External and Internal Crossroads for Banking Supervision in Southern Africa

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1 Introduction

During the autumn of 1994, two events of significance occurred that could have a major bearing on the future direction of banking supervision in the Republic of South Africa and Southern Africa. The first event is of an external, regional dimension: the newly, and informally constituted “East and Southern Africa Banking Supervisors’ Group” (“ESABS”) held its first meeting. The second event is of an internal, domestic dimension: on 27 October 1994 “The Housing Accord-Housing the Nation” was set forth at Botshabelo, Orange Free State (the “Botshabelo Accord”). The purpose of this article is to consider the challenges and opportunities presented by each of these occurrences for the banking regulators and banking industry in Southern Africa and to draw together certain interconnections between these two dimensions of banking supervision.

2 The external dimension

The supervision of international banks, when viewed primarily from the focus of “capital adequacy” and the Basle Committee’s 1988 Capital Report and of “consolidated supervision” as reflected in the Basle Concordat (as revised and supplemented), has proven to be of a “through the looking glass” nature. Terms such as “capital adequacy” and “consolidated supervision” have come to serve more as “code words” for enhanced and broadened bank supervision on both the international and domestic level. Further, a discrete focus upon selective national jurisdictions (that is, the United States and United Kingdom), the regional jurisdiction of the European Community (EC) and the limited international forum of the Basle Committee¹ has unfolded into a

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¹ The formal, initial name of the Committee is the “Basle Committee on Banking Regulations and Supervisory Practices.” The name has been changed to the Basle Committee on Banking Supervision.

The institutions represented on the Basle Supervisors Committee are:
- Belgium: National Bank of Belgium
- Banking Commission
- Canada: Bank of Canada
- Office of the Inspector General of Banks
- France: Bank of France
- Banking Commission
- Germany: Deutsche Bundesbank

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complex web of interconnected supervisory standards and practices having legal significance globally.  
Recent developments in the Republic of South Africa bear out these observations. The 1990 Deposit-taking Institutions Act 94 of 1990, as amended,\(^3\) incorporates significant aspects of the Basle supervisory standards.\(^4\) Also, as alluded to above, in 1993 the South African banking authorities joined an informal group of regional bank supervisors that (in turn) is “tied into” the Basle process and that held its first meeting this past Autumn 1994.\(^5\)

This part 2 provides informed observations as to what “trends” in international bank supervision have become apparent from a “looking back” at the terrain covered over the past decade and as to the possible implications for the Republic of South Africa and Southern Africa.

Federal Banking Supervisory Office
Italy: Bank of Italy
Japan: Bank of Japan
Ministry of Finance
Luxembourg: Luxembourg Monetary Institute
Netherlands: The Netherlands Bank
Sweden: Sveriges Riksbank
Royal Swedish Banking Inspectorate
Switzerland: Swiss National Bank
Swiss Federal Banking Commission
United Kingdom: Bank of England
United States: Federal Reserve Board
Federal Reserve Bank of New York
Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Secretariat Bank for International Settlements
Reference to the founding mandate for the Committee from the Governors of the central banks of the G–10 countries is a Press Communiqué of the G–10 central bank Governors of Feb. 12, 1975 issued through the BIS. Since 1982, the Secretariat of the Committee has endeavoured to prepare an annual “Report on International Developments in Banking Supervision,” which summarizes the annual work of the Committee.

\(^2\) See generally Norton \textit{Devising International Bank Supervisory Standards} (1995), portions of which have provided the research base for this § 2.
\(^5\) An East and Southern Africa Banking Supervisors’ Group (“ESABS”) was formed in 1993; and a West and Central African Group of Bank Supervisors (“WCABS”) was inaugurated in 1994. The ESABS group is represented by thirteen countries: Botswana, Kenya, Lesotho, Malawi, Mauritius, Namibia, South Africa, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe—with its steering committee made up of Kenya, South Africa, Tanzania, Uganda and Zimbabwe. The WCABS group is initially composed of eight countries: Cameroon, Gambia, Ghana, Ivory Coast, Madagascar, Nigeria, Sierra Leone and Zaire. See discussion of these and various other Basle “affiliated subgroups of bank supervisors in Basle Committee, \textit{Report on International Developments in Banking Supervision, Reports} No 8 (Chapter II) and 9 (Chapter X) (1992 and 1994).
2.1 Perceived trends in international bank supervision

2.1.1 An enhanced framework for international bank supervision

The closure of the Bank of Credit and Commerce International ("BCCI") involved only the failure of a $20 billion asset-sized financial institution (about the size of a moderate-size United States regional bank); and, as such it does not appear that this failure (even if left unattended by the international regulators) would have created any serious systemic problems for the international banking community. Nevertheless, it is clear that for London, New York and other world financial markets to continue to prosper there must be a level playing field that instills integrity and confidence on a global basis. BCCI was a case of widespread institutional fraud on a global scale (involving at least 19 jurisdictions) and brought into question the ability of the domestic regulation of international banks to control such transborder fraud.

The remainder of this decade will offer continuing evidence that we are in a global financial market transcending national and regional boundaries. Increasingly supervisors will be required to act jointly if they are to create and to preserve integrity in what has become a world-wide banking system. But what should be remembered is that the recent notoriety of BCCI is really only a tangential event in the development of this "international network of cooperating supervisors". The Basle Committee's cooperative efforts date back to 1974 and have evolved significantly since then—internal and external to the committee; the close cooperation between United States and United Kingdom supervisors have been longstanding (notwithstanding Basle); and the notion of supervisory cooperation is ingrained in both the EC and United States legal framework for banking.

Perhaps the efforts of the Bank of England, its ad hoc "college" of international supervisors, and the Federal Reserve Board in the BCCI affair were too little, too late: certainly the "college" was not an effective substitute for a "lead regulator". But the broader observation is that, at the relevant times, the only feasible approach was through a working international network of cooperating supervisors. Over this decade, something better than this ad hoc crisis-orientated approach most probably will emerge with respect to international financial services generally and with respect to the need for better international information flows—with Basle Committee, EC and United States efforts in these areas serving as catalytic forces for international reform.

2.1.2 Effective Consolidated Supervision

The international bank supervisors, over this past decade, have developed principles of "consolidated supervision" under the original and revised (1983) Basle Concordats (as supplemented in 1990 and in 1993). The utilization by

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6 See, eg, BCCI testimony of Messrs Mattingly, Taylor and Corrigan of United States and NY Federal Reserve before the Committee on Banking, Finance and Urban Affairs, United States House of Representatives (13 September 1991).

7 Prior to the closure, this informal "college" comprised banks regulators from the UK, Switzerland, Spain, Luxembourg, Hong Kong, the Cayman Islands, France and the United Arab Emirates and was established as an information gathering and sharing vehicle.

8 A copy of "1983 Revised Concordat" was published in 1983 Int'l Leg Mt 900. The Basle Committee has since supplemented the Revised Concordat in April 1990: see Supplement to the
BCCI of affiliated bank holding company structures in jurisdictions self-avowedly incapable of any effective consolidated supervision (Luxembourg and the Cayman Islands) and the operation of a hidden "bank within a bank" made evident the existence of persisting and glaring gaps in this supervisory concept. But BCCI aside, the new EC Consolidated Supervision Directive and Prudential Supervision Directive and recent pronouncements by the Basle Committee go a long way toward closing these remaining gaps (though, most likely, all gaps cannot be sealed). But the realities of consolidated supervision operate on the national level; it requires effective coordination and convergence of regulatory and supervisory standards and flows of quality information between home and host country regulators to ensure that there is always an informed and an effective "lead regulator." The recent United States statute (Foreign Bank Supervision Enhancement Act—FBSEA) and regulations on foreign bank supervision incorporate (that is, internalize) the principles of "effective" consolidated supervision into the application, termination and examination administrative's processes for foreign banks in the United States.10

2.1.3 Qualified Home Country Supervision

As the baby should not be thrown out with the bath water, so the principle of home country supervision as espoused by the Basle Committee and the EC Second Directive should not be abandoned.11 What BCCI made clear is that home country supervision only makes sense where that jurisdiction has at least comparable supervisory standards to that of the host jurisdiction, has a capacity to implement and enforce such standards, and has a deposit insurance and/or lender of last resort dimension. The EC authorities have recently rethought and redefined the "mutual recognition" and "home country control" vehicle for convergence of national supervisory standards.12 The United States authorities have already given the Federal Reserve the powers, under the FBSEA, to step into the breach where home country supervision is unfeasible or inadequate.13

2.1.4 Greater transparency and disclosure

Secrecy and confidentiality traditionally have been ingrained into the temperament of bankers and central bankers. However, this can lead to an opaque and non-transparent system, as witnessed by the BCCI affair. A radical review of the possible benefits of greater transparency (not only on a supervisory level, but on public and marketplace levels) is what is needed, in a somewhat similar way as it was needed with securities firms and markets. Clearly, there needs to be a better informed and more transparent international banking system respecting both quantitative and qualitative data and respecting an appropriate international vehicle for digesting, evaluating and disseminating such informa-


9 See Dassesse et al EC Banking Law (1994).


13 see n 6.
Market disclosure may be the best form of market and institutional discipline. However, broad disclosure can in some jurisdictions (such as the United States) greatly complicate and impede international supervisory cooperation in exchange of information.

2.1.5 Increased Role of Auditors and Converging Accounting Standards

Related to the issue of transparency is the proper role of auditors in the supervisory processes. In BCCI, one finds different auditors auditing different affiliated entities under differing national standards. In a consolidated and transparent supervisory network this situation cannot be permitted. But though it may be possible to require one reputable independent auditor (or at least a co-ordination of audits) for an affiliated group, it will be a long-term project to try to harmonize or converge the disparate accounting and auditing principles and standards existing world-wide (though the Basle Committee and IFAC’s International Auditing Practices Committee have begun this dialogue). Also, the relationship of auditors to the official supervisory and regulatory examination processes will need to be sorted out.

2.1.6 Inevitability of Greater Legalism

Because of the complexities of the issues, the multiplicity of the parties involved, the needs for transparency and fairness of application and the inherent "culture" of various jurisdictions (for instance, the United States and certain EC countries), greater legalism will creep into international and EC bank regulation. Such legalism has been anathema to the Bank of England, which prefers the more informal method of "moral suasion" and participative discussions with relevant parties. However, it was (in part) this inability to come to terms with the legalism of the 1987 Banking Act and an apprehension of judicial review that stymied the bank from acting sooner and more decisively in respect of BCCI. Certainly, the density of regulation that exists in the United States is not a desired international norm, but some reasonable level of legalism in bank regulation and supervision is needed to ensure transparency, uniformity of application and fairness within the international banking system.

2.1.7 International Insolvency Laws

Multilateral work will need to be encouraged respecting acceptable international solutions to transnational insolvencies of banking institutions such as BCCI. Such attempts generally have proven to be protracted and most difficult, as can be seen in the efforts to harmonize EC bankruptcy laws. These attempts become even more problematic when dealing with financial institutions. But for an international supervisory network to work at an optimum level, such problems will need to be addressed on a regional and broader

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15 See Taylor and Corrigan of United States and NY Federal Reserve, Testimony to United States House of Representatives Committee, (n 6).
16 See remarks by Fowle on “Role of auditors” Euromoney Conference on International Banking Regulation (n 14).
17 Remarks by Norton on “International bank supervision” at Euromoney Conference (n 14).
multilateral basis, along with issues of the existence of a deposit insurance scheme or lender-of-last resort to reach banking institution operating internationally. These concerns may well become exacerbated as banking institutions in Mexico, Russia and other emerging, developing and transitioning economies (including in Africa) find themselves “under water.”

2.1.8 Co-ordinated and Effective Enforcement
An international supervision network cannot ensure effective national supervision, on a ground level, or prompt and effective national enforcement action (both civil and criminal). These aspects will remain in the hands of national authorities; and, as such, the chain of international supervision will always ultimately be subject to the problem of weak or unco-ordinated national links in the enforcement chain. However, more co-ordinated efforts and better cooperation of the Basle Committee, the EC authorities and the dominant national authorities (for instance, of the US, the UK, Germany and Japan) can promote better national enforcement practices. International cooperative activities in the money laundering area are only a starting point.

2.1.9 Linking Banking and Securities Supervisory Standards
The linkage of banking and securities supervision will become more apparent and co-ordinated. First, many of the European banking models (for instance Germany), as well as the EC Second Banking Directive, embrace the “universal” banking concept that permits securities activities as legitimate banking activities. Even in the United States, where there has long been a federal statutory dichotomy between commercial and investment banking (enshrined in the Glass-Steagall Act), considerable regulatory and judicial erosion of this division has occurred in recent years, and considerable pressure is being placed on the congress by the United States Treasury and others to repeal the Glass-Steagall Act. Second, as prudential concerns continue to focus on a “risk evaluation” of bank activities, it becomes clear that “market risks” (particularly respecting securities), and not simply credit risks, will need to be addressed by the regulators.

However, substantial disparities exist as to how securities firms treat market risks and capital adequacy. To avoid conflict between the securities and bank

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20 See remarks by Sturmer on “Practical problems of enforcement and compliance” Euromoney Conference (n 14).
regulators will require each to minimize competitive advantages between securities firms linked to investment banks and those linked to other banking institutions by a co-ordinated development of a workable and prudent approach to such market risks and related capital issues.26

In recent years, the Basle Committee and the ad hoc International Organization of Securities Commissions (IOSCO) have begun to address these issues regarding traded debt and equity securities and related "capital" definitions.27 Also the issue of derivatives is a matter of mutual concern. In addition, an informal "Tripartite" Committee, through which international bank, securities and insurance supervisors liaise, has been initiated.

2.1.10 Bank supervision as an "art": the inadequacy of capital adequacy

The bank supervisors' "love affair" with capital adequacy will undoubtedly continue in the short-term. But what is unfolding is an incongruity and density of approaches as the regulators try to objectively non-credit risks within an all-embracing capital adequacy formula. Already, it has become clear that any such formula will probably not achieve the policy objective of competitive equality;28 that any forced convergence in such areas as market risk (particularly when trying to converge standards of banks with those of investment firms) will most probably lead to divergency; that the burdens and expenses imposed by such a "high-tech" capital adequacy formula may well exceed the benefits; and that the growing density of such a formula is becoming counter-productive to the residual policy objective of increased transparency.29 As has been rightly noted by a leading international supervisor: "Bank supervision is not a science, but an art."30

The relevance and importance of capital adequacy should be kept within the bounds of this perspective. Obviously, it is an important factor of supervision, but an over-tinkering with capital regulation may simply lead to over-complexity and an increase of marketplace innovations designed to take advantage of inevitable distortions in the capital regulations. As suggested by the chairman of the United States Federal Reserve Board, Greenspan, the bank regulators need to gain a better perspective on the range of risks inherent in such products and a better understanding of the relationship among different risk types.31

2.1.11 An International Institutional Structure?

The recent Key and Scott Report of the Group of Thirty has pondered possible international supervisory structures; some commentators even suggest (in an


27 See Joint Statement by Breeden, Chairman, Technical Committee of IOSCO, and Corrigan, Chairman of Basle Committee (released 29 January 1992).


29 See, eg, "Greenspan says as banking changes, regulators need to change with the times" 1994 BNA Bank Rep 859.


31 See "Greenspan says . . . " (n 29).
ideal world) a multilateral treaty approach. However, what appears realistic and feasible is a continuing maturation and enhancement of the currently informal Basle Committee structure so that this vehicle can assume a broader role in the overall convergence process of international supervisory standards; in the assembly, coordination, analysis and dissemination of relevant supervisory information; in the uniform interpretation of the standards and practices; and in the ultimate surveillance of compliance with and effective implementation by national jurisdiction.

The Basle Committee also most probably will accelerate its attempts to influence and to assist the practices of non-OECD (Organisation for Economic Cooperation and Development) bank supervisors and its dialogue with international securities supervisors. On an EC level, it is probable that when Economic and Monetary Union approaches, so also will proposals for an umbrella EC bank supervisory authority appended to the new EC central bank. On a national level, effective linkages will need to be created between national authorities, regional authorities and the Basle Committee.

Diagram One following this article's text graphically depicts how extensive the "web of influence" of the Basle Committee has been woven.

2.1.12 The Basle Committee’s 1989 capital report (and its related pronouncements) as "international administrative soft law"

The enquiry as to whether the Basle Committee’s 1988 Capital Report (and its other related pronouncements) constitute "international soft law" adds a certain air of profoundness to the enquiry by appearing to require some form of serious response to the classical jurisprudential questions regarding whether soft law is "law". Such an approach, however, would appear to miss the mark.

Certainly the use of the term "soft law" of itself is an admission that one is not dealing with "firm law" in any traditional sense. Such an admission, however, in no way diminishes the importance of determining whether a particular instrument or report is "soft law." If it is soft law, then there is at least a quasi-legitimacy to it as drawn from the collective intent among those involved with the preparation of that instrument or report that the standards and principles espoused therein be observed.

On balance, one could reasonably conclude that the Basle 1988 Capital Report and related Basle Committee pronouncements constitute a type of "soft international law for the following reasons":

(1) Over the past two decades the Basle Committee has been recognized

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32 See Key and Scott International Trade in Banking Services: A Conceptual Framework (Group of Thirty, 1991). Dale, in his testimony before the UK’s Treasury and Civil Service Committee of the House of Commons surmised: “The Basle arrangements seek to be global but are substantially voluntary and in an ideal world no doubt we would have a legally binding international agreement which would also be global in scope . . . ”

33 See Hayward (n 24).

34 See, eg, Report prepared by Fourcans on behalf of the EU Parliament’s Committee on Monetary Affairs, presented on 5 May 1994.


36 See discussion by Gold “Developments in the international monetary system, the international monetary fund and international monetary law since 1971” 1982 Recueil des Cours 107 156 et seqq.

worldwide as the authoritative source for setting supervisory standards with respect to international banking matters.

(2) Though the Committee has no legal source for its existence, its members comprise significant regulatory authorities with significant domestic law-generating capacities.

(3) The areas acted and pronounced upon to date by the Basle Committee have been areas of common concern of its member supervisors.

(4) Though most of the pronouncements have been cast in general terms, these terms (particularly since 1988) are more than aspirational in that it is clearly the intent of the Member States to implement the Basle principles/standards.

(5) By so intending to act and by so acting, Committee members in effect create a form of equitable estoppel with respect to any recalcitrant member.

(6) The authoritative stature of the Basle Committee has been further recognized, and not questioned, with respect to its interpretative and amendment powers in relation to the 1988 Basle Capital Report and the Basle Concordats.

(7) The numerous interconnections of the Basle Committee with regional and national law-making authorities, with regional groupings of supervisors and with international financial and monetary institutions generate numerous degrees of forward transmission of the Basle standards into actual domestic and/or regional law and practice.

An additional note of importance, it is significant to note that the Basle Committee since 1983 has phrased much of its language in an increasingly more mandatory manner. Whereas the 1983 Basle Concordat was intended to be "principles of best practice", the latest refinement of the Concordat is in the form of the "1992 minimum standards". It is not simply inadvertent that the term "principles" has been transformed into that of "minimum standards", and the fact that the "G-10 supervisory authorities do observe these standards". Further, as noted above, the role of the committee as a "monitor of its members' experiences in implementation" has become an integral part of the role of the committee.

Moreover, one cannot help but conjecture as to the legal significance of the Basle Committee and its various pronouncements before a local judiciary that may be considering questions related to these pronouncements (for example, judicial review over some domestic regulatory pronouncements regarding capital adequacy). At minimum, the Basle Committee and its various statements and practices would appear to be a legitimate "persuasive source" of legal interpretation for a particular judiciary on a relevant point of domestic law rooted in or derived from Basle standards.

But at the end of the day, the legitimacy of the Basle Committee's pronouncements rests on a negotiated consensus process and on the large reservoir of goodwill among its member supervisors. So long as such process and reservoir continue, then the Basle Committee can be viewed as an internationally authoritative and law-generating source for international banking standards.
2.2 The implications

The Basle Committee has operated on a low-key (and, at most times, on a non-transparent) basis since its came into being in 1974. It has focused its efforts on areas of prudential supervision respecting international banks which are of common interest among its constituent members. The committee appears to avoid consciously any characterization of itself as a legally-based institution or of its various pronouncements as legal documents.

Yet, the committee, particularly with its “1988 Capital Report”, has spawned significant and widespread national legislation and regulatory instruments within the member countries of the committee. Further, the influence of the committee appears to be truly global.

How all this has come about has been through a rather complex process. In one respect, it appears that the committee has built up a considerable reservoir of goodwill among its member supervisors, which has enabled it to reach a consensus on such sticky issues as capital adequacy and consolidated supervision and which has produced an informal confirmation of national implementary actions by the members. In another respect, the EC single market efforts have provided a regional legal framework for the shaping and national implementation of the Basle standards. The EC framework, however, goes beyond its twelve Member States to a “wider Europe”. To a lesser, but real extent, the NAFTA (North American Free Trade Agreement) framework may have a somewhat analogous impact in the Western Hemisphere. Added to this are the indirect law reform requirements of the International Monetary Fund (IMF), World Bank and IFIs (international financial institutions) and the individual reform agendas of emerging and transitional economies. Putting together this complex of various international and internal dynamics, one begins to understand the deep and wide convergence impact the Basle Committee is having on the prudential standards and practices of national bank supervisors respecting the limited, but important, areas of the Committee’s agenda.

Are the pronouncements of the Basle Committee a type of “international administrative soft law”? Most probably, yes!

It is important in all this that it is understood that the development of these international banking supervision standard is not an obscure and remote subject matter for Swiss gnomes. It is an area that has had a profound impact over the last decade upon the United States, United Kingdom, European Community and other major industrialised countries respective regulatory approaches to risk-based capital adequacy and capital-based supervisory schemes, to money laundering, to the treatment of foreign banks, to regional integration efforts (for example, EC and NAFTA) and the provisions on financial services, to derivative activities and even more generally to the competitiveness of banking industry in the major industrialized countries and globally.

Yet what has all this to do with South Africa and Southern Africa? First, if

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38 See “Remarks by E Gerald Corrigan, President” (n 30). Consider also significant impact the Basle Committee is having on national regulatory practice respecting derivatives activities. See, inter alia, “Fed’s Philips gives update on int’l coordination on derivatives activities” 1994 BNA Bank Rep No 2, 62.

39 See Diagram One appended to the end of this article.
the banking industry is to serve as one of the viable "engines" for South Africa's ambitious plans for reconstruction and development it must be grounded upon a "safe and sound" floor of effective and efficient prudential supervision. In this context, as noted earlier in this article, the South African lawmaker have chosen (and correctly so) to embody the Basle standards within its banking law and bank supervisory practices.

Second, if the South African banking industry is to have access to and interconnections with the major international banking institutions and financial markets, it must demonstrate objectively that it is prepared to live by the same "rules of the road" that govern these major institutions and markets (that is, the Basle standards).

Third, it seems clear that the future, long-term prospects for economic success for South Africa are inseparably linked to sustainable economic development in Southern Africa. This will require the creation of a "safe and sound", integrated banking framework throughout the region. The burden of leadership and direction here falls squarely on the shoulders of South Africa's banking industry and bank supervisors. And, here, once again, a broad commitment to and fostering of the Basle standards will be essential.

Yet, while South Africa and Southern Africa need to be wedded to the Basle standards and process, this "marriage" will create enormous strains and difficulties. How does one "grow" and utilize the once minority South African banking system in a "safe and sound way" to meet the enormous financial demands of the country and of the region? How does one implement a "risk-based capital adequacy system" compatible with Basle in a capital short and risk sensitive region? What does "effective consolidated supervision" mean for the country and the region? How does one effectively mesh the countries supervisory framework with those of other countries in the region?

3 The internal dimension

Traditionally, governmental laws and regulations regarding the lending functions of banking institutions have been based on prudential concerns. However, the recent Botshabelo Accord as to South Africa and recent banking laws and regulations in the United States appear to be placing more emphasis on social objectives such as "fair lending". In effect, there appears to be a trend toward the politicization and socialization of bank supervisory regulation and practices. As this author's expertise is with United States banking laws and practices, and not with those of the Republic of South Africa, he will analyze in this part 3 the advent of "fair lending" in the United States, with the hope of drawing some fruitful insights and guidance for the South African government banking authorities and banking industry.

3.1 The background to the United States experience

Fair lending laws are those laws imposed on banks and lending institutions, which are aimed at achieving social objectives rather than at insuring the "safety and soundness" of the banking system. Specifically, fair lending laws are designed to insure that low-income and minority groups of our society, which in the past may have been denied "fair" access to credit or financial services, can obtain such credit on "fair" terms and thus improve their social condition. Fair lending laws, in other words, can be seen as part of civil rights
reform and as a socially motivated form of credit allocation within an economy.40

The early examples of United States fair lending laws, as will be discussed below, are the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA). Both these acts, which have been in existence for some time, specifically prohibit lending discrimination, which occurs when a bank or lending institution treats a credit applicant less favorably or decides not to extend credit to such applicant on a prohibited basis such as race or gender. Fair lending laws in the United States now also include the Community Reinvestment Act ("CRA"), the Home Mortgage Disclosure Act (HMDA), and the recently enacted "Reigle" Community Development and Regulatory Act of 1994 ("1994 Reigle Act").

Concerned about allegations of widespread "redlining" and lending discrimination within the banking industry, the Clinton administration has tried to improve and to enhance the existing fair lending laws. It has undertaken two "fair lending" initiatives to achieve this goal. The first initiative consists of issuance of an "Interagency Policy Statement" in March 1994, which attempts to clarify, regroup and even redefine what constitutes lending discrimination under the ECOA and the FHA, the two federal statutes that expressly prohibit lending discrimination. The second initiative is aimed at increasing community lending in underdeveloped areas and consists of a call for reform and increased emphasis by regulators on enforcement of the CRA, and of the passage of the 1994 Reigle Act.41

Recent applications of the United States fair lending laws suggest that failure to comply with the community responsibility requirements of the CRA can be considered lending discrimination in violation of the ECOA and the FHA. The Chevy Chase case, discussed below, is an example of this change in the standard used to determine lending discrimination. In effect, the regulators, through their administrative and rule-making processes are transporting affirmative legal standards from a statute such as the CRA into a statute such as ECA which does not create any affirmative obligation to lend but which (unlike the CRA) has tougher sanctions. The government and regulators are "mix-and-matching" legal standards and sanctions from different statutes.

What is happening, to a large extent, is that lending discrimination and community responsibility issues are joined "safety and soundness" concerns among (for example, see, part 2 of this article) the priorities of United States federal financial institution regulators. Traditionally, United States banking statutes, regulations, policy statements, and guidelines have been premised on the fundamental principle that the banking business must be conducted in a "safe and sound" manner to preserve the solvency of the financial institution and the federal deposit insurance funds.

Governmental policy regarding the regulation of the banking industry has been focused on safety and soundness concerns, and not on social objectives aimed at assisting individual bank customers, except for the deposit insurance scheme which could be said to be user-oriented.42 But, beginning, however, in

41 See, inter alia, "Special edition on fair lending policy" 14 Banking Policy Rep No 3 (6-20 Feb 1995).
42 See Norton and Whitley (n 40) ch 2, § 2.04.
the late 1960s and early 1970s, United States federal legislation addressing protection of consumers, ensurance of community-wide access to banking, and expansion of civil rights policies into the financial markets appeared. Although consumer protection (for example the federal Truth-in-Lending Act) has become a major congressional and regulatory objective, "fair lending" has not been given such emphasis until now.43

The March 1994 Policy Statement (discussed below) signifies an important change in United States governmental policy.44 It indicates that fair lending laws are becoming a higher priority among federal regulators and a new objective of the Clinton administration. This objective is to be realized through legislative and regulatory enhancement of the fair lending laws and through vigorous and aggressive governmental (and, perhaps in the future, even private) enforcement efforts. The increased importance of this objective is also evidenced by the legislative passage of the "Reigle" Community Development and Regulatory Improvement Act of 1994, directed in large part to community banking issues.45

The fair lending initiatives by the Clinton administration purport to be consistent with "safety and soundness" concerns. For example, the March 1994 "Policy Statement" explicitly asserts that fair lending is not inconsistent with "safe and sound" operations and that lenders must continue to ensure that their lending practices are consistent with safe and sound operating policies.46 However, the banking industry has expressed substantive concern about the compatibility of fair lending requirement with sound and safe operations. This concern seems to be based on the lack of guidance by the regulators as to how to comply with many of the fair lending requirements without sacrificing the safety and soundness of the financial institution.

The banking industry also claims practices welcomed from a CRA standpoint or a fair lending perspective are often criticized by examiners from the "safety and soundness" perspective while fair lending laws compliance examiners have criticized loan practices that are based on a safety and soundness requirement dictated by law. Thus, in response to the added emphasis on fair lending laws enforcement, as exemplified by the March Policy Statement, the banking industry has demanded a stronger, more affirmative statement, emphasizing the importance of safe and sound lending and addressing how to balance the objectives of fair lending with safety and soundness standards to accurately reflect the standards to which the banking industry is held.47

3.2 The bases of the fair lending policy

The March 1994 Policy Statement, the "Reigle" Act, and the efforts to reform the Community Reinvestment Act are the bases of the recent federal government's emphasis on fair lending.

41 For more on consumer legislation, see Norton and Whitley (n 40) ch 10.
43 1994 Reigle Act, 103 Pub L 324.
45 The banking industry was given the opportunity to comment on the March 1994 "Policy statement" and on 22 June 1994 it released a letter to the regulators with their comments on the "Policy statement". The banking industry concerns regarding the fair lending laws compatibility with safety and soundness principles were taken from this letter.
3.2.1 The March policy statement

On March 8, 1994, the ten federal agencies responsible for enforcing fair lending laws issued a Policy Statement on lending discrimination. The Policy Statement was in part a response to calls by the banking industry for greater regulatory clarity in view of the Clinton administration efforts to increase the enforcement of fair lending laws. It purports to provide guidance about what the agencies consider in determining if lending discrimination exists and to provide a foundation for future interpretations and rule makings by these agencies. Thus, although the Policy Statement does not carry the force of law, the ten agencies will rely upon its definition of discrimination when enforcing fair lending laws.

The Policy Statement applies to all lenders, including mortgage brokers, issuers of credit cards, and any other person who extends credit of any type.

Although there are other federal statutes which seek to promote fair lending, such as the CRA and the HMDA, the March Policy Statement is based upon and addresses only the ECOA and the FHA, the two statutes that specifically prohibit lending discrimination.

Under the Policy Statement, the following three principal methods are outlined as proof of lending discrimination under the ECOA and the FHA:

(a) Overt Discrimination. Overt discrimination is defined in the Policy Statement as blatant discrimination on a prohibited basis. This means discrimination based on race, age, sex, religion, or any other basis covered by the ECOA or the FHA. Although overt discrimination as defined in the policy statement sounds fairly obvious, it may not always be easy for banks and other institutions to detect and safeguard against it. For example, the Policy Statement warns against issuing credit cards with different borrowing limits based on a customer's age.

Moreover, overt discrimination can be subtle in nature and, therefore, difficult to detect, even by institutions that do not condone discrimination in any form. As a result, management of such institutions may be lulled into a false sense of complacency and not be diligent enough in their efforts to detect subtle forms of discrimination. For example, a branch receptionist who for personal reasons may dislike a certain race could be discouraging applicants over the phone or through body language when the potential borrower inquires about a loan. The absence of a smile or handshake or avoidance of eye contact are other subtle actions that could discourage potential borrowers. Thus, lenders are advised by the Policy Statement to take steps to discover the subtle forms of "overt" discrimination. This can be achieved through training, testing, and monitoring.

(b) Disparate Treatment. Disparate treatment means treating some applicants differently from other applicants based on one of the prohibited factors. Disparate treatment can be subtle or overt, making it difficult to identify and interpret.

The loan application process is the most obvious area of concern regarding disparate treatment. The Policy Statement warns against being more helpful to some applicants than to others even if the practice is not motivated by prejudice or a conscious intention to discriminate. Practices

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48 See 59 Fed Reg 18268 (15 April 1994).
that might put a lender at risk during the loan application process could include: taking additional time to inquire about items listed on the application, asking a question about potential area of concern or taking the time to discuss all available loan programs. The Policy Statement does not try to impose a certain level of assistance, but it emphasizes that all applicants must receive the same treatment.

To avoid problems with disparate treatment, banks should be comprehensive in their review of loan files. This will help examiners who otherwise may have difficulties interpreting an individual's credit application experience. Despite the difficulty in assessing the pre-application interview process, banks can overcome this to some extent by training, testing, and careful monitoring aimed at identifying potential areas of risk.

Another pitfall for lenders in terms of disparate treatment relates to explanations about why applicants may receive different treatment. Although a lender may believe that a valid explanation has been given for such treatment, an examiner might find reason to dig deeper, resulting in a finding of discrimination. Consequently, institutions must ensure proper training of personnel and consistency in approvals and disapprovals of applicants.

In addition, banks must understand that they cannot confine their self-analysis of fair lending practices to data gathered under the Home Mortgage Disclosure Act (HMDA). HMDA data may raise red flags for both examiners and institutions about lending practices, but it does not represent substantial or tangible evidence of discrimination.\textsuperscript{49} Therefore, banks must take the extra step of conducting statistical analysis of their loan files to see if credit reports and debt ratios indicate practices of lending discrimination. "Self-testing" becomes a new and important aspect of bank internal procedures; though, it is unclear whether negative information obtained in such testing can be used against the institution by the regulators (a practical form of "self-incrimination").

(c) \textit{Disparate impact}. For lenders and regulators, disparate impact is the most difficult kind of discrimination to address. Disparate impact occurs when a lending practice applies uniformly to all applicants, but the practice has a discriminatory effect on a prohibited basis and is not justified as a "business necessity". In other words, a policy or practice that may have a disproportionate adverse impact on a group which is protected under ECOA or FHA is subject to an "effects test". For example, a bank may have a uniform credit policy not to originate mortgages for less than $60,000. Even though this is a uniform policy regardless of race, sex, or national origin, the credit policy might be found to have a disparate impact because it has a disproportionate adverse impact on applicants from a protected class. Although a bank is given an opportunity to justify the credit policy based on business necessity, the Policy Statement does not clearly define or give examples of what the agencies consider to be a justifiable business necessity. Therefore, the implementation of a disparate impact analysis is potentially problematic.

\textsuperscript{49} The HMDA requires the compilation, aggregation and disclosure of the number and dollar amount of home mortgage and home improvement loans originated or purchased by a banking institution. These requirements are aimed at preventing "redlining". For a more detailed explanation of the HMDA and its requirements, see Norton and Whitley (n 40) ch 9.
Bankers are concerned that the implementation of the disparate impact analysis will prohibit banks from employing legitimate credit policies. For example, using the example above, banks could argue that originating mortgages loans for less than $60,000 is not profitable enough to warrant its practice. But to the dismay of banks and other financial institutions, the Policy Statement does not provide guidance in this respect. Without the Policy Statement providing specific guidance regarding what constitutes acceptable business necessity, bankers will continue to be uncertain about government policy in the fair-lending area.

Although the Policy Statement purports to clarify fair lending requirements by defining the methods of proof of lending discrimination, the federal banking regulators still need to provide further clarification regarding the standards for compliance with the fair lending laws.

It appears that the department of housing and urban development intends to issue a regulation, by or during Spring 1995, that will be designed to provide regulatory clarification and legitimacy to the “disparate impact” theory. From a “real-politick” perspective, it appears that the “payback” for the governmental S & L and bank bailouts and a precondition to further deregulation would be (at least from the eyes of the Clinton administration and bank bureaucracy) the banking industry “buy-in” respecting the government’s fair-lending agenda.

3.2.2 The 1994 Reigle Act

On September 29, 1994, President Clinton signed into law the “Reigle Community Development and Regulatory Improvement Act of 1994” (1994 Reigle Act). The fair lending provisions of the act are in Title I, called the Community Development and Consumer Protection Act, which is designed to enhance lending to underdeveloped areas (subtitle A) and to clamp down on “reverse redlining” (that is, exploitive extensions of home equity credit in minority and low income areas) (Subtitle B). Subtitle A of the 1994 Reigle Act and the CRA in a way compliment each other in their attempt to expand lending in underdeveloped communities. While the CRA attempts to enhance lending in underdeveloped areas by imposing an affirmative responsibility, and continuing obligation, on banks and thrifts to help meet the credit needs of the communities in which they operate, the 1994 Reigle Act creates a special fund designed to assist certain qualified new and existing community lenders to provide capital and other resources to economically-depressed communities. Not surprisingly, the 1994 Reigle Act also directs federal banking agencies to review the CRA examination and enforcement system as early as possible to implement the Administration’s fair lending initiatives.

3.2.3 CRA Reform Proposal

From its inception, the CRA has been criticized by the banking industry as ambiguous and lacking clear standards of compliance. Thus, as part of the Clinton administration “fair lending” initiatives, in July, 1993, the federal

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50 See 59 Fed Reg 57,632 and 57,087 (14 Nov 1994).
51 1994 Reigle Act, 103 PL 324.
banking regulators began a comprehensive review and overhaul of the inter-
agency regulation of the CRA. The regulators’ mission is to reform the CRA
regulations to provide clearer guidance on what banks and thrifts should expect
from CRA examinations, emphasize performance over documentation, and
refocus the regulation on making credit and financial services available to all
communities, including undeserved areas throughout urban and rural
America.

As a result of this review of the CRA regulations, the regulators have so far
issued two sets of proposed changes to the CRA regulations. These changes,
the regulators claim, will greatly expand credit to minority-owned business.
The first proposal was issued in December, 1993 and was strongly opposed by
the banking industry. The second proposal drops several requirements from
the December plan, but adds a new requirement that still faces opposition from
the banking industry, particularly larger banks. This new requirement would
require banks to report race and gender information on small-business loan
applications. The race and sex information could be used to prove discrimi-
nation against minority-owned business much the same way the HMDA data
has been used to prove discrimination against minority home-buyers. The
regulators received substantial comments on the last proposal and had prom-
ised to issue new CRA regulations by the end of 1994. However, with the
dramatic congressional political shift to the right in the November 1994
elections, it appears the Clinton administration and regulators are moving
more cautiously in issuing the pending regulations. In view of the opposition
the CRA reform still faces, it remains to be seen what their final outcome will
be.

3.3 Component parts of fair lending

The ECOA, the FHA, the CRA, and the HMDA are the main components of
the fair lending laws. Although they impose different requirements, as a whole
they are tools the federal government will use to achieve the objectives of fair
lending.

3.3.1 Equal Credit Opportunity Act (ECOA)

The ECOA became effective on October 28, 1974 and has been termed the first
civil rights statute to deal with consumer credit. The premise of the statute is
that all consumers and businesses should have an equal opportunity to obtain
credit. While not expressly directed to the allocation of credit, the ECOA does
not prohibit a lender from allocating or extending on a discriminatory basis.
However, recent applications of the ECOA suggest that the standard for
compliance might be changing and that a bank could be liable under the ECOA
for allocating credit on a discriminatory basis.

As originally enacted, the ECOA prohibited credit discrimination by
financial institutions and other institutions on the basis of sex or marital status.

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54 Pub L No 90-321, Title VII § 701 et seqq, as added to by Pub L No 93-495; 88 Stat 1521, and
55 See generally Bender VIII Banking Law ch 154; Maltz and Miller “Equal Credit Opportunity
As amended, the statute prohibits discrimination on the basis of sex and marital status, race, religion, national origin, age (provided the applicant has the capacity to contract), and receipt of public assistance benefits. The ECOA prohibits discrimination against a person who in good faith exercises a right under the Consumer Credit Protection Act ("CCPA"). The Federal Reserve Board of Governors (FRB) has the statutory responsibility to implement the ECOA and has done so through its Regulation B.

Regulation B provides the following general rule: "A creditor shall not discriminate against an applicant on a prohibited basis regarding any aspect of a credit transaction".

Regulation B contemplates two mechanisms of applicant credit evaluation: those that have an objective basis and those that have a subjective basis. Under Regulation B, the following subjective criteria may be considered by a creditor under specified conditions:

1. **Age** may be considered only for purposes of determining a certain element of credit-worthiness, such as in situations favoring an elderly applicant or in assessing the significance of the applicant's length of employment or residence (if this is done to favor the applicant). An applicant's life expectancy may be considered as a variable determinant;

2. **Income from a public assistance program** may be considered in the context of the length of time an applicant has been receiving such income, residence requirements for the program, and continuing stability of the income; and

3. **Child bearing or child rearing information** as it may pertain to a diminution of income may be considered in the same way and for the same reasons as diminished income for any other reason.

The ECOA and Regulation B also set forth restrictions with respect to information concerning income sources, and credit history.

Various federal agencies are responsible for specific enforcement of the ECOA and Regulation B. Unlike other consumer statutes, the ECOA does not provide for criminal penalties. However, civil penalties, including actual damages and punitive damages, may be collected. Injunctive and declaratory relief may also be granted under the ECOA, and court costs and reasonable attorneys fees may be awarded, if a complainant is successful in his claim.

The enforcement mechanisms for the Equal Credit Opportunity Act are strengthened by the 1991 Federal Deposit Insurance Corporation Improvement Act (FDICIA). The federal banking agencies are required to refer loan discrimination violations of the ECOA to the justice department. This section also authorizes the justice department to seek actual and punitive damages for

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56 15 USC § 1691(a).
57 12 CFR § 202. See generally FRB "Background and summary of regulation B". On 9 April 1992, the FRB published revisions to its official staff commentary interpreting its Regulation B on the ECOA. See 57 Fed Reg 12,202 (9 Apr 1992).
58 12 CFR § 202.4—emphasis added.
59 12 CFR §§ 202.2(p) and 202.6(b).
60 See generally 12 CFR § 202.6. The FRB has issued "Interpretations of regulation B" involving consideration of income and disclosure of reasons for adverse action, which are to be effective in April 1983. See 39 Wash Fin Rep No 15 (18 Oct 1982) 701.
61 See 15 USC § 1691 et seqq, Appendix A.
62 12 CFR § 202.1(c).
violations. The secretary of housing and urban development must be notified of alleged violations not referred to the justice department that may also be violations of the FHA.63

In a footnote to Regulation B, the FRB incorporated a concept utilized in the employment area, known as the "effects test".64

The FRB has stated, in this regard, that it:65

"interprets the application of an 'effects test' to the credit area to mean that the use of certain information in determining credit-worthiness, even though such information is not specifically proscribed by proposed 202.6(b) may violate the amended Act if the use of that information has the effect of denying credit to a class of persons not of that class, unless the creditor is able to establish that the information has a manifest relationship to credit-worthiness. Even then, if an aggrieved applicant could show that a creditor could have used a less discriminatory method which would serve the creditor's need to evaluate credit-worthiness as well as the challenged method, a violation may be found to exist."

This rather limited test is currently being expanded by the regulators by analogy in creating its general "disparate impact test" vis-à-vis "fair lending".

3.3.2 The Fair Housing Act (FHA)

The Fair Housing Act was originally enacted in 1968, and substantially amended in 1988. The FHA prohibits discrimination on the basis of race, colour, national origin, religion, sex, handicap, or familial status in any real estate-related transaction, including home mortgage loans, loans for mobile homes, home improvement loans, and property appraisals.66 The March 1994 Policy Statement specifically addresses the FHA and attempts to clarify what type of conduct is considered a violation of the Act by defining three methods of proof of lending discrimination courts have recognized under the FHA.67

The FHA provides for enforcement by three means: (1) private lawsuits in federal court by persons who believe that they have been injured by an act of unlawful discrimination; (2) complaints to HUD, which investigates and attempts to conciliate, and, where unsuccessful, issues a charge of discrimination when it has reasonable cause to believe the FHA has been violated. The matter is then resolved in a proceeding before an administrative law judge or in federal court; and (3) lawsuits in federal court by the department of justice.68

Where the department of justice files a lawsuit alleging the existence of a pattern or practice of discrimination, the court may award injunctive relief, monetary damages (both compensatory and punitive) to individual victims of proven discrimination, and, to vindicate the public interest, a civil penalty payable to the United States of up to $50,000 per defendant for the first violation and $100,000 for subsequent violations.69

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63 See FDICIA § 223.
66 42 USC s 3601-3619, 3631.
68 See Norton and Whiteley (n 40) ch 9, sec 9.10[2].
69 For a more detailed description of the FHA, see Norton and Whiteley (n 40) ch 9.70 Pub L No 95-128, Title VIII; 91 Stat 1147; 12 USC § 2901 et seqq. See generally Bender (n 55) ch 158.
3.3.3 Community Reinvestment Act (CRA)

The legislative history of the CRA demonstrates that congress considered the CRA to be an integral part of the overall scheme of the Housing and Community Development Act of 1977. Specifically, this legislation was directed against the practice of "redlining", that is, the use of funds deposited by residents in neighbourhood institutions for purposes that would not benefit the depositors or the neighbourhoods. In recent years, compliance with the CRA standards have been aggressively pursued by the federal regulators in their various application processes. An example of the importance of CRA standards in the regulatory application process is evidenced by the dominance of the CRA issue in the FRB's approval, in November 1991, of the merger between Chemical Corp. and Manufacturers Hanover Corp. In the FRB's 35 pages order, the pages were devoted to a discussion of current and future participation in CRA-related problems.

The primary purpose of the CRA is to encourage financial institutions to meet the credit needs of the local communities they serve, consistent with the safe and sound operation of the institution. This purpose is achieved through examination of these institutions by the appropriate federal financial supervisory agency.

The CRA applies to all "regulated financial institutions" (that is, an institution whose deposits are insured by the government insurance fund). The CRA does not establish specific requirements for bank performance, but seeks to use the bank's examination process as a device for fostering acceptable "standards" of performance. The standard for assessing the performance of each financial institution is subjective, and is whether each institution serves the convenience and needs of the community in which it is chartered to do business.

The CRA does not establish a new framework for bank regulation or examination, but is superimposed upon, and accordingly is limited by, the existing federal regulatory structures. Thus, the regulatory authorities that implement the CRA are as follows: (1) the Comptroller supervises national banks; (2) the FRB supervises state-chartered banks that are members of the FRS, and supervises bank holding companies; (3) the Federal Deposit Insurance Corporation (FDIC) supervises state-chartered banks and savings banks that are not members of the FRS, the deposits of which are insured by the FDIC; and (4) the Office of Trust Supervision (OTS) supervises institutions with deposits governmentally insured, and supervises Savings Association holding companies.

The purpose of the CRA examination is two-fold:

70 See, eg, 123 Cong Rec 1202 (daily ed 24 Jan 1979).
71 See generally Hearings on § 406 Before the senate comm on Banking, Housing and Urban Affairs, 95th Cong, 1st Sess 2 (1977).
72 See, inter alia, "The legality of redlining under the civil rights laws" 1977 Am Univ L Rev 463 (1977); "Redlining practices, racial resegregation, and urban decay: neighborhood housing services as a viable alternative" 1975 Urb Law 510.
73 12 USC § 2901(b).
74 12 USC § 2902(2).
75 12 USC § 2901(a) and (b) and § 2903.
76 12 USC § 2902(1).
77 See generally Givens "Antiredlining issue: can banks be forced to lend?" 1978 Banking LJ 515; Healy "A banker's guide to the Community Reinvestment Act" 1979 Banking LJ 705; "The
(1) The continuing assessment and monitoring of a banking institution’s record of meeting the credit needs of its entire community, including low and moderate income neighbourhoods, consistent with the “safe and sound” operations of such institution; and

(2) The consideration of such record of performance when evaluating an “application” by such institution.

The term “application for a deposit facility” by a national bank, would include, for example, an application for a charter for a national bank, deposit insurance in connection with a newly chartered institution, the establishment of a domestic branch, the relocation of a home or branch office, and mergers or acquisitions.78

The CRA provides that the appropriate federal financial supervisory agency has a duty to carry out the purposes of the CRA.79 The respective federal regulations are substantively parallel to each other.80

These regulations are illustrated by the requirement of the Comptroller that a national bank:

(1) Prepare and annually review a delineation of the local community or communities that comprise the entire lending territory of a bank (as portrayed on a map or maps), without excluding low and moderate income neighbourhoods. A national bank is permitted to use its “effective lending territory,” defined as that area or areas around each office or group of offices where it makes “a substantial portion of its loans,” and all areas equally distant from its offices as those areas. The reasonableness of this delineation will be reviewed by the national bank examiners;81

(2) Adopt a Community Reinvestment Act statement (“CRA Statement”) for each delineated community;82 and

(3) Post in the public lobby at each of its offices (other than off-premise electronic deposit facilities) a public notice (“CRA Notice”) in the form prescribed by the CRA.83

These are the only express requirements of specific action to be taken by a national bank or a federal S&L.

The various CRA regulations do not provide specific guidelines for assessing community reinvestment act regulation: another attempt to control redlining” 1979 Cath Univ L Rev 635.

78 12 USC § 2901(3).
79 12 USC § 2905.
80 Cf FRB “Regulation BB” 12 CFR § 228; Comptroller’s “CRA Regulations” 12 CFR § 25; FDIC “CRA Regulations” 12 CFR § 345; and FHLBB CRA Regulations 12 CFR § 563(e). As required by FIRREA, the FFIEC has issued final guidelines for depository institution CRA rating classifications (“outstanding”, “satisfactory”, “needs improvement”, or “substantial noncompliance”) and for related public CRA disclosure. The final rule needs to be implemented by the respective federal regulator. See 55 Fed Reg 18,163 (1 May 1990). The OTS has approved the FFIEC’s CRA changes (Thrift Bulletin 47). The “whistle-blower” protection provisions of FIRREA retroactively protects a depository institution official from employment discharge for reporting CRA violations. See Hicks v RTC 767 F Supp 167 (NDIII 1991). The FFIEC has prepared an overview pamphlet on the CRA for public bank distribution, which has been adopted for distribution by the regulators.
81 12 CFR § 25.3.
82 12 CFR § 25.4.
83 12 CFR § 25.6.
the performance of banking institutions. Performance is assessed within the context of (1) serving the “convenience and needs” of the communities being served (which is to include the needs for credit services as well as deposit services), consistent with (2) the “safe and sound” operations of the banking institution.\footnote{See, eg, 12 CFR § 25.7.}

The phrase “community convenience and needs” first appeared in the Bank Act of 1935, with respect to certification by the Comptroller that a national bank is eligible for FDIC insurance.\footnote{2 USC § 1816.} One author points out that the Senate Report on this act merely makes reference that the aforementioned factors “are similar to those which are considered by the Comptroller of the Currency in authorizing national banks to commence business”.\footnote{See generally Dennis “The Community Reinvestment Act of 1977: Defining ‘Convenience and Needs’ of the Community” 1980 Banking LJ 45.} At that time, the Comptroller required an examiner investigating a bank that had applied for a charter to consider traditional matters related to economic safety and soundness.\footnote{See “Instructions of the comptroller of the currency relative to the organization and powers of national banks” (1920).} Relying on the regulatory procedures of the Comptroller at that time, congress was therefore primarily addressing the requirement that the community be able to support the banking facilities to be chartered.

The phrase “convenience and needs of the community” appears in two other bank related statutes, the Bank Merger Act\footnote{12 USC § 1828(c)(5)(B).} and the Bank Holding Company Act.\footnote{12 USC § 1842(c)(2).} Under these acts, the phrase addresses traditional considerations of competition and sufficient business to ensure the success of the bank, as distinguished from any obligation of a bank to meet the community credit needs.

As required by FIRREA, the Offices of Comptroller of the Currency (OCC), FRB, FDIC and OTS have each adopted final CRA disclosure rules respecting the supervisor’s assessment of an institution’s CRA performance. The FFIEC had adopted a final rule on the manner of agency disclosure, and has adopted other CRA-related policy statements and guidelines.\footnote{Eg, on 6 December 1991, FFIEC adopted a policy statement for the purpose of assisting financial institutions to analyze geographic distinction of their loans for purposes of CRA compliance. In addition, on 17 June 1992, the FFIEC issued guidance for the federal bank and thrift regulatory agency examiners examining institutions for CRA compliance. The Federal Housing Financing Board also adopted a final rule on 15 October 1991, requiring all members of the Federal Home Loan Bank system to submit a “community support statement” on the community lending efforts to qualify for long-term advances from federal home loan banks, which statement is to be filed every two years and must include the institutions latest CRA examination report, information on the members assistance to first home buyers, reports on Equal Credit Opportunity Act/Fair Credit Act compliance, and any additional information indicating community support.}

In a memorandum, dated December 15, 1994, the department of justice’s Office of Legal Counsel advised the Comptroller of the Currency that the federal banking agencies lacked the authority to put into place CRA regulation that contained enforcement action methods contained in 12 United States C. §1818. The CRA does not impose an obligation that could give rise to a § 1818
action: the agencies control over the application evaluation procedures (including denial) is currently the exclusive CRA enforcement mechanism.91

Under the 1991 FDICIA, public disclosure of the records of financial institutions lending to low- and moderate-income borrowers in their communities is broadened to include the “facts and date” supporting conclusions of the federal banking agencies conducting CRA examinations. Under prior law, the public reports of such regulators could include only a discussion of “facts” supporting such conclusions.92

3.3.4 Home Mortgage Disclosure Act (HMDA).93

The Home Mortgage Disclosure Act of 1975, as amended (HMDA), requires depository institutions to collect and disseminate data about mortgage loans, and applications for such loans. There is an exemption for small institutions with total assets below $30 million. Mortgage information must be grouped by census tract, income level, race, and gender. Federal Reserve Regulation C, which applies to banks, thrifts, and holding company subsidiaries, requires that loans be categorized according to: (1) Originations and purchases; (2) Number of loans and dollar amount; and (3) type of loan (conventional home loan, government program loan, home improvement, multi-dwelling, or non-occupant borrower).

The Federal Financial Institution Examinations Council (“FFIEC”) prepares disclosure statements for institutions, that must be made available to the public upon request. The FFIEC also compiles aggregate data for metropolitan areas. HMDA data is used to monitor and evaluate compliance with the CRA and housing laws. As the type and form of data required increases, so do the reporting burdens and costs to the affected institutions. In addition, such data can be used as a “whip-saws” against such institutions by the regulatory the Justice Department, and increasing by sophisticated interest groups.

3.4 Selective examples of applications

Although the ECOA and FHA do not explicitly require lenders to undertake affirmative actions to encourage or facilitate lending to protected class members, recent applications of these fair lending laws suggest that in order to assure compliance with the ECOA and FHA lenders must do more than avoid lending discrimination, but must also engage in some type of affirmative action to make credit available to protected class members. The fair lending enforcement actions taken to date by the department of justice centre around issues of (i) pricing discrimination, (ii) product and services discrimination, and (iii) market-based definition discrimination.

3.4.1 The Chevy chase case:94 What is the appropriate standard?

The justice department recently settled a case against Chevy Chase Federal Savings Bank for alleged lending discrimination and redlining practices in

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91 See “Congress limited agency enforcement of CRA, justice department memo” 64 BNA Bank Rep 41 (2 Jan 1995).
92 See FDICIA § 221.
93 For a more detailed description of the HMDA, see Norton and Whitley (n 40) ch 9, sec 9.09.
violation of the ECOA and the FHA. The settlement agreement requires Chevy Chase to pay $11 million to the redlined areas through a special loan program and the opening of bank branches and mortgage offices.

Chevy Chase, the largest savings and loan association in the DC metropolitan area and one of the nation's largest thrifts, operates 78 branches and 20 mortgages offices. Prior to the justice department's investigation, the bank had virtually all of its branches and mortgage offices in majority white areas—delineated by census tracts. The bank opened no branches in any of DC's majority black census tracts, which accounts for 90% of all African Americans in the city, nor had it opened branches in any of Prince George's County majority black census tracks, accounting for 75% of that county's black population.95

The justice department claimed that the bank intentionally avoided soliciting applications and making home mortgage loans in sections of the DC area that are predominantly African American. It also attacked other marketing practices that allegedly contributed to the lack of lending activity in the African American neighbourhoods. All these activities, the justice department alleged, were in violation of the ECOA and the FHA. Although the Chevy Chase consent decree alleges violations of the ECOA and the FHA, the claims it asserts do not seem to be directly traceable to any specific provisions of those laws when viewed in the light of prior interpretations and precedents.96

As explained above, the ECOA and the FHA have been aimed at two types of conduct: (1) discriminating on a prohibited basis against individuals who have applied for a loan or have been granted a loan and (2) discouraging individuals on a prohibited basis from submitting an application for credit. However, the justice department made no allegation that either of these practices had occurred in the case of Chevy Chase. Instead, it took the position that Chevy Chase violated the FHA and the ECOA not by its actions in connection with its treatment of borrowers, applicants, or prospective applicants, but rather by what it did not do with respect to persons with whom it did not have any contact. Specifically by failing to adequately market its loan products and avoiding doing business in minority census tracts located within the bank's metropolitan area.

The Chevy Chase case should have been brought under the provisions of the CRA, which was enacted to curtail redlining practices such as the practices Chevy Chase allegedly engaged into. But it seems that the government, in its effort to expand the enforcement of the fair lending laws, decided to use the ECOA and the FHA because they allow for more severe penalties than the CRA and because congress assigned the justice department no role in implementing or enforcing the CRA.

Thus, the significance of this case, aside from being an example of the stiff penalties which can result from violations of the fair lending laws, is that it puts the banking industry on notice regarding the type of proof the government believes is required to put forth to substantiate a violation of the ECOA and the FHA. This case indicates a change in the legal standard used to determine violations of the ECOA and the FHA. The new standard appears to include practices in violation of the CRA within the scope of the ECOA and the FHA.

96 id.
Unfortunately, this case was settled and the courts were not given the opportunity to clarify the standard under which violations of the fair lending laws is to be judged. Nevertheless, the United States banking industry seems not to want to wait for such clarification before adjusting its practices to conform with the new standard suggested by the Chevy Chase case as banking institution generally do not want to be in the position of defending itself against these type of violations.

3.4.2 First National Bank of Vicksburg and Blackpipe State Bank cases

These two recent cases, both resulting in settlement agreements, also represent good examples of the manner in which the fair lending laws are being applied by the justice department.

In First National Bank of Vicksburg, this Mississippi bank came under scrutiny by the Office of the Comptroller of the Currency (OCC) when data from the Home Mortgage Disclosure Act revealed discrepancies in the bank's lending practices. In reviewing Vicksburg's records for 1992, the OCC discovered that the bank was charging blacks higher interest rates than whites on unsecured home improvement loans. The bank charged nearly all of its black borrowers interest rates from 14% to 21%, while charging most of its white borrowers rates of only about 10%. The OCC then referred the matter to the justice department which determined that Vicksburg had engaged in a pattern or practice of racial discrimination in violation of the FHA and the ECOA. In order to settle the case, Vicksburg agreed to pay $50,000 in civil penalties and create a $750,000 fund to compensate blacks who were overcharged on interest rates. In addition, Vicksburg was required to undertake changes in its lending practices including: (1) training its loan officers in principles of fair lending; (2) using an application checklist to ensure the bank solicits and records all relevant information; (3) conducting random testing to ensure employees are not treating minorities differently from non-minorities, and (4) establishing a goal of funding at least $1 million in loans to low and moderate income borrowers.97

In another case, the justice department sued Blackpipe State Bank for allegedly refusing to make secured loans where the collateral was located in a reservation, for placing credit requirements on Native Americans that it did not require from whites, and for charging Native Americans greater interest rates and finance charges than those it charged to whites. Blackpipe State Bank settled the case by agreeing to create a $125,000 compensatory fund for discriminating against Native Americans and to undertake specific actions to enhance lending to the affected reservation.98

Although these two cases involve clear lending discrimination in violation of the ECOA and the FHA, they are a signal to the banking industry by the justice department that fair lending requirements cannot be overlooked. The federal government has sent a clear message that it regards lending discrimination as a serious problem and that enforcement of fair lending law is a top priority.

But, as indicated recently by Fed Chairman Greenspan, risk-based pricing disparities are permissible (though lenders need to be careful they do not run afoul of fair lending requirements).99

97 id.
98 id.
99 See “Risk-Based Credit Pricing Compatible . . . ” 63 BNA Bank Rep 820 (5 Dec 1994).
3.5 Some implications

The reality of governmental intervention in the banking area in pursuit of social objectives is certainly not new in the United States experience. As previously indicated, the creation of a comprehensive deposit insurance scheme has clear social as well as economic objectives; the anti-discriminatory statutes of ECOA and CRA have existed for approximately two decades; and a host of consumer-orientated, disclosure-based legislation such as Truth-in-Lending Act, Truth-in-Savings Act, and various real estate lending Acts also have been in existence for some time. What is significant about the most recent Clinton administration and banking agencies' thrust into "fair lending" is an attempt to create an interrelated (if not integrated) federal programme directed to actual credit allocation goals. Certainly to the extent credit markets can be opened to lower and middle class neighbourhoods and to small and medium-sized businesses, the better the likelihood of economic development in those geographic areas and in that business segment.

However, this "fair lending" programme in the United States is clearly governmentally intrusive and directly interferes with normal market forces. In addition, it brings into question the compatibility of the goals of fair lending with the prudential requirements of "safety and soundness". Moreover, the fair lending programme, despite its motivation, demonstrates the liberality with which United States banking authorities view their role: here the regulators, in their administrative discretion, control the faucet of enforcement aggressiveness and are prone to legal imagination in transporting specific legal standards or obligations from one statute into another statute devoid of such standards but with tougher sanctions (governmental "mix-and-matching").

Also, the United States governmental "fair lending" program appears to be another example of regulatory micromanagement and a counter-deregulatory approach by the United States bank regulators.

Perhaps, as recently suggested by Fed Board governor, Lindsey, changing other United States laws (for example the Davis-Bacon Act requiring union wage scale for construction workers on certain banking facilities, the Glass-Steagall Act precluding banks from any wide scale access to capital markets, and real estate appraisal and minimum down-payment regulations) could have a more beneficial effect of promoting home ownership and inner-city development than in continual questionable tinkering with CRA and other so-called "fair lending" requirements.100

From an "on-the-ground" context, the new governmental emphasis on fair lending creates numerous practical dilemmas for United States banking institutions, including the following crises:101

- internal institutional loan policy formulations,
- internal education programs at all and strategies levels,
- approaches to possibly conflicting governmental examinations for differing purposes,
- impact on current reliance on "scorecard" credit evaluations,

100 See "Changing other laws could do the job CRA was intended for, fed's lindsey says" 63 BNA Bank Rep 663 (7 Nov 1994).
101 For some helpful practical suggestions on coping with "fair lending" see Stansifer "Fair lending issues and concerns" 1995 J Commercial Lend 27.
— self-testing and internal monitoring procedures, and
— review of credit denial processes.

Are there comparative lessons to be learned from the United States flirtation with a governmental “fair lending programme”? First, there is a public recognition that the banking industry as a primary financial intermediary in a society can and should have a vital role to play in helping create greater access to a society’s financial resources and financial markets for previously excluded societal groups. However, this role should not be forged at the expense of distorting or significantly delimiting free market and competitive economic forces.

Second, with respect to these financial institutions and markets, a government’s primary concerns should be “safety and soundness” and “economic competitiveness”. In this respect whatever role these institutions and markets are to play in creating greater access for the previously disenfranchised needs to be constructed and effected in a manner consistent with prudential considerations and modern economic realities. On the one hand, private institutions and markets should not be transformed into public institutions and should not be over-laden with “governmental social responsibilities”. On the other hand, these institutions and markets must remain primarily driven by market forces, as in the long-term this will be in the society’s long-term-best interest. Also, these institutions and markets should not be led into practices that will jeopardize a “safe and sound prudential floor” or that will “up the ante” in prudential terms (for example, creation of greater obstacles to compliance with a Basle-based risk capital system).

Third, it should not be forgotten that an overly intrusive government into the private economic sector most likely will lead to counterproductive results (internally and internationally) and to greater costs and burdens for the private sector. What South Africa and Southern Africa need are vibrant, market-responsive and internationally credible financial institutions and markets.

4 Concluding observations

The future for the South African and Southern Africa economies will rest, to a significant degree, upon viable, competitive and economically growing private financial institutions and markets. This will require a large measure of economic discipline and of governmental “level-headedness” in not unduly intervening into or unduly burdening the ongoing development of these institutions and markets. Clearly, moving toward a convergence with the international Basle standards as to banking appears essential.

Yet, at the same time, the local and foreign investing financial institutions should recognize a manageable, but contributing role in providing a broader societal-based access to these institutions and financial markets. The Botshabelo Accord represents an “informal partnership” among government, the banking industry, and diverse affected interest groups. Such an approach, along with a heightened sense of self-enlightenment, self-direction, and ongoing self-assessment by the banking industry in Southern Africa, appears to be the type of excessive “proactive” strategy that will bring better long-term societal results than an approach of excessive governmental intervention into, and participation of, private economic activities and markets in pursuit of these societal goals.
SAMEVATTING

SENTRALE TOESIG OOR SUID-AFRIKAANSE BANKWESE OP DIE KRUISPAD

Die outeur bespreek aan die hand van die mees resente wysigings aan die Amerikaanse wetgewing oor banktoesig die slaggate wat vir die Suid-Afrikaanse ekonomie en dus ook die heropbou en ontwikkelingsprogram van die regering geleë sou wees in 'n onoordeelkundige verabsolutering van sentrale toesig oor die vryemark meganismes ten aansien van die leningsbankpraktyk indien dit gepaard sou gaan met 'n inmenging in en totale negering van die tersake markkragte.

Die weg van 'n industrie gedrewe "vrywillige" samewerking van die kant van die bankwese om bydraes tot die ontwikkeling van minder welaf dele van die gemeenskap te maak, borg volgens die outeur 'n veel groter kans op sukses binne die Suid-Afrikaanse konteks as die klakkelose na-aap van die Amerikaanse wetgewing gemik op dwangmatige uitwissing van sogenaamde diskriminerende leningspraktyke.

Die outeur toon dat selfs binne die Amerikaanse model steeds ruimte behoort te bestaan vir erkenning van diskriminerende resultate mits dit op gesonde ekonomiese beginsels gebaseer sou wees, soos die verhoogde kredietverskaffingsrisiko indien die kredietopnemer 'n ekonomies beduidend slechter kredietrisiko sou wees.
EXTERNAL AND INTERNAL CROSSROADS FOR BANKING SUPERVISION

Diagram One

International Bank Supervision
Basle Committee
(OECD countries)

IOSCO
(securities)

TRI-PARTITE COM
(insurance)

IASC
(accounting)

Other Groups
- Offshore
- Middle East
- Nordic
- Carribean
- Latin America
- E & S Africa
- W & C Africa

Independent
- Taiwan
- Korean
- South Africa
- etc.

EC
2nd Directive
Capit. Direct.
Pru Sup Direct
Cons Super

Wider Europe
- EEA
- CEE

ECO
Training
Education

Contact Group
Overlapping Members

4 Members

FRB, OCC, FDIC, OTS

IMF
World Bank
Reg Banks
SAP's

Emerging

Developing

Transit

US
IBA FBSEA
ILSA

Western Hem.
NAFTA
C & SAM

Bilateral
Consult

MS
Other

UK

Notes

EC = European Community
MS = Member States
UK = United Kingdom
EEA = European Economic Area
CEE = Central and Eastern Europe
OECD = Organisation for Economic Cooperation and Development
US = United States
IBA = International Banking Act
FBSEA = Foreign Bank Supervision Enhancement Act
ILSA = International Lending Supervision Act
NAFTA = North American Free Trade Agreement
C&SAM = Central and South America
IOSCO = International Organisation of Securities Commissioners
IASC = International Accounting Standards Committee
IAF = International Accounting Federation
IMF = International Monetary Fund
Reg = Regional
SAP = Structural Adjustment Program
FRB = Federal Reserve Board of Governors
OCC = Offices of Comptroller of the Currency
FDIC = Federal Deposit Insurance Corporation
OTS = Office of Trust Supervision
Transit = Transitioning Economies

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