan correspondents or purchases loans or pools of loans from unaffiliated, third-party originators. Such channels can encompass significant variety in the nature of the relationships between a given lender and the affiliates, brokers, or third-party originators that deliver loans to the lender. Indeed, such relationships may range across a spectrum from a prime-rate lender that also operates a subprime business in the same geographic market through a direct subsidiary to a regional bank in one section of the country that makes fully "arm's length" purchases of closed loans from an unaffiliated mortgage company operating solely in a different area.

From a fair lending perspective, a lender whose different channels of lending serve either borrowers or geographic areas that differ by race, ethnicity, or other prohibited characteristic is likely to be further reviewed. That will certainly be the case if these different channels produce loan pricing that also differs by race, ethnicity, or other prohibited characteristic.[52] A full review of fair lending compliance in multiple-channel situations will turn on complex factual analyses that are beyond the scope of this article. It is sufficient to note here that such analyses will cover the type and degree of pricing differences, the nature of the various channels, the lender's legal and business relationships with other entities (for example, affiliates, brokers, correspondents, or wholesalers), the lender's business or economic basis for operating through those channels, and the lender's explanation for the pricing differences.

The process of examining an institution for which pricing differences based on race, ethnicity, or sex are statistically significant and for which purely objective pricing factors, such as credit scores or loan-to-value ratios, cannot explain the differences, will include a review of loan files; discussions with management or loan personnel about possible reasons for the differences; a review of evidence put forth to support their explanations; interviews with customers, where necessary, regarding their experiences with the lender; and a careful vetting of an institution's policies and procedures and actual practices. If, after conducting an examination, there is no credible nondiscriminatory explanation for such differences, examiners will consider what supervisory action will be appropriate to address the issue. Moreover, a lender that cannot account for differences in pricing across groups may also be exposed to private rights of action under applicable fair lending laws and may face adverse effects on its reputation.

HOEPA Enforcement

For the agencies that evaluate compliance with HOEPA, the expanded HMDA data provide the first opportunity to readily identify which lenders extend home loans subject to that law and to measure the extent of their involvement in such lending. The new information also provides examiners with the data needed to efficiently select samples of loan files for review. The data can also be used to examine patterns of HOEPA-related lending across borrowers and neighborhoods, arrayed by their racial and ethnic profiles. Such analysis may reveal possible fair lending issues and may indicate communities where credit counseling activities could be targeted.

The Federal Reserve's statistical analysis system has been augmented to include several screens to aid HOEPA-related enforcement. These screens include the identification of HOEPA loans that are potentially unaffordable given a comparison of the applicant's income and the estimated monthly loan payments, the identification of loans with APR spreads that would appear to have triggered HOEPA coverage but were not reported as such, and the calculation of differences across racial and ethnic groups in the incidence of HOEPA lending.[53]

Summary and Conclusions

In 2002 the Federal Reserve Board amended its Regulation C to expand the types of information that lenders covered by HMDA must disclose to the public about their home-lending activities. The amendments are intended to improve the quality, consistency, and utility of the reported data and to keep the regulation in step with recent developments in home-loan markets. Data reported for 2004 are the first to reflect the changes in the reporting rules.

As anticipated, the expanded data provide new opportunities to assess home-lending activity. Newly available information on lien status and on whether a loan is for a site-built or manufactured home, as well as more uniformity in the information on home-improvement and refinancing loans, allows analyses that are more relevant to the current state of the

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52. The expanded HMDA data can be used to roughly differentiate the pricing of an institution's retail lending operations from the pricing of loans obtained from other channels by comparing the locations of borrowers with the locations of an institution's assessment areas. Loans outside an institution's assessment areas are more likely to have been initiated by third-party brokers or through other indirect channels.

53. The estimated monthly loan payment is derived from HMDA data using the reported loan amount and an estimated APR that assumes a fixed-rate thirty-year loan.

market. Most prominently, the new information provides the first publicly available loan-level information on loan pricing in the higher-priced segment of the home-loan market, a segment that was virtually nonexistent a decade or so ago but is now an important part of the overall home-loan market.

This article presents an analysis of the 2004 HMDA data. The analysis is conducted with the national HMDA database and is designed to provide an understanding of the overall patterns in the data rather than patterns that pertain to any individual market or lender. Much of the presentation focuses on the new items in the data. On balance, the analysis suggests that the information on lien status, manufactured homes, requests for pre-approval, and refined product definitions provides a much improved basis for describing lending activity and the disposition of applications for credit. Much of the initial public review of the data will, however, undoubtedly focus on loan pricing and particularly on the incidence of higher-priced lending and the comparison of prices paid by borrowers grouped by race, ethnicity, and sex.

The most likely initial public focus will be on the incidence of higher-priced lending among minorities (particularly blacks) and among non-Hispanic whites. In the raw data, the differences between these two groups in the incidence of higher-priced lending are generally more than 20 percentage points for various loan products. Our analysis shows, however, that more than two-thirds of the aggregate difference in the incidence of higher-priced lending between black and non-Hispanic white borrowers can be explained by differences in the groups' distributions of income, loan amounts, other borrower-related characteristics included in the HMDA data, and the choice of lender. Further, analysis at the level of individual lenders suggests that about 2 percent of the 8,853 lenders covered by HMDA exhibited a statistically significant difference in the incidence of higher-priced loans between black and Hispanic borrowers, on the one hand, and non-Hispanic white borrowers, on the other, after accounting for factors included in the HMDA data.

Thus, we see a sizable narrowing, at both the aggregate and institution levels, in the unexplained differences in the the incidence of higher-priced lending between minority and nonminority groups. This narrowing suggests that controlling for credit-related factors not found in the HMDA data, such as credit history scores and loan-to-value ratios, might further reduce unexplained racial or ethnic differences. Whether controlling for such additional factors will completely account for all remaining differences is unclear. In that regard, our collaborative study with the Credit Research Center on the lending activities of eight large subprime lenders, reported here, suggests that controlling for credit-related factors not included in the data can make a difference. Our analysis demonstrated that for some products the racial or ethnic differences were fully accounted for, whereas for other products, unexplained differences remained. Clearly, reaching convincing conclusions about whether institutions treat individuals differently on a prohibited basis requires institution-specific analysis.

Hence, our analysis strongly indicates that the raw data alone can lead to inaccurate conclusions, which in turn may be unfair to particular institutions and may lead to unnecessary restrictions on the availability of loans to less-creditworthy applicants. Risk-based pricing has greatly expanded the availability of home loans to borrowers who, because of weaknesses in their credit profiles, had previously been unable to qualify. It would be unfortunate if unwarranted accusations of illegal bias, stemming from improperly analyzed pricing differences, discouraged lenders from participating in this segment of the market.

The primary responsibility for ensuring compliance with fair lending laws falls on lenders. HMDA data may help lenders analyze and monitor their lending patterns. In addition, the regulatory agencies use the data for screening purposes to identify individual lenders that warrant heightened scrutiny regarding their loan-pricing activities. Where warranted, such reviews include gaining a fuller understanding of the institution's loan-pricing practices, analyzing loan-level data, and interviewing appropriate personnel to determine whether pricing differences identified through the HMDA screening process are explained by controlling for these additional data or by other objective factors.

To improve its fair lending examination capabilities, the Federal Reserve has modified its statistical analysis tool to use the new data to screen institutions for significant differences in lending outcomes across borrowers grouped by race, ethnicity, or sex. The Federal Reserve has already applied this expanded statistical management system to many of the institutions it supervises. It has also contacted those institutions that exhibit relatively large pricing differences to learn more about their lending practices and to improve its compliance oversight. Moreover, a review of the 2004 data by other agencies is under way, and the Federal Reserve is sharing the screening procedures with other agencies to facilitate their efforts.

Institution-specific evaluations, which are not possible with the HMDA data alone, are essential to determining whether loan-pricing differences in fact reflect discriminatory treatment of minority groups. However, the aggregate data can nonetheless provide valuable, broader insights into the experience of such groups in the home-loan market. For example, black and Hispanic borrowers taken together are much more likely than non-Hispanic white borrowers to obtain credit from institutions that report a higher incidence of higher-priced loans. On the one hand, this pattern may be benign and reflect a sorting of individuals into different market segments by their credit characteristics. On the other hand, it may be symptomatic of a more serious issue. Lenders that report a lower incidence of higher-priced products may be either less willing or less able to serve minority neighborhoods. More troubling, these patterns may stem, at least in part, from borrowers being steered to lenders or to loans that offer higher prices than the credit characteristics of these borrowers warrant. Reaching accurate determinations among these alternative possible outcomes is one goal of the supervision system. Moreover, we hope that future research using the new HMDA data will provide insights that will facilitate this process.

Appendix: Enhanced Data on Private Mortgage Insurance

Historically, mortgage lenders have required prospective borrowers to make a down payment of at least 20 percent of a home's value before they will extend a home-purchase loan. Such down payments are required because experience has shown that homeowners with little equity are substantially more likely to default on their mortgage. Private mortgage insurance (PMI) emerged as a response to both creditors' concerns about the elevated credit risk of lending backed by little equity in a home and the difficulties that some consumers encounter in accumulating sufficient savings to meet required down-payment and closing costs.

PMI protects a lender if a borrower defaults on a loan: It reduces a lender's credit risk by insuring against losses associated with default up to a contractually established percentage of the claim amount. The costs of the insurance are typically paid by the borrower through a somewhat higher interest rate on the loan.

In 1993 the Mortgage Insurance Companies of America (MICA) asked the Federal Financial Institutions Examination Council (FFIEC) to process data from PMI companies on applications for mortgage insurance and to produce disclosure statements for the public based on the data.[54] The PMI data largely mirror the types of information submitted by lenders covered by HMDA. However, because the PMI companies do not receive all the information about a prospective loan from the lenders seeking insurance coverage, some HMDA items are not included in the PMI data. In particular, loan-pricing information, requests for pre-approval, and HOEPA status are unavailable in the PMI data.

For 2004 the seven PMI companies that were writing private mortgage insurance submitted data to the FFIEC through MICA. In total, these companies acted on nearly 2 million applications for insurance: 1.3 million to insure mortgages for purchasing homes and about 650,000 to insure mortgages for refinancing existing mortgages. PMI companies approved more than 90 percent of the applications they received. Approval rates are high because lenders are familiar with the underwriting standards used by PMI companies and generally submit applications for insurance only if the applications are likely to be approved. □

54. Founded in 1973, MICA is the trade association for the PMI industry. The FFIEC prepares disclosure statements for each of the PMI companies. The statements are available at the corporate headquarters of each company and at a central depository in each MSA in which HMDA data are held. The central depository also holds aggregate data for all the PMI companies active in that MSA. In addition, the PMI data are available from the Federal Reserve Board through its HMDA Assistance Line (202-452-2016).

Report on the Condition of the U.S. Banking Industry: First Quarter, 2005

Assets and earnings of reporting bank holding companies continued to show healthy growth in the first quarter of 2005. Total assets reached $10.7 trillion, an increase of $355.0 billion from year-end 2004, while net income rose 13.8 percent, to $32.9 billion over the same period.

Securities and money market assets accounted for more than two-thirds of the total growth in assets. Most of this increase occurred at the fifty large bank holding companies (up $185.4 billion, an increase of 6.4 percent) as these large companies added to their holdings of mortgage-backed securities. These acquisitions were made in large part to investment portfolios as companies adjusted their interest rate risk exposures—responding to long-term interest rates that remained unexpectedly low through the quarter despite significant increases in short-term rates—although some firms expanded the securities and other assets they held in trading portfolios. In addition to the fifty large bank holding companies, insurance-oriented financial holding companies added significantly to their securities holdings (up $76.6 billion, an increase of 18.4 percent).

Loans grew somewhat less robustly, rising $71.6 billion, or 1.4 percent, as did unused commitments to lend (up $83.4 billion, or 1.7 percent). Residential mortgage loans, including home equity lines of credit, contributed significantly to this increase. Commercial loans also increased modestly, although some of that rise was due to one-time technical factors and reclassifications. Weakness was evident in credit card balances, attributable to a seasonal slowdown in new credit card spending and significantly accelerated repayments as households shifted some credit card balances to the rapidly growing home-equity loan category. Commercial real estate lending, especially for construction, again was a significant source of growth for the industry.

Nondeposit borrowings increased sharply, rising 6.8 percent ($209.2 billion), as strong asset growth outstripped deposit increases (up $95.7 billion, or 1.8 percent). Although long-term rates remained low, the increase in borrowings was mostly in short-maturity instruments. Regulatory capital ratios remained strong but tightened slightly during the quarter, as Tier 1 and leverage ratios declined 8 basis points and 11 basis points respectively.

Problem assets continued to decline from already-low levels, reaching 0.76 percent of loans and related assets. Net charge-offs also declined to 0.57 percent of average loans, and provisions for loan losses followed suit.

Fueled by asset growth and improved asset quality, net income rose to $32.9 billion, representing a return of 14.84 percent on average equity and 1.24 percent on average assets. Net interest margins narrowed significantly to 3.18 percent compared with 3.28 percent in the fourth quarter of 2004, a constriction that was attributable to the flattening of the yield curve and, to a lesser extent, competitive pressures on loan and deposit spreads. Non-interest income surged, supported by strong trading revenues and mortgage servicing income.

Assets of the securities broker–dealer subsidiaries of reporting bank holding companies jumped 29.8 percent (or $214.2 billion), to $933.4 billion. Nearly all of that increase was from a single large bank holding company (Citigroup), resulting from a clarification of reporting instructions rather than a change in the underlying volumes.

Tables start on page 396.

1. Financial characteristics of all reporting bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account or ratio[1, 2]	2000	2001	2002	2003	2004	2003		2004				2005
						Q3	Q4	Q1	Q2	Q3	Q4	Q1
Balance sheet												
Total assets	**6,745,836**	**7,486,951**	**7,990,945**	**8,880,547**	**10,339,734**	**8,751,182**	**8,880,547**	**9,358,869**	**9,712,116**	**9,960,476**	**10,339,734**	**10,694,696**
Loans	3,728,569	3,832,553	4,080,049	4,435,863	5,109,788	4,376,319	4,435,863	4,615,601	4,803,609	4,949,498	5,109,788	5,181,398
Securities and money market	2,197,434	2,568,705	2,866,857	3,302,240	3,799,443	3,190,602	3,302,240	3,542,873	3,580,335	3,628,275	3,799,443	4,047,682
Allowance for loan losses	−60,376	−68,833	−74,798	−73,835	−74,619	−73,926	−73,835	−76,629	−76,415	−75,917	−74,619	−73,364
Other	880,209	1,154,528	1,118,837	1,216,279	1,505,123	1,258,187	1,216,279	1,277,024	1,404,588	1,458,620	1,505,123	1,538,981
Total liabilities	**6,227,975**	**6,901,281**	**7,350,200**	**8,177,563**	**9,450,580**	**8,063,922**	**8,177,563**	**8,614,689**	**8,938,434**	**9,107,551**	**9,450,580**	**9,803,120**
Deposits	3,771,749	4,025,769	4,357,245	4,705,043	5,249,505	4,605,545	4,705,043	4,847,914	5,005,099	5,064,773	5,249,505	5,345,178
Borrowings	1,991,564	2,073,770	2,244,331	2,630,168	3,088,885	2,572,084	2,630,168	2,902,949	2,955,221	3,054,677	3,088,885	3,298,122
Other[3]	464,662	801,742	748,624	842,352	1,112,190	886,293	842,352	863,826	978,114	988,102	1,112,190	1,159,820
Total equity	**517,861**	**585,670**	**640,745**	**702,984**	**889,154**	**687,260**	**702,984**	**744,180**	**773,682**	**852,925**	**889,154**	**891,576**
Off-balance-sheet												
Unused commitments to lend[4]	3,297,511	3,481,745	3,650,669	4,097,531	4,823,337	3,887,356	4,097,531	4,350,963	4,420,773	4,569,881	4,823,337	4,906,709
Securitizations outstanding[5]	n.a.	276,717	295,001	298,348	353,978	290,328	298,348	308,543	314,258	313,436	353,978	366,430
Derivatives (notional value, billions)[6]	43,608	48,276	57,886	72,914	89,115	69,452	72,914	79,273	83,109	84,723	89,115	92,601
Income statement												
Net income[7]	73,168	66,510	85,731	107,949	113,483	28,177	29,545	30,673	25,893	29,097	28,910	32,902
Net interest income	197,695	224,470	246,048	257,537	284,745	66,120	68,072	67,441	71,815	72,426	71,485	72,764
Provisions for loan losses	27,604	40,661	45,107	33,075	28,788	8,246	8,944	7,165	6,994	7,489	7,843	6,574
Non-interest income	200,872	218,984	221,532	250,639	273,677	65,423	69,991	67,724	73,698	67,657	68,389	73,536
Non-interest expense	258,213	302,140	296,964	316,330	360,961	81,678	86,323	83,237	101,051	89,118	90,479	91,436
Security gains or losses	−606	4,338	4,598	5,771	5,524	596	655	1,980	1,011	1,981	480	413
Ratios (percent)												
Return on average equity	15.19	11.86	14.11	16.28	14.27	16.81	17.25	17.05	13.52	14.03	13.37	14.84
Return on average assets	1.13	.91	1.11	1.26	1.16	1.29	1.34	1.33	1.07	1.18	1.12	1.24
Net interest margin[8]	3.58	3.61	3.74	3.51	3.39	3.53	3.59	3.42	3.49	3.46	3.28	3.18
Efficiency ratio[7]	63.95	66.92	62.38	61.72	63.67	62.43	62.62	61.37	67.01	63.34	64.51	60.79
Nonperforming assets to loans and related assets	1.09	1.44	1.44	1.15	.82	1.23	1.15	1.09	.96	.89	.82	.76
Net charge-offs to average loans	.64	.89	1.04	.84	.67	.86	.98	.72	.66	.61	.71	.57
Loans to deposits	98.86	95.20	93.64	94.28	97.34	95.02	94.28	95.21	95.97	97.72	97.34	96.94
Regulatory capital ratios												
Tier 1 risk-based	8.84	8.92	9.22	9.58	9.41	9.53	9.58	9.55	9.40	9.38	9.41	9.34
Total risk-based	11.80	11.92	12.28	12.60	12.28	12.54	12.60	12.47	12.26	12.22	12.28	12.21
Leverage	6.81	6.68	6.72	6.87	6.64	6.77	6.87	6.88	6.67	6.75	6.64	6.53
Number of reporting bank holding companies	1,727	1,842	1,979	2,134	2,254	2,120	2,134	2,193	2,211	2,240	2,254	2,280

Footnotes appear on p. 399.

2. Financial characteristics of fifty large bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account or ratio [2, 9]	2000	2001	2002	2003	2004	2003 Q3	2003 Q4	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2005 Q1
Balance sheet												
Total assets	**5,509,329**	**5,883,032**	**6,244,695**	**6,903,426**	**7,940,887**	**6,826,533**	**6,903,426**	**7,348,179**	**7,539,139**	**7,741,040**	**7,940,887**	**8,206,462**
Loans	2,936,756	2,956,272	3,140,427	3,387,295	3,929,885	3,353,598	3,387,295	3,548,140	3,683,748	3,791,894	3,929,885	3,979,933
Securities and money market	1,849,393	2,053,128	2,282,894	2,629,416	2,909,296	2,534,530	2,629,416	2,855,674	2,841,338	2,880,574	2,909,296	3,094,734
Allowance for loan losses	−49,224	−56,575	−61,180	−59,343	−59,484	−59,343	−59,343	−61,854	−61,434	−60,811	−59,484	−58,123
Other	772,404	930,207	882,553	946,058	1,161,189	997,748	946,058	1,006,218	1,075,487	1,129,382	1,161,189	1,189,918
Total liabilities	**5,098,769**	**5,434,925**	**5,758,200**	**6,373,455**	**7,252,392**	**6,306,793**	**6,373,455**	**6,781,436**	**6,949,713**	**7,084,305**	**7,252,392**	**7,513,951**
Deposits	2,847,117	3,022,829	3,261,241	3,512,801	3,948,310	3,436,283	3,512,801	3,629,595	3,759,012	3,793,285	3,948,310	4,019,042
Borrowings	1,814,179	1,878,346	2,040,891	2,358,645	2,713,445	2,314,486	2,358,645	2,614,743	2,642,532	2,742,512	2,713,445	2,898,498
Other [3]	437,474	533,750	456,068	502,010	590,637	556,024	502,010	537,099	548,170	548,509	590,637	596,411
Total equity	**410,560**	**448,107**	**486,496**	**529,971**	**688,495**	**519,740**	**529,971**	**566,743**	**589,426**	**656,735**	**688,495**	**692,511**
Off-balance-sheet												
Unused commitments to lend [4]	3,072,864	3,235,807	3,385,143	3,800,219	4,485,138	3,595,070	3,800,219	4,047,520	4,104,527	4,236,822	4,485,138	4,557,059
Securitizations outstanding [5]	n.a.	271,825	289,905	293,046	348,986	284,850	293,046	304,545	307,878	307,325	348,986	361,524
Derivatives (notional value, billions) [6]	43,544	48,159	57,768	72,725	88,675	69,278	72,725	79,044	82,844	84,463	88,675	92,140
Income statement												
Net income [7]	60,388	52,530	68,308	87,644	90,155	23,116	24,422	25,159	19,494	22,998	23,595	26,392
Net interest income	153,455	166,652	183,796	192,298	212,404	50,003	51,232	50,689	52,809	54,067	53,262	53,462
Provisions for loan losses	24,013	35,786	39,416	28,587	25,360	7,075	7,877	6,396	6,212	6,704	6,752	5,769
Non-interest income	181,585	174,378	172,642	195,668	213,283	51,693	55,543	53,732	56,466	51,882	54,995	57,844
Non-interest expense	216,983	224,502	215,915	229,336	264,069	60,279	63,226	61,045	74,500	64,388	67,059	66,332
Security gains or losses	−603	4,319	5,039	5,186	4,628	478	632	1,610	697	1,723	524	221
Ratios (percent)												
Return on average equity	15.86	12.22	14.71	17.49	14.73	18.24	18.85	18.31	13.34	14.33	14.05	15.30
Return on average assets	1.14	.91	1.13	1.31	1.18	1.35	1.42	1.39	1.03	1.19	1.19	1.29
Net interest margin [8]	3.44	3.39	3.56	3.35	3.23	3.40	3.47	3.26	3.29	3.31	3.16	3.03
Efficiency ratio [7]	64.09	64.61	59.55	58.70	60.96	59.72	59.40	58.34	64.90	60.29	61.89	57.57
Nonperforming assets to loans and related assets	1.17	1.57	1.56	1.22	.84	1.30	1.22	1.14	1.00	.91	.84	.78
Net charge-offs to average loans	.73	1.01	1.21	.97	.80	1.00	1.13	.88	.78	.72	.83	.69
Loans to deposits	103.15	97.80	96.30	96.43	99.53	97.59	96.43	97.76	98.00	99.96	99.53	99.03
Regulatory capital ratios												
Tier 1 risk-based	8.20	8.22	8.51	8.80	8.57	8.81	8.80	8.77	8.63	8.60	8.57	8.52
Total risk-based	11.45	11.57	11.94	12.18	11.84	12.17	12.18	12.05	11.88	11.82	11.84	11.79
Leverage	6.43	6.24	6.25	6.36	6.16	6.29	6.36	6.36	6.14	6.22	6.16	6.09

Footnotes appear on p. 399.

3. Financial characteristics of all other reporting bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account[1, 10]	2000	2001	2002	2003	2004	2003		2004				2005
						Q3	Q4	Q1	Q2	Q3	Q4	Q1
Balance sheet												
Total assets	**1,178,273**	**1,290,686**	**1,414,391**	**1,549,979**	**1,709,085**	**1,517,067**	**1,549,979**	**1,590,705**	**1,636,305**	**1,674,216**	**1,709,085**	**1,722,328**
Loans	767,464	822,127	885,466	969,249	1,097,601	945,603	969,249	996,874	1,034,675	1,069,966	1,097,601	1,119,845
Securities and money market	319,514	359,293	408,750	449,241	474,035	443,645	449,241	465,449	463,381	465,577	474,035	460,222
Allowance for loan losses	-10,884	-11,894	-13,181	-14,075	-14,735	-14,098	-14,075	-14,383	-14,627	-14,799	-14,735	-14,805
Other	102,179	121,160	133,355	145,565	152,184	141,917	145,565	142,765	152,875	153,471	152,184	157,066
Total liabilities	**1,076,381**	**1,174,315**	**1,283,635**	**1,407,777**	**1,550,877**	**1,377,795**	**1,407,777**	**1,444,384**	**1,490,587**	**1,519,327**	**1,550,877**	**1,565,804**
Deposits	912,804	988,825	1,078,022	1,169,677	1,281,283	1,147,564	1,169,677	1,202,669	1,228,499	1,253,522	1,281,283	1,306,451
Borrowings	142,782	159,804	174,398	203,755	228,929	196,562	203,755	201,409	223,675	224,912	228,929	217,206
Other[3]	20,794	25,687	31,214	34,345	40,665	33,669	34,345	40,306	38,413	40,893	40,665	42,147
Total equity	***101,892***	***116,371***	***130,756***	***142,202***	***158,208***	***139,272***	***142,202***	***146,321***	***145,718***	***154,889***	***158,208***	***156,525***
Off-balance-sheet												
Unused commitments to lend[4]	215,583	235,764	253,620	284,399	324,828	278,562	284,399	290,060	301,229	315,742	324,828	335,250
Securitizations outstanding[5]	n.a.	4,567	4,358	4,159	2,877	4,400	4,159	2,875	3,000	2,757	2,877	2,792
Derivatives (notional value, billions)[6]	47	87	86	92	140	97	92	118	109	117	140	73
Income statement												
Net income[7]	12,485	13,841	16,634	17,904	19,663	4,560	4,220	4,826	4,847	5,042	4,948	5,233
Net interest income	43,509	46,215	51,029	53,139	57,389	13,166	13,639	13,867	14,014	14,539	14,968	15,206
Provisions for loan losses	3,420	4,438	5,059	4,271	3,196	1,051	1,127	802	786	798	810	675
Non-interest income	16,181	22,434	24,591	27,754	26,654	7,009	6,754	6,768	6,707	6,616	6,562	6,679
Non-interest expense	38,118	44,389	46,957	51,486	53,586	12,711	13,440	13,160	13,143	13,319	13,964	13,941
Security gains or losses	-9	729	639	993	559	136	187	310	111	134	5	100
Ratios (percent)												
Return on average equity	13.09	12.53	13.53	13.10	13.23	13.35	12.06	13.52	13.29	13.45	12.71	13.38
Return on average assets	1.12	1.13	1.25	1.21	1.21	1.22	1.10	1.24	1.21	1.22	1.17	1.23
Net interest margin[8]	4.31	4.20	4.26	4.00	3.93	3.92	3.97	3.97	3.89	3.92	3.95	3.99
Efficiency ratio[7]	62.24	63.80	61.12	62.94	62.67	62.67	65.72	63.02	62.80	62.91	63.88	62.56
Nonperforming assets to loans and related assets	.77	.97	1.02	.98	.76	1.03	.98	.96	.87	.84	.76	.73
Net charge-offs to average loans	.32	.43	.46	.39	.25	.35	.51	.23	.25	.23	.31	.17
Loans to deposits	84.08	83.14	82.14	82.86	85.66	82.40	82.86	82.89	84.22	85.36	85.66	85.72
Regulatory capital ratios												
Tier 1 risk-based	11.83	12.27	12.50	12.59	12.45	12.59	12.59	12.62	12.48	12.46	12.45	12.30
Total risk-based	13.29	13.83	14.11	14.30	14.09	14.29	14.30	14.31	14.15	14.11	14.09	13.92
Leverage	8.52	8.81	8.93	9.06	9.16	8.99	9.06	9.12	9.10	9.15	9.16	9.13
Number of other reporting bank holding companies	1,652	1,779	1,916	2,071	2,199	2,057	2,071	2,131	2,149	2,182	2,199	2,225

Footnotes appear on p. 399.

4. Nonfinancial characteristics of all reporting bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account	2000	2001	2002	2003	2004	2003		2004				2005
						Q3	Q4	Q1	Q2	Q3	Q4	Q1
Bank holding companies that qualify as financial holding companies [11, 12]												
Domestic												
Number	300	389	435	452	474	449	452	465	471	477	474	471
Total assets	4,497,781	5,440,842	5,921,277	6,610,314	7,462,508	6,451,785	6,610,314	6,856,173	7,082,367	7,279,239	7,462,508	7,635,666
Foreign-owned [13]												
Number	9	10	11	12	14	11	12	13	14	14	14	15
Total assets	502,506	621,442	616,254	710,441	1,376,333	729,244	710,441	994,672	1,117,266	1,193,984	1,376,333	1,526,167
Total U.S. commercial bank assets [14]	**6,129,534**	**6,415,909**	**6,897,447**	**7,397,818**	**8,207,091**	**7,293,920**	**7,397,818**	**7,614,504**	**7,850,644**	**8,040,967**	**8,207,091**	**8,400,147**
By ownership												
Reporting bank holding companies	5,657,210	5,942,575	6,429,738	6,940,992	7,785,428	6,842,727	6,940,992	7,165,651	7,409,186	7,599,384	7,785,428	7,988,330
Other bank holding companies	229,274	230,464	227,017	219,222	209,181	217,035	219,222	213,193	211,725	208,696	209,181	204,799
Independent banks	243,050	242,870	240,692	237,604	212,482	234,157	237,604	235,660	229,733	232,887	212,482	207,019
Assets associated with nonbanking activities [12, 15]												
Insurance	n.a.	426,462	372,405	437,503	579,111	419,575	437,503	468,168	583,073	579,785	579,111	574,466
Securities broker–dealers	n.a.	n.a.	630,851	656,775	719,242	686,049	656,775	713,794	710,485	756,869	719,242	933,479
Thrift institutions [16]	102,218	91,170	107,422	133,056	191,201	143,578	133,056	139,713	156,033	162,396	191,201	193,647
Foreign nonbank institutions	132,629	138,977	145,344	170,600	216,758	162,789	170,600	184,334	226,064	230,569	216,758	219,828
Other nonbank institutions	1,234,714	1,674,267	561,712	686,367	1,128,184	736,515	686,367	853,276	870,833	887,848	1,128,184	1,044,441
Number of bank holding companies engaged in nonbanking activities [12, 15]												
Insurance	n.a.	143	96	102	97	102	102	100	101	98	97	97
Securities broker–dealers	n.a.	n.a.	47	50	43	46	50	49	48	45	43	41
Thrift institutions	50	38	32	27	27	29	27	29	27	25	27	26
Foreign nonbank institutions	25	32	37	41	39	39	41	41	40	40	39	38
Other nonbank institutions	633	743	880	1,042	1,026	992	1,042	1,010	1,030	1,050	1,026	929
Foreign-owned bank holding companies [13]												
Number	21	23	26	27	29	27	27	27	28	28	29	29
Total assets	636,669	764,411	762,901	934,085	1,537,208	947,253	934,085	1,145,476	1,271,378	1,349,900	1,537,208	1,690,118
Employees of reporting bank holding companies (full-time equivalent)	1,859,930	1,985,981	1,992,559	2,034,358	2,162,118	2,031,029	2,034,358	2,099,126	2,085,733	2,133,267	2,162,118	2,165,347
Assets of fifty large bank holding companies [9, 17]												
Fixed panel (from table 2)	5,509,329	5,883,032	6,244,695	6,903,426	7,940,887	6,826,533	6,903,426	7,348,179	7,539,139	7,741,040	7,940,887	8,206,462
Fifty large as of reporting date	5,319,129	5,732,621	6,032,000	6,666,488	7,940,955	6,602,255	6,666,488	7,045,844	7,385,384	7,644,504	7,940,955	8,206,462
Percent of all reporting bank holding companies	78.90	76.60	75.50	75.10	76.80	75.40	75.10	75.30	76.00	76.70	76.80	76.70

NOTE: All data are as of the most recent period shown. The historical figures may not match those in earlier versions of this table because of mergers, significant acquisitions or divestitures, or revisions or restatements to bank holding company financial reports. Data for the most recent period may not include all late-filing institutions.

1. Covers top-tier bank holding companies except (1) those with consolidated assets of less than $150 million and with only one subsidiary bank and (2) multibank holding companies with consolidated assets of less than $150 million, with no debt outstanding to the general public and not engaged in certain nonbanking activities.

2. Data for all reporting bank holding companies and the fifty large bank holding companies reflect merger adjustments to the fifty large bank holding companies. Merger adjustments account for mergers, acquisitions, other business combinations and large divestitures that occurred during the time period covered in the tables so that the historical information on each of the fifty underlying institutions depicts, to the greatest extent possible, the institutions as they exist in the most recent period. In general, adjustments for mergers among bank holding companies reflect the combination of historical data from predecessor bank holding companies.

The data for the fifty large bank holding companies have also been adjusted as necessary to match the historical figures in each company's most recently available financial statement.

In general, the data are not adjusted for changes in generally accepted accounting principles.

3. Includes minority interests in consolidated subsidiaries.

4. Includes credit card lines of credit as well as commercial lines of credit.

5. Includes loans sold to securitization vehicles in which bank holding companies retain some interest, whether through recourse or seller-provided credit enhancements or by servicing the underlying assets. Securitization data were first collected on the FR Y-9C report for June 2001.

6. The notional value of a derivative is the reference amount of an asset on which an interest rate or price differential is calculated. The total notional value of a bank holding company's derivatives holdings is the sum of the notional values of each derivative contract regardless of whether the bank holding company is a payor or recipient of payments under the contract. The actual cash flows and fair market values associated with these derivative contracts are generally only a small fraction of the contract's notional value.

7. Income statement subtotals for all reporting bank holding companies and the fifty large bank holding companies exclude extraordinary items, the cumulative effects of changes in accounting principles, and discontinued operations at the fifty large institutions and therefore will not sum to Net income. The efficiency ratio is calculated excluding nonrecurring income and expenses.

8. Calculated on a fully-taxable-equivalent basis.

9. In general, the fifty large bank holding companies are the fifty largest bank holding companies as measured by total consolidated assets for the latest period shown. Excludes a few large bank holding companies whose commercial banking operations account for only a small portion of assets and earnings.

10. Excludes predecessor bank holding companies that were subsequently merged into other bank holding companies in the panel of fifty large bank holding companies. Also excludes those bank holding companies excluded from the panel of fifty large bank holding companies because commercial banking operations represent only a small part of their consolidated operations.

11. Exclude qualifying institutions that are not reporting bank holding companies.

12. No data related to financial holding companies and only some data on nonbanking activities were collected on the FR Y-9C report before implementation of the Gramm–Leach–Bliley Act in 2000.

13. A bank holding company is considered "foreign-owned" if it is majority-owned by a foreign entity. Data for foreign-owned companies do not include data for branches and agencies of foreign banks operating in the United States.

14. Total assets of insured commercial banks in the United States as reported in the commercial bank Call Report (FFIEC 031 or 041, Reports of Condition and Income). Excludes data for a small number of commercial banks owned by other commercial banks that file separate call reports yet are also covered by the reports filed by their parent banks. Also excludes data for mutual savings banks.

15. Data for thrift, foreign nonbank, and other nonbank institutions are total assets of each type of subsidiary as reported in the FR Y-9LP report. Data cover those subsidiaries in which the top-tier bank holding company directly or indirectly owns or controls more than 50 percent of the outstanding voting stock and that has been consolidated using generally accepted accounting principles. Data for securities broker–dealers are net assets (that is, total assets, excluding intercompany transactions) of broker–dealer subsidiaries engaged in activities pursuant to the Gramm–Leach–Bliley Act, as reported on schedule HC-M of the FR Y-9C report. Data for insurance activities are all insurance-related assets held by the bank holding company as reported on schedule HC-I of the FR Y-9C report.

Beginning in 2002:Q1, insurance totals exclude intercompany transactions and subsidiaries engaged in credit-related insurance or those engaged principally in insurance agency activities. Beginning in 2002:Q2, insurance totals include only newly authorized insurance activities under the Gramm–Leach–Bliley Act.

16. Aggregate assets of thrift subsidiaries were affected significantly by the conversion of Charter One's thrift subsidiary (with assets of $37 billion) to a commercial bank in the second quarter of 2002 and the acquisition by Citigroup of Golden State Bancorp (a thrift institution with assets of $55 billion) in the fourth quarter of 2002.

17. Changes over time in the total assets of the time-varying panel of fifty large bank holding companies are attributable to (1) changes in the companies that make up the panel and (2) to a small extent, restatements of financial reports between periods.

n.a. Not available

SOURCE: Federal Reserve Reports FR Y-9C and FR Y-9LP, Federal Reserve National Information Center, and published financial reports.

Announcements

STATEMENT BY CHAIRMAN ALAN GREENSPAN ON WIM DUISENBERG, FORMER FIRST PRESIDENT, EUROPEAN CENTRAL BANK

"Wim Duisenberg earned respect and admiration worldwide for his successful launching of the euro and his effective leadership as the first president of the European Central Bank. On a personal level, I valued his friendship and I will miss him."

RESIGNATION OF GOVERNOR EDWARD M. GRAMLICH

Governor Edward M. Gramlich submitted his resignation on May 18, 2005, as a member of the Board of Governors of the Federal Reserve System, effective August 31, 2005. Governor Gramlich, who has been a member of the Board since November 5, 1997, submitted his letter of resignation to President Bush. In view of his impending departure and in keeping with Federal Open Market Committee practice, he did not attend the August 9, 2005, meeting of the FOMC.

"Ned has contributed powerfully to the work of the Board and of the FOMC for nearly eight years," said Federal Reserve Board Chairman Alan Greenspan. "Our deliberations have been enriched by his keen insights, his good humor, and his lively mind."

Gramlich resigned to pursue several teaching and research interests. He will become the Richard A. Musgrave collegiate professor in the Gerald R. Ford School of Public Policy at the University of Michigan, teaching in that program and in the new Michigan in Washington Program. He will also hold a part-time appointment as senior fellow at the Urban Institute.

Gramlich, 65, was first appointed to the Federal Reserve Board by President Clinton to a term that expires on January 31, 2008. For most of this time he has served as chair of the Board's Committee on Consumer and Community Affairs. During his tenure the committee proposed, and the Board adopted, important changes in the Home Owner Equity Protection Act and the Home Mortgage Disclosure Act. The committee has also proposed a revision to the Community Reinvestment Act.

He has also been the Board's delegate to, and chair of, the Airline Transportation Stabilization Board, a board set up to administer the $10 billion loan guarantee program enacted in response to the September 11, 2001, disaster.

Governor Gramlich has chaired the board of the Neighborhood Reinvestment Corporation, a partnership that has generated more than $8.5 billion in reinvestment and helped more than 500,000 families of modest means purchase or improve their homes or secure rental or mutual housing.

Before coming to the Board, Governor Gramlich was dean of Michigan's School of Public Policy, now renamed as the Gerald R. Ford School of Public Policy. He also chaired the 1994–96 Quadrennial Advisory Council on Social Security and was staff director for the 1992 Economic Study Committee on Major League Baseball.

FEDERAL OPEN MARKET COMMITTEE STATEMENTS

The Federal Open Market Committee decided on May 3, 2005, to raise its target for the federal funds rate 25 basis points, to 3 percent.

The Committee believes that, even after this action, the stance of monetary policy remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity. Recent data suggest that the solid pace of spending growth has slowed somewhat, partly in response to the earlier increases in energy prices. Labor market conditions, however, apparently continue to improve gradually. Pressures on inflation have picked up in recent months and pricing power is more evident. Longer-term inflation expectations remain well contained.

The Committee perceives that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. With underlying inflation expected to be contained, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

Voting for the FOMC monetary policy action were: Alan Greenspan, Chairman; Timothy F. Geithner, Vice Chairman; Susan S. Bies; Roger W. Ferguson, Jr.; Richard W. Fisher; Edward M. Gramlich; Donald L. Kohn; Michael H. Moskow; Mark W. Olson; Anthony M. Santomero; and Gary H. Stern.

In a related action, the Board of Governors unanimously approved a 25-basis-point increase in the discount rate, to 4 percent. In taking this action, the Board approved the requests submitted by the boards of directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco.

The Federal Open Market Committee decided on June 30, 2005, to raise its target for the federal funds rate 25 basis points, to 3¼ percent.

The Committee believes that, even after this action, the stance of monetary policy remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity. Although energy prices have risen further, the expansion remains firm and labor market conditions continue to improve gradually. Pressures on inflation have stayed elevated, but longer-term inflation expectations remain well contained.

The Committee perceives that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. With underlying inflation expected to be contained, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

Voting for the FOMC monetary policy action were: Alan Greenspan, Chairman; Timothy F. Geithner, Vice Chairman; Susan S. Bies; Roger W. Ferguson, Jr.; Richard W. Fisher; Edward M. Gramlich; Donald L. Kohn; Michael H. Moskow; Mark W. Olson; Anthony M. Santomero; and Gary H. Stern.

In a related action, the Board of Governors unanimously approved a 25-basis-point increase in the discount rate, to 4¼ percent. In taking this action, the Board approved the requests submitted by the boards of directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco.

The Federal Open Market Committee decided on August 9, 2005, to raise its target for the federal funds rate 25 basis points, to 3½ percent.

The Committee believes that, even after this action, the stance of monetary policy remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity. Aggregate spending, despite high energy prices, appears to have strengthened since late winter, and labor market conditions continue to improve gradually. Core inflation has been relatively low in recent months and longer-term inflation expectations remain well contained, but pressures on inflation have stayed elevated.

The Committee perceives that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. With underlying inflation expected to be contained, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

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FEDERAL OPEN MARKET COMMITTEE SCHEDULE FOR 2006

The Federal Open Market Committee announced on June 29, 2005, its tentative meeting schedule for 2006: January 31–February 1 (Tuesday–Wednesday), March 28, May 10, June 28–29 (Wednesday–Thursday), August 8, September 20, October 24, December 12, 2005, and January 30–31, 2007 (Tuesday–Wednesday).

AMENDMENTS TO REGULATION CC, APPENDIX A

The Federal Reserve Board announced on April 19, 2005, amendments to appendix A of Regulation CC (Availability of Funds and Collection of Checks) that reflect the restructuring of the Federal Reserve's check-processing operations in the Tenth and Twelfth Districts. These amendments are part of a series of amendments to appendix A that will take place through the first quarter of 2006, associated with the previously announced restructuring of the Reserve Banks' check-processing operations.

Appendix A provides a routing number guide that helps depository institutions determine the maximum permissible hold periods for most deposited checks. As of June 18, 2005, the Salt Lake City Branch office of the Federal Reserve Bank of San Francisco will no longer process checks, and banks that are served by that office have been reassigned to the Denver Branch office of the Federal Reserve Bank of Kansas City. To ensure that the information in appendix A accurately describes the structure of check-processing operations within the Federal Reserve System, the final rule deletes the reference in appendix A to the San Francisco Reserve Bank's Salt Lake City Branch office and reassigns the routing numbers listed thereunder to the Kansas City Reserve Bank's Denver Branch office. To coincide with the effective date of the underlying check-processing changes, the amendments will become effective June 18, 2005. As a result of these changes, some checks deposited in the affected regions that were nonlocal checks became local checks subject to shorter permissible hold periods.

The Federal Reserve Board announced on August 9, 2005, amendments to appendix A of Regulation CC (Availability of Funds and Collection of Checks) that reflect the restructuring of the Federal Reserve's check-processing operations in the Twelfth District. These amendments are part of a series of amendments to appendix A that will take place through the first quarter of 2006, associated with the previously announced restructuring of the Reserve Banks' check-processing operations.

Appendix A provides a routing number guide that helps depository institutions determine the maximum permissible hold periods for most deposited checks. As of October 22, 2005, the Portland Branch office of the Federal Reserve Bank of San Francisco will no longer process checks, and banks that are served by that office have been reassigned to the Seattle Branch office of the Federal Reserve Bank of San Francisco. To ensure that the information in appendix A accurately describes the structure of check-processing operations within the Federal Reserve System, the final rule deletes the reference in appendix A to the San Francisco Reserve Bank's Portland Branch office and reassigns the routing numbers listed thereunder to the Reserve Bank's Seattle Branch office. To coincide with the effective date of the underlying check-processing changes, the amendments will become effective October 22, 2005. As a result of these changes, some checks deposited in the affected regions that were nonlocal checks became local checks subject to shorter permissible hold periods.

FINAL AMENDMENTS TO REGULATION DD

The Federal Reserve Board published on May 19, 2005, final amendments to Regulation DD (Truth in Savings), which implements the Truth in Savings Act, and the regulation's official staff commentary to improve the uniformity and adequacy of information provided to consumers when they overdraw their deposit accounts. The final amendments, in part, address a specific service provided by many depository institutions to pay checks and allow other transactions when there are insufficient funds in an account. This service is often referred to as *bounced-check protection* or *courtesy overdraft protection.*

Depository institutions sometimes provide overdraft services to deposit account customers as an alternative to a traditional overdraft line of credit. To address concerns about the marketing of this service, the final rule expands the regulation's prohibition against misleading advertisements to cover institutions' communications with current customers about their existing accounts. The staff commentary provides examples of advertisements that would ordinarily be misleading.

Other revisions to Regulation DD require additional disclosures about fees and other terms for overdraft services, including in advertisements. To assist consumers in understanding the financial effect of overdrawing their accounts, the final rule requires institutions that promote the payment of overdrafts in an advertisement to disclose on periodic statements the total dollar amount imposed for overdraft fees and the total dollar amount imposed for returned-item fees, both for the statement period and for the calendar year to date.

The final rule became effective on July 1, 2006.

Annual Adjustment of Fee-Based Trigger Amount for Additional Disclosure Requirements

The Federal Reserve Board published on August 4, 2005, its annual adjustment of the dollar amount that triggers additional disclosure requirements under the Truth in Lending Act for home mortgage loans that bear rates or fees above a certain amount.

The dollar amount of the fee-based trigger has been adjusted to $528 for 2006 based on the annual percentage change reflected in the consumer price index that was in effect on June 1, 2005. The adjustment is effective January 1, 2006.

The Home Ownership and Equity Protection Act of 1994 restricts credit terms such as "balloon payments" and requires additional disclosures when total points and fees payable by the consumer exceed the fee-based trigger (initially set at $400 and adjusted annually) or 8 percent of the total loan amount, whichever is larger.

Request for Comment on Imputing Return on Capital

The Federal Reserve Board requested on May 18, 2005, public comment on alternative approaches to imputing a private-sector-like return on capital that would be considered in setting fees for certain payment services provided to depository institutions. Specifically, the Board requests comment on the targeted return on equity (ROE) capital measure contained in the private-sector adjustment factor (PSAF).

The Monetary Control Act of 1980 requires the Federal Reserve to set fees for the services it provides to depository institutions at a level sufficient to recover, over the long run, the actual costs of providing these services, as well as the imputed costs and profits. The PSAF is an allowance for imputed costs, including financing costs, return on equity capital, taxes, and certain other expenses that are not explicitly incurred by the Reserve Banks but would be incurred by a private business firm providing the services. The methodology underlying the PSAF is reviewed periodically to ensure that it is appropriate and relevant in light of changes that may have occurred in Reserve Bank priced-services activities, accounting standards, finance theory, and regulatory and business practices.

The Board is requesting comment on alternative approaches to the current method used to compute a target ROE, including the analytical models used and the model assumptions and inputs. The Board is also requesting comment on implementing a longer-term planning horizon for targeting the PSAF ROE, and the effect that future regulatory and industry changes could have on the PSAF method.

Comments were requested by July 22, 2005.

Federal Reserve Banks Announce Changes to Increase Efficiency in Check Services

As part of their ongoing effort to respond to the significant shift away from the use of paper checks and toward the much greater use of electronic payments, the Federal Reserve Banks will discontinue check processing at the Federal Reserve Bank of New York's East Rutherford Operations Center. That volume will be processed at the Federal Reserve Bank of Philadelphia. No firm date for the transition has yet been determined, but it is expected to take place in the second half of 2006. The change is aimed at increasing the efficiency of the Reserve Banks' check-processing operations, while continuing to provide high-quality services to depository institutions throughout the country.

"The step announced [on May 25, 2005,] will help the Reserve Banks reduce our check service operating costs in line with the continuing shift in consumer and business preferences for electronic payments," said Gary Stern, chairman of the Reserve Banks' Financial Services Policy Committee and president of the Federal Reserve Bank of Minneapolis. "Today's announcement marks the third annual review of our check infrastructure, which has resulted in a reduction in the number of locations processing checks. We will continue to evaluate our check-processing infrastructure annually to ensure that we are well positioned to meet the needs of the nation's payment system."

Since 2003 the Reserve Banks have reduced the locations where they process checks from forty-five to twenty-nine as of May 25, 2005. An additional six locations, previously announced, will no longer process checks by early 2006, further reducing the number to twenty-three. After this step is completed, the Reserve Banks will process checks from twenty-two locations nationwide.

"The changes that we have implemented over the past three years have been good for the nation's payments system but difficult for our organization as we have been required to reduce our staff," said Stern. To assist affected staff, the Reserve Banks will offer a variety of programs, including separation packages, extended medical coverage, and career transition assistance.

As a result of the action announced on May 25, 2005, the Reserve Banks will reduce their overall check staff by approximately eighty positions, representing about 2 percent of the Reserve Banks' current check employees. At the East Rutherford location, about 140 positions will be affected. Some staff reductions may occur through attrition and there may be some opportunities for reassignment. The Reserve Banks estimate that they will add approximately sixty positions in Philadelphia to help process the additional volume.

In 2004 Reserve Banks' check volume declined at about a 12 percent rate. During 2005 check volumes have continued to decline; further decline is anticipated in the coming years. A 2004 study revealed that about thirty-seven billion checks were paid in the United States in 2003, down from forty-two billion in 2001 and fifty billion in 1995. Electronic payments, including those made by credit cards, debit cards, and through the automated clearinghouse system increased from about thirty billion transactions in 2001 to more than forty-four billion transactions in 2003.

The Federal Reserve Banks' long-term check-processing strategy will allow them to better meet the expectations of the 1980 Monetary Control Act. That act requires the Federal Reserve to set prices to recover, over the long run, its total operating costs of providing payment services to financial institutions, as well as the imputed costs it would have incurred and the profits it would have expected to earn had the services been provided by a private business firm.

The Federal Reserve System 2005 Check Restructuring Fact Sheet can be viewed online at www.federalreserve.gov/boarddocs/press/other/2005/20050525.

FEDERAL RESERVE BANKS ANNOUNCE CHANGES TO CASH INFRASTRUCTURE

The Federal Reserve Banks announced on June 28, 2005, changes to cash services that are intended to improve operating effectiveness by providing cash services at some locations using different distribution methods.

The Reserve Banks plan in the next six to twelve months to switch from branch-based cash services to cash depots in Birmingham, Alabama; Oklahoma City, Oklahoma; and Portland, Oregon. These changes are part of a broader effort to update the Federal Reserve's infrastructure for processing currency.

"We've looked at, and will continue to look at, major metropolitan markets where we do not have a Federal Reserve presence and at smaller markets where we do have a presence but where different service models might be more effective," said Gary Stern, chairman of the Reserve Banks' Financial Services Policy Committee and president of the Federal Reserve Bank of Minneapolis.

"We want to ensure that we're making the best use of resources while satisfying the need for cash services. We want to emphasize that the Federal Reserve will continue to make cash services available to depository institutions throughout the country, although in some cases we will do so with a different business model," he said.

In 2004 and early 2005 the Federal Reserve discontinued cash services through Branches in Little Rock, Arkansas; Louisville, Kentucky; and Buffalo, New York, and established cash depots in those cities.

A cash depot is an alternative market presence for Federal Reserve cash services. With a cash depot, the Federal Reserve contracts with a third party—usually an armored carrier—that acts as a secure collection point for Federal Reserve currency deposits from the region's depository institutions. The depot also distributes currency orders that depository institutions have placed with the Reserve Bank. The work of counting deposits and preparing orders is done by a Federal Reserve office in another city. The Federal Reserve pays for the transportation between the Reserve Bank office and the depot operator. The operator follows strict procedures developed by the Federal Reserve.

The Birmingham cash depot will be serviced by the Federal Reserve Bank of Atlanta's head office, the Oklahoma City cash depot will be serviced by the Federal Reserve Bank of Dallas' head office, and the Portland cash depot will be serviced by the Federal Reserve Bank of San Francisco's Seattle office. Approximately fifty cash employees work at the Birmingham, Oklahoma City, and Portland Branches combined, but the number that will be affected by these changes is undetermined at this time. The Reserve Banks will offer a variety of programs to staff that are affected by these decisions, including separation packages, extended medical coverage, and career transition assistance.

The Federal Reserve will continue its evaluation of cash services and plans to announce further changes as recommendations are approved, including the possibility of serving new markets.

Cash remains a vital component of the nation's payment system. While studies show that the use of electronic payments is growing, cash use also continues to grow, and the dollar amount of U.S. currency in circulation worldwide has increased almost 88 percent since 1994, to $720 billion at the end of 2004. During the same period, the amount of deposits and orders processed through Reserve Banks has increased nearly 70 percent, to seventy-five billion bank notes, in 2004.

"These changes and others that may come later in the review process will help the Federal Reserve provide cash services more effectively, both when transitioning out of our own cash processing facilities and when establishing a first-time presence in a market," Stern said.

GUIDANCE ON BANKING SERVICES FOR MONEY SERVICES BUSINESSES

The Financial Crimes Enforcement Network (FinCEN), along with the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision (collectively, the "Federal Banking Agencies"), issued on April 26, 2005, interpretive guidance designed to clarify the requirements for, and assist banking organizations in, appropriately assessing and minimizing risks posed by providing banking services to money services businesses.

FinCEN also has issued a concurrent advisory to money services businesses to emphasize their Bank Secrecy Act regulatory obligations and to notify them of the types of information that they will be expected to provide to a banking organization in the course of opening or maintaining account relationships.

Although recognizing the importance and diversity of services provided by money services businesses, the guidance to banking organizations specifies that FinCEN and the Federal Banking Agencies expect banking organizations that open and maintain accounts for money services businesses to apply the requirements of the Bank Secrecy Act, as they do with all account holders, on a risk-assessed basis. Registration with FinCEN, if required, and compliance with any state licensing requirements represent the most basic of compliance obligations for money services businesses.

Based on existing Bank Secrecy Act requirements applicable to banking organizations, the minimum compliance expectations associated with opening and maintaining accounts for money services businesses are to

- apply the banking organization's Customer Identification Program;
- confirm FinCEN registration, if required;
- confirm compliance with state or local licensing requirements, if applicable;
- confirm agent status, if applicable; and
- conduct basic risk assessment to determine the level of risk associated with the account.

Through the interpretive guidance, FinCEN and the Federal Banking Agencies confirm that banking organizations have the flexibility to provide banking services to a wide range of money services businesses while remaining in compliance with the Bank Secrecy Act. Although banking organizations are expected to manage risk associated with all accounts, including money services business accounts, banking organizations are not required to ensure their customers' compliance with all applicable federal and state laws and regulations.

The guidance contains examples that may be indicative of lower and higher risk within money services business accounts to assist banking organizations in identifying the risks posed by a money services business customer and in reporting known or suspected violations of law or suspicious transactions relevant to possible violations of law or regulation.

In addition, the guidance addresses the recurring question of the obligation of a banking organization to file a suspicious activity report on a money services business that has failed to register with FinCEN, if required to do so, or failed to obtain a license under applicable state law, if required. The guidance states that a banking organization should file a suspicious activity report if it becomes aware that a customer is operating in violation of the registration or state licensing requirements. This approach is consistent with long-standing practices of FinCEN and the Federal Banking Agencies under which banking organizations file suspicious activity reports on known or suspected violations of law or regulation.

The concurrently issued FinCEN advisory to money services businesses emphasizes the importance of compliance with Bank Secrecy Act regulatory requirements by money services businesses. The advisory is designed to assist money services businesses by outlining the types of information that they should have and be prepared to provide to a banking organization in the course of opening or maintaining account relationships. The advisory also makes clear that money services businesses that fail to comply with the most basic requirements of the Bank Secrecy Act, such as registration with FinCEN, if required, will be subject to regulatory and law enforcement scrutiny, and that continued noncompliance will likely result in the loss of banking services.

More information is available on the Board's public web site at www.federalreserve.gov/boarddocs/press/bcreg/2005/20050426/attachment.pdf and at www.federalreserve.gov/boarddocs/press/bcreg/2005/20050426/attachment2.pdf.

Banking Agencies to Perform Additional Analysis before Issuing Notice of Proposed Rulemaking

The four federal banking agencies (the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision) agreed on April 29, 2005, that additional analysis is needed before publishing a notice of proposed rulemaking (NPR) with respect to the U.S. implementation of the "International Convergence of Capital Measurement and Capital Standards: A Revised Framework," generally known as the Basel II Framework.

The agencies had intended to publish the NPR at midyear 2005, but agreed to a delay to better assess the results of a recently completed quantitative impact study (QIS4). The agencies agreed to issue the NPR at the earliest possible date after considering issues raised by the QIS4 results.

In a joint release published on June 26, 2004, the agencies described U.S. efforts to implement the Basel II Framework through revisions to our existing capital adequacy regulations. Among the key features in that implementation plan was an assessment of the implications of the framework on U.S. regulatory capital requirements through QIS4 and the solicitation of public comments on necessary revisions to existing capital adequacy regulations through an NPR. The QIS4 process was designed to provide the agencies with a better understanding of the ways the implementation of the Basel II Framework might affect minimum required risk-based capital within the U.S. banking industry overall, at consolidated U.S. institutions, and for specific portfolios. The agencies believe that the QIS4 results are critical inputs in the assessment of (1) the implications of Basel II for the safety and soundness of the banking system and (2) the competitive effects of adopting the Basel II Framework. Both are fundamental to the formulation of the NPR.

The agencies have received QIS4 submissions from participating institutions and have completed a preliminary analysis of those materials. The agencies have determined that additional analysis beyond that previously contemplated is necessary before publication of an NPR. The QIS4 submissions evidence material reductions in the aggregate minimum required capital for the QIS4 participant population and significant dispersion of results across institutions and portfolio types. Additional work is necessary to determine whether these results reflect differences in risk, reveal limitations of QIS4, identify variations in the stages of bank implementation efforts (particularly related to data availability), and, or suggest the need for adjustments to the Basel II Framework.

The agencies remain committed to moving forward with the implementation of Basel II while retaining Prompt Corrective Action and leverage requirements. The delay in issuing the NPR is intended to ensure that any proposed changes to the risk-based capital framework are consistent with safety and soundness, good risk-management practices, and the continued competitive strength of the U.S. banking system. The agencies encourage institutions that seek to adopt Basel II-based rules at their inception to continue with their implementation efforts. The agencies continue to target the existing implementation timeline for Basel II. However, the additional work noted above may cause the agencies to revisit this timeline. The agencies will provide additional information on the timing and other aspects of Basel II implementation as it becomes known.

Agencies Issue Credit-Risk Management Guidance for Home-Equity Lending

The federal bank, thrift institution, and credit union regulatory agencies issued guidance on May 16, 2005, that promotes sound risk-management practices for home-equity lines of credit and loans. The agencies have found that in some cases credit-risk management practices for home-equity lending have not kept pace with the product's rapid growth and eased underwriting standards.

The rise in home values, coupled with low interest rates and favorable tax treatment, have made home-equity lines of credit and loans attractive to consumers. To date, delinquency and loss rates for home-equity portfolios have been low, due at least in part to the modest repayment requirements and relaxed structures of this lending. However, the agencies have identified risk factors that, along with vulnerability to interest rate increases, have attracted scrutiny, including

- interest-only features that require no amortization of principal for a protracted period;
- limited or no documentation of a borrower's assets, employment, and income;
- higher loan-to-value (LTV) and debt-to-income ratios;
- lower credit-risk scores for underwriting home-equity loans;
- greater use of automated valuation models and other collateral evaluation tools for the development of appraisals and evaluations; and
- an increased number of transactions generated through a loan broker or other third party.

The agencies note that active portfolio management is especially important for financial institutions that project or have already experienced significant growth or concentrations in higher-risk products, such as high LTV, limited documentation and no documentation interest-only, and third-party generated loans.

Like most other lending activity, home-equity lending can be conducted in a safe and sound manner with appropriate risk-management systems. This guidance outlines the agencies' expectations for sound underwriting standards and effective credit-risk management practices for a financial institution's home-equity lending activity.

Agencies Issue FACT Act Interim Final Rules on Medical Information

The federal bank, thrift institution, and credit union regulatory agencies issued on June 6, 2005, interim final rules under the Fair Credit Reporting Act (FCRA) that create exceptions to the statutory prohibition against obtaining or using medical information in connection with credit eligibility determinations. The interim final rules also address the sharing of medically related information among affiliates.

The effective date for these rules is nine months after the date of publication in the *Federal Register*, which was on June 10, 2005.

Section 411 of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act) amended the FCRA to provide that a creditor may not obtain or use medical information in connection with any determination of a consumer's eligibility, or continued eligibility, for credit except as permitted by regulations or the FACT Act. However, the FACT Act also requires the agencies to prescribe regulations that permit creditors to obtain and use medical information for credit eligibility purposes when necessary and appropriate to protect legitimate operational, transactional, risk, consumer, and other needs. A proposed rule was published for comment on April 28, 2004.

The interim final rules create exceptions to the general statutory prohibition on obtaining and using medical information. The provisions are similar to those contained in the proposed rule and include exceptions for the use of medical information that is also financial information typically considered in credit underwriting. As authorized by the FACT Act, the agencies have expanded the scope of the rules so that the exceptions will apply to all creditors, not just to creditors ordinarily regulated by one of the agencies.

Section 411 of the FACT Act also amended the FCRA to limit the ability of creditors and others to share medically related information among affiliates except as permitted by the statute, regulation, or order. The interim final rules specify the circumstances in which creditors may share medically related information among affiliates without becoming consumer reporting agencies.

The interim final rules are being issued by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision. The rules of each agency are substantively identical.

The rules are being issued as interim final rules to allow for public comment on their expanded scope. The agencies requested comment within thirty days after publication in the *Federal Register*.

Banking Agencies Announce Financial Institution Enrollment Schedule for Central Data Repository

The Federal Financial Institutions Examination Council (FFIEC) Call Report agencies—the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System (FRB), and the Office of the Comptroller of the Currency (OCC)—announced on June 30, 2005, the schedule for financial institutions to enroll in the Central Data Repository (CDR). The CDR is a new Internet-based system created to modernize and streamline the way the agencies collect, validate, manage, and distribute financial data submitted by banks in quarterly "Call Reports." The new system is scheduled for implementation for the third quarter 2005 Call Report and will be the only method available for banks to submit their Call Reports.

In preparation for implementation of the CDR, financial institutions were assigned to one of eight week-long enrollment windows that began July 11, 2005. The implementation and enrollment plan was developed in cooperation with industry representatives, including software vendors, trade associations, and a number of banks from across the country that participate in the Financial Institutions Focus Group for the CDR project. Additional information on the CDR and the Call Report data modernization initiative is available at www.FFIEC.gov/FIND.

Banking Agencies Issue Host State Loan-to-Deposit Ratios

The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency issued on July 7, 2005, the host state loan-to-deposit ratios that the banking agencies will use to determine compliance with section 109 of the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994. These ratios update data released on August 26, 2004.

In general, section 109 prohibits a bank from establishing or acquiring a branch or branches outside of its home state primarily for the purpose of deposit production. Section 109 also prohibits branches of banks controlled by out-of-state bank holding companies from operating primarily for the purpose of deposit production.

Section 109 provides a process to test compliance with the statutory requirements. The first step in the process involves a loan-to-deposit ratio screen that compares a bank's statewide loan-to-deposit ratio to the host state loan-to-deposit ratio for banks in a particular state.

A second step is conducted if a bank's statewide loan-to-deposit ratio is less than one-half of the published ratio for that state or if data are not available at the bank to conduct the first step. The second step requires the appropriate banking agency to determine whether the bank is reasonably helping to meet the credit needs of the communities served by the bank's interstate branches.

A bank that fails both steps is in violation of section 109 and is subject to sanctions by the appropriate banking agency.

The updated list of host state loan-to-deposit ratios are available on the Board's web site at www.federalreserve.gov/boarddocs/press/bcreg/2005/20050707/attachment.pdf.

Bank Secrecy Act/Anti-Money Laundering Interagency Outreach Events

The federal banking and thrift institution agencies, along with the Financial Crimes Enforcement Network (FinCEN), announced on July 18, 2005, registration details for the upcoming outreach events related to the *Bank Secrecy Act/Anti-Money Laundering Examination Manual* (*BSA/AML Examination Manual*) that was released on June 30, 2005. The events included

- three nationwide conference calls to be held August 2–4, 2005; and
- five regional half-day outreach meetings, including a simulcast of one of the meetings via the Internet. These meetings were held in San Francisco, Dallas, Chicago, New York, and Miami.

Banking organizations were encouraged to participate in these voluntary sessions. The content of the events was similar. During the events, the *BSA/AML Examination Manual* was discussed and examination expectations were provided. There was also an opportunity to provide feedback, ask questions, and address implementation issues.

Participating in the outreach sessions was the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Office of Foreign Assets Control, and FinCEN.

The *BSA/AML Examination Manual* emphasizes a banking organization's responsibility to establish and implement risk-based policies, procedures, and processes to comply with the BSA and safeguard its operations from money laundering and terrorist financing.

For questions on the outreach events or the *BSA/AML Examination Manual*, banking organizations should contact the local office of their federal banking agency.

Banking Agencies Issue Final Community Reinvestment Act Rules

The federal banking agencies approved on July 19, 2005, final Community Reinvestment Act (CRA) rules that are intended to reduce regulatory burden on community banks while making CRA evaluations more effective in encouraging banks to meet community development needs. The final rules are essentially as the agencies proposed them in March 2005.

The final rules raise the small bank asset-size threshold to assets of less than $1 billion without regard to holding company affiliation. Accordingly, the new rules reduce data collection and reporting burden for "intermediate small banks" (banks with assets between $250 million and less than $1 billion) and, at the same time, encourage meaningful community development lending, investment, and services by these banks.

The following policies are under the new rules:

- Intermediate small banks will no longer need to collect and report CRA loan data. Nevertheless, examiners will continue to evaluate bank lending activity in the CRA examinations of intermediate small banks and disclose results in the public evaluation.
- Intermediate small banks will be evaluated under two separately rated tests: the small bank lending test; and a flexible new community development test that includes an evaluation of community development loans, investments, and services in light of community needs and the capacity of the bank. Satisfactory ratings are required on both tests to obtain an overall satisfactory CRA rating.

In addition, the following policies apply to banks of any size:

- The new rules expand the definition of community development to include activities that revitalize or stabilize designated disaster areas and distressed or underserved rural areas. By including designated distressed or underserved rural areas, the agencies intend to recognize and encourage community development in more rural areas. (Designated distressed or underserved rural areas are to be listed by the agencies on the Federal Financial Institutions Examination Council web site at www.FFIEC.gov/cra.)
- The regulations also clarify when discrimination or other illegal credit practices by a bank or its affiliate will adversely affect an evaluation of the bank's CRA performance.

The rules, which are being issued jointly by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, became effective on September 1, 2005. The agencies had interim CRA examination procedures for intermediate small banks in place by August 1, 2005.

Agencies Propose Rules on Post-Employment Restrictions for Senior Examiners

The federal banking regulatory agencies issued proposed rules on August 4, 2005, to implement a special post-employment restriction on certain senior examiners employed by an agency or Federal Reserve Bank, as required by the Intelligence Reform and Terrorism Prevention Act of 2004.

Under the proposal, if an examiner serves as the senior examiner for a depository institution or depository institution holding company for two or more months during the examiner's final twelve months of employment with an agency or Reserve Bank, the examiner may not knowingly accept compensation as an employee, officer, director, or consultant from that institution or holding company, or from certain related entities. The restriction applies for one year after leaving the employment of the agency or Reserve Bank. If an examiner violates the one-year restriction, the act requires the appropriate federal banking agency to seek an order of removal and industry-wide employment prohibition for up to five years, a civil money penalty of up to $250,000, or both.

The agencies' proposed rules are substantively similar and vary slightly to reflect differences in the supervisory programs and jurisdictions of the agencies.

Comments on the proposed rules are due sixty days after publication in the *Federal Register*, which was on August 5, 2005.

Bank Secrecy Act/Anti-Money Laundering Interagency Outreach Event Webcast

The federal banking and thrift institution agencies, along with the Financial Crimes Enforcement Network (FinCEN), announced registration details on August 8, 2005, for a live webcast of the *Bank Secrecy Act/Anti-Money Laundering Examination Manual* outreach event that was held in New York on August 22, 2005.

The webcast was open to all parties interested in BSA/AML compliance issues, but registration was required. The outreach event was held from 9 a.m. to noon EDT and will be available for on-demand viewing for three months after the presentation.

The event is part of a series of briefings for the banking industry and field examiners on the *BSA/AML Examination Manual.* The host organizations are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and FinCEN. Also participating in these outreach events are state banking agencies, the Office of Foreign Assets Control, banking organizations, and banking trade associations.

FINANCIAL EDUCATION WEB SITE REDESIGNED

The Federal Reserve System announced on April 18, 2005, that it has redesigned its financial education web site to increase the use of Federal Reserve educational materials and promote financial education in the classroom. The new web site incorporates four Federal Reserve web sites under one main Federal Reserve Education web site.

The redesigned web site (www.FederalReserveEducation.org) has material intended for the general public, as well as materials specifically geared toward teachers and high school and college students. The site includes a new look and feel, while providing easier access to free educational materials, a teacher resource search engine, personal financial education, as well as new multilevel games for various ages and knowledge levels.

"The Federal Reserve has a long history of promoting economic education and financial literacy. In that tradition, this new online tool offers students easier access to a wealth of information in the areas of economics, banking, and financial services," said Federal Reserve Board Chairman Alan Greenspan.

The redesigned web site includes four sections:

- Federal Reserve Education, which provides instructional materials and tools to increase teachers' and students' understanding of the Federal Reserve, economics, and personal finances. Resources include publications and videos, online learning, and links to Federal Reserve System and other economic education web sites.
- Fed 101, an interactive site that provides an overview of the history and organization of the Federal Reserve System, monetary policy and federal regulations, and services provided to depository institutions.
- Personal Financial Education, which helps people make informed decisions about their money and provides guidance for building a stable financial future. The site includes information on topics such as consumer banking, consumer protection, homes and mortgages, interest rates, loans, and credit.
- Teacher Resources, a new site that provides a search tool to allow teachers to locate Federal Reserve System education materials that meet national education standards for incorporation in their lesson plans. The resources on the site include comic books, brochures, teaching guides, magazines, and newsletters on a variety of financial education topics.

PUBLICATION OF THE *INTERNATIONAL JOURNAL OF CENTRAL BANKING*

The Federal Reserve Board, along with the other sponsoring organizations of the *International Journal of Central Banking* (IJCB), announced on May 19, 2005, the publication of the journal's first issue and the launch of a web site (www.ijcb.org) hosted by the Bank for International Settlements.[1]

The IJCB, a new quarterly publication, features articles on central bank theory and practice, with a special emphasis on research relating to monetary and financial stability. The IJCB web site provides additional information about the journal as well as free access to journal articles.

Subscribers to the printed version of the journal will receive issues for 2005 at no cost. Beginning in 2006, print subscriptions will be available for an annual fee of U.S.$100. Subscription orders may be placed online at www.ijcb.org, or by telephone (202) 452-3245, facsimile (202) 728-5886, or e-mail (BDM-IJCB-Editor@frb.gov). Written correspondence should be directed to IJCB—Publications Fulfillment, Mail Stop 127, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, DC 20551.

MAY 2005 UPDATE TO THE *COMMERCIAL BANK EXAMINATION MANUAL*

The May 2005 update to the *Commercial Bank Examination Manual* has been published (supplement no. 23). The *Manual* comprises the Federal

1. Sponsoring organizations are the following: Bank of Algeria, National Bank of Belgium, Central Bank of Brazil, Bank of Canada, People's Bank of China, Bank of England, European Central Bank, Bank of France, Deutsche Bundesbank, Bank of Greece, Hong Kong Monetary Authority, Central Bank of Iceland, Bank of Italy, Bank of Japan, Netherlands Bank, Norges Bank, Bank of Portugal, Central Bank of Russian Federation, Monetary Authority of Singapore, Bank of Spain, Sveriges Riksbank, Swiss National Bank, Central Bank of Turkey, Federal Reserve Board, and Bank for International Settlements.

Reserve System's supervisory and examination guidance for state member banks. The new supplement includes guidance on the following subjects:

1. *Interagency Statement on the Purchase and Risk Management of Life Insurance.* A new section discusses this December 7, 2004, statement placing emphasis on the safety and soundness and risk-management implications of purchases and holdings of life insurance by banks. The agencies issued the guidance because they were concerned that some institutions may not have an adequate understanding of the risks associated with bank-owned life insurance (BOLI), including liquidity, operational, reputational, and compliance or legal risks. Further, institutions may have committed a significant amount of capital to BOLI holdings without properly assessing the associated risks. When an institution is planning to acquire BOLI that will result in an aggregate cash surrender value in excess of 25 percent of its tier 1 capital plus the allowance for loan and lease losses, the agencies expect the institution to obtain the approval of its board of directors or its designated board committee. The guidance addresses the need for institutions to conduct a comprehensive pre- and post-purchase analysis of BOLI, including its unique characteristics, risks, and rewards. Institutions are expected to have comprehensive risk-management processes for their BOLI purchases and holdings; these processes should be consistent with safe and sound banking practices. See SR letters 04-4 and 04-19.

2. *Interagency Advisory on Accounting for Deferred Compensation Agreements and Bank-Owned Life Insurance.* A new section, "Deferred Compensation Agreements" provides guidance from this February 11, 2004, interagency advisory. The advisory was issued because the agencies, through the examination process, had identified many institutions that had incorrectly accounted for the obligations under a type of deferred compensation agreement commonly referred to as a *revenue neutral plan* or an *indexed retirement plan*. The advisory informs institutions that they need to review their accounting for deferred compensation agreements to ensure that they have been appropriately measured and reported. Since institutions often purchase life insurance in conjunction with established deferred compensation programs, the advisory also discusses the appropriate accounting treatment for BOLI. The revised "Other Assets and Other Liabilities" section includes the accounting treatment for BOLI. See SR letters 04-04 and 04-19.

3. *Interagency Joint Guidance on Overdraft Protection Programs.* The sections entitled "Consumer Credit" have been revised to discuss the various types, characteristics, and fee structures of a bank's ad hoc and automated overdraft programs. The sections also include the February 18, 2005, interagency guidance that addresses the agencies' concerns about the potentially misleading implementation, marketing, and disclosure practices associated with the operation of these programs. Financial institutions are encouraged to review their overdraft-protection policies and procedures to make certain that their marketing and communications do not mislead consumers or encourage irresponsible consumer financial behavior that could increase the institution's risk. The guidance also addresses the safety and soundness considerations, risk-based capital treatment, and legal risks associated with overdraft-protection programs.

The sections entitled "Deposit Accounts" have also been revised to discuss this interagency guidance, which was issued to assist banks in the responsible disclosure and administration of their overdraft-protection programs. The guidance states that banks should establish and monitor written policies and procedures for ad hoc and automated, or other overdraft-protection programs. A bank's policies and procedures should be adequate to address the credit, operational, and other risks associated with these types of programs. The examination procedures and internal control questionnaires have been updated to incorporate the guidance. See SR letter 05-3 and CA letter 05-2.

4. *Foreign Correspondent Accounts.* The "Bank-Related Organizations" section has been revised to incorporate the U.S. Department of the Treasury's regulation regarding foreign correspondent accounts. See 31 CFR 103.177 (amended December 24, 2002) and 103.185. The regulation became effective October 28, 2002, and implemented sections 313 and 319(b) of the USA Patriot Act. A covered financial institution (CFI) is prohibited from establishing, maintaining, administering, or managing a correspondent account in the United States for, or on behalf of, a foreign shell bank (a foreign bank that has no physical presence in the United States or other jurisdictions) that is *not* affiliated (1) with a U.S.-domiciled financial institution or (2) with a foreign bank that maintains a physical presence in the United States or a foreign country and is supervised by its home-country banking authority. A CFI that maintains a correspondent account for a foreign bank in the United States must maintain records in the United States identifying the owners of the bank. See SR letter 03-17 and the October 2003 Bank Secrecy Act Examination Procedures for Correspondent Accounts for Foreign Shell Banks; Recordkeeping and Termination of Correspondent Accounts for Foreign Banks. See also SR letter 01-29.

5. *Interagency Guidelines Establishing Information Security Standards and Interagency Guidance on Response Programs for Unauthorized Access to Customer Information and Customer Notice.* The sections entitled, "Information Technology" have been revised to include the Board's December 16, 2004, adoption of rule changes (effective July 1, 2005) that implement section 216 of the Fair and Accurate Credit Transactions Act of 2003, and amend the Interagency Guidelines Establishing Standards for Safeguarding Customer Information. See the Board's December 21, 2004, press release. To address the risks associated with identity theft, financial institutions are required to make modest adjustments to their information security programs to develop, implement, maintain, and monitor, as part of their existing information security program, appropriate measures to properly dispose of consumer and customer information derived from credit reports. Each financial institution must contractually require its service providers to develop appropriate measures for the proper disposal of the institution's consumer and customer information and, when warranted, monitor its service providers to confirm that they have satisfied their contractual obligations.

The sections have also been revised to include the Board's March 21, 2005, adoption of the jointly issued Interagency Guidance on Response Programs for Unauthorized Access to Customer Information and Customer Notice. See the Board's March 23, 2005, press release. Financial institutions are to develop and implement a response program designed to address incidents of unauthorized access to sensitive customer information, maintained by the institution or its service provider, that could result in substantial harm or inconvenience to the customer. Each financial institution has the flexibility to design a risk-based response program tailored to the size, complexity, and nature of its operations. Customer notice is a key feature of an institution's response program. See Regulation H, appendix D-2, supplement A (12 CFR 208, appendix D-2, supplement A). The examination objectives, examination procedures, and the internal control questionnaire have been updated to incorporate or reference the rule changes and the interagency guidance.

6. *Interagency Advisory on the Confidentiality of the Supervisory Rating and Other Nonpublic Supervisory Information.* The February 28, 2005, advisory reminds banking organizations of the statutory prohibitions on the disclosure of supervisory ratings and other confidential supervisory ratings to third parties. See SR letter 05-4.

7. *Customer Identification Programs.* The "Private Banking" section has been revised to incorporate new and enhanced statutory requirements of the USA Patriot Act (the act). The requirements are designed to prevent, detect, and prosecute money laundering and terrorist financing. For banking organizations, the act's provisions are implemented through regulations issued by the U.S. Department of the Treasury (31 CFR 103). Section 326 of the USA Patriot Act (codified in the BSA at 31 U.S.C. 5318)(*l*) requires financial institutions to have customer identification programs, that is, programs to collect and maintain certain records and documentation on customers. Institutions should also develop and use identity verification procedures to ensure the identity of customers. See SR letter 04-13, which describes the BSA examination procedures for customer identification programs; examiners should follow these procedures when evaluating compliance with the regulation. See also SR letters 03-17 and 01-29. Relevant interagency interpretive guidance, in a question-and-answer format, addresses the customer identification rules. See SR letter 05-9.

A more detailed summary of changes is included with the update package. Copies of the new supplement were shipped directly by the publisher to the Reserve Banks for distribution to examiners and other System staff members. The public may obtain the *Manual* and the updates (including pricing information) from Publications Fulfillment, Mail Stop 127, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, DC 20551; telephone (202) 452-3244; or send a facsimile to (202) 728-5886. The *Manual* is also available on the Board's public web site at www.federalreserve.gov/boarddocs/supmanual/.

AGENCIES RELEASE BANK SECRECY ACT/ ANTI-MONEY LAUNDERING EXAMINATION MANUAL

The Federal Financial Institutions Examination Council (FFIEC) released on June 30, 2005, the *Bank Secrecy Act/Anti-Money Laundering Examination Manual (FFIEC BSA/AML Examination Manual).* The manual's release marks an important step forward in the effort to ensure the consistent application of the BSA to all banking organizations, including commercial banks, savings associations, and credit unions.

The *FFIEC BSA/AML Examination Manual* was developed by the Board of Governors of the Federal Reserve System (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) (collectively referred to as the federal banking agencies) in collaboration with the Financial Crimes Enforcement Network (FinCEN), the delegated administrator of the BSA. In addition, through the Conference of State Bank Supervisors, the state banking agencies played a consultative role. The Office of Foreign Assets Control (OFAC) collaborated on the development of core overview and examination procedures addressing compliance with regulations enforced by OFAC.

The *FFIEC BSA/AML Examination Manual* emphasizes a banking organization's responsibility to establish and implement risk-based policies, procedures, and processes to comply with the BSA and safeguard its operations from money laundering and terrorist financing. The BSA/AML examination procedures will guide examiners through an evaluation of a banking organization's BSA/AML compliance program regardless of its size or business lines. The majority of the *FFIEC BSA/AML Examination Manual* provides narrative guidance and resource materials rather than specific examination procedures. This includes an overview of the BSA requirements and the federal banking agencies' supervisory expectations in this area.

The Board, the FDIC, the OCC, the OTS, and FinCEN have planned a series of events to brief the banking industry and field examiners on the *FFIEC BSA/AML Examination Manual.* These events include nationwide conference calls, regional outreach meetings, and a simulcast via the Internet. Banking organizations are encouraged to participate in these voluntary sessions.

Online Financial Education Project

The Federal Reserve Board launched on July 26, 2005, a new online project with USA Today that teaches middle-school and high-school students about economics and personal finances by challenging them to construct a newspaper front page.

Students are provided with instructions and a template of the front page of *The Fed Today*. Over four weeks, they are expected to consult the Federal Reserve's recently redesigned education web site—FederalReserveEducation.org—for information needed to complete all of the elements of the page, including headlines, photos, captions, graphs, and statistics. The project helps teachers meet national and state academic content standards for high-school economics and personal finance courses. The online project may be found on the web at www.usatoday.com/educate/federalreserve/index_new2.html.

Minutes of the Board's Discount Rate Meetings

The Federal Reserve Board released on April 19, 2005, the minutes of its discount rate meetings from February 7, 2005, through March 22, 2005.

On May 31, 2005, the Board released the minutes of its discount rate meetings from April 4, 2005, through May 3, 2005.

On July 28, 2005, the Board released the minutes of its discount rate meetings from May 23, 2005, through June 30, 2005.

Minutes of the Federal Open Market Committee

The Federal Reserve Board and the Federal Open Market Committee, released on May 24, 2005, the minutes of the Committee meeting held on May 3, 2005.

On July 21, 2005, the Federal Reserve Board and the Federal Open Market Committee released the minutes of the Committee meeting held on June 29–30, 2005.

The minutes for each regularly scheduled meeting of the Committee are made available three weeks after the day of the policy decision and subsequently are published in the Board's *Annual Report*. The summary descriptions of economic and financial conditions contained in the minutes are based solely on the information that was available to the Committee at the time of the meetings.

FOMC minutes can be viewed on the Board's web site at www.federalreserve.gov/fomc.

Consumer Advisory Council Meeting

The Board of Governors of the Federal Reserve System announced on June 3, 2005, that the Consumer Advisory Council would hold its next meeting on Thursday, June 23, 2005. The meeting, which was open to public observation, took place at the Federal Reserve Board's offices in Washington, D.C., in Dining Room E on the Terrace level in the Board's Martin Building.

The Council's function is to advise the Board on the exercise of its responsibilities under various consumer financial services laws and on other matters on which the Board seeks its advice. Time permitting, the Council planned to discuss the following topics:

- Truth in Lending Act
- Information security
- Community Reinvestment Act and community development

Reports by committees and other matters initiated by the Council members were also discussed. The Board invited comments from the public on any of these matters.

Board Seeks Nominations for Appointments to Consumer Advisory Council

The Federal Reserve Board announced on June 15, 2005, that it is seeking nominations for appointments to its Consumer Advisory Council.

The Council advises the Board on the exercise of its responsibilities under various consumer financial services laws and on other matters on which the Board seeks advice. The group meets in Washington, D.C., three times a year.

Ten new members will be appointed to serve three-year terms beginning in January 2006. Nominations should include a résumé and the following information about nominees:

- complete name, title, mailing address, e-mail address, telephone, and fax numbers;
- organization's name, brief description of organization, address, telephone, and fax numbers;
- past and present positions, dates, and description of responsibilities;

• knowledge, interests, or experience related to community reinvestment, consumer protection regulations, consumer credit, or other consumer financial services; and

• positions held in community and banking associations, councils, and boards.

Nominations should also include the nominator's complete name, organization name, title, mailing address, e-mail address, and telephone and fax numbers.

Letters of nomination with complete information, including a résumé for each nominee, were to be received by August 26, 2005.

ENFORCEMENT ACTIONS

Assessments of Civil Money Penalties

The Federal Reserve Board announced on April 21, 2005, the issuance of a consent order of assessment of a civil money penalty against the Irwin Union Bank, Columbus, Indiana, a state member bank. Irwin Union Bank, without admitting to any allegations, consented to the issuance of the order in connection with its alleged violations of the Board's regulations implementing the National Flood Insurance Act.

The order requires Irwin Union Bank to pay a civil money penalty of $22,300, which will be remitted to the Federal Emergency Management Agency for deposit into the National Flood Mitigation Fund.

The Federal Reserve Board announced on April 21, 2005, the issuance of a consent order of assessment of a civil money penalty against The Bank, Warrior, Alabama, a state member bank. The Bank, without admitting to any allegations, consented to the issuance of the order in connection with its alleged violations of the Board's regulations implementing the National Flood Insurance Act.

The order requires The Bank to pay a civil money penalty of $46,050, which will be remitted to the Federal Emergency Management Agency for deposit into the National Flood Mitigation Fund.

The Federal Reserve Board announced on June 9, 2005, the issuance of a consent order of assessment of a civil money penalty against the Bank of Pontiac, Pontiac, Illinois, a state member bank. The Bank of Pontiac, without admitting to any allegations, consented to the issuance of the order in connection with its alleged violations of the Board's regulations implementing the National Flood Insurance Act.

The order requires the Bank of Pontiac to pay a civil money penalty of $32,550, which will be remitted to the Federal Emergency Management Agency for deposit into the National Flood Mitigation Fund.

The Federal Reserve Board announced on June 9, 2005, the issuance of a consent order of assessment of a civil money penalty against the First Bank and Trust Company, Lebanon, Virginia, a state member bank. The First Bank and Trust Company, without admitting to any allegations, consented to the issuance of the order in connection with its alleged violations of the Board's regulations implementing the National Flood Insurance Act.

The order requires the First Bank and Trust Company to pay a civil money penalty of $7,750, which will be remitted to the Federal Emergency Management Agency for deposit into the National Flood Mitigation Fund.

The Federal Reserve Board announced on July 6, 2005, the issuance of a consent order of assessment of a civil money penalty against the Frontier Bank, Everett, Washington, a state member bank. Frontier Bank, without admitting to any allegations, consented to the issuance of the order in connection with its alleged violations of the Board's regulations implementing the National Flood Insurance Act.

The order requires Frontier Bank to pay a civil money penalty of $12,500, which will be remitted to the Federal Emergency Management Agency for deposit into the National Flood Mitigation Fund.

The Federal Reserve Board announced on July 6, 2005, the issuance of a consent order of assessment of a civil money penalty against the Security Bank, Ralls, Texas, a state member bank. Security Bank, without admitting to any allegations, consented to the issuance of the order in connection with its alleged violations of the Board's regulations implementing the National Flood Insurance Act.

The order requires Security Bank to pay a civil money penalty of $3,250, which will be remitted to the Federal Emergency Management Agency for deposit into the National Flood Mitigation Fund.

Written Agreements

The Federal Reserve Board announced on April 25, 2005, the execution of a written agreement by and between the Civitas BankGroup, Inc., Franklin, Tennessee, and the Federal Reserve Bank of Atlanta.

The Federal Reserve Board announced on April 29, 2005, the execution of a written agreement by and among Banco Industrial de Venezuela, C.A., Caracas, Venezuela; Banco Industrial de Venezuela, C.A. New York Agency, New York, New York; Banco Industrial de Venezuela, C.A. Miami Agency, Miami, Florida; the New York State Banking Department, New York, New York; the State of Florida Office of Financial Regulation, Tallahassee, Florida; the Federal Reserve Bank of New York; and the Federal Reserve Bank of Atlanta.

The Federal Reserve Board announced on July 14, 2005, the execution of a written agreement by and among the First Citizens Bank of Butte, Butte, Montana; the Montana Division of Banking and Financial Institutions; and the Federal Reserve Bank of Minneapolis.

Final Decisions and Orders

The Federal Reserve Board announced on May 13, 2005, the issuance of a final decision and order of prohibition against Donald K. McKinney, a former vice president of American National Bank, Wichita Falls, Texas. The order, the result of an action brought by the Office of the Comptroller of the Currency, prohibits Mr. McKinney from participating in the conduct of the affairs of any financial institution or holding company.

The Federal Reserve Board announced on June 7, 2005, the issuance of a final decision and cease and desist order against eighteen former institution-affiliated parties of First Western Bank, Cooper City, Florida, and an order of prohibition against Carl V. Thomas, one of the former institution-affiliated parties. The orders were the result of an action brought by the Board to address violations of the Change in Bank Control Act in connection with the respondents' acquisition of shares of First Western Bank in 1997 and 1998.

The Federal Reserve Board announced on June 17, 2005, the issuance of an order of prohibition against Frank G. Caton, previously branch manager of the former Farmers Bank of Maryland, Annapolis, Maryland.

Mr. Caton, without admitting to any allegations, consented to the issuance of the order based on his alleged participation in violations of law and breaches of fiduciary duty to the bank and its customers in connection with embezzlement of funds and falsification of the bank's books and records.

The Federal Reserve Board announced on June 28, 2005, the issuance of an order of prohibition and order to cease and desist against Matthew T. Stromgren, a former financial adviser at J.P. Morgan Chase and Company, New York, New York.

Mr. Stromgren, without admitting to any allegations, consented to the issuance of the order based on his alleged participation in violations of law and breaches of fiduciary duty to the bank and its customers in connection with embezzlement of funds, forgery, and falsification of the bank's books and records. The order requires Mr. Stromgren to make restitution to the bank in the amount of $31,000.

The Federal Reserve Board announced on July 21, 2005, the issuance of an order of prohibition against Stefanie Milmine, a former employee of Fifth Third Bank in Grand Rapids, Michigan.

Ms. Milmine, without admitting to any allegations, consented to the issuance of the order based on her alleged participation in violations of law and breaches of fiduciary duty in connection with embezzlement of funds at the bank, as well as similar violations and breaches at other banks.

The Federal Reserve Board announced on August 1, 2005, the issuance of a cease and desist order and order of assessment of a civil money penalty against Frank French, a former institution-affiliated party of the Montana State Bank, Plentywood, Montana.

Mr. French, without admitting to any allegations, consented to the issuance of the order for alleged violations of the Board of Governors' Regulation O, which governs loans to executive officers, directors, and principal shareholders of member banks. The order also requires Mr. French to pay a civil money penalty of $10,000.

Termination of Enforcement Actions

The Federal Reserve Board announced on April 21, 2005, the termination of the enforcement actions listed below. The Federal Reserve's enforcement action web site, www.federalreserve.gov/boarddocs/enforcement, reports the terminations as they occur.

- Bank of the Orient, San Francisco, California
  Cease and desist order dated May 7, 2002
  Terminated April 18, 2005
- Gold Bank, Leawood, Kansas, and Gold Banc Corporation, Inc., Leawood, Kansas
  Written agreement dated August 26, 2003
  Terminated April 19, 2005

CHANGES IN BOARD STAFF

Herbert A. Biern, senior associate director, in the Division of Banking Supervision and Regulation, retired from the Board on May 13, 2005, after twenty-five years of service.

The Board of Governors approved on May 4, 2005, the appointment of Robin L. Lumsdaine as associate director for Quantitative Risk Management, Division of Banking Supervision and Regulation. Ms. Lumsdaine will now report to Deputy Director Stephen M. Hoffman. In her new position, Ms. Lumsdaine will establish a Quantitative Risk Management section that will work with Reserve Banks and other financial market authorities to implement Basel II and oversee advanced risk-management and risk-measurement techniques.

Ms. Lumsdaine recently served as director, Global Real Rates and Agency Strategist and Global Econometric Strategist for Deutsche Bank. Previously, she was a senior economist at the White House Council of Economic Advisers and a professor of economics at Brown University. Earlier in her career, she was an assistant professor at Princeton University. Ms. Lumsdaine holds a BS in mathematics from Brown University and a master's degree and doctorate in economics from Harvard University.

After forty-one years of service with the Federal Reserve Board, including thirty-four years as a member of the Board's official staff, Mr. Edward Ettin retired on July 29, 2005.

The Board of Governors approved on June 16, 2005, the following officer actions in the Division of Research and Statistics in conjunction with a reorganization of the division:

Patrick M. Parkinson was promoted to deputy director. He will have oversight responsibilities for the micro-financial functions of the division and play a leadership role throughout the Board and the System on issues relating to financial regulations and financial stability. Mr. Parkinson joined the Board in 1980 as an economist in the Division of International Finance and moved to the Division of Research and Statistics in 1984. In 1986 he joined the Division of Banking Supervision and Regulation as the manager of the Financial Analysis section. He returned to Research and Statistics in 1988 as chief of the Capital Markets section. He was promoted to assistant director in 1989 and to associate director in 1994. Mr. Parkinson received his PhD in economics from the University of Wisconsin-Madison.

Myron L. Kwast was promoted to senior associate director. He will share responsibility with Mr. Parkinson for the Division's work on issues related to financial regulations and financial stability, with a special focus on banking analysis and competition policy. Mr. Kwast joined the Board in 1978 as an economist in the Financial Studies section. He was promoted to chief of that section in 1985, to assistant director in 1987, and to associate director in 1994. Mr. Kwast received his PhD in economics from the University of Wisconsin-Madison.

A. Patricia White was promoted to associate director for the Risk Analysis, Microstatistics, and Financial Reports sections. Ms. White joined the Board in 1979 as an economist in the Financial Structure section. She served as special assistant to Governor Wallich in 1982 and then returned to the Division of Research and Statistics. She was promoted to chief of the newly created Trading Risk Analysis section in 1993, to assistant director in 2000, and to deputy associate director in 2004. Ms. White received her PhD in economics from Yale University.

S. Wayne Passmore was promoted to deputy associate director of the Financial Studies and the Financial Structure sections. In 1984 Mr. Passmore began his career at the Federal Reserve Bank of New York. He worked briefly at the Board as a staff economist in 1987 before taking a management position with the Federal Home Loan Bank in San Francisco. Mr. Passmore returned to the Board in 1990 as a senior economist in the Capital Markets section. He was promoted to chief of the newly formed Household and Real Estate Finance section in 1997 and, in 2000, was promoted to assistant director and chief. Mr. Passmore received a PhD in economics from the University of Michigan.

Janice Shack-Marquez was promoted to deputy associate director. She will continue to provide oversight for the Research Library, the Automation and Research Computing (ARC) section, and Administration. Ms. Shack-Marquez joined the Board in 1986 as an economist in the Economic Activity section (now Macroeconomic Analysis). She was promoted to chief of the ARC section in 1994 and to assistant director in 1997. In 2001 she assumed responsibility for the Research Library. Ms. Shack-Marquez received her PhD in public policy analysis from the University of Pennsylvania.

Robin A. Prager was appointed assistant director and chief of the Financial Structure section. Ms. Prager joined the Board in 1994 as an economist in the Financial Structure section. She was promoted to senior economist in 1998 and to chief in 2000. Before joining the Board, she taught in the business schools of Vanderbilt University, Boston University, and the Massachusetts Institute of Technology (MIT). Ms. Prager received her PhD in economics from MIT.

Michael S. Cringoli was appointed assistant director and chief of the Automation and Research Computing (ARC) section. Mr. Cringoli began his career at the Board in 1983 as a computer applications programmer in the Division of Data Processing. In 1985 he transferred to the Division of Research and Statistics as part of the new ARC section that designed and built the original Unix network that supported the computing work of the division. Mr. Cringoli was promoted to chief of the ARC section in 2000. Before joining the Board, he worked as a project planner for the Maryland National Capital Park and Planning Commission and as a manager with Dames and Moore Engineering Consultants. Mr. Cringoli received his bachelor's degree in geography from Rutgers University.

Jim Houpt, associate director in the Division of Banking Supervision and Regulation, retired from the Board at the end of August after thirty-two years of service and nearly four years in the United States Army.

Irene (Shawn) McNulty, senior adviser in the Division of Consumer and Community Affairs, will retire on September 30, 2005, after more than thirty-three years of service. □

Legal Developments

ORDERS ISSUED UNDER BANK HOLDING COMPANY ACT

Orders Issued Under Section 3 of the Bank Holding Company Act

Capital City Bank Group, Inc.
Tallahassee, Florida

Capital City Bank
Tallahassee, Florida

Order Approving the Merger of Bank Holding Companies, Merger of Banks, and Establishment of Branches

Capital City Bank Group, Inc. ("Capital City"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to merge with First Alachua Banking Corporation ("First Alachua"), with Capital City as the surviving entity, and thereby indirectly acquire First Alachua's wholly owned subsidiary, First National Bank of Alachua ("First National Bank"), both of Alachua, Florida. In addition, Capital City's subsidiary bank, Capital City Bank, a state member bank, has requested the Board's approval under section 18(c) of the Federal Deposit Insurance Act[2] ("Bank Merger Act") to merge with First National Bank, with Capital City Bank as the surviving entity. Capital City Bank has also applied under section 9 of the Federal Reserve Act ("FRA") to retain and operate branches at the locations of First National Bank's main office and branches.[3]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (69 *Federal Register* 71,056 (2004)) and locally in accordance with the relevant statutes and the Board's Rules of Procedure.[4] As required by the BHC Act and the Bank Merger Act, reports on the competitive effects of the mergers were requested from the United States Attorney General and the appropriate banking agencies. The time for filing comments has expired, and the Board has considered the applications and all comments received in light of the factors set forth in section 3 of the BHC Act, the Bank Merger Act, and the FRA.

Capital City, with total consolidated assets of approximately $2.4 billion, is the 28th largest insured depository organization in Florida, controlling deposits of approximately $1.4 billion.[5] First Alachua, with total consolidated assets of approximately $231.8 million, is the 111th largest insured depository organization in Florida, controlling deposits of approximately $207 million. On consummation of the proposal, Capital City would become the 26th largest insured depository organization in Florida, controlling deposits of approximately $1.6 billion, which would represent less than 1 percent of total deposits of insured depository institutions in the state.[6]

Competitive Considerations

Section 3 of the BHC Act and the Bank Merger Act prohibit the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act and the Bank Merger Act also prohibit the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[7]

Capital City Bank and First National Bank compete directly in the Gainesville and Palatka banking markets in Florida.[8] The Board has carefully reviewed the competitive effects of the proposal in these banking markets in light of all the facts of record, including the number of competitors that would remain in the markets, the relative shares of total deposits in depository institutions in each market ("market deposits") controlled by Capital City Bank and

1. 12 U.S.C. § 1842.
2. 12 U.S.C. § 1828(c).
3. 12 U.S.C. § 321. These branches are listed in the appendix.
4. 12 CFR 262.3(b).

5. Asset data are as of December 31, 2004, and deposit data and statewide ranking data are as of June 30, 2004. Ranking data are adjusted to reflect merger and acquisition activity through March 4, 2005.
6. In this context, the term "insured depository institutions" includes insured commercial banks, savings banks, and savings associations.
7. *See* 12 U.S.C. § 1842(c)(1); 12 U.S.C. § 1828(c)(5).
8. The Gainesville banking market is defined as Alachua, Gilchrist, and Levy Counties. The Palatka banking market is defined as Putnam County and the town of Hastings in St. Johns County.

First National Bank,[9] the concentration level of market deposits and the increase in this level as measured by the Herfindahl-Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[10] and other characteristics of the markets.

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in the Gainesville banking market. This banking market would remain moderately concentrated, and the post-merger HHI would increase 67 points, to 1,293. Fourteen competitors would remain in the banking market.[11]

In the Palatka banking market, the HHI would slightly exceed DOJ Guidelines on consummation. Capital City Bank is the fifth largest depository institution in the market, controlling approximately $63.8 million in deposits, which represent approximately 13.5 percent of market deposits. First National Bank is the sixth largest depository institution with deposits of approximately $42.7 million, which represent approximately 9 percent of market deposits. On consummation of the merger, Capital City Bank would become the largest depository institution in the market, controlling deposits of approximately $106.5 million, which represent approximately 22.5 percent of market deposits. The HHI would increase 242 points, to 1,808.

In reviewing the competitive effects of this proposal, the Board has considered that several factors appear to mitigate the likely effect of the proposal on competition in the Palatka banking market. The Palatka banking market has five commercial banking organizations and one thrift organization that would remain in the market after consummation. Two commercial bank competitors each would control approximately 20 percent of market deposits and local branch networks as large as Capital City's.

The Board also has considered that this banking market has two active community credit unions in Palatka that offer a wide range of consumer banking products. The First Coast Community Credit Union controls $45.9 million in deposits in the Palatka banking market, and the Putnam County Federal Credit Union controls $22.5 million in deposits in the market. Almost all residents in the Palatka banking market are eligible for membership in each credit union, and both credit unions operate street-level branches with drive-up service lanes. The Board concludes that these credit unions exert a competitive influence that mitigates, in part, the potential anticompetitive effects of the proposal.[12]

The Board concludes that the foregoing considerations, including the presence of two accessible credit unions, the number and size of competitors that would remain in the Palatka banking market after consummation, and other factors, mitigate the transaction's potential anticompetitive effects. The DOJ has advised the Board that consummation of the proposal is not likely to have a significantly adverse competitive effect in the Palatka banking market. The Board also has received no objections to the proposal from the other federal banking agencies.

Based on all the facts of record, the Board concludes that consummation of the proposed transaction would not likely result in a significantly adverse effect on competition or on the concentration of banking resources in any relevant banking market and that competitive factors are consistent with approval.

Financial and Managerial Resources and Supervisory Considerations

In reviewing the proposal under section 3 of the BHC Act, the Bank Merger Act, and the FRA, the Board has carefully considered the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record including, among other things, confidential reports of examination and other supervisory information received from the federal and state banking supervisors of the organizations involved, publicly reported and other financial information, and information provided by the applicants.

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9. Deposit and market share data are as of June 30, 2004, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group,* 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation,* 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.,* 77 *Federal Reserve Bulletin* 52 (1991).

10. Under the DOJ Guidelines, a market is considered moderately concentrated if the post-merger HHI is between 1000 and 1800, and a market is considered highly concentrated if the post-merger HHI is more than 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

11. Capital City Bank operates the seventh largest depository institution in the market, controlling deposits of approximately $148.1 million, which represent approximately 5.5 percent of market deposits. First National Bank operates the fifth largest depository institution in the market, controlling deposits of approximately $164.3 million, which represents approximately 6.1 percent of market deposits. On consummation of the proposal, Capital City Bank would become the third largest depository institution in the market, controlling deposits of approximately $312.4 million, which represents approximately 11.6 percent of market deposits.

12. The Board previously has considered the competitiveness of certain active credit unions as a mitigating factor. *See F.N.B. Corporation,* 90 *Federal Reserve Bulletin* 481 (2004); *Gateway Bank & Trust Co.,* 90 *Federal Reserve Bulletin* 547 (2004). With deposits of these credit unions included at 50 percent, Capital City Bank would be the fifth largest of nine depository institutions in the market, with approximately 12.6 percent of market deposits, and First National Bank would be the sixth largest depository institution in the market, controlling approximately 8.4 percent of market deposits. On consummation of the proposal, Capital City Bank would be the largest depository institution in the market with deposits of approximately $106.5 million or approximately 21 percent of market deposits. The HHI would increase 211 points, to 1,598.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary banks and significant nonbanking operations. In this evaluation, the Board considers a variety of areas, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization, including its capital position, asset quality, and earnings prospects and the impact of the proposed funding of the transaction.

Based on its review of these factors, the Board finds that Capital City has sufficient financial resources to effect the proposal. The transaction would be effected through a combination of cash and an exchange of shares. Capital City would fund the cash consideration by issuing trust preferred securities. Capital City and Capital City Bank are well capitalized and would remain so on consummation of the proposal.

The Board also has evaluated the managerial resources of the organizations involved and of the proposed combined organization. The Board has reviewed the examination records of Capital City, First Alachua, and their subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experience and that of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking law. The Board also has considered Capital City's plans to integrate First Alachua and First National Bank and the proposed management, including the risk-management systems, of the resulting organization.

Based on all the facts of record, the Board has concluded that the financial and managerial resources and future prospects of the organizations and the other supervisory factors involved are consistent with approval of the proposal.

Convenience and Needs and Other Considerations

In acting on the proposal, the Board also must consider its effects on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[13] Capital City Bank received an overall rating of "satisfactory" at its most recent CRA performance evaluation by the Federal Reserve Bank of Atlanta, as of November 17, 2003. First National Bank also received a "satisfactory" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency, as of October 7, 2002. The Board notes that the proposal would provide the combined entity's customers with access to a broader array of products and services in expanded service areas, including access to expanded branch and automated teller machine networks. Based on all the facts of record, the Board concludes that the considerations relating to the convenience and needs of the communities to be served and the CRA performance records of the institutions involved are consistent with approval of this proposal.

As previously noted, Capital City also has applied under section 9 of the FRA to establish branches at the locations listed in the appendix. The Board has assessed the factors it is required to consider when reviewing an application under section 9 of the FRA, including section 208.6 of the Board's Regulation H, which implements section 9(4) of the FRA, and finds those factors to be consistent with approval.[14]

Conclusion

Based on the foregoing and all facts of record, the Board has determined that the applications should be, and hereby are, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act, the Bank Merger Act, and the FRA. The Board's approval is specifically conditioned on compliance by Capital City with the conditions imposed in this order, the commitments made to the Board in connection with the applications, and receipt of all other regulatory approvals. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposed transactions may not be consummated before the fifteenth calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Atlanta, acting pursuant to delegated authority.

By order of the Board of Governors, effective April 28, 2005.

Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

Appendix

Addresses of Main Office and Branches in Florida to be Acquired by Capital City

Alachua
15000 N.W. 140th Street

13. 12 U.S.C. § 2901 et seq.

14. 12 U.S.C. § 322; 12 CFR 208.6(b).

Gainesville
4000 N. Main Street
6360 N.W. 13th Street
4040 N.W. 16th Boulevard
4041 N.W. 37th Place, Suite A

Hastings
207 N. Main Street

High Springs
660 N.E. Santa Fe Boulevard

Jonesville
14009 W. Newberry Road

Newberry
24202 W. Newberry Road, Suite F

C-B-G, Inc.
West Liberty, Iowa

Order Approving the Acquisition of Shares of a Bank Holding Company

C-B-G, Inc. ("C-B-G"), a bank holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire up to 24.35 percent of the voting shares of Washington Bancorp ("Washington") and thereby indirectly acquire an interest in Washington's subsidiary bank, Federation Bank, both of Washington, Iowa.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (69 *Federal Register* 78,028 (2004)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.

C-B-G, with consolidated assets of approximately $189 million, is the 63rd largest depository organization in Iowa, controlling deposits of $160 million, which represent less than 1 percent of total deposits of insured depository institutions in Iowa ("state deposits").[2] Washington, with total consolidated assets of $106 million, is the 154th largest depository organization in Iowa, controlling $75 million in deposits. If C-B-G were deemed to control Washington on consummation of the proposal, C-B-G would become the 43rd largest depository organization in Iowa, controlling approximately $235 million in deposits, which represents 1 percent of state deposits.

The Board received comments from Washington and a local resident objecting to the proposal and expressing concern that the proposal would result in C-B-G controlling and potentially harming Washington.[3] The Board has considered carefully these comments in light of the factors that the Board must consider under section 3 of the BHC Act.

The Board previously has stated that the acquisition of less than a controlling interest in a bank or bank holding company is not a normal acquisition for a bank holding company.[4] However, the requirement in section 3(a)(3) of the BHC Act that the Board's approval be obtained before a bank holding company acquires more than 5 percent of the voting shares of a bank suggests that the Congress contemplated the acquisition by bank holding companies of between 5 percent and 25 percent of the voting shares of banks.[5] On this basis, the Board previously has approved the acquisition by a bank holding company of less than a controlling interest in a bank or bank holding company.[6]

C-B-G has indicated that it does not propose to control or exercise a controlling influence over Washington or Federation Bank. C-B-G has agreed to abide by certain commitments previously relied on by the Board in determining that an investing bank holding company would not be able to exercise a controlling influence over another bank holding company for purposes of the BHC Act.[7] For example, C-B-G has committed not to exercise or attempt to exercise a controlling influence over the management or policies of Washington or any of its subsidiaries; not to seek or accept representation on the board of directors of Washington or any of its subsidiaries; and not to have any director, officer, employee, or agent interlocks with Washington or any of its subsidiaries. C-B-G also has committed not to attempt to influence the dividend policies, loan decisions, or operations of Washington or any of its subsidiaries. The Board notes that the BHC Act prohibits C-B-G from acquiring additional shares of Washington or attempt-

1. 12 U.S.C. § 1842.

2. Asset data are as of December 31, 2004. Statewide deposit and ranking data are as of June 30, 2004. Deposit data reflect the total of the deposits reported by each organization's insured depository institutions in their Consolidated Reports of Condition and Income or Thrift Financial Reports. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

3. Washington requested a private meeting with C-B-G about the proposal. Under the Board's Rules of Procedures, the Reserve Bank may arrange a private meeting between a protestant and the applicant for the purposes of clarifying and narrowing issues and resolving differences when both parties agree to such a meeting. 12 CFR 262.25(c). The parties ultimately declined the invitation of the Federal Reserve Bank of Chicago to participate in a private meeting.

4. *See, e.g., Brookline Bancorp, MHC*, 86 *Federal Reserve Bulletin* 52 (2000) ("*Brookline*"); *North Fork Bancorporation, Inc.*, 81 *Federal Reserve Bulletin* 734, 735 (1995) ("North Fork"); *First Piedmont Corp.*, 59 *Federal Reserve Bulletin* 456, 457 (1973).

5. 12 U.S.C. § 1842(a)(3).

6. *S&T Bancorp, Inc.*, 91 *Federal Reserve Bulletin* 74 (2005) (acquisition of up to 24.9 percent of the voting shares of a bank holding company); *Brookline* (acquisition of up to 9.9 percent of the voting shares of a bank holding company); *GB Bancorporation*, 83 *Federal Reserve Bulletin* 115 (1997) (acquisition of up to 24.9 percent of the voting shares of a bank).

7. *See, e.g., S&T Bancorp*; *Brookline*; *FleetBoston Financial Corp.*, 86 *Federal Reserve Bulletin* 751, 766 (2000). The commitments are set forth in the appendix. Washington also has expressed concern that C-B-G might in the future seek relief from some of these commitments. Any such request would be evaluated by the Board in light of all facts and circumstances at that time.

ing to exercise a controlling influence over Washington without the Board's prior approval.

The Board has adequate supervisory authority to monitor compliance by C-B-G with its commitments and can take enforcement action against C-B-G if it violates any of the commitments.[8] The Board also has authority to initiate a control proceeding against C-B-G if facts presented later indicate that C-B-G or any of its subsidiaries or affiliates in fact controls Washington for purposes of the BHC Act.[9] Based on these considerations and all other facts of record, the Board has concluded that C-B-G would not acquire control of, or have the ability to exercise a controlling influence over, Washington through the proposed acquisition of voting shares.[10]

Competitive and Convenience and Needs Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. Section 3 also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the Board finds that the anticompetitive effects of the proposal clearly are outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[11]

The Board previously has stated that one company need not acquire control of another company to lessen competition between them substantially.[12] C-B-G and Washington, however, do not compete directly in any relevant banking market. Based on all the facts of record, the Board has concluded that consummation of the proposal would have no significant adverse effect on competition or on the concentration of banking resources in any relevant banking market and that competitive factors are consistent with approval of the proposal.

8. *See* 12 U.S.C. § 1818(b)(1).

9. *See* 12 U.S.C. § 1841(a)(2)(C).

10. Washington asserted that the proposal is inconsistent with the Board's source of strength doctrine. As explained above, the Board previously has permitted a bank holding company that meets the requirements of section 3 of the BHC Act to acquire shares of a bank or bank holding company in a transaction that does not trigger the Board's source of strength regulation.

Washington also expressed concern that the proposal could subject Federation Bank to liability under the cross-guarantee provision of the Federal Deposit Insurance Act, 12 U.S.C. § 1815(e) ("FDI Act"), if a subsidiary bank of C-B-G were to fail or require assistance from the Federal Deposit Insurance Corporation ("FDIC"). The Board notes that the application of this provision of the FDI Act is a matter for the FDIC to decide.

11. 12 U.S.C. § 1842(c)(1).

12. The Board has found that noncontrolling interests in directly competing depository institutions may raise serious questions under the BHC Act and has concluded that the specific facts of each case will determine whether the minority investment in a company would be anticompetitive. *See, e.g., BOK Financial Corp.*, 81 *Federal Reserve Bulletin* 1052, 1053–54 (1995); *Mansura Bancshares, Inc.*, 79 *Federal Reserve Bulletin* 37, 38 (1993).

In addition, considerations relating to the convenience and needs of the communities to be served, including the records of performance of the institutions involved under the Community Reinvestment Act ("CRA"),[13] are consistent with approval. C-B-G's subsidiary banks each received "satisfactory" ratings, and Federation Bank received an "outstanding" rating, at their most recent evaluations for CRA performance by the FDIC.[14]

Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered carefully these factors in light of all the facts of record, including confidential reports of examination, other confidential supervisory information from the federal and state banking supervisors of the organizations involved, publicly reported and other financial information, information provided by C-B-G, and comments received.[15]

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary depository institutions and significant nonbanking operations. In this evaluation, the Board considers a variety of areas, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization on consummation, including its capital position, asset quality, and earnings prospects and the impact of the proposed funding of the transaction.[16]

Based on its review of these factors, the Board finds that C-B-G has sufficient financial resources to effect the proposal. C-B-G and its subsidiary banks currently are well capitalized and would remain so on consummation of this proposal. The proposed transaction is structured as a cash transaction, and the consideration to be received by the Washington shareholders who are selling their shares to C-B-G would be funded from issuance of trust preferred securities.

13. 12 U.S.C. § 2901 et seq.

14. The most recent CRA performance evaluations of Community Bank, Muscatine, Iowa, the larger of C-B-G's subsidiary banks, and Wilton Savings Bank, Wilton, Iowa, C-B-G's other subsidiary bank, were as of February 2004 and July 2003 respectively. Federation Bank's most recent CRA performance evaluation was as of August 2004.

15. Washington also expressed concern that C-B-G could seek access to Washington's confidential records. The Board notes that Iowa law delineates the rights of shareholders to access an Iowa corporation's records. *See* Iowa Code § 490.1602.

16. As previously noted, the current proposal provides that C-B-G would acquire only up to 24.35 percent of Washington. Under these circumstances, the financial statements of C-B-G and Washington would not be consolidated for purposes of Federal Reserve reporting requirements.

The Board also has considered the managerial resources of the organizations involved. The Board has reviewed the examination records of C-B-G, Washington, and their subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking agencies with the organizations and their records of compliance with applicable banking laws. C-B-G, Washington, and their subsidiary depository institutions are considered well managed.

Based on all the facts of record, the Board concludes that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors the Board must consider under the BHC Act.

Other Considerations

Washington has asserted that the proposal would violate an Iowa statute that requires a bank holding company making an offer to purchase, directly or indirectly, shares of an Iowa-chartered bank to extend the same offer to all shareholders of the bank.[17] If a bank is wholly owned by a bank holding company, as in this case, Washington argues that the same offer must be made to all the shareholders of the parent holding company. C-B-G, which made an offer only to some shareholders of Washington, has responded that the Iowa statute does not apply to the proposal because it is acquiring shares of a bank holding company, and not a bank, and that no additional shares of Federation Bank exist to purchase.

The Board may not approve a proposal that is prohibited by a valid state law.[18] The Board is not, however, the arbiter of disputes regarding the applicability or meaning of state corporate law.

The Board has reviewed the state law in this case and the submissions from C-B-G and Washington regarding the interpretation of the Iowa statute. In addition, the Board has consulted with the Iowa Superintendent of Banking and the Iowa Attorney General's Office.

Based on this review, it appears that the proposed acquisition of Washington shares is not prohibited under state law and can be consummated without violating state law. Under C-B-G's interpretation, the transaction would be permitted as structured. Even under Washington's interpretation, C-B-G would be permitted to acquire the shares at issue if it made a similar offer to all Washington shareholders. Accordingly, state law does not prohibit C-B-G from acquiring shares of Washington under either interpretation.

The Board conditions its action in this case on C-B-G's compliance with applicable state law.[19] If C-B-G must offer to purchase and then acquire additional shares of Washington, further review and approval by the Federal Reserve may be required under the BHC Act at that time.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by C-B-G with the conditions imposed in this order and all the commitments made to the Board in connection with the application. For purposes of this transaction, those conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The acquisition of Washington's voting shares may not be consummated before the fifteenth calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Chicago, acting pursuant to delegated authority.

By order of the Board of Governors, effective April 26, 2005.

Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

Appendix

In connection with its application to acquire up to 24.35 percent of Washington, C-B-G commits that it will not, directly or indirectly:

(1) take any action that would cause Washington[1] to become a subsidiary of C-B-G;
(2) acquire or retain shares that would cause the combined interests of C-B-G and its officers, directors, and affiliates to equal or exceed 25 percent of the outstanding voting shares of Washington;
(3) exercise or attempt to exercise a controlling influence over the management or policies of Washington;
(4) seek or accept representation on the board of directors of Washington;

17. Iowa Code §524.1803.

18. *Whitney National Bank in Jefferson Parish v. Bank of New Orleans and Trust Co.*, 379 U.S. 411 (1965).

19. *See also Central Pacific Financial Corp.*, 90 *Federal Reserve Bulletin* 93 (2004); *Brookline Bancorp, MHC*, 86 *Federal Reserve Bulletin* 52 (2000); *Security Pecos Bancshares, Inc.*, 85 *Federal Reserve Bulletin* 640 (1999).

1. All references to Washington in these commitments include any subsidiary of Washington.

(5) have or seek to have any representative serve as an officer, agent, or employee of Washington;
(6) propose a director or slate of directors in opposition to a nominee or slate of nominees proposed by the management or board of directors of Washington;
(7) solicit or participate in soliciting proxies with respect to any matter presented to the shareholders of Washington;
(8) attempt to influence the dividend policies or practices; the loan, credit, or investment decisions or policies; the pricing of services; any personnel decisions; any operations activities, including the location of any offices or branches or their hours of operation; or any similar activities or decisions of Washington;
(9) dispose or threaten to dispose of shares of Washington in any manner as a condition of specific action or nonaction by Washington; or
(10) enter into any other banking or nonbanking transactions with Washington, except that C-B-G may establish and maintain deposit accounts with bank subsidiaries of Washington, provided that the aggregate balances of all such accounts do not exceed $500,000 and that the accounts are maintained on substantially the same terms as those prevailing for comparable accounts of persons unaffiliated with Washington.

The PNC Financial Services Group, Inc. Pittsburgh, Pennsylvania

Order Approving the Merger of Bank Holding Companies

The PNC Financial Services Group, Inc. ("PNC"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire Riggs National Corporation ("Riggs"), Washington, D.C., and its subsidiary bank, Riggs Bank National Association ("Riggs Bank"), McLean, Virginia.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (69 *Federal Register* 50,382 (2004)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.

PNC, with total consolidated assets of approximately $80 billion, is the 20th largest depository organization in the United States, controlling deposits of approximately $52.2 billion, which represent less than 1 percent of the total deposits of insured depository institutions in the United States.[3] PNC operates subsidiary insured depository institutions in Delaware, Florida, Indiana, Kentucky, New Jersey, Ohio, and Pennsylvania.

Riggs, with total consolidated assets of approximately $6 billion, controls deposits of $3.8 billion through Riggs Bank, its only subsidiary depository institution. On consummation of this proposal, PNC would become the 19th largest depository organization in the United States, with total consolidated assets of approximately $85.5 billion and total deposits of $56 billion, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States.

Interstate Analysis

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the home state of such bank holding company if certain conditions are met.[4] For purposes of the BHC Act, the home state of PNC is Pennsylvania, and Riggs's subsidiary bank is located in Washington, D.C., Maryland, and Virginia.[5]

Based on a review of all the facts of record, including a review of relevant state statutes, the Board finds that all the conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[6] Accordingly, based on all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be

1. 12 U.S.C. § 1842.

2. Immediately after the merger of Riggs into PNC, PNC would contribute all the shares of Riggs Bank to PNC Bancorp, Inc., Wilmington, Delaware, a subsidiary bank holding company of PNC. PNC's lead subsidiary bank, PNC Bank, National Association ("PNC Bank"), Pittsburgh, Pennsylvania, then would acquire substantially all the assets and assume substantially all the liabilities of Riggs Bank. This proposed transaction by PNC Bank is subject to approval by the Office of the Comptroller of the Currency ("OCC") under section 18(c) of the Federal Deposit Insurance Act. 12 U.S.C. § 1828(c).

3. Asset, deposit, and nationwide ranking data are as of December 31, 2004. Deposit data reflect the unadjusted total of the deposits reported by each organization's insured depository institutions in their Consolidated Reports of Condition and Income or Thrift Financial Reports. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

4. A bank holding company's home state is the state in which the total deposits of all subsidiary banks of the company were the largest on the later of July 1, 1966, or the date on which the company became a bank holding company. 12 U.S.C. § 1841(o)(4)(C).

5. For purposes of section 3(d), the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch. *See* 12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and (d)(2)(B).

6. 12 U.S.C. §§ 1842(d)(1)(A) & (B), and (d)(2)(A) & (B). PNC is adequately capitalized and adequately managed, as defined by applicable law. Riggs Bank has been in existence and operated for the minimum period of time required by applicable law. On consummation of the proposal, PNC would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States. All other requirements of section 3(d) would be met in this case.

in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposed bank acquisition that would substantially lessen competition in any relevant banking market, unless the Board finds that the anticompetitive effects of the proposal clearly are outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[7]

PNC and Riggs do not compete directly in any relevant banking market. Accordingly, the Board concludes, based on all the facts of record, that consummation of the proposal would not have an adverse effect on competition or on the concentration of banking resources in any relevant banking market and that competitive factors are consistent with approval of the proposal.

Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and banks involved in the proposal and certain other supervisory factors. In reviewing these factors, the Board has considered, among other things, confidential reports of examination and other supervisory information received from the primary federal supervisors of the organizations involved in the proposal. In addition, the Board has consulted with the relevant supervisory agencies, including the OCC and the Federal Deposit Insurance Corporation ("FDIC"). The Board also has considered publicly available financial and other information on the organizations and their subsidiaries, all the information submitted on the financial and managerial aspects of the proposal by PNC, and public comment received by the Board about the financial and managerial resources of PNC and Riggs.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary banks and significant nonbanking operations. In this evaluation, the Board considers a variety of areas, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the effect of the transaction on the financial condition of the applicant and the target, including their capital positions, asset quality, and earnings prospects and the impact of the proposed funding of the transaction.

The Board has reviewed these factors carefully in this case and believes that financial factors are consistent with approval of this application. The Board notes that PNC and its subsidiary depository institutions are well capitalized and would remain so on consummation of the proposal.[8] The Board also finds that PNC has sufficient financial resources to effect the proposal.[9] The proposed transaction is structured as a partial share exchange/partial cash purchase of shares, and PNC will use existing cash resources to fund the cash purchase of shares.

The Board also has considered the managerial resources of PNC, Riggs, and the banking institutions and nonbanking subsidiaries to be acquired, and the effect of the proposal on these resources.[10] In reviewing this proposal, the Board has assembled and considered a broad and detailed record, including substantial confidential and public information about PNC and Riggs. The Board has carefully reviewed the examination records of PNC, Riggs, and their subsidiaries, including assessments of their risk-management systems by relevant supervisors. The Board also reviewed confidential supervisory information on the policies, procedures, and practices of PNC and Riggs for complying with the Bank Secrecy Act ("BSA"), and other anti-money-laundering laws, and has consulted with the appropriate federal financial supervisory agencies of PNC's subsidiary banks and Riggs Bank about their records of compliance with anti-money-laundering laws.

In assessing these matters, the Board notes that PNC is considered well managed overall. The Board has taken account of the experience and capability of PNC's senior management; the enterprise-wide risk-management programs used to identify, measure, and control corporate and business line risks; and the adequacy of the organization's internal controls and audit procedures as well as other management programs and matters. The Board also has considered PNC's plans for integrating Riggs into the PNC organization, including the experience of the management team PNC has named to run the banking operations to be acquired from Riggs.[11]

7. 12 U.S.C. § 1842(c)(1).

8. One commenter questioned the basis for the selection by Riggs's board of directors of PNC's bid from among the competing offers and expressed concern that certain senior management officials of Riggs Bank may receive excessive severance payments. The Board notes that the transaction may be consummated only if approved by the Riggs shareholders, that information concerning the selection of PNC's bid and the management officials' severance payments has been disclosed to shareholders, and that PNC would remain well capitalized on consummation. The Board also notes that the price or consideration received by shareholders is not, by itself, within the limited statutory factors the Board may consider when reviewing an application under the BHC Act. *See Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

9. The commenter expressed concern about PNC's disclosure in a recent filing with the Securities and Exchange Commission that it may have to adjust its tax treatment for certain leveraged leases, based on an Internal Revenue Service ("IRS") audit of PNC's tax returns for the years 1998 to 2000. PNC has stated in its filing that it believes that its tax treatment of these leases was appropriate under federal tax law and that it plans to file an appeal with the IRS. The Board notes that the IRS and the federal courts, and not the Board, have jurisdiction to adjudicate compliance with federal tax laws. The Board has taken account of this matter, including the effect of both the current treatment and potential adjustment on the financial resources of PNC.

10. The commenter expressed concern about lending by PNC to unaffiliated payday lenders. PNC stated that neither it nor any of its subsidiaries currently have any banking or similar financial relationships with any payday lenders.

11. The commenter expressed concerns about PNC's managerial record in light of past enforcement actions against the organization, including enforcement actions by the Department of Justice ("DOJ"),

The Board has taken into account that Riggs Bank pleaded guilty to a criminal violation of the BSA and paid a $16 million fine,[12] and that Riggs and Riggs Bank were subject to enforcement actions by the Board and the OCC, respectively, that included payment by Riggs Bank of a $25 million civil money penalty for BSA violations.[13] The Board continues to monitor investigations of Riggs and Riggs Bank by various U.S. governmental authorities and is consulting with the DOJ and the OCC about the ongoing investigations of former and current management officials of Riggs and its subsidiaries.[14]

The Board notes that most of Riggs's supervisory issues arose from its international banking and foreign embassy banking business. In 2004, Riggs announced its intention to exit those lines of business, and Riggs Bank has substantially completed the sale or termination of those activities.[15] The Board has reviewed the progress of Riggs, and has consulted with the OCC about the progress of Riggs Bank, in complying with the Consent Orders. In addition, the Board has consulted with the OCC about enhancements Riggs Bank has made to its programs for complying with the requirements of the BSA.

The Board has also reviewed and taken account of proposals by PNC as the acquiring institutions to implement enhanced risk-management and BSA-compliance programs at Riggs after consummation of this proposal. The Board has considered PNC's record of enhancing its own risk-management and BSA-compliance programs and its plans for implementing those programs at Riggs. These considerations included PNC's proposed management personnel and implementation of corporate-wide risk-management systems for compliance, including BSA-compliance programs, for the expanded PNC operations after consummation and PNC's record of successfully integrating acquired institutions into its existing operations. As previously noted, the banking operations of Riggs Bank will be merged into PNC Bank after consummation of the proposal.

Based on all the facts of record, the Board concludes that considerations relating to the financial and managerial resources and future prospects of PNC and the depository institutions involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.[16]

Convenience and Needs Considerations

In acting on this proposal, the Board must consider the effects of the proposal on the convenience and needs of the

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the Federal Reserve Bank of Cleveland ("Reserve Bank"), and the OCC. The Board previously considered these enforcement actions in its order approving PNC's application to acquire United National Bancorp, Bridgewater, New Jersey (order dated November 19, 2003) (the "United National Order"). As noted in the United National Order, PNC has developed a new ethics policy and training program, an enterprise-wide risk-management program, and enhanced credit administration procedures, internal controls, and corporate governance procedures. The Board notes that the Federal Reserve and the OCC terminated their respective enforcement actions with PNC in September 2003. In addition, the DOJ's complaint against PNC was dismissed in June 2004, with the DOJ's concurrence, after PNC's compliance with the deferred prosecution agreement that PNC and the DOJ entered into in June 2003. *U.S. v. PNC ICLC Corp.*, CRIM. No. 03-M-187 (W.D. Pa. June 2, 2003). Based on its review of the record in this case, the Board hereby reaffirms and adopts the facts and findings detailed in the United National Order with respect to these enforcement matters. *See* 90 *Federal Reserve Bulletin* 72, 74 n.9 (2004).

12. *See United States of America v. Riggs Bank N.A.*, Cr. 05-35 (RMU). The commenter objected to the size of the fine and to other terms of the plea agreement. The Board notes that the United States District Court for the District of Columbia, and not the Board, has jurisdiction to adjudicate the criminal complaint against Riggs Bank and that the court has approved the fine amount and the other terms of Riggs Bank's plea agreement.

13. The Consent Orders entered into in May 2004 required Riggs and Riggs Bank to improve management and internal controls, in addition to enhancing compliance with BSA and other anti-money-laundering requirements and requiring Riggs Bank to pay the $25 million civil money penalty. The Board and the OCC modified their consent orders with Riggs and Riggs Bank in January 2005 to reflect the progress made in fulfilling the requirements of the May 2004 Consent Orders and to add provisions reflecting the most recent examinations of the institutions. The Board notes that the reviews required by the May 2004 Consent Orders of certain Riggs accounts to ensure that suspicious activity reports were properly filed have been completed.

14. As a matter of practice and policy, the Board has generally not tied consideration of an application or notice to the scheduling or completion of an investigation if the applicant has an overall satisfactory record of performance and the issues being reviewed can be resolved in the examination and supervisory process. *See* 62 *Federal Register* 9,290 (1997) (Preamble to the Board's Regulation Y). In this case, as explained above, the Board has also considered the progress and cooperation shown by Riggs as well as the plans and ability of the acquiring institution to address these matters. As the Board has indicated previously, it has broad supervisory authority under the banking laws to address matters that are found in the examination and supervisory process. *See Citigroup Inc.*, 91 *Federal Reserve Bulletin* 262 (2005). Moreover, many issues are more appropriately and adequately addressed in the supervisory process, where particular matters and violations of law can be identified and addressed specifically, rather than in the application process, which requires a weighing of the overall record of the companies involved. The Board further notes that consummation of the proposed transaction would not impede the ability of the Congress, the DOJ, or the appropriate federal banking agencies to gain access to the records of Riggs or otherwise to complete investigations of these matters.

15. Specifically, Riggs has represented that it has terminated all banking relationships with foreign embassies and is in the process of closing or selling its operations outside the United States. Riggs terminated the operations of Riggs International Banking Corporation ("RIBC"), Miami, Florida, the Edge Act subsidiary of Riggs Bank, during the third quarter of 2004, and RIBC surrendered its permit in December 2004.

16. The commenter also noted press reports about litigation against Riggs, including suits claiming Riggs was negligent in failing to alert authorities to suspicious financial transactions allegedly related to the September 11, 2001, terrorist attacks and criminal and civil claims in a Spanish court asserting Riggs's concealment of assets and money laundering in connection with Riggs accounts held for the benefit of former Chilean President Augusto Pinochet. The Board notes that the Spanish civil and criminal claims were dismissed after Riggs reached a settlement with the plaintiffs in the civil suit in Spain. As previously noted, the courts, and not the Board, have jurisdiction to adjudicate legal claims against Riggs. In considering the financial and managerial factors in this case, the Board has considered how these litigation matters might affect the future prospects of the combined organization.

communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[17] The CRA requires the federal financial supervisory agencies to encourage financial institutions to help meet the credit needs of local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account an institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.

The Board has considered carefully the convenience and needs factor and the CRA performance records of PNC's subsidiary banks and Riggs Bank in light of all the facts of record, including public comment received on the proposal. One commenter opposed the proposal and alleged, based on data reported under the Home Mortgage Disclosure Act ("HMDA"),[18] that PNC Bank and Riggs Bank engaged in disparate treatment of minority individuals in home mortgage lending in the banks' assessment areas. The commenter also expressed concern about possible branch closures.

A. CRA Performance Evaluations

As provided in the CRA, the Board has evaluated the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[19]

PNC Bank. PNC Bank, PNC's largest subsidiary bank as measured by total deposits, received an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of April 15, 2002 ("2002 Evaluation").[20] Riggs Bank received an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of April 7, 2003 ("2003 Evaluation"). The Board consulted with the OCC about the CRA performance of PNC Bank and Riggs Bank since their most recent CRA evaluations. PNC has indicated that after the merger of PNC Bank and Riggs Bank, PNC Bank's CRA program will be implemented at the resulting bank.

The 2002 Evaluation was discussed in the United National Order.[21] In that evaluation, PNC Bank received a "high satisfactory" rating under the lending test and "outstanding" ratings under the investment and service tests.[22] Examiners reported that the bank had excellent lending activity in its major markets and good distribution of loans by geography and borrower income. They noted that the bank had developed a bank-wide lending program to assist LMI borrowers through expanded credit criteria, reduced minimum loan amounts, and closing cost assistance. Examiners further stated that the bank's record of community development lending for affordable housing, community services, and economic revitalization was strong. Examiners also reported that PNC Bank made more than $169 million of qualifying community development investments during the evaluation period, a level examiners characterized as excellent. In addition, they reported that the bank's services were readily accessible to LMI individuals and geographies and that the bank was a leader in providing community development services in its assessment areas.

Riggs Bank. In the 2003 Evaluation, Riggs Bank received "outstanding" ratings under the lending, investment, and service tests.[23] Examiners reported that the percentage of home purchase loans by Riggs Bank to LMI borrowers exceeded the percentage of LMI families in the bank's assessment area and that the bank's market share of home purchase loans to LMI borrowers exceeded its overall market share of home purchase loans in that area. Examiners stated that the bank made use of innovative and flexible loan products, which provide relaxed underwriting standards for LMI borrowers. Examiners also indicated that the bank had a high level of community development lending.

Examiners characterized Riggs Bank's level of qualified investments as excellent and stated that the bank played a vital role in increasing the level of funds available for affordable mortgages in the bank's assessment area. In addition, examiners reported that the bank provided a relatively high level of community development services, which included participation in or sponsorship of seminars that provided training and assistance on home buying, consumer loans, debt and credit management, and building financial knowledge and relationships with financial institutions.

B. HMDA Data and Fair Lending Record

The Board has carefully considered the lending record of PNC in light of public comment received on the proposal. The commenter alleged, based on a review of 2003 HMDA data, that PNC Bank and Riggs Bank disproportionately

17. 12 U.S.C. § 1842(c)(2); 12 U.S.C. § 2901 et seq.

18. 12 U.S.C. § 2801 et seq.

19. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 and 36,639 (2001).

20. PNC Bank, Delaware, PNC's other subsidiary bank, also received an "outstanding" rating at its most recent CRA performance evaluation by the FDIC, as of January 21, 2003.

21. 90 *Federal Reserve Bulletin* at 74–77.

22. The evaluation period for the lending test was January 1, 1998, through December 31, 2001, except for community development loans, which were evaluated from July 6, 1998, through December 31, 2001. The evaluation period for the investment and service tests was July 6, 1998, through March 31, 2002.

23. The evaluation period for the lending test was from September 1, 1999, through December 31, 2002, except for community development lending, which was evaluated from September 1, 1999, through April 7, 2003. For the investment test and the service test, the evaluation period was from September 1, 1999, through April 7, 2003.

excluded or denied African-American or Hispanic applicants for home mortgage loans in various Metropolitan Statistical Areas ("MSAs").[24] The Board reviewed the HMDA data for 2002 and 2003 reported by PNC Bank and PNC Bank, Delaware (collectively "PNC Banks"), and by Riggs Bank for the states or MSAs where the banks' primary assessment areas were located.[25]

The HMDA data indicate that the PNC Banks' denial disparity ratios[26] for African-American and Hispanic applicants for the banks' total HMDA-reportable loans in Delaware, New Jersey, and Pennsylvania, which together accounted for more than 77 percent of the banks' combined HMDA-reportable loans in 2003, were generally comparable with the ratios for the aggregate of lenders ("aggregate lenders") in those areas.[27] In addition, the percentages of the PNC Banks' total HMDA-reportable loans to African Americans and Hispanics in these states in 2003 were generally comparable with the percentages for the aggregate lenders. The data also indicate that the PNC Banks increased the percentages of their total HMDA-reportable loans originated to African Americans and Hispanics in each of these states from 2002 to 2003.[28]

The HMDA data indicate that Riggs Bank's denial disparity ratios for African-American applicants in its assessment area were higher than those ratios for the aggregate lenders in both years. The data indicate, however, that Riggs Bank significantly reduced its denial disparity ratios for African-American applicants and increased the number and percentage of its total HMDA-reportable loans to African Americans in 2003.

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial groups in certain local areas, these data generally do not demonstrate that either PNC Bank or Riggs excluded any racial group on a prohibited basis. The Board nevertheless is concerned when HMDA data for an institution indicate disparities in lending and believes that all banks are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending, but also equal access to credit by creditworthy applicants regardless of their race or income level. The Board recognizes, however, that HMDA data alone provide an incomplete measure of an institution's lending in its community because these data cover only a few categories of housing-related lending. HMDA data, moreover, provide only limited information about covered loans.[29] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has not assisted adequately in meeting its community's credit needs or has engaged in illegal lending discrimination.

Because of the limitations of HMDA data, the Board has considered these data carefully in light of other information, including examination reports that provide an on-site evaluation of compliance by PNC and its subsidiary banks and Riggs Bank with fair lending laws. The Board also consulted with the OCC, which has responsibility for enforcing compliance with fair lending laws by PNC Bank and Riggs Bank, about this proposal and the compliance record of these banks.[30]

The record indicates that PNC has taken steps to ensure compliance with fair lending laws. PNC's fair lending policy includes a commitment to provide full and equal access to credit while maintaining safe and sound credit standards. To implement this commitment, PNC's fair lending compliance program includes employee training and review by senior management of credit decisions, pricing, marketing, and fair lending-related polices and procedures.

The Board has also considered the HMDA data and the overall performance records of the subsidiary banks of PNC and Riggs under the CRA. Their established efforts demonstrate that the banks are actively helping to meet the credit needs of their entire communities.

C. Branch Closings

PNC has indicated that it has no plans to close any branches of PNC Bank or Riggs Bank as a result of the proposed transaction.[31] The Board has considered PNC Bank's branch banking policy and its record of opening

24. Specifically, the commenter cited HMDA data on lending by PNC's subsidiary banks to African Americans or Hispanics in the Wilmington MSA in Delaware, Newark and Jersey City MSAs in New Jersey, Harrisburg and Pittsburgh MSAs in Pennsylvania, Philadelphia MSA in Pennsylvania and New Jersey, and Newburgh MSA in New York. The commenter cited HMDA data on Riggs Bank's lending to African Americans in the Washington MSA in Washington, D.C., Maryland, and Virginia.

25. The Board reviewed HMDA data for the PNC Banks in Delaware, New Jersey, and Pennsylvania, and in the Newark, Philadelphia, and Pittsburgh MSAs.

26. The denial disparity ratio equals the denial rate of a particular racial category (*e.g.*, African American) divided by the denial rate for whites.

27. The lending data of the aggregate lenders represent the cumulative lending for all financial institutions that have reported HMDA data in a particular area.

28. The commenter also commented on HMDA data it derived from 2004 loan application registers of PNC Bank and Riggs Bank. The Board notes that such data are preliminary and that 2004 data for lenders in the aggregate are not yet available.

29. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. Credit history problems and excessive debt levels relative to income (reasons most frequently cited for a credit denial) are not available from HMDA data.

30. In addition, the Board consulted with the FDIC, the primary supervisor of PNC Bank, Delaware, about the bank's record of compliance with fair lending laws.

31. The commenter also expressed concern about possible job losses resulting from this proposal. The effect of a proposed acquisition on employment in a community is not among the limited factors the Board is authorized to consider under the BHC Act, and the convenience and needs factor has been interpreted consistently by the federal banking agencies, the courts, and the Congress to relate to the effect of a proposal on the availability and quality of banking services in the community. *See, e.g., Wells Fargo & Company*, 82 *Federal Reserve Bulletin* 445, 457 (1996).

and closing branches. In the 2002 Evaluation, examiners concluded that PNC Bank's record of opening and closing branches had not adversely affected the bank's delivery of services in LMI areas or to LMI individuals.

The Board also has considered the fact that federal banking law provides a specific mechanism for addressing branch closings.[32] Federal law requires an insured depository institution to provide notice to the public and to the appropriate federal supervisory agency before closing a branch. In addition, the Board notes that the OCC, as the appropriate federal supervisor of PNC Bank, will continue to review the bank's branch closing record in the course of conducting CRA performance evaluations.

D. Conclusion on Convenience and Needs Factor

The Board has carefully considered all the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by PNC, public comments on the proposal, and confidential supervisory information. PNC has stated that the proposal would provide PNC and Riggs customers with expanded products and services, including access to expanded branch and ATM networks. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor, including the CRA performance records of the relevant depository institutions, are consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved.[33] In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes.[34] The Board's approval is specifically conditioned on compliance by PNC with the conditions imposed in this order and the commitments made to the Board in connection with the application.[35] For purposes of this transaction, these conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The merger with Riggs and the acquisition of Riggs Bank may not be consummated before the fifteenth calendar day after the effective date of this order or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Cleveland, acting pursuant to delegated authority.

By order of the Board of Governors, effective April 26, 2005.

Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

Republic Bancorp, Inc.
Munden, Kansas

Order Approving the Formation of a Bank Holding Company

Republic Bancorp, Inc. ("Republic") has requested the Board's approval under section 3 of the Bank Holding

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32. Section 42 of the Federal Deposit Insurance Act (12 U.S.C. § 1831r-1), as implemented by the Joint Policy Statement Regarding Branch Closings (64 *Federal Register* 34,844 (1999)), requires that a bank provide the public with at least thirty days' notice and the appropriate federal supervisory agency and customers of the branch with at least ninety days' notice before the date of the proposed branch closing. The bank also is required to provide reasons and other supporting data for the closure, consistent with the institution's written policy for branch closings.

33. The commenter requested that the Board hold a public meeting or hearing on the proposal. Section 3(b) of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a timely written recommendation of denial of the application. The Board has not received such a recommendation from the appropriate supervisory authority. Under its regulations, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if a meeting or hearing is necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony. 12 CFR 225.16(e). The Board has considered carefully the commenter's request in light of all the facts of record. In the Board's view, the commenter has had ample opportunity to submit its views, and in fact, commenter has submitted written comments that the Board has considered carefully in acting on the proposal. The commenter's request fails to demonstrate why written comments do not present its views adequately. The request also fails to identify disputed issues of fact that are material to the Board's decision that would be clarified by a public meeting or hearing. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the request for a public meeting or hearing on the proposal is denied.

34. The commenter also requested that the Board extend the comment period and delay action on the proposal. As previously noted, the Board has accumulated a significant record in this case, including reports of examination, confidential supervisory information, public reports and information, and public comment. In the Board's view, the commenter has had ample opportunity to submit its views and, in fact, has provided multiple written submissions that the Board has considered carefully in acting on the proposal. Moreover, the BHC Act and Regulation Y require the Board to act on proposals submitted under those provisions within certain time periods. Based on a review of all the facts of record, the Board has concluded that the record in this case is sufficient to warrant action at this time and that neither an extension of the comment period nor further delay in considering the proposal is warranted.

35. The commenter asked that the Board's Chairman recuse himself from consideration of the application. The Board and the Chairman have carefully considered this request and concluded that recusal is not required by any law or warranted. The commenter also expressed concern about compliance by staff with the Board's *ex parte* communications policies in this case. The Board has carefully considered this concern and concludes that Federal Reserve System staff did not engage in any inappropriate communications.

Company Act ("BHC Act")[1] to become a bank holding company and acquire 99.7 percent of the voting shares of National Family Bank ("NFB"), Munden, Kansas.[2]

Notice of the proposal, affording interested persons an opportunity to comment, has been published (70 *Federal Register* 10,402 (2005)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

Republic is a newly organized corporation formed for the purpose of acquiring control of NFB. NFB, with total assets of approximately $15.5 million, is the 287th largest insured depository institution in Kansas, controlling deposits of approximately $14.8 million, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the state.[3]

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or that would be in furtherance of an attempt to monopolize the business of banking. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[4]

This proposal represents Republic's initial entry into retail banking in Kansas. Based on all the facts of record, the Board has concluded that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of banking resources in any relevant banking market and that competitive considerations are consistent with approval.

Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including information provided by Republic, confidential reports of examination, and other confidential supervisory information from the Office of the Comptroller of the Currency ("OCC"), the primary federal supervisor of NFB.

In evaluating financial factors in proposals involving newly formed small bank holding companies, the Board reviews the financial condition of both the applicant and the target depository institution. The Board also evaluates the financial condition of the pro forma organization, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

Based on its review of these factors, the Board finds that Republic has sufficient financial resources to effect the proposal. NFB is well capitalized and would remain so on consummation of this proposal. Republic proposes to fund this transaction through a combination of debt and equity. The Board has recognized that the transfer of ownership of small banks often requires the use of acquisition debt.[5] It appears that Republic would have sufficient financial flexibility to service this debt without unduly straining the resources of Republic or NFB.

The Board also has considered the managerial resources of the applicant, including the proposed management of the organization. The Board has reviewed the examination record of NFB, including assessments of its current management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking agencies with NFB and the management officials and principal shareholders of Republic. The Board also has considered Republic's plans to implement the proposal, including its proposed expansion of NFB's products and services and the changes in management at NFB after the acquisition.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of Republic and NFB are consistent with approval, as are the other supervisory factors under the BHC Act.

Convenience and Needs Considerations

In acting on proposals under section 3 of the BHC Act, the Board is also required to consider the effects of the proposal on the convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[6] The CRA requires the federal financial supervisory agencies to encourage financial institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account an institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, in evaluating proposals under section 3 of the BHC Act.

The Board has considered carefully the convenience and needs factor and the CRA performance record of NFB

1. 12 U.S.C. § 1842.
2. Admiral Family Banks, Inc., Alsip, Illinois, currently owns 99.7 percent of the voting shares of NFB, and Republic has applied to acquire all these shares.
3. Asset data are as of December 31, 2004. Deposit data and state rankings are as of June 30, 2004. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.
4. *See* 12 U.S.C. § 1842(c)(1).
5. Small Bank Holding Company Policy Statement, 12 CFR Part 225, Appendix G.
6. 12 U.S.C. § 2901 et seq.

in light of all the facts of record, including public comment received regarding the proposal and the bank's CRA record. The Board received one comment from an individual suggesting that NFB was not serving the needs of its community, particularly its agricultural lending needs, and that Republic also might not serve the community's needs.[7]

NFB received an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of November 25, 2002 ("2002 Examination"). Examiners reported that the bank's record of lending to borrowers of different income levels and farms of different revenue amounts was excellent. They also noted that the bank's average loan-to-deposit ratio of 70 percent was comparable to the ratio for its peer group. Since the examination, however, NFB's lending volume and average loan-to-deposit ratio has significantly declined.

Several factors have affected NFB's overall lending activity in its assessment area, which is Republic County, Kansas, a nonmetropolitan area in north central Kansas. This area has experienced a population decline of 9 percent since 2000. Of the six depository institutions in the assessment area, NFB is the smallest bank in terms of deposits, and its deposits decreased from 2003 to 2004. Moreover, the main business in Republic County is agriculture, and drought conditions have had a negative impact on lending during the past two years. These factors have affected NFB's ability to make loans to its community and resulted in a marked decrease in lending since the 2002 Examination.

Republic's proposed business plan includes several improvements to services and products that should strengthen the bank's overall condition and its ability to serve the community's lending and other banking needs. The Board has consulted with the OCC about Republic's proposed business plan for NFB. The business plan includes a strategy for growth through enhanced product offerings and by hiring employees and management officials with agricultural lending experience and a familiarity with the community and its banking needs. Republic also proposes to update the bank's processing systems and introduce internet banking, ATMs, and debit and credit cards, as well as other banking products in the future. In addition, the proposed principals of Republic and its management are residents who are familiar with the community and its needs and who have banking experience.[8]

The Board has considered carefully all the facts of record, including reports of examination of the CRA performance records of the institutions involved, the business plan and other information provided by Republic, public information about the economic conditions of NFB's community, and confidential supervisory information. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant depository institution are consistent with approval.

7. The commenter also questioned the identity of the proposed purchasers. Republic has disclosed its ownership structure, as required by the BHC Act, and has stated that the commenter has met with some of Republic's principal shareholders.

8. The proposed president and vice president of NFB recently served as management officials at a bank that received an "outstanding" CRA rating at its last examination.

Conclusion

Based on the foregoing and all facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by Republic with the condition imposed in this order and the commitments made to the Board in connection with the application. For purposes of this transaction, the condition and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the fifteenth calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Kansas City, acting pursuant to delegated authority.

By order of the Board of Governors, effective April 26, 2005.

Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

Wells Fargo & Company
San Francisco, California

Order Approving the Acquisition of a Bank Holding Company

Wells Fargo & Company ("Wells Fargo"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act to acquire First Community Capital Corporation ("FCCC"), Houston, and its subsidiary banks, First Community Bank, National Association, Houston, and First Community Bank San Antonio, National Association, San Antonio, all in Texas.[1]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (69 *Federal Register* 60,877 (2004)). The time for filing comments has expired, and the Board has considered the

1. 12 U.S.C. § 1842.

proposal and all comments received in light of the factors set forth in the BHC Act.

Wells Fargo, with total consolidated assets of approximately $434.6 billion, is the fifth largest depository organization in the United States,[2] controlling deposits of approximately $267.8 billion, which represents approximately 4.7 percent of the total amount of deposits of insured depository institutions in the United States.[3] Wells Fargo is the third largest depository institution in Texas, controlling $22.7 billion in deposits, which represents approximately 7.3 percent of the total amount of deposits of insured depository institutions in the state ("state deposits"). Wells Fargo operates subsidiary depository institutions in 23 states, including Texas, and engages in numerous nonbanking activities that are permissible under the BHC Act.

FCCC, with total consolidated assets of approximately $604.6 million, is the 76th largest depository organization in Texas, controlling deposits of $446 million. FCCC operates subsidiary insured depository institutions only in Texas. On consummation of the proposal, Wells Fargo would remain the third largest depository organization in Texas, controlling deposits of approximately $23.2 billion, which represents 7.5 percent of state deposits.

Interstate Analysis

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the home state of such bank holding company if certain conditions are met.[4] For purposes of the BHC Act, the home state of Wells Fargo is Minnesota, and FCCC's subsidiary banks are located in Texas.[5]

Based on a review of all the facts of record, including a review of relevant state statutes, the Board finds that all the conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[6] Accordingly, in light of the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposed bank acquisition that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. In addition, section 3 prohibits the Board from approving a proposed bank acquisition that would substantially lessen competition in any relevant banking market unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by its probable effect in meeting the convenience and needs of the community to be served.[7]

Wells Fargo competes directly with FCCC's subsidiary banks in the Brazoria, Grimes County, Houston, and San Antonio banking markets in Texas.[8] The Board has reviewed the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking markets, the relative shares of total deposits in depository institutions in the markets ("market deposits") controlled by Wells Fargo and FCCC,[9] the concentration level of market deposits and the increase in this level as measured by the Herfindahl-Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[10] and other characteristics of the markets.

Consummation of the proposal would be consistent with Board precedent and the DOJ Guidelines in each of these

2. Asset data are as of March 31, 2005, and national ranking data are as of December 31, 2004, and reflect consolidations through that date.

3. Deposit data reflect the total of the deposits reported by each organization's insured depository institutions in their Consolidated Reports of Condition and Income or Thrift Financial Reports for June 30, 2004. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

4. A bank holding company's home state is the state in which the total deposits of all subsidiary banks of the company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later. 12 U.S.C. § 1841(o)(4)(C).

5. For purposes of section 3(d), the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch. *See* 12 U.S.C. §§ 1841(o)(4)-(7) and 1842(d)(1)(A) and (d)(2)(B).

6. *See* 12 U.S.C. §§ 1842(d)(1)(A) & (B), and (d)(2)(A) & (B). Wells Fargo is adequately capitalized and adequately managed, as defined by applicable law. FCCC's subsidiary depository institutions have been in existence and operated for the minimum period of time required by applicable law. On consummation of the proposal, Wells Fargo would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States and less than 30 percent of the total amount of deposits of insured depository institutions in Texas. All other requirements pursuant to section 3(d) of the BHC Act also would be met on consummation of the proposal.

7. 12 U.S.C. § 1842(c)(1).

8. These banking markets are described in Appendix A.

9. Deposit and market share data are as of June 30, 2004, adjusted to reflect mergers and acquisitions through May 20, 2005, and on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group,* 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation,* 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.,* 77 *Federal Reserve Bulletin* 52 (1991).

10. Under the DOJ Guidelines, 49 *Federal Register* 26,823 (1984), a market is considered unconcentrated if the post-merger HHI is less than 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI is more than 1800. The Department of Justice has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. The Department of Justice has stated that the higher than normal HHI thresholds for screening bank mergers for anticompetitive effects implicitly recognize the competitive effects of limited-purpose lenders and other nondepository financial institutions.

banking markets.[11] After consummation of the proposal, the Brazoria and San Antonio banking markets would remain moderately concentrated, and the Grimes and Houston banking markets would remain highly concentrated, as measured by the HHI.[12] In each of the four banking markets, the increase in market concentration would be small, and numerous competitors would remain.

The Department of Justice also has conducted a detailed review of the anticipated competitive effects of the proposal and has advised the Board that consummation of the proposal would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any of the four banking markets where Wells Fargo and FCCC compete directly or in any other relevant banking market. Accordingly, based on all the facts of record, the Board has determined that competitive considerations are consistent with approval.

Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. In reviewing these factors, the Board has considered, among other things, confidential reports of examination and other supervisory information from the primary federal and state supervisors of the organizations involved in the proposal. The Board also has considered publicly reported and other financial information, comments received on the proposal, and information provided by Wells Fargo.[13] In addition, the Board has consulted with the Office of the Comptroller of the Currency ("OCC"), the primary supervisor of Wells Fargo's lead bank, Wells Fargo Bank, N.A. ("WF Bank"), Sioux Falls, South Dakota ("WF Bank"), and FCCC's subsidiary banks.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis and the financial condition of the subsidiary banks and significant nonbanking operations. In this evaluation, the Board considers a variety of areas, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization on a pro forma basis, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

Based on its review of the financial factors in this case, the Board finds that Wells Fargo has sufficient financial resources to effect the proposal. Wells Fargo, FCCC, and their subsidiary depository institutions currently are well capitalized and the resulting organization and its subsidiary banks would remain so on consummation of the proposal. The proposed transaction is structured primarily as a share exchange.

The Board also has considered the managerial resources of Wells Fargo, FCCC, and the banking subsidiaries to be acquired and the effect of the proposal on these resources. In reviewing this proposal, the Board has assembled and considered a broad and detailed record, including substantial confidential and public information about Wells Fargo, FCCC, and their subsidiaries. The Board has carefully reviewed assessments and examinations of the organizations' management, risk-management systems, and compliance records by, and consulted with, relevant federal and state supervisors.[14] In addition, the Board has considered Wells Fargo's plans for implementing the proposal, including its proposed management after consummation, and the company's record of successfully integrating acquired institutions into its existing operations.

In evaluating the managerial resources of a banking organization in an expansion proposal, the Board considers assessments of an organization's risk management—that is, the ability of the organization's board of directors and senior management to identify, measure, monitor, and control risk across all business and corporate lines in the organization—to be especially important.[15] As part of an appropriate risk-management system, the Board expects each banking organization, including Wells Fargo, to implement and operate effective, enterprise-wide compliance risk assessment and management programs and internal audit programs to identify, manage, address, and monitor the risks of the organization's activities. As part of compliance risk management, banking organizations operating in the United States are required to implement and operate effective anti-money-laundering programs.

11. The effects of the proposal on the concentration of banking resources in these banking markets are described in Appendix B.

12. Analysis of the Houston banking market is based on the Summary of Deposits for June 30, 2004, without the adjustments reflected in the Board's analysis of the Houston Market in *J.P. Morgan Chase*, 90 *Federal Reserve Bulletin* 352, 354 (2004). If such adjustments were made to the deposit data for the Houston banking market, the market would be moderately concentrated on consummation of the proposal.

13. A commenter criticized Wells Fargo's relationships with unaffiliated payday and car title lenders and other nontraditional providers of financial services. Wells Fargo represented that it has acted as a lender or provider of credit facilities and in other ordinary business relationships to unaffiliated consumer finance businesses, which may include payday and title lenders. Wells Fargo stated that it does not participate in the credit review process of such lenders and customarily requires the entities to represent, warrant, and covenant to Wells Fargo in credit agreements that such entities have and will comply with all applicable laws in the conduct of their business.

14. This included consultations with relevant state agencies with oversight authority for Wells Fargo's nonbank consumer finance subsidiaries and the appropriate functional regulators of Wells Fargo's securities-related activities.

15. *See Revisions to Bank Holding Company Rating System*, 69 *Federal Register* 70,444 (2004).

In this case, the Board has considered the existing compliance risk-management systems and internal audit programs at Wells Fargo and the assessment of these systems and programs by the relevant federal and state supervisory agencies. The Board has also considered additional information provided by Wells Fargo on enhancements it has made and is currently making to its systems and programs as part of the ongoing review, development, implementation, and maintenance of effective enterprise-wide risk-management systems.

Based on all the facts of record, including a review of the comments received, the Board concludes that considerations relating to the financial and managerial resources and future prospects of Wells Fargo, FCCC, and their respective subsidiaries are consistent with approval, as are the other supervisory factors under the BHC Act.[16]

Convenience and Needs Considerations

Section 3 of the BHC Act requires the Board to consider the effects of a proposal on the convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[17] The CRA requires the federal financial supervisory agencies to encourage financial institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account an institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating depository institutions' expansionary proposals.[18]

The Board has considered carefully the convenience and needs factor and the CRA performance records of the subsidiary depository institutions of Wells Fargo and FCCC in light of all the facts of record, including public comments received on the proposal. A commenter opposing the proposal asserted, based on data reported under the Home Mortgage Disclosure Act ("HMDA"),[19] that Wells Fargo engages in discriminatory treatment of African-American and Hispanic individuals in its home mortgage operations.[20]

A. CRA Performance Evaluations

As provided in the CRA, the Board has evaluated the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the insured depository institutions of both organizations. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[21]

Wells Fargo Bank, N.A. ("WF Bank CA"), San Francisco, California, received an "outstanding" rating at its performance evaluation from the OCC, as of October 1, 2001.[22] In addition, Wells Fargo's subsidiary depository institutions that were evaluated under the CRA received either "outstanding" or "satisfactory" ratings at their most recent CRA performance evaluations.[23] FCCC's lead bank, First Community Bank, N.A., received a "satisfactory" rating at its most recent CRA performance evaluation by the OCC, as of June 18, 2004.[24] Wells Fargo has represented that it will implement its program for managing community reinvestment activities at FCCC's subsidiary depository institutions on consummation of the proposal.

B. CRA Performance of Wells Fargo

As noted above, WF Bank CA received an overall "outstanding" rating for CRA performance in the OCC's most recent CRA performance evaluation.[25] WF Bank CA received an "outstanding" rating under each of the lending, investment, and service tests.

Examiners commended the excellent lending performance of WF Bank CA overall and reported that the bank had good distribution of home mortgage loans to borrowers of different income levels. They noted that WF Bank

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16. A commenter expressed concern about Wells Fargo's and WF Bank's information security systems and cited a press report describing three instances of theft of computers containing information relating to customers of Wells Fargo's subsidiaries. Wells Fargo represented that it is not aware of actual identity theft or fraudulent activity as a result of these incidents and that it provided potentially affected customers with notice of the thefts and credit bureau monitoring and identity theft insurance services. In reviewing Wells Fargo's application, the Board has considered the enhancements Wells Fargo is making to its information security systems and has consulted with the OCC, the primary federal supervisor of WF Bank.

17. 12 U.S.C. § 2901 et seq.

18. 12 U.S.C. § 2903.

19. 12 U.S.C. § 2801 et seq.

20. A commenter included in its comment three individual customer complaints concerning mortgage loans from WF Bank and Wells Fargo Home Mortgage, Des Moines, Iowa ("WF Mortgage"), a former subsidiary of WF Bank that became a division of the bank in May 2004. The complaints provided by the commenter have been forwarded to the OCC, the primary federal supervisor of WF Bank.

21. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 and 36,639 (2001).

22. In 2001, WF Bank CA was the largest subsidiary depository institution of Wells Fargo in terms of deposits and assets. In the performance evaluation, examiners weighted WF Bank CA's performance in California more heavily than its performance in other areas in its overall rating because more than 98 percent of its deposits and more than 87 percent of its loans were in California during the evaluation period. On February 20, 2004, Wells Fargo consolidated 18 of its subsidiary depository institutions, including WF Bank CA, with and into WF Bank. Wells Fargo currently operates ten subsidiary depository institutions, including WF Bank.

23. Appendix C lists the most recent CRA ratings of Wells Fargo's subsidiary depository institutions that are subject to the CRA.

24. In 2004, FCCC transferred the San Antonio operations of First Community Bank, N.A., to the newly chartered First Community Bank San Antonio, N.A., which has not yet been examined under the CRA by the OCC.

25. The evaluation period was April 1, 1998, through September 20, 2001. At the time of the 2001 Evaluation, WF Bank SF had sixty assessment areas in nine states (Arizona, California, Colorado,

CA had excellent geographic distribution of small loans to small businesses.[26]

Examiners reported that WF Bank CA demonstrated a significant responsiveness overall to the needs of its assessment areas through community development lending. They found that WF Bank CA helped address a significant need for affordable housing in California through its community development lending. WF Bank CA's community development loans for affordable housing in its assessment areas subject to a full-scope review totaled $312 million during the evaluation period.

Examiners commended WF Bank CA for its excellent level of qualified investments and noted that the investments were highly responsive to the needs of the bank's assessment areas. They reported that WF Bank CA's investment and grant activities helped address essential identified needs in the full-scope assessment areas subject to review, particularly with respect to financing of affordable housing. Community development investments in those assessment areas totaled $162.4 million during the evaluation period.

Examiners reported that WF Bank CA's banking services were readily accessible to essentially all portions of the bank's assessment areas. They noted that WF Bank CA's alternative delivery systems included ATMs, banking by phone or mail, and Internet banking. Examiners also reported that Wells Fargo provided numerous community development services such as financial educational community seminars.

C. HMDA Data and Fair Lending Record

The Board has carefully considered the lending record of Wells Fargo in light of public comments received on the proposal. A commenter alleged, based on a review of 2003 data reported pursuant to the Home Mortgage Disclosure Act, 12 U.S.C. 2891 et seq. ("HMDA"), that Wells Fargo engages in discriminatory lending by directing African-American and Hispanic applicants in certain markets to Wells Fargo Financial, Inc. ("WF Financial"), Des Moines, Iowa, a subsidiary of Wells Fargo that is engaged primarily in subprime lending, rather than to Wells Fargo's subsidiary banks and other prime lending channels. The commenter further alleged, based on a review of 2003 HMDA data, that there are systemic disparities in Wells Fargo's lending because it disproportionately excludes or denies applications for HMDA-reportable loans by African-American and Hispanic applicants.[27]

The Board reviewed HMDA data reported by the lending subsidiaries of Wells Fargo in 2002 and 2003 in certain areas.[28] An analysis of the HMDA data does not support the contention that Wells Fargo disproportionately directs African-American and Hispanic borrowers to WF Financial or that WF Prime Lenders have disproportionately denied applications of African-American or Hispanic individuals.[29] The 2003 HMDA data show that the WF Prime Lenders extended more HMDA-reportable loans to African-American and Hispanic borrowers than WF Financial in most of the MSAs reviewed. Moreover, the data show that the percentages of the WF Prime Lenders' total home mortgage applications that were received from African-American and Hispanic applicants at the WF Prime Lenders exceeded the percentages received at WF Financial in all of the markets reviewed.

In addition, the origination rates[30] for the WF Prime Lenders' total HMDA-reportable loans to African-American and Hispanic borrowers was comparable to or exceeded the rates for the aggregate of lenders ("aggregate lenders") in most of the markets reviewed.[31] The HMDA data indicate that the percentages of the WF Prime Lenders' total HMDA-reportable loans to African Americans and Hispanics increased or remained constant from 2002 to 2003 in most of the markets reviewed. The percentages of the WF Prime Lenders' total HMDA-reportable loan originations in minority census tracts also increased during this time period in all the markets reviewed.

Moreover, a review of the 2003 HMDA data indicates that the WF Prime Lenders' denial disparity ratios for

Idaho, Minnesota, Nevada, Oregon, Utah, and Washington), including sixteen that received full-scope reviews.

26. Small businesses are businesses with gross annual revenues of $1 million or less. Small loans to businesses include loans with original amounts of $1 million or less that are either secured by nonfarm, nonresidential properties or classified as commercial and industrial loans.

27. Specifically, the commenter's allegations are based on 2003 HMDA data by WF Bank CA and WF Financial. The commenter cited Well Fargo's HMDA data for lending to African Americans and Hispanics in the Los Angeles and San Francisco Metropolitan Statistical Areas ("MSAs"), in California, and the Austin, Dallas, El Paso, San Antonio, and Houston MSAs, in Texas.

28. The Board reviewed 2002 and 2003 HMDA data reported by all of Wells Fargo's lending subsidiaries, including WF Financial, in California and Texas and in the MSAs that comprise the major assessment areas of WF Bank CA and Wells Fargo's depository institutions in those states, which are noted in footnote 27. For WF Financial in the Texas MSAs, the Board's review included only 2003 HMDA data. Wells Fargo's lending subsidiaries that offered prime mortgage products in California and Texas in 2002 and 2003 included WF Bank CA; Wells Fargo Bank Texas, N.A., San Antonio, Texas; Wells Fargo Bank Nevada, N.A., Las Vegas, Nevada; Wells Fargo Funding, Inc., Minneapolis, Minnesota; and WF Mortgage ("WF Prime Lenders"). Although some of these entities made some loans that could be considered subprime, these loans represented a small portion of their loan portfolios. In the MSAs reviewed, the Board compared the HMDA data reported by the WF Prime Lenders with the HMDA data reported by WF Financial.

29. The commenter also alleged that Wells Fargo engaged in discriminatory lending based on a review of the prices of loans extended to African-American and Hispanic borrowers as compared to white borrowers in 2004. The commenter based this allegation on 2004 HMDA data derived from loan application registers that it obtained from Wells Fargo. These data are preliminary and 2004 data for lenders in the aggregate are not yet available. *See Frequently Asked Questions About the New HMDA Data* (March 31, 2005) available at (www.federalreserve.gov/boarddocs/press/bcreg/2005).

30. The origination rate equals the total number of loans originated to applicants of a particular racial category divided by the total number of applications received from members of that racial category.

31. The lending data of the aggregate lenders represent the cumulative lending for all financial institutions that have reported data in a particular area.

African-American and Hispanic applicants for the banks' total HMDA-reportable loans in the markets reviewed were generally comparable with the ratios for the aggregate lenders in those areas.[32] In addition, WF Prime Lenders' denial disparity ratios for African-American and Hispanic applicants decreased from 2002 to 2003 in most of the markets reviewed.

Although the HMDA data may reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial groups in certain local areas, the HMDA data do not demonstrate that the WF Prime Lenders are excluding any racial group on a prohibited basis. The Board, nevertheless, is concerned when the record of an institution indicates disparities in lending and believes that all banks are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending, but also equal access to credit by creditworthy applicants regardless of race or income level. The Board recognizes, however, that HMDA data alone, even with the recent addition of pricing information, provide an incomplete measure of an institution's lending in its community because these data cover only a few categories of housing-related lending and provide only limited information about covered loans.[33] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has not assisted adequately in meeting its community credit needs or has engaged in illegal lending discrimination. Moreover, HMDA data indicating that one affiliate is lending to minorities or LMI individuals more than another affiliate do not, without more information, indicate that either affiliate has engaged in illegal discriminatory lending activities.

Because of the limitations of HMDA data, the Board has considered these data carefully in light of other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by the subsidiary depository and lending institutions of Wells Fargo and FCCC. Examiners noted no substantive violations of applicable fair lending laws in the examinations of the depository institutions controlled by Wells Fargo or FCCC. Moreover, the Board has consulted with the OCC about the consumer compliance records of the WF Prime Lenders and with relevant state supervisors about the consumer compliance records of WFFI.

The record also indicates that Wells Fargo has taken various measures to help ensure compliance with fair lending laws and other consumer protection laws at all its lending subsidiaries, including WF Financial.[34] Wells Fargo represented that it has implemented corporate-wide policies and procedures to help ensure compliance with all fair lending and other consumer protection laws and regulations. These policies and procedures apply to all of Wells Fargo's prime and subprime lending subsidiaries. Wells Fargo's corporate Fair Lending Policy requires each business unit to adopt and implement fair lending policies and procedures, including control standards related to marketing, pricing, and referrals. Wells Fargo's Compliance Risk Management Group guides, maintains, and monitors compliance of business units with fair lending and consumer protection laws. Wells Fargo's Law Department provides oversight and guidance on the fair lending policies and on the business unit compliance programs. Furthermore, Wells Fargo's Corporate Fair Lending Steering Committee, which includes senior management representatives from its bank and nonbank subsidiaries, meets regularly to identify and provide guidance on fair lending practices throughout the company.

Wells Fargo represented that each of its lending operations has developed, implemented, and maintained compliance programs for fair lending and other consumer protection laws. These fair lending compliance programs include components such as pricing limits, programs for second review of initially declined applications, analysis of decision and pricing data, and comparative file analysis. All lending operations are required to include compliance training in employee training programs. Wells Fargo's internal audit unit conducts audits for compliance with fair lending and consumer law that involve an independent evaluation of results through data analysis or comparative file review.

The Board also has considered the HMDA data in light of other information, including the CRA performance records of the subsidiary depository institutions of Wells Fargo and FCCC. These records demonstrate that Wells Fargo and FCCC are active in helping to meet the credit needs of their entire communities.

Conclusion on Convenience and Needs Considerations

The Board has carefully considered all the facts of record, including reports of examination of the CRA records of the

32. The denial disparity ratio equals the denial rate for a particular racial category (e.g., African American) divided by the denial rate for whites.

33. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. Credit history problems and excessive debt levels relative to income (reasons most frequently cited for a credit denial) are not available from HMDA data.

34. A commenter criticized the customer service and complaint procedures of a Wells Fargo subsidiary engaged in subprime lending in Puerto Rico and urged the Board, without specific allegations, to closely scrutinize the subprime lending operations of Wells Fargo in general. Wells Fargo originates subprime mortgage loans through WF Financial and Island Finance, and numerous joint ventures originate subprime loans that are underwritten and processed through WF Mortgage's unit, Wells Fargo Mortgage Resource. WF Financial and Island Finance are nonbanking subsidiaries of Wells Fargo. As the Board has previously noted, subprime lending is a permissible activity that provides needed credit to consumers who have difficulty meeting conventional underwriting criteria. The Board, however, continues to expect all bank holding companies and their affiliates to conduct their subprime lending operations without any abusive lending practices. *See, e.g. Royal Bank of Canada*, 88 *Federal Reserve Bulletin* 385, 388 n. 18 (2002).

institutions involved, information provided by Wells Fargo and FCCC, comments on the proposal,[35] confidential supervisory information, and Well Fargo's plans to implement its CRA-related policies, procedures, and programs at FCCC's subsidiary banks. The Board notes that the proposal would expand the availability and array of banking products and services to the customers of Wells Fargo and FCCC, including access to expanded branch and ATM networks and internet banking services. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant depository institutions are consistent with approval.

Conclusion

Based on the foregoing and in light of all the facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching this conclusion, the Board has considered all the facts of record in light of the factors it is required to consider under the BHC Act and other applicable statutes.[36] The Board's approval is specifically conditioned on compliance by Wells Fargo with the conditions in this order and all the commitments made to the Board in connection with this proposal. For purposes of this action, the commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal shall not be consummated before the fifteenth calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of San Francisco, acting pursuant to delegated authority.

By order of the Board of Governors, effective June 23, 2005.

Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, and Olson. Absent and not voting: Governor Kohn.

JENNIFER J. JOHNSON
Secretary of the Board

Appendix A

Texas Banking Markets Where Wells Fargo and FCCC Subsidiary Depository Institutions Compete Directly

Brazoria
Brazoria County, excluding the cities of Alvin and Pearland and the surrounding unincorporated area in the Houston Ranally Metropolitan Area ("RMA").

Grimes County
Grimes County.

Houston
Houston RMA, including the portion of Montgomery County not included in the Houston RMA.

San Antonio
Bexar, Comal, Guadalupe, Kendall, and Wilson counties.

Appendix B

Market Data for Banking Markets

Moderately Concentrated Banking Markets

Brazoria
Wells Fargo operates the fifth largest depository institution in the market, controlling deposits of approximately $68.2 million, which represent approximately 8.3 percent of market deposits. FCCC operates the 12th largest depository institution in the market, controlling deposits of approximately $12.4 million, which represent approximately 1.5 percent of market deposits. After the proposed merger, Wells Fargo would operate the fifth largest depository institution in the market, controlling deposits of approximately $80.6 million, which represent approximately 9.8 percent of market deposits. Fifteen depository institutions would remain in the banking market. The HHI would increase 25 points, to 1,279.

35. A commenter expressed concern that the length of the Board's review of the proposal negatively affected the customers, stockholders, and employees of FCCC.

36. A commenter requested that the Board hold a public hearing or meeting on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for any of the banks to be acquired makes a timely written recommendation of denial of the application. The Board has not received such a recommendation from any supervisory authority. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if a meeting or hearing is necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony. 12 CFR 225.16(e). The Board has considered carefully the commenter's requests in light of all the facts of record. In the Board's view, the public has had ample opportunity to submit comments on the proposal and, in fact, the commenter has submitted written comments that the Board has considered carefully in acting on the proposal. The commenter's requests fail to demonstrate why its written comments do not present its views adequately or why a meeting or hearing otherwise would be necessary or appropriate. The requests also fail to identify disputed issues of fact that are material to the Board's decision that would be clarified by a public hearing or meeting. For these reasons, and based on all the facts of record, the Board has determined that a public hearing or meeting is not required or warranted in this case. Accordingly, the requests for a public hearing or meeting on the proposal are denied.

San Antonio

Wells Fargo operates the fourth largest depository institution in the market, controlling deposits of approximately $1.4 billion, which represent approximately 6.8 percent of market deposits. FCCC operates the 42nd largest depository institution in the market, controlling deposits of approximately $13.4 million, which represent less than 1 percent of market deposits. After the proposed merger, Wells Fargo would remain the fourth largest depository institution in the market, controlling deposits of approximately $1.4 billion, which represent approximately 6.8 percent of market deposits. Fifty-one depository institutions would remain in the banking market. The HHI would increase 1 point, to 1,574.

Highly Concentrated Banking Markets

Grimes

Wells Fargo operates the fourth largest depository institution in the market, controlling deposits of approximately $23.4 million, which represent approximately 10.2 percent of market deposits. FCCC operates the sixth largest depository institution in the market, controlling deposits of approximately $4.9 million, which represent approximately 2.1 percent of market deposits. After the proposed merger, Wells Fargo would remain the fourth largest depository institution in the market, controlling deposits of approximately $28.3 million, which represent approximately 12.4 percent of market deposits. Five depository institutions would remain in the banking market. The HHI would increase 44 points, to 2,408.

Houston

Wells Fargo operates the third largest depository institution in the market, controlling deposits of approximately $6.1 billion, which represent approximately 8.1 percent of market deposits. FCCC operates the 23rd largest depository institution in the market, controlling deposits of approximately $415.3 million, which represent less than 1 percent of market deposits. After the proposed merger, Wells Fargo would remain the third largest depository institution in the market, controlling deposits of approximately $6.5 billion, which represent approximately 8.7 percent of market deposits. Ninety depository institutions would remain in the banking market. The HHI would increase 9 points, to 1,912.

Appendix C

CRA Performance Evaluations of Wells Fargo

Subsidiary Bank	CRA Rating	Date	Supervisor
1. Wells Fargo Bank, N.A., San Francisco, California (now Sioux Falls, South Dakota)	Outstanding	October 2001	OCC
2. Wells Fargo Bank Northwest, N.A., Ogden, Utah	Outstanding	May 1999	OCC
3. Wells Fargo HSBC Trade Bank, N.A., San Francisco, California	Satisfactory	August 2000	OCC
4. Wells Fargo Financial National Bank, Las Vegas, Nevada	Outstanding	March 2003	OCC
5. Wells Fargo Financial Bank, Sioux Falls, South Dakota	Outstanding	March 2005	FDIC

ORDERS ISSUED UNDER BANK MERGER ACT

The Citizens Bank
Batesville, Arkansas

Order Approving the Acquisition and Establishment of a Branch

The Citizens Bank ("Citizens Bank"),[1] a state member bank, has requested the Board's approval under section 18(c) of the Federal Deposit Insurance Act (the "Bank Merger Act")[2] to purchase the assets and assume the liabilities of the Cave City branch ("Branch") of First National Bank and Trust Company ("First National Bank"), Mountain Home, Arkansas.[3] Citizens Bank also has requested the Board's approval to operate Branch as a branch of Citizens Bank pursuant to section 9 of the Federal Reserve Act ("FRA").[4]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been given in accor-

1. Citizens Bank is a wholly owned subsidiary of Citizens Bancshares of Batesville, Inc., also of Batesville, which is a bank holding company within the meaning of the Bank Holding Company Act, 12 U.S.C. § 1842.

2. 12 U.S.C. § 1828(c).

3. The branch's address is 201 South Main Street, Cave City, Arkansas.

4. 12 U.S.C. § 321.

dance with the Bank Merger Act and the Board's Rules of Procedure.[5] As required by the Bank Merger Act, reports on the competitive effects of the merger were requested from the United States Attorney General and relevant banking agencies. The time for filing comments has expired, and the Board has considered the applications and all the facts of record in light of the factors set forth in the Bank Merger Act and section 9 of the FRA.

Citizens Bank, with total consolidated assets of approximately $418.6 million, is the 24th largest insured depository institution in Arkansas, controlling deposits of approximately $301.9 million.[6] Branch controls deposits of approximately $7 million. On consummation of the proposal, Citizens Bank would become the 23rd largest insured depository institution in Arkansas, controlling deposits of $308.9 million, which represent less than 1 percent of total deposits of insured depository institutions in the state.

Competitive Considerations

The Bank Merger Act prohibits the Board from approving an application if the proposal would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market.[7] The Bank Merger Act also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[8]

Citizens Bank and First National Bank compete directly in the Batesville banking market in Arkansas.[9] The Board has carefully reviewed the competitive effects of the proposal in this banking market in light of all the facts of record, including the number of competitors that would remain in the market, the relative shares of total deposits in depository institutions in the market ("market deposits") controlled by Citizens Bank and First National Bank,[10] the concentration level of market deposits and the increase in this level as measured by the Herfindahl-Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[11] and other characteristics of the market.

Although the Batesville banking market would remain highly concentrated on consummation of the proposal, the increase in the post-merger HHI would be consistent with DOJ Guidelines and Board precedent. Citizens Bank is the largest depository institution in the market, controlling approximately $291.5 million in deposits, which represents approximately 45.6 percent of market deposits.[12] First National is the smallest depository institution in the market, with deposits of approximately $7 million, which represent approximately 1.1 percent of market deposits. On consummation of the proposal, Citizens Bank would remain the largest depository institution in the market, controlling deposits of approximately $298.5 million, and its market share would increase by a small percentage to 46.7 percent of market deposits. The HHI would increase 100 points, to 3,145, which is consistent with DOJ Guidelines.

The Board also has considered other factors that indicate the proposal is not likely to have a significant effect on competition in the Batesville banking market. Six commercial banking organizations would remain in the market after consummation, including two competitors each with more than 10 percent of deposits in the market. In addition, the second largest competitor increased its market share from 14.2 percent to 27.6 percent between 1999 and 2004, while Citizens Bank's market share decreased four percentage points during the same period.

In addition, several factors indicate that the Batesville banking market is attractive for entry. One of the existing competitors entered the market de novo in February 2005 and another commercial banking organization recently received approval to open a de novo branch in the market. Moreover, Independence County, the main county in the market, experienced above-average population and deposit growth rates relative to the average rates for nonmetropolitan counties in Arkansas between 1996 and 2003, and its per capita income exceeded the averages for nonmetropolitan counties during this period.

The DOJ has reviewed the proposal and advised the Board that consummation of the proposal is not likely to have a significantly adverse competitive effect in the Batesville banking market. The other federal banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposed transaction would not likely result in a significantly adverse effect on competition or on the concentration of banking resources in the Batesville banking market or in any other relevant banking market and that competitive factors are consistent with approval.

5. 12 CFR 262.3(b).

6. In this context, depository institutions include commercial banks, savings banks, and savings associations. Deposit and ranking data are as of June 30, 2004. Ranking data are adjusted to reflect merger and acquisition activity through May 6, 2005.

7. 12 U.S.C. § 1828(c)(5)(A).

8. 12 U.S.C. § 1828(c)(5)(B).

9. The Batesville banking market is defined as Independence County and Sharp County south of the Strawberry River.

10. Deposit and market share data are as of June 30, 2004.

11. Under the DOJ Guidelines, a market is considered highly concentrated if the post-merger HHI is more than 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. The DOJ has stated that the higher than normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

12. Citizens Bank increased its market share by opening seven de novo branches over a 23-year period.

Financial and Managerial Considerations

In reviewing the proposal under the Bank Merger Act and section 9 of the FRA, the Board has carefully considered the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record including, among other things, confidential reports of examination and other supervisory information received from the federal and state banking supervisors of Citizens Bank and First National Bank, publicly reported and other financial information, and information provided by Citizens Bank.

In evaluating financial factors in expansion proposals by depository institutions, the Board reviews the financial condition of the institutions involved. In this evaluation, the Board considers a variety of areas, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the applicant on a pro forma basis, including its capital position, asset quality, and earnings prospects and the impact of the proposed funding of the transaction.

Based on its review of these factors, the Board finds that Citizens Bank is well capitalized and would remain so on consummation of the proposal. The Board also finds that Citizens Bank has sufficient financial resources to effect the proposal. The proposed transaction would be funded with cash on hand at Citizens Bank.

The Board also has considered the managerial resources of the institutions involved, including the resources of Citizens Bank on a pro forma basis. The Board has reviewed the examination records of Citizens Bank and First National Bank, including assessments of their management, risk management systems, and operations. In addition, the Board has considered its supervisory experience and that of the other relevant banking supervisory agencies with the institutions and their records of compliance with applicable banking law. The Board also has considered Citizens Bank's plans to integrate Branch and its proposed management and to implement Citizen Bank's risk-management systems at Branch.

Based on all the facts of record, the Board has concluded that the financial and managerial resources and future prospects of the institutions and the other supervisory factors involved are consistent with approval of the proposal.

Convenience and Needs

In acting on the proposal, the Board also must consider its effects on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[13] Citizens Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Reserve Bank of St. Louis, as of November 12, 2003. First National Bank received an "outstanding" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency, as of November 4, 2002. The Board notes that the proposal would provide Branch's customers with access to a broader array of products and services in expanded service areas, including access to larger branch and ATM networks.

Based on all the facts of record, the Board concludes that the considerations relating to the convenience and needs of the communities to be served and the CRA performance records of the institutions involved are consistent with approval of this proposal.

Establishment of a Branch

Citizens Bank also has applied under section 9 of the FRA to establish a branch at the Cave City location of First National Bank. The Board has assessed the factors it is required to consider when reviewing an application under section 9 of the FRA, including section 208.6 of the Board's Regulation H, which implements sections 9(3) and 9(4) of the FRA, and finds those factors to be consistent with approval.[14]

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the applications should be, and hereby are, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the Bank Merger Act and the FRA. The Board's approval is specifically conditioned on compliance by Citizens Bank with the conditions imposed in this order, commitments made to the Board in connection with the applications, and receipt of all other regulatory approvals. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law. The transaction may not be consummated before the fifteenth calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of St. Louis, acting pursuant to delegated authority.

By order of the Board of Governors, effective June 2, 2005.

Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

13. 12 U.S.C. §2901 et seq.

14. 12 U.S.C. §§321 and 322; 12 CFR 208.6(b).

ORDERS ISSUED UNDER INTERNATIONAL BANKING ACT

Aozora Bank, Ltd.
Tokyo, Japan

Order Approving Establishment of a Representative Office

Aozora Bank, Ltd. ("Bank"), Tokyo, Japan, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 10(a) of the IBA (12 U.S.C. § 3107(a)) to establish a representative office in New York, New York. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a representative office in the United States.

Notice of the application, affording interested persons an opportunity to submit comments, has been published in a newspaper of general circulation in New York, New York (*New York Times*, September 21, 2004). The time for filing comments has expired, and all comments have been considered.

Bank, with total consolidated assets of approximately $44.5 billion,[1] is the 46th largest bank in Japan. Bank provides a range of financial services to corporate and retail clients. Outside Japan, Bank operates three representative offices in Singapore, Seoul, and Jakarta. Bank's proposed New York office would be the first office in the United States under its current ownership.[2] A limited partnership, Cerberus NCB Acquisition, L.P. ("Acquisition"), Cayman Islands, holds approximately 62 percent of Bank's shares.[3] Two other companies, Tokio Marine & Nichido Fire Insurance Co., Ltd. and ORIX Corporation, both in Tokyo, each hold approximately 15 percent of Bank's shares.[4]

The proposed representative office would market Bank's services to existing and potential customers in the United States. The proposed office would also act as a liaison with customers of Bank and would conduct research on loan participation opportunities for Bank.

Under the IBA and Regulation K, in acting on an application by a foreign bank to establish a representative office, the Board must consider whether the foreign bank (1) engages directly in the business of banking outside of the United States, (2) has furnished to the Board the information it needs to assess the application adequately, and (3) is subject to comprehensive supervision on a consolidated basis by its home country supervisor (12 U.S.C. § 3107(a)(2); 12 CFR 211.24(d)(2)).[5] The Board also may consider additional standards set forth in the IBA and Regulation K (12 U.S.C. § 3105(d)(3)–(4); 12 CFR 211.24(c)(2)). The Board will consider that the supervision standard has been met if it determines that the applicant bank is subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities.[6] This is a lesser standard than the comprehensive, consolidated supervision standard applicable to proposals to establish branch or agency offices of a foreign bank. The Board considers the lesser standard sufficient for approval of representative office applications because representative offices may not engage in banking activities (12 CFR 211.24(d)(2)). This application has been considered under the lesser standard.

As noted above, Bank engages directly in the business of banking outside the United States. Bank also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

With respect to supervision by home country authorities, the Board previously has determined, in connection with applications involving other banks in Japan, that those banks were subject to home country supervision on a consolidated basis by their home country supervisor, Japan's Financial Services Agency ("FSA").[7] Bank is

1. Unless otherwise indicated, data are as of March 31, 2005.

2. Bank was originally established in 1957 as the Nippon Fudosan Bank, Ltd. It was renamed the Nippon Credit Bank, Ltd. and by the mid-1990s operated both banking offices and nonbanking subsidiaries in the United States. The bank was intervened in 1998; U.S. operations were closed; and the government of Japan sold Bank's shares to private investors, who changed Bank's name to Aozora Bank, Ltd.

3. The general partner of Acquisition, Cerberus Aozora GP LLC ("Cerberus Aozora"), is a U.S. entity controlled by three other U.S. entities, Cerberus Japan Investment LLC, Cerberus Series One Holdings, LLC, and Richter Investment Corporation, that hold interests of 49 percent, 26 percent, and 25 percent, respectively, in Cerberus Aozora. These companies are members of the Cerberus group, a U.S.-based investment group.

4. Regional Japanese banks hold the remaining shares of Bank.

5. In assessing the supervision standard, the Board considers, among other factors, the extent to which the home country supervisors:

(i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide;
(ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise;
(iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic;
(iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; and
(v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis.

These are indicia of comprehensive, consolidated supervision. No single factor is essential, and other elements may inform the Board's determination.

6. *See, e.g., Jamaica National Building Society*, 88 *Federal Reserve Bulletin* 59 (2002); *RHEINHYP Rheinische Hypothekenbank AG*, 87 *Federal Reserve Bulletin* 558 (2001); *see also Promstroybank of Russia*, 82 *Federal Reserve Bulletin* 599 (1996); *Komercni Banka, a.s.*, 82 *Federal Reserve Bulletin* 597 (1996); *Commercial Bank Ion Tiriac, S.A.*, 82 *Federal Reserve Bulletin* 592 (1996).

7. *See, e.g., Mitsubishi Tokyo Financial Group, Inc.*, 87 *Federal Reserve Bulletin* 349 (2001); *Mizuho Holdings, Inc.*, 86 *Federal Reserve Bulletin* 776 (2000); *The Sanwa Bank, Limited*, 86 *Federal Reserve Bulletin* 54 (2000); *The Fuji Bank, Limited*, 85 *Federal Reserve Bulletin* 338 (1999).

supervised by the FSA on substantially the same terms and conditions as those other banks. As noted above, however, Bank is part of a larger U.S.-based financial group with a complex ownership structure and is controlled by entities in the Cayman Islands and the United States.[8] Based on all the facts of record, it has been determined that Bank is subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities.

The additional standards set forth in section 7 of the IBA and Regulation K (*see* 12 U.S.C. §3105(d)(3)–(4); 12 CFR 211.24(c)(2)) have also been taken into account. The FSA has no objection to the establishment of the proposed representative office.

With respect to the financial and managerial resources of Bank, taking into consideration Bank's record of operations in its home country, its overall financial resources, and its standing with its home country supervisor, financial and managerial factors are consistent with approval of the proposed representative office. Bank appears to have the experience and capacity to support the proposed representative office and has established controls and procedures for the proposed representative office to ensure compliance with U.S. law, as well as controls and procedures for its worldwide operations generally.

Japan is a member of the Financial Action Task Force and subscribes to its recommendations regarding measures to combat money laundering and international terrorism. In accordance with these recommendations, Japan has enacted laws and created legislative and regulatory standards to deter money laundering, terrorist financing, and other illicit activities. Money laundering is a criminal offense in Japan, and credit institutions are required to establish internal policies, procedures, and systems for the detection and prevention of money laundering throughout their worldwide operations. Bank has policies and procedures to comply with these laws and regulations that are monitored by governmental entities responsible for anti-money-laundering compliance.

With respect to access to information on Bank's operations, the restrictions on disclosure in relevant jurisdictions in which Bank operates have been reviewed and relevant government authorities have been communicated with regarding access to information. Bank and its parent companies have committed to make available to the Board such information on the operations of Bank and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act of 1956, as amended, and other applicable federal law. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, Bank has committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from third parties for disclosure of such information. In addition, subject to certain conditions, the FSA may share information on Bank's operations with other supervisors, including the Board. In light of these commitments and other facts of record, and subject to the condition described below, it has been determined that Bank has provided adequate assurances of access to any necessary information that the Board may request.

Based on the foregoing and all the facts of record, Bank's application to establish a representative office is hereby approved.[9] Should any restrictions on access to information on the operations or activities of Bank or its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Bank or its affiliates with applicable federal statutes, the Board may require termination of any of Bank's direct or indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by Bank with the conditions imposed in this order and the commitments made to the Board in connection with this application.[10] For purposes of this action, these commitments and conditions are deemed to be conditions imposed by the Board in writing in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

By order, approved pursuant to authority delegated by the Board, effective June 29, 2005.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

Banco del Estado de Chile
Santiago, Chile

Order Approving Establishment of a Branch

Banco del Estado de Chile ("Bank"), Santiago, Chile, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 7(d) of the IBA (12 U.S.C. §3105(d)) to establish a branch in New York, New York. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a branch in the United States.

Notice of the application, affording interested persons an opportunity to comment, has been published in a newspaper of general circulation in New York, New York (*The Daily News*, June 30, 2004). The time for filing comments has expired, and all comments have been considered.

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8. Establishment of a representative office will not cause Bank and its parent companies to become subject to the Bank Holding Company Act.

9. Approved by the Director of the Division of Banking Supervision and Regulation, with the concurrence of the General Counsel, pursuant to authority delegated by the Board.

10. The Board's authority to approve the establishment of the proposed representative office parallels the continuing authority of the State of New York to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the State of New York to license the proposed office of Bank in accordance with any terms or conditions that it may impose.

Bank, with total assets of $15.4 billion, is the third largest commercial bank in Chile,[1] and is wholly owned by the Chilean state. It provides a variety of banking services to retail and corporate customers through more than 300 branches in Chile. It also provides through its subsidiaries stock brokerage, insurance brokerage, fund management, and financial advisory services. The proposed branch would be its first office outside Chile. Bank is a qualifying foreign banking organization under Regulation K (12 CFR 211.23(b)).

The proposed branch would engage in wholesale banking business focusing on trade finance and lending activities. In addition, Bank anticipates that the branch would conduct treasury operations, participate in loan syndicates, invest in fixed-income securities, and provide cash management services.

Under the IBA and Regulation K, in acting on an application by a foreign bank to establish a branch, the Board must consider whether the foreign bank (1) engages directly in the business of banking outside of the United States; (2) has furnished to the Board the information it needs to assess the application adequately; and (3) is subject to comprehensive supervision on a consolidated basis by its home country supervisor (12 U.S.C. §3105(d)(2); 12 CFR 211.24(c)(1)).[2] The Board also may consider additional standards set forth in the IBA and Regulation K (12 U.S.C. §3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3)).

As noted above, Bank engages directly in the business of banking outside the United States. Bank also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

With respect to supervision by home country authorities, the Federal Reserve previously has determined, in connection with applications involving other banks in Chile, that those banks were subject to home country supervision on a consolidated basis by their home country supervisor, the Superintendencia de Bancos e Instituciones Financieras ("SBIF").[3] Bank is supervised by the SBIF on substantially the same terms and conditions as those other banks. Based on all the facts of record, it has been determined that Bank is subject to comprehensive supervision on a consolidated basis by its home country supervisor.

The additional standards set forth in section 7 of the IBA and Regulation K (*see* 12 U.S.C. §3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3)) have also been taken into account. The SBIF has no objection to the establishment of the proposed branch.

Chile's risk-based capital standards are consistent with those established by the Basel Capital Accord ("Accord"). Bank's capital is in excess of the minimum levels that would be required by the Accord and is considered equivalent to capital that would be required of a U.S. banking organization. Managerial and other financial resources of Bank also are considered consistent with approval, and Bank appears to have the experience and capacity to support the proposed branch. Bank has established controls and procedures for the proposed branch to ensure compliance with U.S. law and for its operations in general.

Chile is a member of GAFISUD (Financial Action Task Force for South America), which is an observer organization to the Financial Action Task Force. Chile has enacted laws and adopted regulations to deter money laundering. Money laundering is a criminal offense in Chile, and financial institutions are required to establish internal policies, procedures, and systems for the detection and prevention of money laundering throughout their worldwide operations. Bank has policies and procedures to comply with these laws and regulations. Bank's compliance with applicable laws and regulations is monitored by its auditors and the SBIF.

With respect to access to information about Bank's operations, the restrictions on disclosure in relevant jurisdictions in which Bank operates have been reviewed and relevant government authorities have been communicated with regarding access to information. Bank has committed to make available to the Board such information on the operations of Bank and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act, and other applicable federal law. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, Bank has committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from third parties for disclosure of such information. In addition, subject to certain conditions, SBIF may share information on Bank's operations with other supervisors, including the Board. In light of these commitments and other facts of record, and subject to the condition described below, it has been determined that Bank has provided adequate assurances of access to any necessary information that the Board may request.

Based on the foregoing and all the facts of record, Bank's application to establish a branch is hereby

1. Asset data are as of March 31, 2005.

2. In assessing this standard, the Board considers, among other factors, the extent to which the home country supervisors:

(i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide;
(ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise;
(iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic;
(iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; and
(v) evaluate prudential standards, such as capital adequacy and risk-asset exposure, on a worldwide basis.

These are indicia of comprehensive, consolidated supervision. No single factor is essential, and other elements may inform the Board's determination.

3. *See Banco de Chile*, 90 *Federal Reserve Bulletin* 550 (2004); *Banco de Credito e Inversiones S.A.*, 85 *Federal Reserve Bulletin* 446 (1999). *See also*, *Banco de Chile*, 80 *Federal Reserve Bulletin* 179 (1994).

approved.[4] Should any restrictions on access to information on the operations or activities of Bank and its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Bank or its affiliates with applicable federal statutes, the Board may require termination of any of Bank's direct or indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by Bank with the conditions imposed in this order and the commitments made to the Board in connection with this application.[5] For purposes of this action, these commitments and conditions are deemed to be conditions imposed by the Board in writing in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

By order, approved pursuant to authority delegated by the Board, effective June 20, 2005.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

4. Approved by the director of the Division of Banking Supervision and Regulation, with the concurrence of the general counsel, pursuant to authority delegated by the Board.

5. The Board's authority to approve the establishment of the proposed branch parallels the continuing authority of the State of New York to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the State of New York to license the proposed office of Bank in accordance with any terms or conditions that it may impose.

Banco Financiera Comercial Hondureña, S.A.
Tegucigalpa, Honduras

Order Approving Establishment of a Representative Office

Banco Financiera Comercial Hondureña, S.A. ("Bank"), Tegucigalpa, Honduras, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 10(a) of the IBA (12 U.S.C. §3107(a)) to establish a representative office in Miami, Florida. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a representative office in the United States.

Notice of the application, affording interested persons an opportunity to submit comments, has been published in a newspaper of general circulation in Miami, Florida (*Miami Daily Business Review*, March 19, 2004). The time for filing comments has expired, and all comments received have been considered.

Bank, with total consolidated assets of approximately $612 million,[1] is the fourth largest commercial bank in Honduras and provides wholesale and retail banking services through a network of domestic branches.[2] In the United States, Bank has licenses to operate nonbank subsidiaries in Florida, Georgia, New York, North Carolina, and Virginia that engage in money remittance services.[3]

The proposed representative office is intended to act as a liaison between Bank's head office in Honduras and its existing and prospective customers in Honduras and the United States. The office would engage in representative functions in connection with the activities of Bank, solicit new business, provide information to customers concerning their accounts, inform U.S.- and Honduran-owned businesses of business opportunities existing in Honduras, and receive applications for extensions of credit and other banking services on behalf of Bank.

In acting on an application by a foreign bank to establish a representative office under the IBA and Regulation K, the Board must consider whether the foreign bank: (1) engages directly in the business of banking outside of the United States; (2) has furnished to the Board the information it needs to assess the application adequately; and (3) is subject to comprehensive supervision on a consolidated basis by its home country supervisor (12 U.S.C. §3107(a)(2); 12 CFR 211.24(d)(2)).[4] The Board also may consider additional standards set forth in the IBA and Regulation K (12 U.S.C. §3105(d)(3)–(4); 12 CFR 211.24(c)(2)). The Board will consider that the supervision standard has been met where it determines that the applicant bank is subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities.[5] This is a lesser standard than the comprehensive, consoli-

1. Unless otherwise indicated, data are as of December 31, 2004.

2. Corporación del Pacifico SA de CV ("CORPASA"), a Honduran holding company, is Bank's largest shareholder with a 51.3 percent ownership interest in Bank. CORPASA in turn is owned by members of the Atala family.

3. Bank owns its money remittance subsidiaries through Ficohsa Express Holding LLC, a holding company organized in Florida, which in turn is owned by Grupo Financiero Ficohsa Ltd, a company organized in the British Virgin Islands.

4. In assessing the supervision standard, the Board considers, among other factors, the extent to which the home country supervisors:

(i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide;
(ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise;
(iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic;
(iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; and
(v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis.

These are indicia of comprehensive, consolidated supervision. No single factor is essential, and other elements may inform the Board's determination.

5. *See, e.g., Jamaica National Building Society*, 88 *Federal Reserve Bulletin* 59 (2002); *RHEINHYP Rheinische Hypothekenbank AG*, 87 *Federal Reserve Bulletin* 558 (2001); *see also Promstroybank of Russia*, 82 *Federal Reserve Bulletin* 599 (1996); *Komercni Banka, a.s.*, 82 *Federal Reserve Bulletin* 597 (1996); *Commercial Bank "Ion Tiriac," S.A.*, 82 *Federal Reserve Bulletin* 592 (1996).

dated supervision standard applicable to applications to establish branch or agency offices of a foreign bank. The Board considers the lesser standard sufficient for approval of representative office applications because representative offices may not engage in banking activities (12 CFR 211.24(d)(2)).

In connection with this application, Bank has provided certain commitments that limit the activities of the representative office. It has committed that the representative office would engage only in certain specified activities and would not make credit decisions on behalf of Bank, solicit deposits on behalf of Bank, or engage in activities related to securities trading, foreign exchange, or money transmission. Bank has also committed that the representative office would not solicit business for or promote the services of Bank's U.S. nonbank subsidiaries and would not share office space with those subsidiaries.

As noted above, Bank engages directly in the business of banking outside the United States. Bank also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

Bank has provided the following information regarding home country supervision. Bank is supervised by the National Commission on Banking and Insurance ("NCBI"). The NCBI is responsible for the regulation and supervision of financial institutions operating in Honduras. The NCBI issues and implements regulations concerning accounting requirements, asset quality, management, operations, capital adequacy, loan classification and loan loss reserve requirements. In addition, the NCBI has authority to order corrective measures, impose sanctions, and assume management of a financial institution or liquidate it.

The NCBI supervises and regulates Bank in Honduras through a combination of on-site examinations and off-site monitoring.[6] On-site examinations are conducted on an annual basis and cover capital adequacy, asset quality, profitability, administrative efficiency, liquidity, and compliance with the law. If necessary, the NCBI can also conduct special on-site examinations. Off-site monitoring of Bank is conducted by the NCBI through the review of required monthly and quarterly reports. An external audit is also part of the supervisory process and must be conducted at least annually.[7]

Based on all the facts of record, including the commitments provided by Bank limiting the activities of the proposed office, it has been determined that Bank is subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities.

The additional standards set forth in section 7 of the IBA and Regulation K (*see* 12 U.S.C. §3105(d)(3)–(4); 12 CFR 211.24(c)(2)) have also been taken into account. The NCBI has no objection to the establishment of the proposed representative office.

With respect to the financial and managerial resources of Bank, taking into consideration its record of operations in its home country, its overall financial resources, and its standing with its home country supervisor, financial and managerial factors are consistent with approval of the proposed representative office. Bank appears to have the experience and capacity to support the proposed representative office and has established controls and procedures for the proposed representative office to ensure compliance with U.S. law.

Although Honduras is not a member of the Financial Action Task Force ("FATF"), Honduras has enacted laws based on the general recommendations of the FATF. Additionally, Honduras is a member of the Caribbean Financial Action Task Force and participates in other international forums that address the prevention of money laundering.[8] Money laundering is a criminal offense in Honduras, and banks are required to establish internal policies and procedures for the detection and prevention of money laundering.[9] Legislation and regulation require banks to adopt know-your-customer policies, report suspicious transactions, and maintain records. Accordingly, Bank has established anti-money-laundering policies and procedures, which include the implementation of know-your-customer policies, suspicious activity reporting procedures, and related training programs and manuals. Bank's external auditors review compliance with requirements to prevent money laundering.

With respect to access to information on Bank's operations, the restrictions on disclosure in relevant jurisdictions in which Bank operates have been reviewed and relevant government authorities have been communicated with regarding access to information. Bank and its parent have committed to make available to the Board such information on the operations of Bank and any of its affiliates as the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act of 1956, as amended, and other applicable federal law. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, Bank and Bank's parent have committed to cooperate with the Board to obtain any necessary consents or waivers that might be

6. The laws governing bank supervision in Honduras are in need of strengthening. The law was amended in September 2004 to require banks to obtain the prior authorization of the NCBI to establish foreign operations and to report monthly to the NCBI on their operations. The NCBI continues to work to obtain additional legislation that would allow it to supervise banks on a fully consolidated basis.

7. The external auditing firm must be approved by and registered with the NCBI.

8. Honduras is a member of the Organization of American States Inter-American Drug Abuse Control Commission Experts Group to Control Money Laundering. Honduras is also party to the 1988 UN Convention Against the Illicit Traffic of Narcotics and Psychotropic Substances, the UN International Convention Against Transnational Organized Crime and the UN International Convention for the Suppression of the Financing of Terrorism.

9. In 2002, legislation was enacted to strengthen the anti-money laundering regime in Honduras. Among other measures, the legislation expanded the definition of money laundering, strengthened enforcement, and established a financial intelligence unit within the NCBI.

required from third parties for disclosure of such information. In addition, subject to certain conditions, the NCBI may share information on Bank's operations with other supervisors, including the Board. In light of these commitments and other facts of record, and subject to the condition described below, it has been determined that Bank has provided adequate assurances of access to any necessary information that the Board may request.

Based on the foregoing and all the facts of record, and subject to the commitments made by Bank and its parent and the terms and conditions set forth in this order, Bank's application to establish the representative office is hereby approved.[10] Should any restrictions on access to information on the operations or activities of Bank or any of its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Bank or its affiliates with applicable federal statutes, the Board may require or recommend termination of any of Bank's direct and indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by Bank and its parent with the conditions imposed in this order and the commitments made to the Board in connection with this application.[11] For purposes of this action, these commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its finding and decision and, as such, may be enforced in proceedings under applicable law.

By order, approved pursuant to authority delegated by the Board, effective April 20, 2005.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

FINAL ENFORCEMENT DECISIONS ISSUED BY THE BOARD OF GOVERNORS

In the Matter of

Carl V. Thomas, Eva June Thomas, Stephen P. Thomas, Mary Beth Thomas, Marguerite Thomas, Charles Tomlinson, Herbert Phillips, Lloyd Phillips, R.L. Phillips, Stanley Phillips, Rhonda Phillips, Scott Ward, Angela Ward, Forrest Buckley, James C. Crowe, Johnny V. Jones, Harper Guinn, and Jeff Guinn, Current and Former Institution Affiliated Parties First Western Bank, Cooper City, Florida (State Member Bank)

Docket Nos. 99-027-B-I (20)-(41), 99-027-CMP-I (20)-(41), 99-027-E-I (20)

Final Decision

This is an administrative proceeding pursuant to the Federal Deposit Insurance Act ("the FDI Act") in which the Office of the Comptroller of the Currency of the United States of America ("OCC") seeks to prohibit Respondent Carl Thomas from further participation in the affairs of any financial institution, and to issue civil monetary penalties as well as cease-and-desist orders against all Respondents based on their conduct as institution affiliated parties of First Western Bank, Cooper City, Florida (the "Bank").

Upon review of the administrative record, the Board issues this Final Decision adopting the Recommended Decision ("Recommended Decision" or "RD") of Administrative Law Judge Arthur L. Shipe (the "ALJ"), except as specifically supplemented or modified herein. The Board therefore orders that the attached Order of Prohibition issue against Respondent Carl Thomas, and that the attached Cease-and-Desist Order be issued against all Respondents. For the reasons set forth in this Final Decision, the Board has determined to withdraw its assessment of civil monetary penalties in this case.

I. Procedural History

On November 22, 2002, the Board issued a combined Notice of Charges and of Hearing, Notice of the Assessment of Civil Monetary Penalties and Notice of Intent to Prohibit (the "Notice"). The Notice alleged that Respondents willfully and knowingly violated the Change in Bank Control Act ("CIBC"), 12 U.S.C. § 1817(j), its implementing regulation, and an order of the Board when they acquired control of the Bank through a series of coordinated purchases without obtaining the Board's prior approval. The Notice further alleged that such actions resulted in financial gains and other benefits to Respondents; involved personal dishonesty on the part of Respondent Carl Thomas; and were part of a pattern of misconduct with respect to Respondents Carl Thomas and Stephen Thomas.

The Notice initially was issued against 22 individual Respondents. Shortly after receiving the Notice, four of the named Respondents settled with the Board by agreeing to enter into consent orders. The remaining 18 Respondents, who appeared and have participated pro se, filed answers to the Notice but did not challenge the allegations set forth in the Notice.

On September 25, 2003, Enforcement Counsel for the Board filed a Motion for Summary Disposition, supplemented by evidence submitted on March 5, 2004. On

10. Approved by the director of the Division of Banking Supervision and Regulation, with the concurrence of the general counsel, pursuant to authority delegated by the Board. *See* 12 CFR 265.7(d)(12).

11. The Board's authority to approve the establishment of the proposed representative office parallels the continuing authority of the State of Florida to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the State of Florida or its agent, the Florida Department of Financial Services, to license the proposed office of Bank in accordance with any terms or conditions that it may impose.

July 30, 2004, the ALJ issued a Recommended Decision, advising that Enforcement Counsel's Motion for Summary Disposition be granted and recommending the imposition of an order of prohibition against Respondent Carl Thomas, as well as civil monetary penalties and a cease-and-desist order against all Respondents. Following the filing of a so-called "Affidavit of Proof" by Respondents and a response by Board Enforcement Counsel, the matter was referred to the Board for final decision. 12 U.S.C. §1818(h)(1).

On March 29, 2005, Enforcement Counsel filed a motion with the Board requesting that the Board withdraw its civil monetary penalty assessment and authorize Enforcement Counsel to arrange for the proceeds of the sale of Respondents' First Western shares, currently held in the registry of the United States District Court for the Northern District of Georgia, to be transferred to the registry of the United States Bankruptcy Court for the Middle District of Florida for ultimate distribution to the victims of fraud by Greater Ministries International, Inc. ("Greater Ministries").

II. Statutory Framework

1. Statutory and Regulatory Requirements For Obtaining Control of a State Member Bank

The CIBC and its implementing regulation, Regulation Y, provide that no person acting directly or indirectly or through or in concert with one or more persons, may acquire control of any state member bank unless the Board has been given at least sixty days prior written notice and has not disapproved the acquisition. 12 U.S.C. §1817(j)(1); 12 CFR 225.41. These requirements allow the Board to conduct an investigation of the competence, experience, integrity, and financial ability of each controlling person by and for whom shares of a state member bank are acquired. 12 U.S.C. §1817(j)(2)(B)(i); 12 CFR 225.43(f).

Regulation Y defines "acting in concert" to include knowing participation in a joint activity or parallel action toward a common goal of acquiring control of a state member bank, whether or not pursuant to an express agreement. 12 CFR 225.41(b)(2). Regulation Y creates a rebuttable presumption that an individual and the individual's immediate family members act in concert. 12 CFR 225.41(d)(2).

The CIBC Act defines "control" as the power, indirectly or directly, to direct the management or policies of a state member bank or to vote 25 percent or more of any class of voting securities of a state member bank. 12 U.S.C. §1817(j)(8)(B). Regulation Y presumes that an acquisition of voting securities of a state member bank constitutes an acquisition of control if, immediately following the transaction, the acquiring person or persons will own, control, or hold with power to vote 10 percent or more of any class of voting securities and no other person will own, control, or hold power to vote a greater percentage of that class of voting securities. 12 CFR 225.41(c)(2).

The CIBC Act sets forth the specific information that must be provided in the notice to the Board. Among other things, the notice must contain the identity, personal history, business background, and financial condition of each person by whom or on whose behalf the acquisition is to be made; the terms and conditions of each acquisition; and the identity, source, and amount of funds or other consideration used or to be used in making the acquisition. 12 U.S.C. §1817(j)(6)(A)–(H). The CIBC Act also sets forth circumstances under which the Board may disapprove a proposed acquisition, including situations in which an acquiring person "neglects, fails, or refuses to furnish [the Board] all the information required by the Board." 12 U.S.C. §1817(j)(7)(E); 12 CFR 225.43(h).

2. 18 U.S.C. §1001

Pursuant to 18 U.S.C. §1001, it is a violation of law to knowingly and willfully make any materially false, fictitious, or fraudulent statement or representation in a matter within the jurisdiction of a federal agency.

III. Facts

Beginning in 1997, Respondent Carl Thomas, with the primary assistance of his son, Respondent Stephen Thomas, initiated an effort to persuade a group of approximately 40 individuals and business entities to join them in acquiring shares in First Western Bank. (FF ¶¶9–10; 21–22).[1] All named Respondents in this matter, including Carl and Stephen Thomas, were members of a group that coordinated to buy shares in First Western Bank (hereinafter referred to collectively as "Purchasing Group" members). (FF ¶10). The acquisition of shares was undertaken on behalf of the Greater Ministries organization, a purported religious and charitable organization with which the Purchasing Group members were affiliated. (FF ¶12; Wall dep. at 30). Greater Ministries desired to obtain control of a financial institution and secure favorable account relationships for itself and its members, a task it had been unable to accomplish in the previous two years. (FF ¶¶2, 5, 9). Greater Ministries appointed Respondent Carl Thomas as one of its Elders and paid him approximately $535,000 between June 1997 and June 1998 as part of its "Gifting Program," a program that has been found to be essentially a Ponzi scheme. (FF ¶9; Hoch. Exh. Z-37).[2]

Respondents Carl and Stephen Thomas solicited members of the Purchasing Group to buy First Western shares on various occasions, including at the conclusion of Carl

1. "FF" denotes the ALJ's findings of fact in the Recommended Decision.

2. The ALJ described the "Gifting Program" as one in which Greater Ministries followers were persuaded to make "gifts" to the organization with the expectation of receiving returns as high as tenfold. The program was promoted by Greater Ministries with the biblical passage "Give and it shall be given unto you." (Luke 6:38) Elders such as Carl Thomas were awarded a portion of the "gifts" associated with the members they brought into the organization or who were otherwise assigned to them.

Thomas's Bible study meetings. (Skrobot Decl. ¶9). They advocated the opportunity to purchase shares in a "Christian-tied bank" that would protect Greater Ministries' privacy against the government. (Skrobot Decl. ¶9). Before solicitation by Carl and Stephen Thomas, members of the Purchasing Group had never heard of First Western Bank, or thought to invest in it. (Sellers depo p. 57; Skrobot Decl. ¶12). At least some of the Purchasing Group members were specifically told of Greater Ministries' ultimate goal to take control of the Bank's board of directors, while others were simply told it was necessary that multiple individuals purchase the stock so that it was not all in one name. (FF ¶13; Sellers dep. at 58, 60). The members of the Purchasing Group were assured that either Greater Ministries, Carl Thomas, or Stephen Thomas would provide the funds for the purchases of the shares or reimburse the members for such purchases. (FF ¶11). The evidence establishes that it was widely apparent to all Purchasing Group members that they were involved in a group effort to acquire shares in the Bank. (FF ¶12).

Members of the Purchasing Group generally did not communicate with the individuals from whom they purchased First Western shares. (FF ¶22). Instead, Carl and Stephen Thomas contacted individuals who were willing to sell their shares to negotiate and establish the amount of shares that would be purchased as well as the price. (FF ¶22). Subsequently, Carl or Stephen Thomas instructed the Purchasing Group members to write checks for the determined amount. (FF ¶22). Carl or Stephen Thomas provided the Purchasing Group members with funds derived from Greater Ministries to pay for the acquired shares. (FF ¶22). In some cases, such payments were made to members of the Purchasing Group in cash. (Agee Decl; Nieminen Decl. ¶6; Salhgreen Aff. ¶4; Skrobot Decl. ¶10). Carl or Stephen Thomas instructed the Purchasing Group members to deposit the cash in amounts under $10,000 each, so as not to raise any "red flags."[3] (Nieminen Decl. ¶9; Skrobot Decl. ¶10).

The Purchasing Group acquired their First Western shares between August 1997 and the end of February 1998, with the largest concentration of shares purchased in October 1997. (FF ¶¶16–21; 23; 27–28; 33–34). At various points, the Purchasing Group's accumulation of shares triggered notification requirements pursuant to the CIBC Act and its implementing regulation. Each time, however, Respondents and the other members of the Purchasing Group failed to provide proper notification and other necessary information.

The first of these required notification points came by October 16, 1997, when members of the Purchasing Group had acquired in excess of 10 percent of outstanding First Western shares. (FF ¶23). Even after a series of correspondence from Federal Reserve staff advising of the requirements of the CIBC Act and the Board's regulations, the Purchasing Group members refused to supply the required information. (FF ¶24–25). Instead, in a group response organized by Carl and Stephen Thomas, the Purchasing Group members insisted that the CIBC Act and other regulations did not apply to them. (FF ¶26). The evidence reveals that the Purchasing Group members habitually deferred to Respondents Carl and Stephen Thomas to organize responses on behalf of the group. (Agee Aff. at p. 2; Sahlgren Aff. ¶11, 12; Skrobot Decl. ¶16).

The second point came on or about December 2, 1997, when Respondent Carl Thomas and his wife, Respondent Eva Thomas, made a purchase of shares through a nominee which brought their joint ownership from about 18,814 to approximately 20,539 shares and elevated the Purchasing Group's ownership to over 25 percent. (FF ¶¶28–29).[4] The Purchasing Group members failed to file prior written notification with the Board before acquiring these shares and continued to conceal the source of funds used to acquire their shares. (FF ¶¶28, 32). Further, in an apparent attempt to conceal that the Purchasing Group owned more than 25 percent, Carl Thomas maintained in a December 9, 1997, "Draft" CIBC notice, as well as in another document he submitted to the Board on December 22, 1997, that he and his wife only owned 18,814 shares. (FF ¶29).

The third failure to adhere to the notification requirements took place around February 2, 1998, after additional purchases resulted in the "immediate" Thomas family[5] owning over 10 percent of First Western shares. (FF ¶33). The Thomas family failed to file prior written notice of the acquisition and failed to submit evidence rebutting the presumption that they were acting in concert and acquired control of First Western. (FF ¶33). Finally, prior notification also was not sought before the Purchasing Group made its last known purchase on February 26, 1998, which brought the group's ownership to over 29 percent. (FF ¶34; Bd. Rec. 1–39). Instead, in documents submitted on April 10, 1998, and August 17, 1998, Carl Thomas continued to conceal the true ownership of his family and of the group. In both documents, he continued to claim that he and his immediate family owned only 18,814 shares, when they actually owned at least 33,039 by that time.[6] (FF ¶¶35, 37). In the April 10, 1998, document, he failed to disclose that the Purchasing Group's acquisition of shares exceeded

3. Cash deposits of $10,000 or more require a financial institution to file a Currency Transaction Report ("CTR") with the Department of the Treasury, thus alerting government officials to large cash deposits. *See* 31 CFR 103.22(b).

4. Other members of the Purchasing Group also acquired additional shares between October 16, 1997, and December 2, 1997. (Hoch. Add. 2).

5. Pursuant to 12 CFR 225.41(c)(3), the "immediate" Thomas family includes Carl Thomas; his wife, Eva Thomas; his son and daughter-in-law, Stephen and Mary Beth Thomas; his mother, Marguerite Thomas; and his brother-in-law, William Barber.

6. Contrary to representations he consistently made to Federal Reserve staff, Carl Thomas asserted in a February 20, 2004, letter to the First Western Board of Directors that he held 33,039 shares of First Western stock. (Enforcement Counsel's March 5, 2004, Motion to File Supplemental Evidence.) Mr. Thomas sent the letter to First Western in response to proxy solicitations the Bank had mailed to Mr. Thomas and his family in connection with a proposed merger between First Western and 1st United Bank. Mr. Thomas presumably claimed ownership of 33,039 shares in his February 20, 2004, letter because he stood to benefit from the sale of the shares in the proposed merger.

25 percent. In the August 17, 1998 submission, he admitted that the Purchasing Group had acquired an additional 14,212 shares, but claimed the these shares were held in "open title." (FF ¶35, 37). Neither the April nor August 1998 submission revealed that Greater Ministries provided the funds used by Purchasing Group members to acquire First Western shares. (FF ¶35–38).

From August 24, 1998, to December 22, 1998, Federal Reserve staff persisted in its attempt to obtain information from the Respondents and other Purchasing Group members in order to achieve compliance with the CIBC and other regulations. (FF ¶38). Despite numerous letters requesting additional information, including the source of funds used to acquire the First Western shares, the Purchasing Group failed to correct its deficiencies. (FF ¶38). Ultimately, on February 10, 1999, the Board issued an order mandating that each Respondent divest his or her shares within ninety days of the date of the order. (FF ¶39). None of the Respondents divested their respective shares within that time. (FF ¶40).

In March 1999, eight Greater Ministries officials pleaded guilty or were convicted of fraud, money laundering, and conspiracy charges in connection with a "Gifting Program" operated by Greater Ministries, which was found to be a Ponzi scheme through which Greater Ministries defrauded thousands of United States residents. (FF ¶8). In August 1999, a United States District Court placed Greater Ministries into receivership after multiple states filed lawsuits against the organization for fraudulent violation of federal and state securities laws. (FF ¶6).

By letter dated May 18, 1999, Federal Reserve staff advised Respondents that they would be subject to an enforcement action for their continued violations of the CIBC and its accompanying regulation. (FF ¶40; Hoch. Dec. Ex. Z42). The letter also informed Respondents that prompt action to terminate their voting control of First Western shares could mitigate and possibly eliminate the need to impose remedies, but Respondents failed to take such action. (Hoch. Dec. Ex. Z42 and Z43; FF ¶40).

In November 2002, Board Enforcement Counsel initiated this action against Respondents, seeking an order of prohibition against Carl Thomas, a cease-and-desist order against all Respondents, and civil money penalties ranging from $10,000 to $250,000 against each Respondent.

On February 27, 2004, the Board approved an application submitted by 1st United Bank, Boca Raton, Florida, to merge with First Western by purchasing First Western shares for $17 per share. In March 2004, Board Enforcement Counsel filed an asset freeze action in United States District Court for the Northern District of Georgia pursuant to 12 U.S.C. § 1818(i)(4) in order to require the payment into the court of the sales proceeds necessary to pay the civil money penalty amounts assessed in the Notice in the event the Board's final decision assessed penalties against the Respondents. *Board of Governors v. Thomas*, et al., No. 1:04-CV-0777. The District Court issued a temporary restraining order on April 2, 2004, and a preliminary injunction on April 28, 2004, ordering each Respondent to direct 1st United to deposit in the court registry the proceeds of the sale of Respondents' First Western shares to the extent of the civil money penalty assessed in the Notice, pending final resolution of this enforcement action. Also on April 28, 2004, the United States Bankruptcy Court for the Middle District of Florida ordered 1st United to transfer into the registry of the bankruptcy court all amounts due to any Respondent in excess of the civil money penalties already ordered to be deposited in the District Court in Georgia.[7] Thus, pursuant to these orders, the Respondents have been divested of the proceeds of the sale of First Western shares they acquired in the course of the Greater Ministries scheme.

IV. Legal Conclusions

The Board has reviewed the record in this matter and finds that the ALJ properly granted Enforcement Counsel's Motion for Summary Disposition. The Board agrees that a prohibition order, civil monetary penalties and cease-and-desist order should be issued, as described in detail below.

A. *Respondents' Affidavit of Truth*

As noted earlier, Respondents filed a so-called "Affidavit of Truth" at the point at which exceptions to the ALJ's recommended decision were permitted by the Board's regulations. 12 CFR 263.39(a). The regulation provides that that exceptions must "set forth page or paragraph references to the specific parts of the administrative law judge's recommendations to which exception is taken, the page or paragraph references to those portions of the record relied upon to support each exception, and the legal authority relied upon to support each exception." 12 CFR 263.39(c)(2). Failure of a party to file exceptions to a finding, conclusion, or proposed order "is deemed a waiver of objection." 12 CFR 263.39(b)(1).

Respondents' "Affidavit of Truth" fails to conform to any of the requirements of a valid exception. It does not identify the portions of the ALJ's recommendation to which an exception was taken or cite the portions of the record or legal authority in support of its position. Accordingly, the Respondents are deemed to have waived their right to object to any portion of the Recommended Decision.

Even if Respondents' filing could be considered a valid exception, the Board finds that it raises no meritorious claim. At best, it raises only three claims related to the present case. The document claims that the Board "does not have jurisdiction of state member bank stockholder" (Aff. Truth at 16). To the contrary, such individuals qualify as "institution-affiliated parties" under the statute if they are controlling shareholders or are required to file a change in control notice, and the Board is specifically granted jurisdiction over them. 12 U.S.C. §§ 1813(q), (u)(1) and (2). Second, the "Affidavit of Truth" asserts that because

7. *See* Case No. 99-13967-8B1, United States Bankruptcy Court, Middle District of Florida.

Greater Ministries International was a dissolved corporation as of 1996, the present case should not have been brought against Respondents. (Aff. Truth at 18). Greater Ministries' corporate existence is irrelevant to the matter, as this action is against these individual Respondents for their role in acquiring control of First Western. Third, the Affidavit insists that an August 24, 1998, letter from the Federal Reserve Bank of Atlanta evidenced that Respondents complied with all of the CIBC Act requirements. (Aff. Truth at 19). This simply misstates the content of the letter, which in fact informed Respondents that they needed to provide additional information concerning, among other things, the source of funds for their purchases of shares. Accordingly, even if Respondents' "Affidavit of Truth" qualified as an exception, it would be entirely unpersuasive.

B. Prohibition Order

Pursuant to the FDI Act, IAPs may be prohibited from the banking industry if the appropriate federal banking agency—here, the Board—makes three separate findings: (1) that the IAP engaged in identified *misconduct*, including a violation of law or regulation, an unsafe or unsound practice, or a breach of fiduciary duty; (2) that the conduct had a specified *effect*, including financial loss to the institution or gain to the respondent; and (3) that the IAP's conduct involved *culpability* of a certain degree—either personal dishonesty or a willful or continuing disregard for the safety or soundness of the institution. 12 U.S.C. § 1818(e)(1)(A)–(C).

Respondent Carl Thomas is the only individual Respondent against whom an order of prohibition was sought. Based on the evidence in the administrative record, his actions satisfy the misconduct, effect, and culpability element required for an order of prohibition. As mentioned previously, Carl Thomas—either as part of his immediate family, part of the Purchasing Group, or both—became subject to and failed to meet the notification requirements of the CIBC Act and its implementing Regulation Y at various points between October 1997 and February 1998. He also violated 18 U.S.C. § 1001 by falsely understating the amount of shares owned by both his immediate family and the group in submissions he made to Federal Reserve staff in December 1997, April 1998, and August 1998. Finally, he violated the Board's February 10, 1999, order by refusing to divest his First Western shares. Thus, the misconduct element is more than sufficiently established.

Through his maintenance of the shares he was ordered to divest, Carl Thomas received financial gain and other benefits, satisfying the effect element. Finally, Carl Thomas's actions also exhibited personal dishonesty. As with all members of the Purchasing Group, Respondent Carl Thomas had a legal duty to provide Federal Reserve staff with the specific information required by the CIBC Act. *See* 12 U.S.C. § 1817(j)(6)(A)–(H). He not only failed to do so on numerous occasions, even after prompting and several requests by Federal Reserve staff, the facts here demonstrate that he purposefully and willfully represented information he knew to be false. The Board agrees with the ALJ's finding that such actions were evasive and deceptive, and evidenced personal dishonesty. In sum, all elements necessary for the issuance of a prohibition order against Respondent Carl Thomas are present in this case.

C. Cease and Desist Order

An IAP also may be subject to a cease-and-desist order if the Board finds that the IAP is engaging or has engaged in an unsafe or unsound practice, or is violating or has violated a law, rule, regulation or any condition imposed in writing by the appropriate banking agency in connection with the granting of an application or other request by the depository institution or any written agreement entered into with the agency. 12 U.S.C. § 1818(b)(1). Such an order may require the IAP to "cease and desist" from the practice or violation and "to take affirmative action to correct the conditions resulting from any such violation or practice." *Id.*

Here, Enforcement Counsel sought a cease-and-desist order against all Respondents based on their collaborative actions to acquire shares in First Western. The evidence in this matter confirms that none of the Respondents ever complied with the CIBC Act or its implementing regulation in acquiring their First Western shares. In lieu of providing the required information, Respondents insisted that the CIBC Act did not apply to them, concealed that the Greater Ministries organization funded their purchases of First Western shares, and permitted Carl Thomas to make false representations to Federal Reserve staff on behalf of the group. Following the leadership of Carl Thomas, they also failed to divest their shares when ordered to do so.

Based on these violations, the Board finds that entry of a cease-and-desist order against each of the Respondents is appropriate in this case. However, the Board is not adopting all terms outlined in the proposed cease-and-desist order originally sought by Enforcement Counsel in its Motion for Summary Disposition and adopted by the ALJ in his Recommended Decision because the acquisition of First Western by 1st United in 2004 has rendered many of those terms inapplicable. As discussed above, the Respondents' shares have been acquired by 1st United, and the proceeds from these sales have been transferred to the United States District Court for the Northern District of Georgia and/or the United States Bankruptcy Court for the Middle District of Florida, as required by the orders issued by both of those courts. As such, the terms Board Enforcement Counsel initially sought for a cease-and-desist order relating to the transfer, sale, and voting of Respondents' First Western shares are no longer applicable.[8] For these

8. Also, on November 8, 2004, the United States Bankruptcy Court for the Middle District of Florida issued an order that pertained to three Respondents in this case who apparently refused to turn over their First Western stock certificates to the bankruptcy trustee. The order provided that any interest these three Respondents claimed in First Western stock or proceeds is void. Accordingly, even if these

reasons, the Board finds that the following terms for a cease-and-desist order are appropriate at this time:

(1) Respondents shall not serve as an officer, director, agent or employee of the Bank or its successor institution without prior written approval of the Board of Governors;

(2) Respondents shall not knowingly acquire any additional legal, beneficial, or other interests in the Bank or its successor institution; and

(3) Respondents shall not directly or indirectly engage or participate in any violation of the CIBC Act.

D. Civil Monetary Penalties

As noted above, the Notice in this matter assessed a civil monetary penalty against each Respondent in an amount roughly reflecting the particular respondent's level of involvement in the illegal scheme.[9] Although the Board is convinced that penalties could be assessed against each Respondent on the basis of this record, it has determined to withdraw its penalty assessment for the reasons set forth below.[10]

The Respondents' scheme to acquire First Western was undertaken as part of a broader fraudulent scheme by Greater Ministries. As the ALJ found, Greater Ministries had attempted to acquire a financial institution to assist with the influx of cash from the Gifting Program from early 1996 on. The Purchasing Group was motivated to take part in the acquisition scheme by their religious conviction and their desire to promote Greater Ministries' mission. Moreover, virtually all of the funds used by Purchasing Group members to acquire First Western shares were provided by Greater Ministries, and were presumably derived from the victims of the Gifting Program.

Greater Ministries is now in bankruptcy proceedings, and the court-appointed trustee has been working to marshal assets of the estate to pay the claims of those victims. He has obtained the cooperation of several state agencies that have pursued their own civil or criminal claims against Greater Ministries and have agreed to subordinate their claims to those of the estate for the benefit of the victims. In addition, he has obtained a Final Judgment against all of the Respondents declaring, among other things, that all First Western stock and proceeds of such stock owned by those individuals are "property of the estate" of Greater Ministries.[11] Under the bankruptcy court's orders, all First Western stock or proceeds held in the registry of the Atlanta court is "available for distribution by the trustee in accordance with the terms of the confirmed plan of liquidation or order of this Court," subject only to the claims of the Board.

The Trustee has requested that the Board withdraw its civil monetary penalty against the Respondents in order to permit the entire proceeds of the sale of their First Western shares to be distributed to the victims of Greater Ministries' fraud. The Board has determined that the public interest favors this outcome. The trustee has assured the Board that none of the Respondents will receive any payment from the bankruptcy estate. It is the Board's intention that the proceeds currently held in the registry of the United States District Court for the Northern District of Georgia be transferred to the registry of the United States Bankruptcy Court for the Middle District of Florida in accordance with that court's orders, and Board Enforcement Counsel is directed to take any appropriate measures to ensure that result.

Conclusion

For these reasons, the Board orders the issuance of the attached Order of Prohibition against Respondent Carl Thomas, as well as the Cease and Desist Order against all Respondents.

By Order of the Board of Governors, this 7th day of June 2005.

Board of Governors of the
Federal Reserve System

JENNIFER J. JOHNSON
Secretary of the Board

Order to Cease and Desist

It is hereby ordered, pursuant to 12 U.S.C. § 1818(b), that Carl Thomas, Stephen Thomas, Eva Thomas, Mary Beth Thomas, Marguerite Thomas, Charles Tomlinson, Herbert Phillips, Lloyd Phillips, R.L. Phillips, Stanley Phillips, Rhonda Phillips, Scott Ward, Angela Ward, Forrest Buckley, James Crowe, Johnny V. Jones, Harper Guinn, and Jeff Guinn (collectively "Respondents"):

(1) shall not serve as an officer, director, agent, or employee of First Western Bank, Cooper City, Florida ("the Bank") or its successor institution without prior written approval of the Board of Governors;

(2) shall not knowingly acquire any additional legal, beneficial, or other interests in the Bank or its successor institution; and

(3) shall not directly or indirectly engage or participate in any violation of the Change in Bank Control Act.

Any violation of this order shall separately subject the Respondents to appropriate civil or criminal penalties or both under 12 U.S.C. § 1818(i).

Respondents continue to maintain their First Western share certificates, the documents are of no value.

9. The amounts assessed ranged from $250,000 jointly and severally against Carl Thomas and his wife Eva and $100,000 against their son Stephen Thomas, to $10,000 against most other respondents.

10. The Board has the legal authority to "compromise, modify, or remit" any penalty it has previously assessed. 12 U.S.C. § 1818(i)(2)(F); 12 U.S.C. § 1817(j)(16)(E); *see* 12 CFR 263.63(a).

11. *See* Final Default Judgment dated September 17, 2004; Final Default Judgment dated November 4, 2004; Final Summary Judgment dated April 8, 2005, in *O'Halloran v. 1st United Bank*, et al., Adv. Pro. No. 04-223 (Bkr. M.D. Fl.)

The provisions of this order shall not bar, estop, or otherwise prevent the Board of Governors, or any other federal or state agency or department from taking any other action affecting each of the Respondents named above.

By Order of the Board of Governors, this 7th day of June 2005.

Board of Governors of the
Federal Reserve System

JENNIFER J. JOHNSON
Secretary of the Board

Order of Prohibition of Carl V. Thomas

WHEREAS, pursuant to section 8(e) of the Federal Deposit Insurance Act, as amended, (the "FDI Act") (12 U.S.C. § 1818(e)), the Board of Governors of the Federal Reserve System ("the Board") is of the opinion, for the reasons set forth in the accompanying Final Decision, that a final Order of Prohibition should issue against CARL V. THOMAS, an institution-affiliated party, as defined in section 3(u) of the FDI Act (12 U.S.C § 1813(u)), of First Western Bank, Cooper City, Florida.

NOW, THEREFORE, IT IS HEREBY ORDERED, pursuant to section 8(e) of the FDI Act, 12 U.S.C. § 1818(e), that:

1. In the absence of prior written approval by the Board, and by any other federal financial institution regulatory agency where necessary pursuant to section 8(e)(7)(B) of the Act (12 U.S.C. § 1818(e)(7)(B)), Thomas is hereby prohibited:

(a) from participating in any manner in the conduct of the affairs of any institution or agency specified in section 8(e)(7)(A) of the FDI Act (12 U.S.C. § 1818(e)(7)(A)), including, but not limited to, any insured depository institution, any insured depository institution holding company or any U.S. branch or agency of a foreign banking organization;

(b) from soliciting, procuring, transferring, attempting to transfer, voting or attempting to vote any proxy, consent or authorization with respect to any voting rights in any institution described in subsection 8(e)(7)(A) of the FDI Act (12 U.S.C. § 1818(e)(7)(A));

(c) from violating any voting agreement previously approved by any Federal banking agency; or

(d) from voting for a director, or from serving or acting as an institution-affiliated party as defined in section 3(u) of the FDI Act (12 U.S.C. § 1813(u)), such as an officer, director, or employee in any institution described in section 8(e)(7)(A) of the FDI Act (12 U.S.C. § 1818(e)(7)(A)).

2. Any violation of this order shall separately subject Thomas to appropriate civil or criminal penalties or both under section 8 of the FDI Act (12 U.S.C. § 1818).

3. This order, and each and every provision hereof, is and shall remain fully effective and enforceable until expressly stayed, modified, terminated, or suspended in writing by the Board.

This order shall become effective at the expiration of thirty days after service is made.

By Order of the Board of Governors, this 7th day of June 2005.

Board of Governors of the
Federal Reserve System

JENNIFER J. JOHNSON
Secretary of the Board

In the Matter of a Notice to Prohibit Further Participation Against

Donald K. McKinney,
Former Vice President,
American National Bank,
Wichita Falls, Texas

Docket No. OCC-AA-EC-04-70

Final Decision

This is an administrative proceeding pursuant to the Federal Deposit Insurance Act ("the FDI Act") in which the Office of the Comptroller of the Currency of the United States of America ("OCC") seeks to prohibit the Respondent, Donald K. McKinney ("Respondent"), from further participation in the affairs of any financial institution based on actions he took both to obtain employment and while employed at American National Bank, Wichita Falls, Texas (the "Bank"). Under the FDI Act, the OCC may initiate a prohibition proceeding against a former employee of a national bank, but the Board must make the final determination whether to issue an order of prohibition.

Upon review of the administrative record, the Board issues this Final Decision adopting the Recommended Decision of Administrative Law Judge Arthur L. Shipe (the "ALJ"), and orders the issuance of the attached Order of Prohibition.

I. Statement of the Case

A. Statutory and Regulatory Framework

Under the FDI Act and the Board's regulations, the ALJ is responsible for conducting proceedings on a notice of charges. 12 U.S.C. § 1818(e)(4). The ALJ issues a recommended decision that is referred to the deciding agency together with any exceptions to those recommendations filed by the parties. The Board makes the final findings of fact, conclusions of law, and determination whether to issue an order of prohibition in the case of prohibition orders sought by the OCC. *Id.*; 12 CFR 263.40.

The FDI Act sets forth the substantive basis upon which a federal banking agency may issue against a bank official or employee an order of prohibition from further participation in banking. To issue such an order, the Board must make each of three findings: (1) that the respondent engaged in identified *misconduct*, including a violation of law or regulation, an unsafe or unsound practice, or a breach of fiduciary duty; (2) that the conduct had a specified *effect*, including financial loss to the institution or gain to the respondent; and (3) that the respondent's conduct involved either personal dishonesty or a willful or continuing disregard for the safety or soundness of the institution. 12 U.S.C. § 1818(e)(1)(A)–(C).

An enforcement proceeding is initiated by filing and serving on the respondent a notice of intent to prohibit. Under the OCC's and the Board's regulations, the respondent must file an answer within twenty days of service of the notice. 12 CFR 19.19(a) and 263.19(a). Failure to file an answer constitutes a waiver of the respondent's right to contest the allegations in the notice, and a final order may be entered unless good cause is shown for failure to file a timely answer. 12 CFR 19.19(c)(1) and 263.19(c)(1).

B. Procedural History

On September 27, 2004, the OCC served upon Respondent a Notice of Intention to Prohibit Further Participation and Notice of Assessment of a Civil Monetary Penalty ("Notice") that sought, *inter alia*, an order of prohibition against Respondent based on his conduct in obtaining employment and while employed at the Bank. The Notice alleged that Respondent obtained his employment at the Bank through deceitful misrepresentations. Specifically, the Notice charged that Respondent submitted an application and résumé in which he lied about his prior criminal record and represented that he had been employed by two companies during a period of time when he was serving a jail sentence.

The Notice further asserted that after obtaining employment at the Bank, Respondent engaged in various other acts of misconduct. He falsified Bank records to make it appear that he was fulfilling an agreement to pay for the lease of two cars that the Bank purchased for his use. He sold a motorcycle the Bank had leased for his use but did not forward the sale proceeds to the Bank, notwithstanding that a balance was owed on the motorcycle. On multiple occasions, Respondent deposited into his own personal account checks made payable to the Bank, individuals other than himself, and two nonprofit organizations. He also withdrew for his own use funds from the Bank and from these two nonprofit organizations. Finally, Respondent abused the signatory power he had over the account of one of these nonprofit organizations by forging a required second signature for some of the withdrawals he made from that account.

The Bank's total loss from Respondent's misconduct amounted to $129,046.45. The Respondent's mother made full restitution to the Bank, and accordingly, the Notice only sought an imposition of an order of prohibition and assessment of civil monetary penalties.

The Notice directed Respondent to file an answer within twenty days and warned that failure to do so would constitute a waiver of his right to appear and contest the allegations. The record shows that the Respondent received service of the Notice. Nonetheless, Respondent failed to file an answer within the twenty-day period.

On or about November 16, 2004, Enforcement Counsel filed a Motion for Entry of an Order of Default. The motion was served on Respondent in accordance with the OCC's rules, but he did not respond to it. Finally, on or about December 3, 2004, the ALJ issued an Order to Show Cause, which was mailed to the address at which Respondent had received the Notice. The Order for Show Cause was signed for on December 6, 2004, by Respondent's mother. The order provided Respondent 20 days from the receipt of the order to appear and show cause why the ALJ should not grant Enforcement Counsel's default motion. Respondent ignored the Order to Show Cause and has never filed an answer to the Notice.

II. Discussion

The OCC's Rules of Practice and Procedure set forth the requirements of an answer and the consequences of a failure to file an answer to a Notice. Under the Rules, failure to file a timely answer "constitutes a waiver of [a respondent's] right to appear and contest the allegations in the notice." 12 CFR 19.19(c). If the ALJ finds that no good cause has been shown for the failure to file, the judge "shall file . . . a recommended decision containing the findings and the relief sought in the notice." *Id.* An order based on a failure to file a timely answer is deemed to be issued by consent. *Id.*

In this case, Respondent failed to file an answer despite notice to him of the consequences of such failure, and also failed to respond to the ALJ's Order to Show Cause. Respondent's failure to file an answer constitutes a default.

Respondent's default requires the Board to consider the allegations in the Notice as uncontested. The allegations in the Notice, described above, meet all the criteria for entry of an order of prohibition under 12 U.S.C. § 1818(e). It was a breach of fiduciary duty for Respondent to accept employment by the Bank and continue working for the Bank after lying in his job application and résumé and failing to disclose his prior criminal history. Further, it was a violation of law, breach of fiduciary duty, and an unsafe or unsound practice for Respondent to falsify bank records, forge a signature and steal funds from the bank at which he is employed. Respondent's actions caused gain to himself, as well as loss to the bank. Finally, such actions also exhibit personal dishonesty. Accordingly, the requirements for an order of prohibition have been met and the Board hereby issues such an order.

Conclusion

For these reasons, the Board orders the issuance of the attached Order of Prohibition.

By Order of the Board of Governors, this 13th day of May 2005.

Board of Governors of the
Federal Reserve System

JENNIFER J. JOHNSON
Secretary of the Board

Order of Prohibition

WHEREAS, pursuant to section 8(e) of the Federal Deposit Insurance Act, as amended, (the "FDI Act") (12 U.S.C. § 1818(e)), the Board of Governors of the Federal Reserve System ("the Board") is of the opinion, for the reasons set forth in the accompanying Final Decision, that a final Order of Prohibition should issue against DONALD K. McKINNEY ("McKINNEY"), a former employee and institution-affiliated party, as defined in Section 3(u) of the FDI Act (12 U.S.C. § 1813(u)), of American National Bank, Wichita Falls, Texas.

NOW, THEREFORE, IT IS HEREBY ORDERED, pursuant to section 8(e) of the FDI Act, 12 U.S.C. § 1818(e), that:

1. In the absence of prior written approval by the Board, and by any other federal financial institution regulatory agency where necessary pursuant to section 8(e)(7)(B) of the Act (12 U.S.C. § 1818(e)(7)(B)), McKinney is hereby prohibited:

(a) from participating in any manner in the conduct of the affairs of any institution or agency specified in section 8(e)(7)(A) of the FDI Act (12 U.S.C. § 1818(e)(7)(A)), including, but not limited to, any insured depository institution, any insured depository institution holding company, or any U.S. branch or agency of a foreign banking organization;

(b) from soliciting, procuring, transferring, attempting to transfer, voting or attempting to vote any proxy, consent, or authorization with respect to any voting rights in any institution described in subsection 8(e)(7)(A) of the FDI Act (12 U.S.C. § 1818(e)(7)(A));

(c) from violating any voting agreement previously approved by any Federal banking agency; or

(d) from voting for a director, or from serving or acting as an institution-affiliated party as defined in section 3(u) of the FDI Act (12 U.S.C. § 1813(u)), such as an officer, director, or employee in any institution described in section 8(e)(7)(A) of the FDI Act (12 U.S.C. § 1818(e)(7)(A)).

2. Any violation of this order shall separately subject McKinney to appropriate civil or criminal penalties or both under section 8 of the FDI Act (12 U.S.C. § 1818).

3. This order, and each and every provision hereof, is and shall remain fully effective and enforceable until expressly stayed, modified, terminated, or suspended in writing by the Board.

This order shall become effective at the expiration of thirty days after service is made.

By Order of the Board of Governors, this 13th day of May 2005.

Board of Governors of the
Federal Reserve System

JENNIFER J. JOHNSON
Secretary of the Board

Membership of the Board of Governors of the Federal Reserve System, 1913–2005

APPOINTED MEMBERS[1]

Name	Federal Reserve District	Date initially took oath of office	Other dates and information relating to membership[2]
Charles S. Hamlin	Boston	Aug. 10, 1914	Reappointed in 1916 and 1926. Served until Feb. 3, 1936.[3]
Paul M. Warburg	New York	Aug. 10, 1914	Term expired Aug. 9, 1918.
Frederic A. Delano	Chicago	Aug. 10, 1914	Resigned July 21, 1918.
W.P.G. Harding	Atlanta	Aug. 10, 1914	Term expired Aug. 9, 1922.
Adolph C. Miller	San Francisco	Aug. 10, 1914	Reappointed in 1924. Reappointed in 1934 from the Richmond District. Served until Feb. 3, 1936.[3]
Albert Strauss	New York	Oct. 26, 1918	Resigned Mar. 15, 1920.
Henry A. Moehlenpah	Chicago	Nov. 10, 1919	Term expired Aug. 9, 1920.
Edmund Platt	New York	June 8, 1920	Reappointed in 1928. Resigned Sept. 14, 1930.
David C. Wills	Cleveland	Sept. 29, 1920	Term expired Mar. 4, 1921.
John R. Mitchell	Minneapolis	May 12, 1921	Resigned May 12, 1923.
Milo D. Campbell	Chicago	Mar. 14, 1923	Died Mar. 22, 1923.
Daniel R. Crissinger	Cleveland	May 1, 1923	Resigned Sept. 15, 1927.
George R. James	St. Louis	May 14, 1923	Reappointed in 1931. Served until Feb. 3, 1936.[4]
Edward H. Cunningham	Chicago	May 14, 1923	Died Nov. 28, 1930.
Roy A. Young	Minneapolis	Oct. 4, 1927	Resigned Aug. 31, 1930.
Eugene Meyer	New York	Sept. 16, 1930	Resigned May 10, 1933.
Wayland W. Magee	Kansas City	May 18, 1931	Term expired Jan. 24, 1933.
Eugene R. Black	Atlanta	May 19, 1933	Resigned Aug. 15, 1934.
M.S. Szymczak	Chicago	June 14, 1933	Reappointed in 1936 and 1948. Resigned May 31, 1961.
J.J. Thomas	Kansas City	June 14, 1933	Served until Feb. 10, 1936.[3]
Marriner S. Eccles	San Francisco	Nov. 15, 1934	Reappointed in 1936, 1940, and 1944. Resigned July 14, 1951.
Joseph A. Broderick	New York	Feb. 3, 1936	Resigned Sept. 30, 1937.
John K. McKee	Cleveland	Feb. 3, 1936	Served until Apr. 4, 1946.[3]
Ronald Ransom	Atlanta	Feb. 3, 1936	Reappointed in 1942. Died Dec. 2, 1947.
Ralph W. Morrison	Dallas	Feb. 10, 1936	Resigned July 9, 1936.
Chester C. Davis	Richmond	June 25, 1936	Reappointed in 1940. Resigned Apr. 15, 1941.
Ernest G. Draper	New York	Mar. 30, 1938	Served until Sept. 1, 1950.[3]
Rudolph M. Evans	Richmond	Mar. 14, 1942	Served until Aug. 13, 1954.[3]
James K. Vardaman, Jr.	St. Louis	Apr. 4, 1946	Resigned Nov. 30, 1958.
Lawrence Clayton	Boston	Feb. 14, 1947	Died Dec. 4, 1949.
Thomas B. McCabe	Philadelphia	Apr. 15, 1948	Resigned Mar. 31, 1951.
Edward L. Norton	Atlanta	Sept. 1, 1950	Resigned Jan. 31, 1952.
Oliver S. Powell	Minneapolis	Sept. 1, 1950	Resigned June 30, 1952.
Wm. McC. Martin, Jr.	New York	April 2, 1951	Reappointed in 1956. Term expired Jan. 31, 1970.
A.L. Mills, Jr.	San Francisco	Feb. 18, 1952	Reappointed in 1958. Resigned Feb. 28, 1965.
J.L. Robertson	Kansas City	Feb. 18, 1952	Reappointed in 1964. Resigned Apr. 30, 1973.
C. Canby Balderston	Philadelphia	Aug. 12, 1954	Served through Feb. 28, 1966.
Paul E. Miller	Minneapolis	Aug. 13, 1954	Died Oct. 21, 1954.
Chas. N. Shepardson	Dallas	Mar. 17, 1955	Retired Apr. 30, 1967.
G.H. King, Jr.	Atlanta	Mar. 25, 1959	Reappointed in 1960. Resigned Sept. 18, 1963.
George W. Mitchell	Chicago	Aug. 31, 1961	Reappointed in 1962. Served until Feb. 13, 1976.[3]
J. Dewey Daane	Richmond	Nov. 29, 1963	Served until Mar. 8, 1974.[3]
Sherman J. Maisel	San Francisco	Apr. 30, 1965	Served through May 31, 1972.
Andrew F. Brimmer	Philadelphia	Mar. 9, 1966	Resigned Aug. 31, 1974.
William W. Sherrill	Dallas	May 1, 1967	Reappointed in 1968. Resigned Nov. 15, 1971.
Arthur F. Burns	New York	Jan. 31, 1970	Term began Feb. 1, 1970. Resigned Mar. 31, 1978.
John E. Sheehan	St. Louis	Jan. 4, 1972	Resigned June 1, 1975.
Jeffrey M. Bucher	San Francisco	June 5, 1972	Resigned Jan. 2, 1976.
Robert C. Holland	Kansas City	June 11, 1973	Resigned May 15, 1976.
Henry C. Wallich	Boston	Mar. 8, 1974	Resigned Dec. 15, 1986.

Name	Federal Reserve District	Date initially took oath of office	Other dates and information relating to membership[2]
Philip E. Coldwell	Dallas	Oct. 29, 1974	Served through Feb. 29, 1980.
Philip C. Jackson, Jr.	Atlanta	July 14, 1975	Resigned Nov. 17, 1978.
J. Charles Partee	Richmond	Jan. 5, 1976	Served until Feb. 7, 1986.[3]
Stephen S. Gardner	Philadelphia	Feb. 13, 1976	Died Nov. 19, 1978.
David M. Lilly	Minneapolis	June 1, 1976	Resigned Feb. 24, 1978.
G. William Miller	San Francisco	Mar. 8, 1978	Resigned Aug. 6, 1979.
Nancy H. Teeters	Chicago	Sept. 18, 1978	Served through June 27, 1984.
Emmett J. Rice	New York	June 20, 1979	Resigned Dec. 31, 1986.
Frederick H. Schultz	Atlanta	July 27, 1979	Served through Feb. 11, 1982.
Paul A. Volcker	Philadelphia	Aug. 6, 1979	Resigned August 11, 1987.
Lyle E. Gramley	Kansas City	May 28, 1980	Resigned Sept. 1, 1985.
Preston Martin	San Francisco	Mar. 31, 1982	Resigned April 30, 1986.
Martha R. Seger	Chicago	July 2, 1984	Resigned March 11, 1991.
Wayne D. Angell	Kansas City	Feb. 7, 1986	Served through Feb. 9, 1994.
Manuel H. Johnson	Richmond	Feb. 7, 1986	Resigned August 3, 1990.
H. Robert Heller	San Francisco	Aug. 19, 1986	Resigned July 31, 1989.
Edward W. Kelley, Jr.	Dallas	May 26, 1987	Reappointed in 1990; resigned Dec. 31, 2001.
Alan Greenspan	New York	Aug. 11, 1987	Reappointed in 1992.
John P. LaWare	Boston	Aug. 15, 1988	Resigned April 30, 1995.
David W. Mullins, Jr.	St. Louis	May 21, 1990	Resigned Feb. 14, 1994.
Lawrence B. Lindsey	Richmond	Nov. 26, 1991	Resigned Feb. 5, 1997.
Susan M. Phillips	Chicago	Dec. 2, 1991	Served through June 30, 1998.
Alan S. Blinder	Philadelphia	June 27, 1994	Term expired Jan. 31, 1996.
Janet L. Yellen	San Francisco	Aug. 12, 1994	Resigned Feb. 17, 1997.
Laurence H. Meyer	St. Louis	June 24, 1996	Term expired Jan. 31, 2002.
Alice M. Rivlin	Philadelphia	June 25, 1996	Resigned July 16, 1999.
Roger W. Ferguson, Jr.	Boston	Nov. 5, 1997	Reappointed in 2001.
Edward M. Gramlich	Richmond	Nov. 5, 1997	Resigned Aug. 31, 2005.
Susan S. Bies	Chicago	Dec. 7, 2001	
Mark W. Olson	Minneapolis	Dec. 7, 2001	
Ben S. Bernanke	Atlanta	Aug. 5, 2002	Resigned June 21, 2005.
Donald L. Kohn	Kansas City	Aug. 5, 2002	

Chairmen[4]

Charles S. Hamlin	Aug. 10, 1914–Aug. 9, 1916
W.P.G. Harding	Aug. 10, 1916–Aug. 9, 1922
Daniel R. Crissinger	May 1, 1923–Sept. 15, 1927
Roy A. Young	Oct. 4, 1927–Aug. 31, 1930
Eugene Meyer	Sept. 16, 1930–May 10, 1933
Eugene R. Black	May 19, 1933–Aug. 15, 1934
Marriner S. Eccles	Nov. 15, 1934–Jan. 31, 1948[5]
Thomas B. McCabe	Apr. 15, 1948–Mar. 31, 1951
Wm. McC. Martin, Jr.	Apr. 2, 1951–Jan. 31, 1970
Arthur F. Burns	Feb. 1, 1970–Jan. 31, 1978
G. William Miller	Mar. 8, 1978–Aug. 6, 1979
Paul A. Volcker	Aug. 6, 1979–Aug. 11, 1987
Alan Greenspan	Aug. 11, 1987–[6]

Vice Chairmen[4]

Frederic A. Delano	Aug. 10, 1914–Aug. 9, 1916
Paul M. Warburg	Aug. 10, 1916–Aug. 9, 1918
Albert Strauss	Oct. 26, 1918–Mar. 15, 1920
Edmund Platt	July 23, 1920–Sept. 14, 1930
J.J. Thomas	Aug. 21, 1934–Feb. 10, 1936
Ronald Ransom	Aug. 6, 1936–Dec. 2, 1947
C. Canby Balderston	Mar. 11, 1955–Feb. 28, 1966
J.L. Robertson	Mar. 1, 1966–Apr. 30, 1973
George W. Mitchell	May 1, 1973–Feb. 13, 1976
Stephen S. Gardner	Feb. 13, 1976–Nov. 19, 1978
Frederick H. Schultz	July 27, 1979–Feb. 11, 1982
Preston Martin	Mar. 31, 1982–Apr. 30, 1986
Manuel H. Johnson	Aug. 4, 1986–Aug. 3, 1990
David W. Mullins, Jr.	July 24, 1991–Feb. 14, 1994
Alan S. Blinder	June 27, 1994–Jan. 31, 1996
Alice M. Rivlin	June 25, 1996–July 16, 1999
Roger W. Ferguson, Jr.	Oct. 5, 1999–

Notes and list of ex officio members appear on page 457.

EX OFFICIO MEMBERS [1]

Secretaries of the Treasury

W.G. McAdoo	Dec. 23, 1913–Dec. 15, 1918
Carter Glass	Dec. 16, 1918–Feb. 1, 1920
David F. Houston	Feb. 2, 1920–Mar. 3, 1921
Andrew W. Mellon	Mar. 4, 1921–Feb. 12, 1932
Ogden L. Mills	Feb. 12, 1932–Mar. 4, 1933
William H. Woodin	Mar. 4, 1933–Dec. 31, 1933
Henry Morgenthau, Jr.	Jan. 1, 1934–Feb. 1, 1936

Comptrollers of the Currency

John Skelton Williams	Feb. 2, 1914–Mar. 2, 1921
Daniel R. Crissinger	Mar. 17, 1921–Apr. 30, 1923
Henry M. Dawes	May 1, 1923–Dec. 17, 1924
Joseph W. McIntosh	Dec. 20, 1924–Nov. 20, 1928
J.W. Pole	Nov. 21, 1928–Sept. 20, 1932
J.F.T. O'Connor	May 11, 1933–Feb. 1, 1936

1. Under the provisions of the original Federal Reserve Act, the Federal Reserve Board was composed of seven members, including five appointed members, the Secretary of the Treasury, who was ex-officio chairman of the Board, and the Comptroller of the Currency. The original term of office was ten years, and the five original appointed members had terms of two, four, six, eight, and ten years respectively. In 1922 the number of appointed members was increased to six, and in 1933 the term of office was increased to twelve years. The Banking Act of 1935, approved Aug. 23, 1935, changed the name of the Federal Reserve Board to the Board of Governors of the Federal Reserve System and provided that the Board should be composed of seven appointed members; that the Secretary of the Treasury and the Comptroller of the Currency should continue to serve as members until Feb. 1, 1936; that the appointed members in office on the date of that act should continue to serve until Feb. 1, 1936, or until their successors were appointed and had qualified; and that thereafter the terms of members should be fourteen years and that the designation of Chairman and Vice Chairman of the Board should be for a term of four years.

2. Date following *Resigned* and *Retired* denotes final day of service.

3. Successor took office on this date.

4. Chairman and Vice Chairman were designated Governor and Vice Governor before Aug. 23, 1935.

5. Served as Chairman Pro Tempore from February 3, 1948, to April 15, 1948.

6. Served as Chairman Pro Tempore from March 3, 1996, to June 20, 1996.

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August 16, 2005

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August 16, 2005

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BOOKS AND MISCELLANEOUS PUBLICATIONS

ANNUAL PERCENTAGE RATE TABLES (Truth in Lending—Regulation Z) *Vol. I* (Regular Transactions). 1969. 100 pp. *Vol. II* (Irregular Transactions). 1969. 116 pp. Each volume $5.00.

ANNUAL REPORT, 2004.

ANNUAL REPORT: BUDGET REVIEW, 2005.

ANNUAL STATISTICAL DIGEST: period covered, release date, number of pages, and price.

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STAFF STUDIES: Only Summaries Printed in the BULLETIN

Studies and papers on economic and financial subjects that are of general interest. Staff Studies 1–158, 161, 163, 165, 166, 168, and 169 are out of print, but photocopies of them are available. Staff Studies 165–176 are available online at www.federalreserve.gov/pubs/staffstudies. Requests to obtain single copies of any paper or to be added to the mailing list for the series may be sent to Publications Fulfillment.

159. NEW DATA ON THE PERFORMANCE OF NONBANK SUBSIDIARIES OF BANK HOLDING COMPANIES, by Nellie Liang and Donald Savage. February 1990. 12 pp.
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173. IMPROVING PUBLIC DISCLOSURE IN BANKING, by Study Group on Disclosure, Federal Reserve System. March 2000. 35 pp.
174. BANK MERGERS AND BANKING STRUCTURE IN THE UNITED STATES, 1980–98, by Stephen Rhoades. August 2000. 33 pp.
175. FUTURE OF RETAIL ELECTRONIC PAYMENTS SYSTEMS: INDUSTRY INTERVIEWS AND ANALYSIS, Federal Reserve Staff, for the Payments System Development Committee, Federal Reserve System. December 2002. 27 pp.
176. BANK MERGER ACTIVITY IN THE UNITED STATES, 1994–2003, by Steven J. Pilloff. May 2004. 23 pp.

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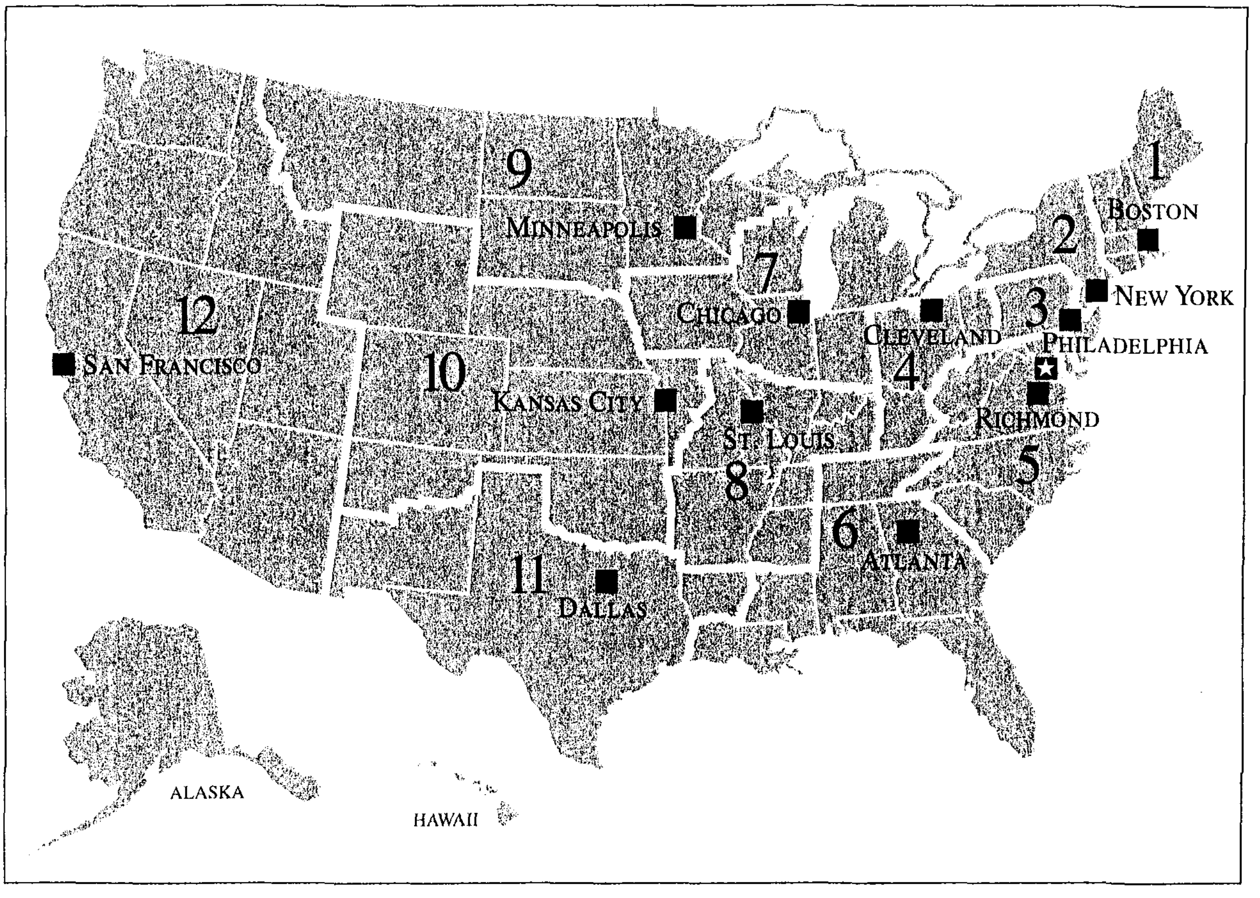
Release number and title	Annual mail rate	Annual fax rate	Approximate release days[1]	Period or date to which data refer	Corresponding *Bulletin* or *Statistical Supplement* table numbers[2]
Weekly Releases					
H.2. Actions of the Board: Applications and Reports Received	$55.00	n.a.	Friday	Week ending previous Saturday	. . .
H.3. Aggregate Reserves of Depository Institutions and the Monetary Base[3]	$20.00	n.a.	Thursday	Week ending previous Wednesday	1.20
H.4.1. Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks[3]	$20.00	n.a.	Thursday	Week ending previous Wednesday	1.11, 1.18
H.6. Money Stock Measures[3]	$35.00	n.a.	Thursday	Week ending Monday of previous week	1.21
H.8. Assets and Liabilities of Commercial Banks in the United States[3]	$30.00	n.a.	Friday	Week ending previous Wednesday	1.26A–F
H.10. Foreign Exchange Rates[3]	$20.00	$20.00	Monday	Week ending previous Friday	3.28
H.15. Selected Interest Rates[3]	$20.00	$20.00	Monday	Week ending previous Friday	1.35
Monthly Releases					
G.5. Foreign Exchange Rates[3]	$ 5.00	$ 5.00	First of month	Previous month	3.28
G.17. Industrial Production and Capacity Utilization[3]	$15.00	n.a.	Midmonth	Previous month	2.12, 2.13
G.19. Consumer Credit[3]	$ 5.00	$ 5.00	Fifth working day of month	Second month previous	1.55, 1.56
G.20. Finance Companies[3]	$ 5.00	n.a.	End of month	Second month previous	1.51, 1.52

Release number and title	Annual mail rate	Annual fax rate	Approximate release days[1]	Period or date to which data refer	Corresponding *Bulletin* or *Statistical Supplement* table numbers[2]
Quarterly Releases					
E.2. Survey of Terms of Business Lending[3]	$ 5.00	n.a.	Midmonth of March, June, September, and December	February, May, August, and November	4.23
E.11. Geographical Distribution of Assets and Liabilities of Major Foreign Branches of U.S. Banks	$ 5.00	n.a.	15th of March, June, September, and December	Previous quarter	. . .
E.16. Country Exposure Lending Survey[3]	$ 5.00	n.a.	January, April, July, and October	Previous quarter	. . .
Z.1. Flow of Funds Accounts of the United States: Flows and Outstandings[3]	$25.00	n.a.	Second week of March, June, September, and December	Previous quarter	1.57, 1.58, 1.59, 1.60

1. Please note that for some releases, there is normally a certain variability in the release date because of reporting or processing procedures. Moreover, for all series unusual circumstances may, from time to time, result in a release date being later than anticipated.
2. Beginning with the Winter 2004 issue (vol. 90, no. 1) of the *Bulletin*, the corresponding table for the statistical release no longer appears in the *Bulletin*. Statistical tables are now published in the *Statistical Supplement to the Federal Reserve Bulletin*; the table numbers, however, remain the same.
3. These releases are also available on the Board's web site, www.federalreserve.gov/releases.
n.a. Not available.

Maps of the Federal Reserve System



LEGEND

Both pages

■ Federal Reserve Bank city

☒ Board of Governors of the Federal Reserve System, Washington, D.C.

Facing page

• Federal Reserve Branch city

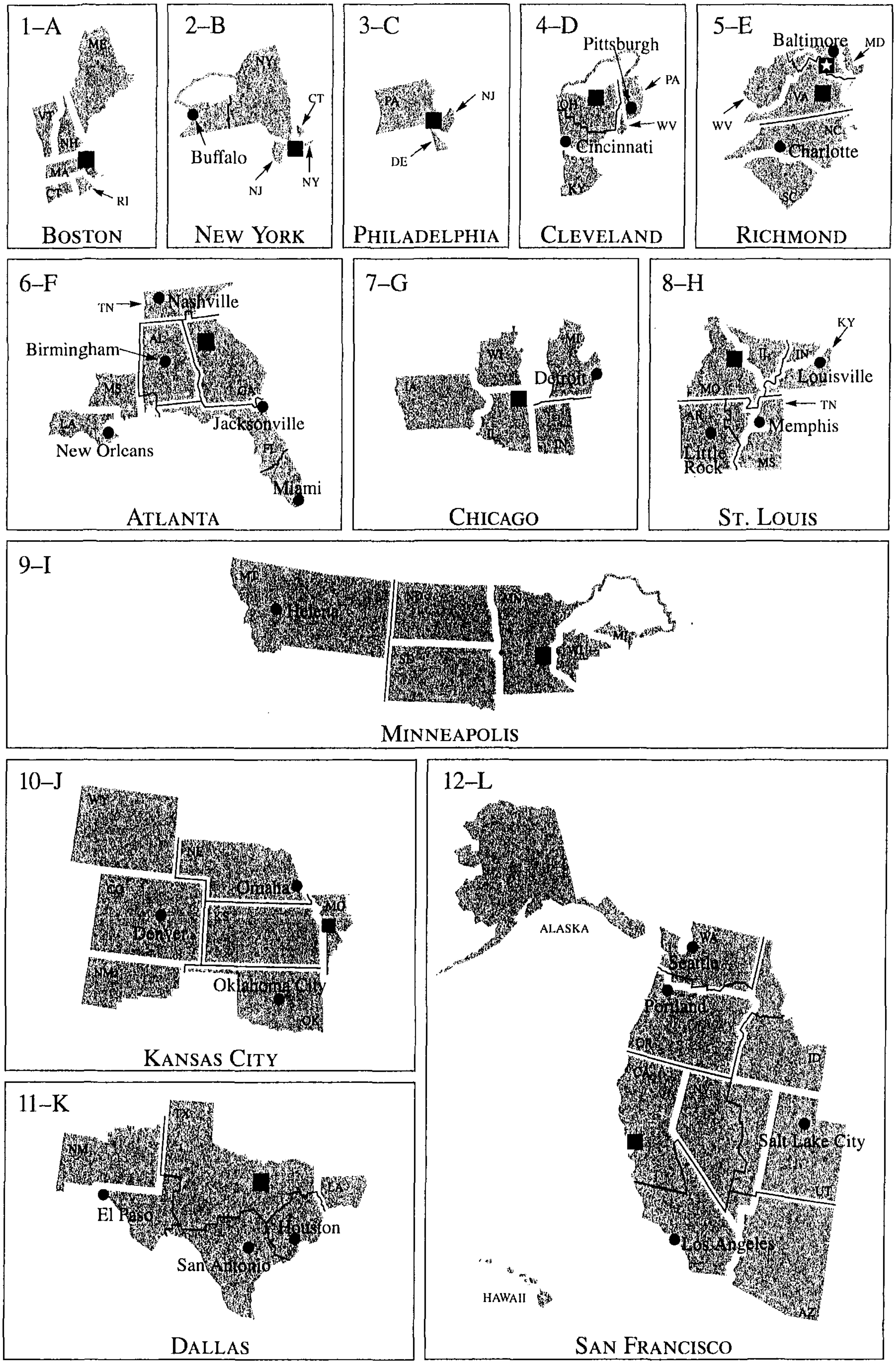
— Branch boundary

NOTE

The Federal Reserve officially identifies Districts by number and Reserve Bank city (shown on both pages) and by letter (shown on the facing page).

In the 12th District, the Seattle Branch serves Alaska, and the San Francisco Bank serves Hawaii.

The System serves commonwealths and territories as follows: the New York Bank serves the Commonwealth of Puerto Rico and the U.S. Virgin Islands; the San Francisco Bank serves American Samoa, Guam, and the Commonwealth of the Northern Mariana Islands. The Board of Governors revised the branch boundaries of the System most recently in February 1996.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August 16, 2005

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