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REDLINING, DISINVESTMENT AND THE ROLE OF MUTUAL SAVINGS BANKS: A SURVEY OF SOLUTIONS

I. Introduction

In recent years, a fierce debate has arisen over the practice of redlining¹ in mortgage lending. As a result of this debate, numerous studies have been made,² state and federal legislation has been

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1. "Redlining" is best defined as:

[T]he denial of mortgage credit on properties located in certain geographic areas even though the market value of the property is sufficient collateral and the applicant is creditworthy, or the approval of mortgage credit on less favorable terms than those granted on properties located in other areas even though the market value of the property and the creditworthiness of the borrower are similar.

R. SCHAFER, MORTGAGE LENDING DECISIONS: CRITERIA AND CONSTRAINTS 1-10 (1978) JOINT CENTER FOR URBAN STUDIES OF THE MASSACHUSETTS INSTITUTE OF TECHNOLOGY AND HARVARD UNIVERSITY [hereinafter cited as SCHAFER]. This definition will be referred to in this Comment as redlining in the "strict sense" of the word.

The arbitrary criteria used by mortgage lenders to refuse loans may include not only the race of residents in a neighborhood, but other factors such as the age of the housing stock, and the location of the neighborhood. NYPIRG, SQUEEZING US DRY: BANK REDLINING IN THE BRONX 2 (1978) [hereinafter cited as SQUEEZING US DRY]. SCHAFER *supra*, at 13-4.

Methods by which loans may be effectively refused include: shortening the mortgage term; raising the interest rate; requiring a higher down payment; raising closing costs; refusing to approve loans for less than a certain minimum amount; lowering the percentage of the appraised value for which the loan will be issued or under-appraising the property; requiring the outstanding principal of a "balloon" mortgage to be paid immediately rather than rolling it over or extending such a loan only at an exorbitant rate of interest; charging "front end" fees to the loan applicant; and imposing a "due-on-sale" clause rather than allowing the loan applicant to assume the obligations of an existing mortgage. If an institution habitually employs these practices, people do not even submit applications to it for mortgages. Thus the institution's denial is implicit rather than explicit. NYPIRG, TAKE THE MONEY AND RUN: REDLINING IN BROOKLYN II (1977) [hereinafter cited as TAKE THE MONEY AND RUN]; Werner, Frej & Madway, *Redlining & Disinvestment: Causes, Consequences & Proposed Remedies*, 10 CLEARINGHOUSE REV. 501, 502 (1976); [hereinafter cited as Werner, Frej & Madway]; Note, *Attacking the Urban Redlining Problem*, 56 B.U. L. REV. 989 (1976); Comment, *Red-Lining And The Home Mortgage Disclosure Act of 1975: A Decisive Step Toward Private Urban Redevelopment*, 25 EMORY L. REV. 667, 669-70 n.10 (1976).

2. SCHAFER, *supra* note 1, Werner, Frej & Madway, *supra* note 1, at 501; MIT—HARVARD JOINT CENTER, FINANCIAL INSTITUTIONS AND NEIGHBORHOOD DECLINE: A REVIEW OF THE LITERATURE (1974); NEW YORK STATE BANKING DEPARTMENT, MORTGAGE FINANCING AND HOUSING MARKETS IN NEW YORK STATE: A PRELIMINARY REPORT (1977) [hereinafter cited as N.Y.S. BANKING DEP'T]. See generally G. LEYLAND, DETERMINING PRIORITIES OF NEED FOR GUARANTEED MORTGAGE FUNDS (1976) [hereinafter cited as LEYLAND].

enacted,³ and regulations have been promulgated.⁴ The legislation and regulations, in turn, have caused further controversy because of their ambiguity and lack of a practicable means of enforcement.⁵ In this Comment, current federal and New York State laws and regulations pertaining to redlining and disinvestment will be analyzed. In addition, the current problems facing mutual savings banks, the primary lenders in the mortgage market⁶ will be discussed and their role in the mortgage market will be examined. Finally, proposals for future legislation to remedy the problems of redlining, disinvestment, and the current problems of the mutual savings banks will be discussed.

The word redlining is also used in a broad sense to mean geographic disinvestment.⁷ However, the practice of geographic disin-

3. Home Mortgage Disclosure Act of 1975, Pub. L. No. 94-200, 89 Stat. 1125 (codified at 12 U.S.C. §§ 2801-2809 (1976)); Community Reinvestment Act of 1977, Pub. L. No. 95-128, 91 Stat. 1147 (codified at 12 U.S.C. §§ 2901, 2903-2905 (Supp. II 1978)), 12 U.S.C. § 2902, *as amended* by Pub. L. No. 95-630, § 1502, 92 Stat. 3713 (1978). Act of December 8, 1978, ch. 788, 1978 N.Y. LAWS (codified at N.Y. BANKING LAW § 9-f (McKinney Supp. 1979-1980)).

4. 12 C.F.R. § 345 (1980). Supervisory Procedure G-107 was promulgated pursuant to N.Y. BANKING LAW §§ 10, 36(1), 36(3), 125(2) (McKinney 1971) [hereinafter cited as *Supervisory Procedure G-107*].

5. See notes 14, 15, 24-28, 33-36, 69, 70, 72 *infra*.

6. N.Y.S. BANKING DEP'T, *supra* note 2, at II-1.

7. The terms "redlining" and "neighborhood disinvestment" are often confused. See TAKE THE MONEY AND RUN, *supra* note 1, at ii (1977). SQUEEZING US DRY, *supra* note 1, at 1. Disinvestment refers to depository institutions' use of deposits to make mortgage loans outside the neighborhoods where such deposits are made. Wisniewski, *Mortgage Redlining (Disinvestment): The Parameters of Federal, State, and Municipal Regulation*, 54 J. URB. L. 370 (1977). Disinvestment has also been defined as:

(1) Refusal to make mortgage and home improvement loans to credit-worthy people in those city neighborhoods and older suburbs which are *not* characterized by unusual or excessive risks. (2) Exporting of savings generated from city neighborhoods and older suburbs into other communities where they are invested in residential construction and mortgage loans without first considering the lending needs of older communities. (3) Relocation of associations' home offices out of the older communities and into other areas, usually into newly developing suburbs or "downtown" business centers. (4) Withdrawal of opportunities for residents in older communities to save at neighborhood-based savings and loan associations.

Administrative Meeting on Racial Discrimination in Lending Before the Department of Housing and Urban Development, Hartford, Conn., May 21, 1974 (testimony of Calvin Bradford) cited in Comment, *Urban Housing Finance and The Redlining Controversy*, 25 CLEV. ST. L. REV. 110, 111 n.7 (1976) [hereinafter cited as *Urban Housing Finance*]. The first definition in the quote is synonymous with the definition of redlining. The latter three definitions can also be considered part of a definition of disinvestment. The inclusion of the relocation of financial institutions' home offices from older communities to other neighbor-

vestment does not necessarily include redlining;⁸ therefore, the distinction between these terms will be retained throughout this comment.⁹ In addition, a distinction between redlining and disin-

hoods as part of the definition of disinvestment gives coherence to the methods chosen to enforce the Community Reinvestment Act on both the federal and state levels. See notes 32-34, 75 *infra*.

Depository institutions play a crucial role in maintaining the stability of neighborhoods. The process of "pulling out" of a neighborhood raises the proverbial query of the chicken or the egg. Do banks pull out of a neighborhood first or do landlords and homeowners who participate in a flurry of sales, alerting banks to a perceived decline in the neighborhood? When landlords do pull out of buildings do they cause an actual decline in property value due to their perceived fear of a decline in property value? The process of decline is probably a combination of all of these actions. Wisniewski, *supra* note 7, at 370. Redlining in the strict sense is damaging because it is the process by which banks' predictions of decline become self-fulfilling prophecies. Bankers' fear of decline in a neighborhood is largely the cause of the decline. SQUEEZING US DRY, *supra* note 1, at 2.

Redlining should also be distinguished from discrimination against an individual loan applicant. Again, it is the distinction which makes redlining so damaging. When institutions redline, they reject an entire neighborhood, not just the individual applicant, thereby accelerating the deterioration of the neighborhood. Wisniewski, *supra* note 7, at 370.

8. See note 7 *supra*. Under the definition of redlining which will be used in this Comment, a bank could decide to issue no further loans to a neighborhood based upon the need to diversify its portfolio of mortgage loans. While the decision not to lend would be based upon the location of the property, it would not be an arbitrary criterion in that instance.

9. This article will be based upon the assumption that both redlining and disinvestment exist. Werner, Frej & Madway, *supra* note 1, at 505; Comment, *Redlining: Potential Civil Rights and Sherman Act Violations Raised by Lending Policies*, 8 IND. L. REV. 1045 n.3 (1975). *Urban Housing Finance*, *supra* note 7, at 112-13 n.14.

The prestigious MIT-Harvard Joint Center surveyed all relevant studies and reports available in late 1974 and concluded: "Red-lining—the unavailability of mortgages on the basis of area—although no longer formally practiced, nevertheless is found to be effectively present. A process of disinvestment by local thrift institutions is found to be occurring in many inner-city neighborhoods. . . ." MIT-HARVARD JOINT CENTER, FINANCIAL INSTITUTIONS AND NEIGHBORHOOD DECLINE: A REVIEW OF THE LITERATURE 4 (1974), in *S. 1281 Hearings* at 618, cited in Comment, *Urban Housing Finance and the Redlining Controversy*, 25 CLEV. ST. L. REV. 112-13 n.14 (1976).

Id.

Fourteen Brooklyn-based banks have been chosen for study to evaluate the effectiveness of state and federal legislation prohibiting redlining. The results in a recent study on redlining in New York State were mixed. SCHAFER *supra* note 1, at 3-102. The Crown Heights, East Flatbush and Fort Greene neighborhoods in Brooklyn are among those for which results were mixed. Allegations that the racial composition of the neighborhood was one of the arbitrary criteria used by lenders in discriminating among mortgage applications were contradicted by the results in three metropolitan areas. Yet the results were mixed in the New York-Nassau-Suffolk and Rochester metropolitan areas. *Id.* at 13-5, 13-11. In these areas equivocal results occurred because different segments of the analysis pointed to opposite conclusions. *Id.* at 13-11. In another section of the study, it was found that some but not all the neighborhoods alleged to have been redlined had higher than average default rates. In

vestment, and what will be referred to as "discrimination in the larger sense" or the "multiplier effect of discrimination" will be made.¹⁰

addition, default rates in several areas allegedly not redlined were found to be higher than those in areas alleged to be redlined. *Id.* at 3-102. However, delinquency rates and foreclosure rates were not highly correlated. *Id.* at 3-103. In addition, there was consistent evidence that "default risk [was] not associated with the age of the housing stock within a neighborhood." *Id.* at 3-104.

[Also,] properties located in areas alleged to be redlined [did] not have statistically significantly higher probabilities of delinquency. They also [did] not have more severe delinquencies.

The finding that a default risk [was], in general, unrelated to whether a property [was] located in an area alleged to be redlined reveals the danger of using simple area-specific default rates in the investigation of lending risk. Although the analysis of simple delinquency and foreclosure rates shows that not all areas alleged to be redlined have higher-than-average default rates, enough of these areas have sufficiently high rates to warrant concern over the risk of lending in them. However, the multivariate analysis of default risk suggests that many factors other than location may be responsible for the high delinquency and foreclosure rates that are occurring in these areas. (emphasis added) *Id.* at 3-105—3-106.

These conclusions can be criticized. The study relied upon the subjective perceptions of community organizations and neighborhood residents to identify allegedly redlined neighborhoods rather than objective criteria. *Id.* at 13-5. These perceptions are in all likelihood biased and may further be inaccurate. Yet redlining may still objectively exist. The results of the study, however, strongly supported the allegations that the race of an applicant is a crucial factor in lending decisions in New York State. *Id.* at 13-11.

In other studies stronger conclusions with respect to the existence of redlining have been reached.

Stuyvesant Heights is a stable, all black neighborhood with very high rates of homeownership that has been more than 50% black since the late 1930s. [sic] It had a perfect foreclosure record with the ten banks in the last five years, and eighty-one sales last year, yet received only four mortgages.

...
In the Flatbush-East/Flatbush communities . . . the mortgage stock maps indicate a relatively heavy concentration in the past of conventional one-to-four family mortgages; however, on the flow map for the same type of loans there is a large void in the area. . . . The property sales and non-white population change maps show that this is an area of high racial and property turnover. There have been some foreclosures in the past five years but the overwhelming majority of the more than forty census tracts have had no foreclosures. NEW YORK STATE BANKING DEPARTMENT: MORTGAGE REFINANCING AND HOUSING MARKETS IN NEW YORK STATE: A PRELIMINARY REPORT IV-E-10, IV-E-12 (1977) [hereinafter cited as N.Y.S. BANKING DEP'T]

See also G. LEYLAND, DETERMINING PRIORITIES OF NEED FOR GUARANTEED MORTGAGE FUNDS 1-3 (1976).

10. The latter will be defined as discrimination in employment and/or housing, which causes people to earn lower salaries and obtain poorer quality housing than would be obtained by those against whom no discrimination has been practiced. As a result, those against whom discrimination has been practiced live in neighborhoods which would truly be

II. Current Legislation

A. The Home Mortgage Disclosure Act of 1975

In 1975 Congress enacted the Home Mortgage Disclosure Act ("HMDA").¹¹ The Act requires depository institutions to make public the location and amount of mortgage loans issued by depository institutions each year. Using this information, public officials can then determine whether the depository institutions are fulfilling their obligations to serve the housing needs of the neighborhoods in which they are located.¹²

The HMDA was adopted in response to intense lobbying efforts by a national federation of community groups, organized to eliminate redlining.¹³ However, the HMDA fails to achieve the ultimate goal of these groups for two reasons. First, the HMDA imposes no duty upon banks to refrain from redlining or disinvestment.¹⁴ Second, neither the HMDA nor the regulations promulgated pursuant to it proscribe any sanctions for noncompliance with the disclosure requirements.¹⁵ Congress merely intended to mandate disclosure of loan statistics in the hope that depositors would invest their funds in an institution which had demonstrated in the past that it has reinvested depositors' funds in the community.¹⁶ However, the HMDA only requires that the loan statistics be made available upon the request of interested citizens.¹⁷ Therefore, because this

considered bad risks by mortgage lenders. There is a "multiplier effect" when a person is paid a lower salary than he should receive because of employment discrimination, and can only obtain poor quality housing. This Comment is also based upon the assumption that "discrimination in the larger sense" is practiced. See Civil Rights Act of 1964, Pub. L. No. 88-352, 78 Stat. 255 (codified at 42 U.S.C. 2000e-2 (1976)) as amended by Pub. L. No. 92-261, 86 Stat. 109 (1972); Fair Housing Act of 1968, Pub. L. No. 90-284, 82 Stat. 81 (codified at 42 U.S.C. 3601 (1976)); An Act of April 13, 1951, ch. 800, 1951 N.Y. Laws (codified at N.Y. EXEC. LAW § 296 (McKinney 1972)).

11. 12 U.S.C. §§ 2801-2809 (Supp. 1976).

12. *Id.* § 2801(b).

13. NYPIRG, TAKE THE MONEY AND RUN: REDLINING IN BROOKLYN, TWO YEARS LATER 2 (1979) [hereinafter cited as TWO YEARS LATER].

14. See 12 U.S.C. §§ 2801-2809 (Supp. 1976).

15. *Id.* See 12 C.F.R. § 203 (1980).

16. See H.R. Rep. No. 94-561, 94th Cong., 1st Sess. (1975); H.R. Rep. No. 94-10024, 94th Cong., 1st Sess. (1975); H.R. Rep. No. 94-726, 94th Cong., 1st Sess. (1975); S. Rep. No. 94-187, 94th Cong., 1st Sess. (1975); S. Rep. No. 94-533, 94th Cong., 1st Sess. (1975); 121 Cong. Rec. for the following days: July 26, 1975; Sept. 4, 1975; Oct. 30, 1975; Oct. 31, 1975; Dec. 15, 1975; Dec. 18, 1975.

17. 12 C.F.R. § 203.4 (a)(2)(i)-(ii) (1980).

information is not widely disseminated, even this hoped for depositor action is unlikely to materialize.¹⁸

B. The Community Reinvestment Act of 1977

In 1977, Congress enacted the Community Reinvestment Act ("CRA").¹⁹ The purpose of the CRA is to "encourage [financial] institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions."²⁰ These institutions "are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business" and they have a "continuing and affirmative obligation to help meet [such] needs."²¹ In short, the CRA reaffirms the traditional role of the mutual savings banks as well as requiring other depository institutions to help meet the investment needs of their communities.²² In addition, the CRA requires these institutions to meet the credit needs of the entire community, including low- and moderate-income neighborhoods.²³

The language used in the CRA is unclear. The CRA does not specifically prohibit redlining, because it does not prohibit a bank's arbitrary refusal of a prudent mortgage loan on the basis of the location of the property for which the loan is to be issued.²⁴ Instead the language of the CRA mandates reinvestment.²⁵ Congress' intent in enacting the CRA supports this interpretation.²⁶ This lat-

18. Only community groups, legislators and analysts rather than the general public have taken advantage of this availability. *SQUEEZING US DRY*, *supra* note 1. *TAKE THE MONEY AND RUN*, *supra* note 2. *SCHAFER*, *supra* note 1. See S. HIRSCH, *MORTGAGE LENDING PRACTICES OF SAVINGS BANKS IN NEW YORK STATE* (1979) [hereinafter cited as *HIRSCH*].

19. 12 U.S.C. § 2901 (Supp. II 1978).

20. *Id.* § 2901.

21. *Id.*

22. See note 176 *infra*.

23. 12 U.S.C. § 2903(1) (Supp. 1969-1979).

24. See note 1 *supra*. A statute prohibiting redlining could use language of proscription and define redlining as discrimination, based upon the location of property being used as security for a loan.

25. See notes 20, 21, 23 *supra*. Under the CRA, the banks have an obligation to serve their communities credit needs. 12 U.S.C. § 2901 (Supp. 1969-1979). This is language of prescription rather than of proscription.

26. See Cong. Rep. No. H.R. 6655, *reprinted in* Cong. Rec. H10097 (daily ed. Sept. 26, 1977); Cong. Rec. H10564 (daily ed. Oct. 4, 1977); Cong. Rec. S16112 (daily ed. Oct. 1, 1977). The legislative history indicates that Congress only intended the CRA to embody a nation-

ter interpretation of the CRA is the more radical one. Rather than just prohibiting discrimination, the CRA imposes upon the private sector an obligation to society.²⁷

While the CRA, like the HMDA, contains no specific means of enforcement,²⁸ regulations promulgated pursuant to the CRA do include enforcement provisions.²⁹ Under these regulations, a banking institution must survey the neighborhood surrounding its home

wide policy of community reinvestment.

27. The private business sector's moral obligations to the public have been the subjects of controversy in the past. See *Peck v. Greyhound Corp.*, 97 F. Supp. 679 (S.D.N.Y. 1951). In *Peck*, it was held that a recommendation by shareholders that the management of Greyhound should consider abolition of the segregated seating system on buses in the south was not a proper subject for shareholder action. *Id.* See 17 C.F.R. § 240.14a-8(c)(2) (1952) (repealed 1979). Under this rule a proposal was not a proper subject for shareholder action "[i]f it clearly appears that the proposal is submitted by the security holder . . . primarily for the purpose of promoting general economic, political, racial, religious, social or similar causes." *Id.*

Depository institutions have argued that being forced to invest in their local communities, subjects their depositors' funds to greater risk, because their portfolios will no longer be diversified. CUTLER, *History, Character and Recent Difficulties of Mutual Savings Banks, PUBLIC POLICY TOWARD MUTUAL SAVINGS BANKS IN NEW YORK STATE: PROPOSALS FOR CHANGE* 33, 106 (L. Lapidus ed. 1974) [hereinafter cited as CUTLER]. One commentator has argued that if Congress intended to mandate reinvestment, this policy may be unconstitutional. Givens, *The "Antiredlining" Issue: Can Banks Be Forced to Lend?*, 95 BANKING L.J. 515, 520-525 (1978). If the "safe and sound" investment language of the CRA is not read to require reinvestment only where the return and risk are as good as otherwise obtainable, the CRA may be unconstitutional for three reasons. First, the reinvestment provisions may constitute an uncompensated taking thereby violating both state and federal due process clauses. *Id.* at 521. If "sound operation" means obtaining the best return on investment, it may also be relevant to state or local reinvestment requirements that go beyond barring redlining in the narrow sense. Alternatively, "sound operations" may merely require local investment where equally favorable from the viewpoint of risk and return. *Id.* Second, the reinvestment requirement may also violate the commerce clause as local regulation which favors local economic interests at the expense of the free flow of commerce. *Id.* See *Philadelphia v. New Jersey*, 437 U.S. 617 (1978); *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976). In addition, the CRA, when applied to nationally chartered institutions may further conflict with the commerce clause, in that "Congress' intent was that these institutions fulfill a national function in making credit and investment available on a national scale as part of a countrywide interlocking system." Givens, *supra*, at 524. At the same time, if the reinvestment provisions of the CRA were held inapplicable to federally chartered institutions, state chartered institutions would be at a competitive disadvantage. *Id.* at 525.

Finally, the CRA reinvestment requirements may violate the contract clause of the federal Constitution. When depositors and stockholders invest in an institution, there is an implied contract that those funds be deposited or invested in a prudent manner. Forced reinvestment may impair the ability of banks to meet this obligation. *Id.* at 523.

28. See 12 U.S.C. §§ 2801-2809 (Supp. 1976); 12 U.S.C. §§ 2901-2905 (Supp. II 1978).

29. 12 C.F.R. § 345 (1980).

office and branches and draft a statement, known as the Community Reinvestment Act Statement ("CRAS") which describes the physical boundaries of the area the bank will serve and identifies the credit services and terms it is prepared to offer in this area.³⁰ The appropriate federal financial supervisory agency, normally the Federal Home Loan Bank Board in the case of mutual savings banks, is required to assess the institution's record of meeting the local credit needs of its "entire community."³¹ The agency must then use this information to determine whether to grant an institution's application for a charter, for participation in deposit insurance, for a new branch or a relocation, merger, consolidation, or acquisition of shares in a bank holding company.³² If the agency determines that the bank has not met the credit needs of its community, it must deny the application.

In addition to the problems created by the ambiguities in the language of the CRA, other problems are created by the means of enforcement. The appropriate agency can only review a bank's community reinvestment performance when a bank applies for a charter, for permission to open a new branch or to merge with another bank, or for permission to engage in similar activities. This means of enforcement can be used often, because banks continually branch or merge with other banks to survive. However, these agencies have no other means of compelling banks to change their investment behavior.³³ In addition, an individual applicant for a mortgage loan who thinks he has been refused a loan because of redlining has no civil redress.³⁴

Banks often evade the purpose of the CRA. Banks define the local communities which they serve either so narrowly that they serve only those communities which they wish to serve,³⁵ or so broadly that it is difficult to attribute reinvestment to any particu-

30. *Id.* § 345.4.

31. *Id.* § 345.7.

32. *Id.* § 345.8.

33. *See* 12 C.F.R. § 345 (1980).

34. *Id.* Allowing an individual redress is only necessary if the CRA was intended, at least in part, to prevent redlining.

35. The New York State Banking Department has sometimes asked a bank to redefine its local community in its CRA statement to include a larger area, before the Department would approve an application for a new branch, or for a merger, etc. Interview with a member of the New York State Banking Department (Sept. 12, 1980). *See* note 75 *infra*.

lar community or neighborhood.³⁶ In addition, while federal regulatory agencies appear to have used the regulations promulgated under the CRA as effectively as is possible,³⁷ changes in banks' lending patterns have been slow. It is clear that while banks have reversed their patterns of mortgage investment as a whole, they have not changed their lending patterns substantially in neighbor-

36. For example, in its CRA statement, the Dime Savings Bank of New York defines its local community for the purposes of the CRA, as approximately the center third of Manhattan and all of Brooklyn, Staten Island, Nassau and Suffolk counties and part of Queens. Community Reinvestment Act Statement, The Dime Savings Bank of New York (Feb. 2, 1979).

37. In April 1979, the Federal Depositors Insurance Corporation (FDIC) was the first agency to reject an application because a bank had failed to meet the reinvestment requirements of the CRA. *TWO YEARS LATER*, *supra*, note 13, at 5. Federal agencies have not refused any other applications in New York for noncompliance with the CRA. The FDIC recently rejected a second application in New Jersey, and has denied other applications in other regions. The FDIC does not have records of the number of applications received and their disposition. Interview with Cynthia Lewis, Regional Advisor for Community Affairs, FDIC, in New York City (Oct. 2, 1980). However, regulatory agencies and community groups often negotiate compromises with banks whose applications they have challenged. Once a compromise is reached, the bank's application is approved. See note 75 *infra*.

hoods which have been alleged to be redlined.³⁸ The more subtle change has been in the attitudes of both the banks and the agencies regulating them.³⁹

38.

	1977**		1978**		1979**	
	Redlined*	Non-Redlined	Redlined	Non-Redlined	Redlined	Non-Redlined
Dime of New York	1109	31,209	1341	33,110	3150	51,699
Lincoln	—	—	1366	8730	540	8236
Greater New York	492	1093	1873	6816	5059	24,443
Williamsburgh	—	—	2255	9040	1712	4934
Brooklyn	690	2062	2542	6429	3498	6897
Anchor	38	1737	334	15,472	102	6483
Metropolitan	2013	8289	—	—	387	12,926
Greenpoint	—	—	267	18,227	80	10,467
Independence	2976	3519	3451	3274	6375	6777
Franklin Savings	72	253	0	987	28	8118
East New York	502	1910	0	111	116	995
Hamburg	503	2534	53	1845	0	364
Roosevelt	46	709	45	2403	72	4710
Dime of Williamsburgh	722	991	44	2124	168	564

Dollar amounts are in thousands

*For the purposes of this study the following neighborhoods are considered to be redlined: Boerum Hill, Brooklyn Heights, Carroll Garden Clinton Hills, Cobble Hill, Downtown Brooklyn, Fort Greene, Gowanus, Crown Heights, East Flatbush, Park Slope. See Schafter, *supra* note 1 at vi. The statistics from each census tract were aggregated into neighborhoods. The boundary lines of the neighborhoods are both historical and subjective views of where these neighborhoods are. COOPERATIVE COMMUNITY PLANNING, NEW YORK CITY DEPARTMENT OF CITY PLANNING, *Neighborhood Profiles* (Aug. 1978).

**See *Supervisory Procedure G-107*, *supra* note 4, at Appendix 9, 1977, 1978.

***The source of this information is a New York State Banking Department print-out of statistics from the real estate register of each borough, aggregated into neighborhoods, for 1979.

†All of the banks, except the Franklin Savings Bank, are considered to be based in Brooklyn by the New York State Banking Department. The Franklin Savings Bank was also included because, while it is Manhattan-based, over a third of its deposits are from Brooklyn neighborhoods. Two Years Later, *supra* note 13 at 11.

While the number and dollar amount of loans to redlined neighborhoods increased three-fold from 1977 to 1979, two-thirds of the total was in Park Slope, a former Italian neighborhood which is now being flooded with young professionals from Manhattan, and Brooklyn Heights, a neighborhood included by community groups as part of central Brooklyn, which traditionally has been an upper middle-class white neighborhood. The figures for Metropolitan and Fulton Savings Banks are combined for 1977 and 1978. Fulton Savings Bank merged into Metropolitan Savings Bank, therefore, 1979 figures are for Metropolitan only.

39. The FDIC's rejection of a New Jersey bank's application was the first application

C. New York's Equivalent "HMDA" Regulations

A state-chartered depository institution is exempted from the requirements of the HMDA, if the Board of Governors of the Federal Reserve System determines that under state law, the institution is subject to requirements similar to those of the HMDA.⁴⁰ The New York State Banking Department promulgated Supervisory Procedure G-107 which exempts state-chartered banks from the federal reporting requirements.⁴¹

In Appendix 9, under the G-107 regulations, a bank must report the number and dollar amount of mortgage loans by census tract or ZIP code.⁴² Banks must make this information available to the public under a format prescribed by the regulation and must submit this information to the Banking Department no later than August of the year following the calendar year to be reported.⁴³

In Appendix 7 which is entitled the "Equal Housing Opportunity Lender Form,"⁴⁴ a banking organization must record all loan applications, the reasons for granting or denying each application, and the terms of those approved.⁴⁵ A bank must also answer questions about the loan applicant's creditworthiness, and about his race and marital status.⁴⁶ This information is not disclosed to the public. It is for the use of the Banking Department only, and its

which was not challenged by a community group. For the first time, members of the FDIC placed the onus of enforcing the law upon themselves, not upon community groups. Interview with Cynthia Lewis, Regional Advisor for Community Affairs, FDIC, in New York City (Oct. 2, 1980). Just scheduling a proceeding to hear testimony about a bank's record has a psychological impact on banks. Community groups have stated that banks would not talk to them until a proceeding was scheduled. *Id.*; *TWO YEARS LATER*, *supra* note 13, at 4. The FDIC has been able to facilitate negotiations between banks and community groups and establish communications where previously there were none. Prior to the CRA, the FDIC and other regulatory agencies condoned the practice of taking money out of bad areas for the sake of safety. Now, some bankers see the eventual possibility of making money. One also cannot emphasize just mortgage loans. For example, one must also look at banks' records of investment in participation loans, in rehabilitation, and section eight housing, when gauging the changes in the community. Interview with Cynthia Lewis, Regional Advisor for Community Affairs, FDIC, in New York City (Oct. 2, 1980).

40. 12 U.S.C. § 2805(b) (Supp. 1976).

41. *See Supervisory Procedure G-107*, *supra* note 4; Regulation C, 12 C.F.R. Part 203 (1980).

42. *Supervisory Procedure G-107*, *supra* note 4, § 107.2(b)(1),(2).

43. *Id.* § 107.2(a).

44. *Id.*, Appendix 7 at 5.

45. *Id.*, § 107.7, Appendix 7, Part III, at 8.

46. *Id.*, Appendix 7 at 5, Part I.

purpose is to "insure that discrimination in housing mortgage credit does not occur."⁴⁷

The M2 record in Appendix 8 of the G-107 format, requires banking organizations to keep records of the number and dollar amount of mortgaged properties in each census tract or ZIP code which currently are being foreclosed. Records must also be kept of those properties which have been foreclosed in the last fiscal year and of those which have been foreclosed in the last five fiscal years.⁴⁸ Banks must also keep records of the number and dollar amount of delinquent payments on mortgaged properties,⁴⁹ and of the number and dollar amount of distressed properties for which loans have been renegotiated prior to maturity, sold at a loss or written off, in the last five fiscal years.⁵⁰ Finally, records of the average terms of the loans granted in the last fiscal year must be kept. The terms required are the average ratios of the original loan amount to the original appraisal amount, the average rate of interest on loans granted, and the average maturity of loans granted in the last fiscal year.⁵¹ This information must be made available to the public.⁵²

Prior to the enactment of the HMDA and the G-107 Supervisory Procedure, information on the number and dollar amount of loans and their location could only be obtained with a substantial amount of time and effort.⁵³ Now this information is readily avail-

47. *Id.*, Appendix 7 at 5. See *Supervisory Procedure G-107*, *supra* note 4, §§ 107.6, 107.7, 107.8.

48. *Id.*, Appendix 8, (e), M2 at 3(b)(1)-(2), (f)(1)-(2), (g)(1)-(2), 4(b)(1)-(2), (f)(1)-(2), (g)(1)-(2), 5(b)(1)-(2), (f)(1)-(2), (g)(1)-(2), 6(b)(1)-(2), (f)(1)-(2), (g)(1)-(2), 7(b)(1)-(2), (f)(1)-(2), (g)(1)-(2), 8(b)(1)-(2), (f)(1)-(2), (g)(1)-(2).

49. *Id.*, Appendix 8, (e), M2 at 3(c)(1)-(2), 4(c)(1)-(2), 5(c)(1)-(2), 6(c)(1)-(2), 7(c)(1)-(2), 8(c)(1)-(2).

50. *Id.*, Appendix 8, (e), M2 at 3(h)(1)-(2), 4(h)(1)-(2), 5(h)(1)-(2), 6(h)(1)-(2), 7(h)(1)-(2), 8(h)(1)-(2).

51. *Id.*, Appendix 8, (e), M2 at 3(i)(3)-(5), 4(i)(3)-(5), 5(i)(3)-(5), 6(i)(3)-(5), 7(i)(3)-(5), 8(i)(3)-(5).

52. *Id.* § 107.6.

53. Before the HMDA and the G-107 Supervisory Procedure were enacted, community groups examined local real estate registers to determine in what neighborhoods banks had issued mortgage loans and to determine the types of loan issued. From the registers they could also determine demand, by counting the number of loans financed by the seller himself (a purchase money mortgage) or by other private lending institutions. However, obtaining this information was a time consuming job for groups which were understaffed and underpaid, if paid at all. *TWO YEARS LATER*, *supra* note 13, at 2-3.

able to the public in a format which is easy to understand.

However, there are three criticisms of the present G-107 format. First, while the number and dollar amount of mortgage loans can be obtained from a real estate register either the same day or a few days after the loan is closed,⁵⁴ under Supervisory Procedure G-107, this information cannot be obtained month by month, but rather by the entire year and only nine months after the end of the year.⁵⁵ Second, under the present G-107 format, the Banking Department does not require banks to divide the data on the number and dollar amount of mortgage loans issued for multi-family dwellings into initial or first mortgages on the building, and mortgage loans refinancing the building.⁵⁶ Refinancing of loans to multi-family dwellings is as crucial to the economic stability of a neighborhood as an initial mortgage loan.⁵⁷ However, this aspect of the mortgage market is hidden. Refinancing is often ignored in studies, because loans refinancing apartment buildings are not recorded since no property transaction takes place. Further, under the present procedure, loans to apartment buildings are not divided into these two categories.⁵⁸ Third, the Banking Department presently does not make Appendix 7 public.⁵⁹ The information in this appendix could contain proof of two types of discrimination. First, it could be used to prove discrimination against an individual applicant.⁶⁰ Second, in combination with Appendix 8, it could be used to prove the existence of redlining.⁶¹ To prove redlining, information from both

54. Interview with Office Associate of the Brooklyn City Register, in New York City (Sept. 12, 1980). Title companies report property transactions either every day or every few days. The City Register is required by law to record the transaction on the day it receives notice of the transaction. *Id.*

55. *Supervisory Procedure G-107*, *supra* note 4, § 107.2(b)(1),(2).

56. *Id.* at Appendices 8-10.

57. See *TWO YEARS LATER*, *supra* note 13, at 8-9.

58. *SCHAFER*, *supra* note 1, at 3-82—3-83.

59. *Supervisory Procedure G-107*, *supra* note 4, Appendix 7 at 5. See *Supervisory Procedure G-107*, *supra* note 4, at §§ 107.6, 107.7, 107.8.

60. See notes 45, 46 *supra* and accompanying text. It is unlikely that a loan officer would explicitly state that he denied a loan or granted one with modified terms for discriminatory reasons; however, if an applicant is creditworthy, even an evasive or vague statement of reasons for the denial or modification may provide circumstantial evidence of discrimination.

61. See notes 48-50 *supra* and accompanying text. Ironically, the information in Appendix 8 in and of itself could contain strong circumstantial evidence of geographic discrimination, yet community groups do not use it in their studies. See *TWO YEARS LATER*, *supra* note

appendices would be necessary. First, one would have to show that the rate of foreclosure and delinquent payments are no higher in the neighborhood for which the loan is sought than in neighborhoods where the creditor regularly grants loans, and second, that the loan applicant is creditworthy. Other information in Appendix 7 could also be helpful in proving redlining. Appendix 7, as opposed to Appendix 8, contains information on the modification of terms of specific loans and on the loan-to-appraised value ratio of particular properties rather than an average of terms for all loans within a ZIP code or census tract.⁶²

D. Chapter 788 of the New York State Banking Law

In December 1978, the New York state legislature enacted chapter 788 of the New York Banking Law,⁶³ which prohibits geographic discrimination in mortgage lending. Pursuant to chapter 788, no banking institution may refuse to make a prudent mortgage loan "or otherwise discriminate with respect thereto," because of the geographic location of property "if such property is located within the geographic area ordinarily serviced by such bank or within the community within which the principal or any branch office of such bank is located."⁶⁴ A prudent loan means "a loan upon the security of real property which is prudent by acceptable banking standards and is in compliance with all of the provisions of this chapter, regulations of the banking board and rules of the superintendent."⁶⁵

In contrast to the CRA, the language of chapter 788 prohibits rather than mandates certain behavior by a bank.⁶⁶ More importantly, chapter 788 explicitly prohibits discrimination.⁶⁷ Chapter 788 could be interpreted as preventing disinvestment as well; if a

13, at 11; *SQUEEZING US DRY*, *supra* note 1, at 6.

62. Compare *Supervisory Procedure G-107*, *supra* note 4, Appendix 8, (e), M2, 3(i)(3)-(5), 4(i)(3)-(5), 5(i)(3)-(5), 6(i)(3)-(5), 7(i)(3)-(5), 8(i)(3)-(5) with Appendix 7, Part III, *Disposition of Mortgage Loan Applications* at 8.

63. N.Y. BANKING LAW § 9-f (McKinney Supp. 1979-1980).

64. *Id.* § 9-f(1).

65. *Id.* § 9-f(3).

66. See notes 20, 21 and 66 *supra*. Each bank has a continuing and affirmative obligation to meet the credit needs of their local communities under the CRA. Under chapter 788, no bank may refuse a prudent loan or otherwise discriminate with respect to such a loan. N.Y. BANKING LAW § 9-f(1) (McKinney Supp. 1979-1980).

67. N.Y. BANKING LAW § 9-f(1) (McKinney Supp. 1979-1980).

bank decides to make no further loans in an area in order to diversify its portfolio, it would make the decision based upon the location of the property.⁶⁸ However, because the word "discrimination" is used in the statute and is coupled with language proscribing discrimination rather than mandating investment, the intent of chapter 788 to prohibit redlining is clear.

The term "prudent loan," however, as defined under chapter 788 is as ambiguous as the term "safe and sound operation" under the CRA.⁶⁹ It is unclear in both the CRA and chapter 788 whether a prudent or safe loan is one which involves no risk or a slight risk, or whether such a loan must be the most profitable loan which the bank can make at that time.⁷⁰

The state legislature included a practicable means of enforcement in chapter 788. A person refused a mortgage loan can request that the superintendent of banks review the denial. The superintendent can require a lender who has allegedly violated chapter 788 to appear before him with an explanation of the denial, and can order the lender to discontinue the practice. The superintendent may also, after notice and a hearing, require the lender to pay a fine for each violation.⁷¹ However, an individual has no civil remedy under chapter 788.⁷²

E. New York's Equivalent "CRA" Regulations

The state banking department has also adopted regulations which incorporate the federal CRA regulations into its state guidelines for evaluating a bank's application for a new branch, for merger with another institution, or for similar activities.⁷³ In addition, chapter 788 requires banking institutions to submit CRA reports to the superintendent of the New York State Banking De-

68. CUTLER, *supra* note 28, at 106; see notes 7 and 8 *supra* and accompanying text.

69. N.Y. BANKING LAW § 9-f(3) (McKinney Supp. 1979-1980); 12 U.S.C. § 2901 (Supp. 1969-1979).

70. GIVENS, *supra* note 29, at 520-21.

71. N.Y. BANKING LAW § 39, 44 (McKinney 1971). These are general remedies under which the superintendent of banks has the power to bring suit against a bank for violation of any section of the banking law. See generally N.Y. BANKING LAW § 2 (McKinney 1971).

72. See *id.* §§ 2, 39, 44.

73. General Regulations of the Banking Board §§ 76.1-3, promulgated pursuant to N.Y. BANKING LAW §§ 10, 601-b (McKinney 1971), 14(1), 28-b, 29 (McKinney Supp. 1979-1980) (hereinafter cited as Regulation 76). These regulations became effective on April 23, 1979. SAVINGS ASSOCIATION NEWS, March 1979, at 1.

partment as well as to the federal agencies monitoring their compliance with the Act.⁷⁴

Enforcement of state regulations, like that of federal regulations, has not yet caused increases in banks' mortgage portfolios in redlined areas. The New York State Banking Department, like the FDIC, has rejected only one bank's application for non-compliance with the CRA, and has decided in favor of many others, but often with some accommodation by the banks.⁷⁵ Although there has been an increase in the number of loans issued in Brooklyn⁷⁶ in the face of tremendous disintermediation in 1978 and 1979,⁷⁷ the lending patterns of the banks with respect to redlined neighborhoods have not substantially changed.⁷⁸ Although demand has been shown,⁷⁹ and although it has been demonstrated that there is only a slight increase in risk when making loans to these areas, the majority of mutuals studied, do not issue many mortgage loans to the neigh-

74. Ch. 788, 1978 N.Y. LAWS; N.Y. BANKING LAW § 28-b(1) (McKinney Supp. 1979-1980).

75. Sixty-two applications have been accepted by the New York State Banking Department after an initial review, without challenges from any community groups. The Banking Department has rejected only one bank's application. However, there have been 11 challenges by community groups which were either withdrawn by these groups, after a review of the data, or after a settlement was negotiated with the bank. There have been nine bank applications which were accepted in the face of challenges by community groups. Several of these decisions, including those in favor of the Dime Savings Bank of New York and Anchor Savings Banks, were conditional approvals. For example, the Banking Department asked the Seaman's Savings Bank to pledge that it would reinvest all the deposits from its new branch in the community. The Banking Department has asked other banks to redefine the community which it serves or, in the case of the Dime Savings Bank of New York, the Banking Department monitored the bank's lending practices for several months. Three banks whose applications have been challenged by community groups, have not been resolved as of July, 14, 1980.

The Banking Department itself, challenged eight applications which it eventually approved, but with some accommodations by the banks. In three other instances, applications challenged by the Banking Department were not resolved or the challenges were withdrawn by the Department. Interview with a member of the New York State Banking Department, in New York City (Sept. 12, 1980).

76. See note 39 *supra*.

77. See note 167 *infra* and accompanying text.

78. See note 39 *supra* and accompanying text.

79. See note 80 *infra*.

borhoods which community groups cite as being redlined.⁸⁰

F. The Human Rights Law of New York State

The New York State Human Rights Law ("HRL") prohibits discrimination against a person applying for credit on the basis of race, creed, color, national origin, age, sex, marital status, childbearing potential, or disability.⁸¹ The HRL also prohibits discrimination against a class of borrowers on the basis of their creed,

80.

DEMAND FOR LOANS VERSUS LOAN ISSUED BY EACH
BANK IN REDLINED NEIGHBORHOODS IN 1979

Bank	Boerum Hills		Brooklyn Heights		Carroll Garden		Clinton Hills		Cobble Hill		Downtown Brooklyn		Fort Greene		Gowanus		Crown Heights		East Flatbush		Park Slope	
	Loans Issued	Total Demand																				
Dime of New York	167	3,050	122	18,782	452	11,747	134	1,231	298	2,575	53	17,471	353	30,882	0	3,114	613	20,989	20	1,406	908	19,160
Lincoln	61	"	120	"	0	"	0	"	40	"	0	"	0	"	0	"	21	"	0	"	298	"
Greater New York	71	"	61	"	71	"	0	"	0	"	0	"	0	"	88	"	34	"	0	"	4,734	"
Williamsburgh	199	"	30	"	75	"	72	"	25	"	226	"	305	"	65	"	33	"	64	"	618	"
Brooklyn	70	"	1,163	"	510	"	58	"	647	"	0	"	0	"	7	"	0	"	0	"	1,043	"
Anchor	0	"	15	"	0	"	0	"	0	"	0	"	0	"	15	"	23	"	15	"	34	"
Metropolitan	0	"	0	"	75	"	0	"	30	"	0	"	0	"	0	"	204	"	0	"	78	"
Green Point	0	"	0	"	0	"	26	"	0	"	0	"	0	"	0	"	24	"	0	"	30	"
Independence	475	"	1,162	"	1,340	"	170	"	822	"	75	"	240	"	466	"	82	"	0	"	1,543	"
Franklin	0	"	0	"	0	"	0	"	0	"	0	"	0	"	0	"	0	"	0	"	28	"
East New York	0	"	0	"	0	"	0	"	0	"	0	"	0	"	0	"	103	"	0	"	13	"
Hamburg	0	"	0	"	0	"	0	"	0	"	0	"	0	"	0	"	0	"	0	"	0	"
Roosevelt	0	"	0	"	0	"	0	"	0	"	0	"	10	"	0	"	47	"	15	"	0	"
Dime of Williamsburgh	0	"	0	"	0	"	19	"	0	"	0	"	0	"	0	"	0	"	0	"	149	"

Dollar amounts are in thousands

Source: New York State Banking Department print-out of statistics from the real estate register of each borough, aggregated into neighborhoods in 1979.

81. N.Y. EXEC. LAW § 296-a (McKinney 1972). (Sections 296-a, 297, 297-a will be cited hereinafter as N.Y. HUMAN RIGHTS LAW § 296 in the text.)

color, national origin, age, sex, marital status, childbearing potential or disability.⁸² While the HRL does not prohibit redlining, it will be discussed as a prototype upon which future legislation prohibiting redlining should be based.

Under the HRL an aggrieved party has two possible administrative remedies. The party may file a complaint with the Human Rights Division of New York or with the New York State Banking Department.⁸³ If a complaint is filed with the human rights division and the division finds that there is probable cause to believe that the allegation is true, it may attempt to eliminate the unlawful discriminatory practice by conference, conciliation and persuasion.⁸⁴ If the complainant objects to the agreement reached as part of this conference, the division must schedule a public hearing before a hearing examiner.⁸⁵ The hearing examiner, at his discretion may allow intervention by any party with a substantial personal interest and may join necessary parties.⁸⁶ The examiner also may enter a default judgment if a bank fails to answer the complaint.⁸⁷ If the hearing officer finds that the bank engaged in a discriminatory practice, the hearing officer may issue: (1) an order requiring the bank to cease and desist from the practice; (2) an order requiring the bank to take affirmative action to effect the purposes of the law, or (3) the hearing officer may require the bank to pay the aggrieved party compensatory damages, and/or require the bank to turn over to the state any profits obtained through the unlawful discriminatory practice.⁸⁸

If, after such an order, the commissioner of human rights deter-

82. *Id.* § 296-a(1)(a). Under a similar federal regulation, creditors are prohibited from discriminating against an applicant, regarding any aspect of the credit transaction on the basis of race, color, religion, national origin, sex, marital status, or age (provided that the applicant has the capacity to enter into a binding contract) or due to the fact that all or part of the applicant's income derives from any public assistance program, or the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act or any State law upon which an exemption has been granted by the Board. 12 C.F.R. § 202.4, 202.2(2) (1980).

83. N.Y. BANKING LAW § 9-d (McKinney Supp. 1979-1980); N.Y. EXEC. LAW § 296-a (McKinney Supp. 1972-1979).

84. N.Y. EXEC. LAW § 297(3)(a) (McKinney 1972).

85. *Id.* §§ 297(2)(b),(4)(a).

86. *Id.* § 297(4)(a).

87. *Id.* § 297(4)(b).

88. *Id.* § 297(4)(c).

mines that the bank is acting in a manner which renders the order ineffectual, the commissioner may apply to a state supreme court for an order to show cause why the bank should not be enjoined from such action.⁸⁹ However, within a year after the conciliation agreement or order, the commissioner of human rights must take action to assure compliance with his order, if he finds upon investigation that the bank has not complied with the agreement or order.⁹⁰

An aggrieved person's alternative administrative remedy is to lodge a complaint with the superintendent of the banking department.⁹¹ The superintendent, like the commissioner of human rights, may attempt to resolve the complaint by conference and conciliation, if there is probable cause to believe that redlining is being practiced.⁹² If the complaint is not resolved in this manner, a hearing must be conducted.⁹³ One fault of section 296-a is that the hearing examiner need not be someone detached from any attempt at conference or conciliation of the complaint. The objectivity of one connected with prior negotiations is questionable.

Unlike the commissioner, neither the superintendent nor his representative are empowered to enter an order in default.⁹⁴ However, an aggrieved party may obtain judicial review of the superintendent's order, just as he may obtain review of an order by the commissioner of human rights. Finally, an aggrieved party has a cause of action in state supreme court if he has not already filed a complaint with the division of human rights or with the banking department.⁹⁵ His right to file a complaint in court is not prejudiced if he previously filed a complaint with the division of human rights which was dismissed.⁹⁶

A major criticism of hearings before both the human rights division and the banking department is that most mortgagors must

89. *Id.* § 297(6).

90. *Id.* § 297(7).

91. N.Y. BANKING LAW § 9-d (McKinney Supp. 1979-1980); N.Y. EXEC. LAW § 296-a (McKinney Supp. 1972-1979).

92. N.Y. EXEC. LAW § 296-a(7)(a) (McKinney Supp. 1972-1979).

93. *Id.* § 296-a(7)(b). The Superintendent may also issue orders similar to those under section 297 of the HRL. *Id.* at § 296-a(7)(c)(1)-(4).

94. See N.Y. EXEC. LAW § 296-a (McKinney Supp. 1972-1979).

95. *Id.* §§ 296-a(f)(d), 297(a).

96. *Id.*

find a means of finance quickly and therefore have little incentive to file a grievance against the creditor, once substitute financing is arranged.⁹⁷ Shortening the time allowed the banking department or the human rights division between the filing of a complaint and its resolution is one solution. However, there are better solutions. At present in a hearing before the human rights division, the hearing examiner may, at his discretion, permit a person with a substantial interest to intervene.⁹⁸ The right to intervene should be expanded to allow intervention by a party with a substantial interest such as a public interest organization. In the alternative, such an organization should be allowed to initially bring suit on the mortgagor's behalf. It would be better to allow an organization to file the complaint initially, because it may be able to choose a good test case and assume the expense of preparation for the hearing. Also, enabling such an organization to file a complaint initially would strengthen the chances that the case would continue rather than be dropped once the mortgagor obtains credit.

A second criticism of hearings before the human rights division and the banking department is that in both, the burden of proof is not defined by statute and it is ill-defined by case law.⁹⁹ Unless Appendix seven is made public, the complainant will not have access to the facts necessary to prove discrimination against him, based upon personal characteristics, or based upon the location of the property to be security for the loan.¹⁰⁰ Therefore, the burden of

97. See SCHAFFER, *supra* note 1, at 13-45.

98. N.Y. EXEC. LAW § 297(4)(a) (McKinney Supp. 1979).

99. Under sections 296-a and 297 the hearing examiner is not bound by the strict rules of evidence. However, these sections do not mention any procedural standards. N.Y. EXEC. LAW §§ 296-a(7)(b), 297(4)(a). While there are no cases adjudicating the burden of proof under section 296, under section 297, courts defining the burden of proof have reached differing results. In *Palmer v. New York State Human Rights Appeal Bd.*, 63 A.D.2d 1053, 405 N.Y.S.2d 814 (3d Dep't 1978), *rev'd on other grounds*, 47 N.Y.2d 734, 390 N.E.2d 1174, 417 N.Y.S.2d 250 (1979), the complainant carried the burden of proving by substantial evidence, the truth of his allegations of unlawful discrimination. In *New York Inst. of Technology v. State Div. of Human Rights*, 48 A.D.2d 132, 368 N.Y.S.2d 207 (1st Dep't), *rev'd on other grounds*, 40 N.Y.2d 316, 353 N.E.2d 598, 386 N.Y.S.2d 685 (1975), the burden of proof shifted to the respondent employer, after a prima facie showing of a discriminatory employment practice had been made. In *Board of Ed. v. State Div. of Human Rights*, 42 A.D.2d 49, 345 N.Y.S.2d 93 (2d Dep't), *aff'd*, 35 N.Y.2d 673, 319 N.E.2d 202, 360 N.Y.S.2d 887 (1973), the burden of proof lay with the respondent employer named in the complaint to prove he had not given exceptional treatment to an employee on the basis of gender.

100. See notes 46-49 *supra*.

proof should be shifted to the creditor, the party with knowledge of these facts.¹⁰¹

In addition to the criticisms of both remedies, a major distinction between the hearing before the human rights commissioner and the hearing before the superintendent of banks may make the former the preferred remedy. In view of the fact that the superintendent of banks or his representative hears only cases dealing with discriminatory practices by creditors,¹⁰² such a representative may develop an expertise greater than that of a hearing examiner presiding over cases involving all types of discriminatory practices proscribed under the Human Rights Law. The banking department representative's caseload may be lighter as well for this reason. However, because the representative is from the banking department it would be difficult for such a representative to maintain political neutrality. The banking department, particularly in light of the CRA, the law preventing geographic discrimination, and the Human Rights Law, must balance two roles, that of a watchdog whose job it is to prevent discrimination, with its traditional role as bank examiner, protecting depositors and other bank customers by assuring the financial soundness of state-chartered banks.¹⁰³ Like any regulatory agency, it must maintain the respect of those it regulates and yet enforce the laws. While an examiner from the banking department may have expertise as to banking practices, an examiner of the human right division may have developed an expertise about discrimination in general and moreover, may be able to maintain greater objectivity.

G. The State of New York Mortgage Agency

In 1970 the legislature created the State of New York Mortgage Agency ("SONYMA").¹⁰⁴ The purpose of the agency is to provide greater stability to the construction industry by making residential mortgages a more attractive investment for the private banking system.¹⁰⁵ By attracting more investments, the volatility of the

101. See notes 61-64 *supra*.

102. See N.Y. EXEC. LAW § 296-a (McKinney Supp. 1979).

103. N.Y. BANKING LAW §§ 9-f, 36 (McKinney 1971); N.Y. EXEC. LAW §§ 296, 296-a, 297, 297-a (McKinney Supp. 1979).

104. State of New York Mortgage Agency Act, chs. 612-614, 1970 N.Y. LAWS (codified at N.Y. PUB. AUTH. LAW §§ 2401-2429-f (McKinney Supp. 1970-79)).

105. N.Y. PUB. AUTH. LAW § 2401 (McKinney Supp. 1970-1979).

supply of mortgage funds over the business cycle is supposed to be reduced.¹⁰⁶ The legislature deemed SONYMA necessary to remedy the "seriously inadequate supply of safe and sanitary dwelling accommodations, including accommodations for persons and families of low income."¹⁰⁷ The legislature also found that there has been a recurrent cyclical shortage of residential mortgage funds in private banking which has contributed "to the persistence of slums and blight and to the deterioration of the quality of the environment and living conditions of New York State residents."¹⁰⁸ Because of this shortage people were unable to either buy or sell homes, and legislators feared that the shortage might result in a crisis in refinancing many of the sound, older multiple dwellings.¹⁰⁹

SONYMA periodically creates a secondary mortgage market by purchasing mortgages from state banks whenever there is an inadequate supply of credit available for residential mortgage loans.¹¹⁰ The banks in turn, must invest an amount equal to the proceeds they receive from the sale of the mortgages in residential real property, within the state.¹¹¹ SONYMA at its discretion prescribes the terms of the new mortgages which the banks must purchase.¹¹² The terms prescribed include: (1) the loan-to-appraised value ratio, (2) the length of maturity, (3) the interest rate, and (4) the types of dwelling, such as one-to-two family dwellings, or in the most recent offering, one-to-four family dwellings.¹¹³ In addition, thirty percent of these new commitments have to be made on property meeting

106. *Id.* § 2401. In the statute's legislative findings it is stated that the "seriously inadequate supply of safe and sanitary dwellings and accommodations, including accommodations for persons and families of low income . . . is contrary to the public interest and threatens the health, safety, welfare, comfort and security of the people of the state." *Id.* For an excellent discussion of the constitutionality of such government mortgage agencies, whose only purpose is to increase the housing supply, see 84 HARV. L. REV. 1921 (1971); cf. 49 N.C. L. REV. 830, 836 (1970-1971) (where the Housing Corporation's goal is to eliminate the shortage of low cost housing, the Corporation's activities are achieving a public purpose although the corporation does so indirectly by engaging in private business).

107. Governor's Memoranda, Nelson A. Rockefeller, 1970 N.Y. LAWS 3111 (McKinney's).

108. N.Y. PUB. AUTH. LAW § 2401 (McKinney Supp. 1970-1979).

109. Governor's Memoranda, Nelson A. Rockefeller, 1970 N.Y. LAWS 3111 (McKinney's).

110. *Id.* § 2405(1),(10) (McKinney Supp. 1970-1979).

111. *Id.* § 2405(1).

112. *Id.* §2405(3).

113. See, e.g., State of New York Mortgage Agency, Invitation for Offers Relating to 120,000,000 Series 1, Home Mortgage Revenue Bonds, Sept. 15, 1978 at C.

one of several criteria which are prescribed by the agency.¹¹⁴ Until recently, the requirement that the property be in a low-income or redlined neighborhood has never been included among the additional criteria.¹¹⁵

SONYMA cannot approve commitments or actual loans on multi-family dwellings unless the borrower is a corporation and prior written approval from SONYMA has been obtained.¹¹⁶ SONYMA may not approve such a commitment if it would increase the dollar amount of mortgages for multi-family dwellings approved by the agency in excess of forty percent of the total purchase price of all mortgages previously purchased by SONYMA.¹¹⁷

The dollar amount of bonds issued by SONYMA from 1971 to 1979 is small even when compared only to the demand for mortgage loans issued by private financial institutions in Brooklyn in 1979.¹¹⁸

114. *Id.* at C(1).

115. *See* note 122 *infra*.

116. N.Y. PUB. AUTH. LAW § 2405(3) (McKinney Supp. 1979). In its latest offering, because of the Ullman-Connable Bill pending in Congress, SONYMA had to require, for the first time that seventy of the bank's new commitments be made to low and moderate income neighborhoods. These new commitments had to be made in census tracts where seventy percent or more of the families have income which is eighty percent or less than the New York median family income. This information is to be determined through the latest census statistics. State of New York Mortgage Agency, Invitation for Offers, September 15, 1978, at 2, ¶ C ("Obligations to Make New Mortgages").

117. N.Y. PUB. AUTH. LAW § 2405(3) (McKinney Supp. 1979).

118. To date seven series of bonds have been issued. The face amount of the first six totalled \$519,490,000. Letter from Joseph Cord Bosch, Associate Legislative Budget Analyst, Ways and Means Committee, to Assemblyman Samuel Hirsch (January 14, 1980). One series of bonds was issued in 1971 and 1973, three series were issued in 1974, and one each was issued in 1978 and 1980. *Id.* This amount is compared to the demand for loans in Brooklyn in 1979 which totalled \$69,279,000. *See* note 39 *supra* and accompanying text. The agency's capability to borrow from the public at tax-exempt rates is limited to \$750 million of outstanding obligations. N.Y. PUB. AUTH. LAW § 2407(1) (McKinney Supp. 1979). Of this amount approximately \$302 million remains outstanding. State of New York Mortgage Agency, Official Statement Relating to \$125,000,000 Series 2, Home Mortgage Revenue Bonds, Feb. 1, 1980. SONYMA reports that 25,000 new residential mortgages have been made available under its program. However, this figure cannot be verified. Letter from Joseph Cord Bosch, Associate Legislative Budget Analyst, Ways and Means Committee, to Assemblyman Samuel Hirsch (January 14, 1980).

Due to legislation pending in Congress, the use of tax-exempt bonds may be curbed considerably. The Mortgage Subsidy Bond Tax Act of 1979, H.R. 5741, 96th Cong., 1st Sess. (1979). This bill, known as the Ullman-Connable Bill, would repeal the exemption from federal income tax presently given for interest paid on bonds or other interest obligations

Thus, SONYMA has not cured the problems which are the reason for its creation. It has not cured the "seriously inadequate supply of dwellings . . . [for] families of low income," nor the "persistence of slums and blight and the deterioration of the quality of the environment and living conditions" for the states' residents.¹¹⁹ Nor has SONYMA prevented "a crisis in refinancing many of the sound, older multiple dwellings."¹²⁰

Although SONYMA has the power to prescribe the terms of new loans made by banks,¹²¹ the agency has not, except in its latest offering, required that loans be made in low-income neighborhoods.¹²² Even if the agency had included this as one of the additional criteria which banks must meet for thirty-percent of their new loans, it is doubtful that the criterion would have proved effective. In the typical offering, banks are given a choice in seven additional criteria. Of these, banks need only meet one.¹²³ For this

which are issued by a state or municipality for the purpose of providing mortgages for residential housing. *Id.*, sec. 2, § 103A(a). See generally Keohane, *The Mortgage Subsidy Bond Tax Act of 1979: An Unwarranted Attack On State Sovereignty*, 8 FORDHAM URB. L.J. 483 (1980).

119. See notes 108 and 109 *supra*.

120. See note 107 *supra*.

121. See note 112 *supra*.

122. State of New York Mortgage Agency, Invitation for Offers Relating to \$125,000,000 Series 2, Home Mortgage Revenue Bonds, Feb. 1, 1980 [hereinafter cited as Invitation for Offers]. See Invitation for Offers, *supra*. Relating to \$113,350,000 Series 1, Home Mortgage Revenue Bonds, Sept. 15, 1978 at C(1); State of New York Mortgage Agency, Prospectus Relating to \$25,000,000 Series E, General Revenue Bonds, Nov. 1, 1974 [hereinafter cited as Prospectus]; at C; Prospectus, *supra*, Relating to 110,000,000 Series D General Revenue Bonds, Nov. 1, 1974, at C; Prospectus *supra*, Relating to 108,000,000 Series C, General Revenue Bonds, Aug. 1, 1974; Prospectus, *supra*, Relating to \$113,490,000 Series B, General Revenue Bonds, Oct. 30, 1973, at C; Prospectus, *supra*, Relating to \$49,650,000 Series A, General Revenue Bonds, Oct. 1, 1971, at C.

123. For example, in 1978 for a neighborhood to qualify one of the following characteristics had to be satisfied (1) the median income in the neighborhood was at least 20% below the median income in the area; (2) the unemployment rate in the neighborhood was at least 20% above the unemployment rate in the area; (3) a facility providing employment for at least 20% of the working population of the neighborhood had closed within the last four years; (4) the minority population in the neighborhood had increased by at least 20% in the past four years; (5) multiple dwellings in the neighborhood had a vacancy rate of at least 20%; (6) more than 75% of the buildings in the neighborhood were over 50 years old; or, (7) the total population in the neighborhood had declined at least 20% in the past seven years. Invitation for Offers, *supra* note 122, Sept. 15, 1978, at C(1).

As a result, in 1978 banks could choose a wealthy historic neighborhood in which 75% of the buildings were over 50 years old to meet the 30 percent requirement and thus could avoid making loans to low income or redlined neighborhoods, and could recommit the other

reason, SONYMA and the banks may be able to continue to side-step a commitment to increase the funds available for mortgages on low-income dwellings. Ironically, even if the Ullman-Connable Bill, pending in Congress, is enacted, SONYMA would not be forced to lend to low-income neighborhoods.¹²⁴

The goal of increasing the supply of low-income housing and of refinancing many old sounder dwellings is impaired by the limitation placed upon loans to apartment buildings.¹²⁵ There are two reasons for the limitation. First, due to their size, mortgage loans for apartment buildings would exhaust the Agency's funds too quickly.¹²⁶ Second, the Agency's policy seems implicitly aimed at increasing mortgages to one-to-two family detached dwellings, that is, to increasing funds to middle-class and lower-middle class neighborhoods.¹²⁷ This implicit policy choice should not be automatically criticized. Too often lower middle class and middle class families are slighted by legislation. However, this is not the purpose for which SONYMA was created;¹²⁸ even if it were, the

70% to mortgages without meeting any agency criteria.

124. See note 118 *supra*. Representative Ullman stated his reasons for introducing the bill as follows:

Despite its popularity, the use of tax-exempt revenue bonds to finance these private investments is poor public policy. The primary goal of Federal housing policy has been to provide shelter for low-income families. Any additional Federal resources for housing should be for priority purposes and be subject to the discipline of the budget process.

Use of these bonds . . . is an ineffective way to administer a housing program. In fact, it amounts to a subsidized housing program with no exercise of any judgment or restraint over the use of the funds by either the Administration or Congress. There are no controls over the allocation of funds among programs nor with respect to total budget expenditures. It funds programs for which Congress has refused to provide through the normal budget process.

125 Cong. Rec. H2349 (daily ed. April 25, 1979). While the bill would repeal the exemption for mortgage subsidy bonds generally, these are exceptions. The Mortgage Subsidy Bond Tax Act of 1979 H.R. 5741, 96th Cong., 1st Sess. sec. 2, §§ 103A(b)(2)(a), 102A(b)(2)(B) (1979). The second exception is for "qualified mortgage bonds." In the bill, a list of criteria have been established which any bond issue must fulfill in order to meet this exception. *Id.* § 103A(c)-(1). Ironically, none of these criteria require that loans be made to low-income neighborhoods. *Id.* Therefore, it can be inferred that the bill's thrust is not to force the states to follow the federal policy of subsidizing low-income housing, but rather require states to adhere to any supplemental housing policy which Congress wishes to implement.

125. N.Y. PUB. AUTH. LAW § 2405(3)(a)-(b) (McKinney Supp. 1970-1979).

126. See *id.* § 2405(3)(b).

127. See notes 123-25 *supra* and accompanying text.

128. N.Y. PUB. AUTH. LAW § 2401 (McKinney Supp. 1979).

Agency's liberal range of criteria for recommitting funds defeats even this policy.¹²⁹

In addition, while curing redlining is not one of SONYMA's explicit purposes, such a goal is implicit. Many minority neighborhoods consist of low-income families living in old multi-family buildings,¹³⁰ which even under a strict definition of redlining would include some stable middle-class minority families with older single and multi-family properties.¹³¹ Therefore, the Agency's stated goals of increasing mortgage funds in general and increasing mortgage loans to low-income neighborhoods in particular, implicitly includes increasing funds to redlined neighborhoods. However, because these explicit goals are not being implemented the implicit goal of alleviating the effects of redlining has not been achieved.

The means the legislature chose to stabilize the housing industry must also be scrutinized. The supply of funds in the housing industry decreases when interest rates are high. High interest rates cause an outflow of deposits, known as disintermediation, from banking institutions.¹³² As a result banks experience illiquidity and thus have less funds for mortgages.¹³³ SONYMA, in an attempt to counter disintermediation, will float bonds to increase the supply of mortgage funds.¹³⁴ SONYMA, in essence, subsidizes the banks' supply of mortgage funds during periods of disintermediation. However, when one compares the dollar amount of bonds issued by SONYMA¹³⁵ to the total dollar demand for loans,¹³⁶ and then compares the amount of bonds issued by SONYMA to the net outflow of deposits from mutuals,¹³⁷ SONYMA's shielding effect has been negligible. One must consider then, which method, much more massive subsidies to banks, or legislation to cure disintermediation, in particular, legislation to change the structure of mutuals is more

129. See note 123 *supra* and accompanying text. Banks need meet only one of seven criteria for 30% of their new loans, issued with the proceeds from the sale of mortgages to SONYMA.

130. See note 10 *supra* and accompanying text.

131. See N.Y.S. BANKING DEP'T *supra* note 9, at IV-E-(10), (12).

132. See notes 164, 168-70 *infra* and accompanying text.

133. See note 171 *infra* and accompanying text.

134. See N.Y. PUB. AUTH. LAW § 2401 (McKinney Supp. 1979).

135. See note 118 *supra*. SONYMA's first six offering totalled \$519,490,000.

136. See note 79 *supra* and accompanying text.

137. See note 77 *supra* and accompanying text.

worthwhile.

III. Extra-Legislative Solutions

A. Efforts by Community Groups

Aside from lobbying in favor of the HMDA and CRA, community groups have made other efforts to improve the lending patterns of banks in their communities.¹³⁸ The New York Public Interest Research Group ("NYPIRG"), after compiling a record of mortgage investment by banks in Brooklyn,¹³⁹ formed a group known as Bank On Brooklyn which after meeting with banks and public officials¹⁴⁰ reached agreement with eight savings banks and savings and loan associations.¹⁴¹ These agreements made available over fifty million dollars for mortgage lending in Brooklyn neighborhoods.¹⁴² Subsequently NYPIRG formed five other Bank On Brooklyn chapters to continue monitoring investment patterns in Brooklyn.¹⁴³

Two groups, the Greenpoint-Williamsburgh Committee Against Redlining and the Flatbush Mortgage Committee, began negotia-

138. See note 13 *supra* and accompanying text. TWO YEARS LATER, *supra* note 13, at 4.

139. TWO YEARS LATER, *supra* note 13, at 2.

140. *Id.* at 3. The first meetings between the two groups were fruitless.

A branch manager at Fulton Savings Bank told them the bank would not make loans in their neighborhood because those areas were not considered good risks. Greater New York Savings Bank President Jerome Maron, said that Brooklyn has "gone down the tubes," that this bank was not interested in making loans in the borough, and that anyone who thought otherwise was anti-capitalist. . . . Community members started picketing the Flatbush Federal Savings and Loan Association, whose president had told one applicant, "Jesus Christ himself could not get a mortgage in Brooklyn." *Id.*

However, the group on East Flatbush organized by NYPIRG continued its efforts. When banks claimed there was no local demand for mortgages, the group documented more than twenty-four million dollars in local mortgage transactions that had taken place the previous year. When banks claimed that no one had come to them for mortgages, the group brought in applicants who had been rejected. When banks doubted that the group's concern was widespread, the group gathered support from the community. *Id.* Finally, within a month of each other in the spring of 1977, before the CRA was passed, Flatbush Federal, Fulton Savings and Independence Savings banks signed the first negotiated agreements between Brooklyn lending institutions and community groups. *Id.* at 3-4.

141. SQUEEZING US DRY, *supra* note 1, at 1.

142. *Id.* The Greater New York Savings Bank pledged 25 million dollars in new mortgage loans to New York City in 1978; the Williamsburgh Savings Bank pledged 10 million dollars in new loans to Brooklyn in 1978. Letter from Beth Ziegler, member of Bank On Brooklyn to Deborah Smith (August 13, 1979).

143. TWO YEARS LATER, *supra* note 13, at 4.

tions with other banks in Brooklyn.¹⁴⁴ A fourth group, South Brooklyn Against Investment Discrimination (AID), sponsored a withdrawal campaign in which one million dollars in deposits from the Greater New York Savings Bank's main branch was removed.¹⁴⁵ These groups also attended and presented testimony at the public hearings on branch and merger applications of banks which were held by the New York State Banking Department.¹⁴⁶

The prodigious and persistent efforts by these and other community groups across the country make clear that it was their efforts and the attendant publicity which not only were the cause for the passage of the HMDA and the CRA,¹⁴⁷ but are also in large part the reason these laws have been enforced at all.¹⁴⁸ In addition, the negotiations and signed agreements between these community groups and the banks, not just enforcement of the CRA and the

144. *Id.*

145. *Id.* at 3.

146. *Id.* at 4. The New York City Commission on Human Rights Neighborhood Stabilization Program has also challenged several bank applications. NEW YORK CITY COMMISSION ON HUMAN RIGHTS, REDLINING IN THE BRONX (1978).

147. See notes 13 & 14 *supra*.

148. After the CRA was enacted, NYPIRG joined the Northwest Bronx Community and Clergy Coalition to request public hearings to address the issue of how to enforce the Act. In February 1978, the New York State Banking Department held its first public hearing for this purpose. As a result of the attendance and testimony at this hearing, four other federal agencies held similar hearings in New York City in April. After regulations to enforce the CRA were promulgated, community groups continued their efforts. TWO YEARS LATER, *supra* note 13, at 4-5.

The Crown Heights Bank of Brooklyn chapter prevented the East New York Savings Bank from moving a branch out of Brownsville, where it was the only savings institution. At the State Banking Board's January meeting, Superintendent Muriel Siebert credited a letter from Downtown Bank on Brooklyn for her tie-breaking vote permitting Independence Savings Bank — one of the most cooperative in making serious commitments and carrying them out — to open a new branch. And, after three weeks of phone calls, letters, and political pressure, the FDIC agreed for the first time to hold a public hearing on a branch or merger application during evening hours. The hearing dealt with the Dime Savings Bank of New York's merger application.

The picket lines, testimony, negotiations, and research came to fruition on April 22, 1979. AID and the East Flatbush Bank on Brooklyn chapter had testified against the Greater New York Savings Bank's branch application the previous fall. AID and Bank on Brooklyn presented [t]heir statistics, cash histories, and arguments, all of which were heard with no more response than regulators had previously shown during the FDIC "investigation" which concluded that Greater New York had done more than its duty just by signing an agreement. The FDIC's rejection of the application surprised the neighborhoods as much as it shocked the nation's banking industry.

Id.

HMDA, are in part the cause of the banks' improved mortgage lending records.¹⁴⁹

B. Efforts By the Banks

In 1977, the Savings Association League of New York State established the Mortgage Review Fund.¹⁵⁰ The Fund's purpose is to review the mortgage loan applications of applicants who feel that they were unfairly rejected by banks which participate in the review program.¹⁵¹ Member banks notify the applicant that a review of his application is available at the time the loan is rejected.¹⁵² The application is reviewed by a regional review committee.¹⁵³ The review committee is comprised of three savings and loan representatives and three public members.¹⁵⁴ After evaluating the application, the committee has three choices: (1) it may confirm the rejection and state its reasons, (2) recommend reconsideration of the application, or (3) recommend submission of the application to another participating member bank.¹⁵⁵ The review committee may also recommend modification of the terms or conditions of the original loan application.¹⁵⁶ While the Fund would not recommend that a member institution make a high-risk loan, it tries to make every effort to see the merit of any application.¹⁵⁷

From 1977 through 1979, the regional committees received 345 completed applications; of these the committees rejected 135 applications and recommended 165.¹⁵⁸ Of those recommended, the Mortgage Review Fund Committee, the final review committee, approved 119 loans for a total of \$9,009,695.¹⁵⁹

149. See notes 141, 142, 144, 147 *supra* and accompanying text.

150. The Reporter Dispatch, White Plains, New York, Jan. 17, 1977, at 1, col. 1. For other efforts by banks to improve their local communities, see HIRSCH, *supra* note 18, at 41.

151. MORTGAGE REVIEW FUND, 1979 Annual Report 1 (1979).

152. The Reporter Dispatch, *supra* note 150, at 1, col. 2.

153. *Id.*

154. *Id.* at col. 3.

155. *Id.* at col. 2.

156. *Id.*

157. MORTGAGE REVIEW FUND, 1979 Annual Report 1 (1979) (Report From The Chairman, I.J. Lasurdo).

158. MORTGAGE REVIEW FUND, 1979 Annual Report 7 (1979).

159. *Id.* at 8. Savings banks made five loans for a total of \$654,000 after approval of the Mortgage Review Committee and five loans for a total of \$198,500 after recommendation by the Regional Committee but before Mortgage Review Fund Committee action. *Id.* at 8-9.

While the Fund is a useful addition to the current remedies for discrimination, it can be improved.¹⁶⁰ Only persons denied a loan by a participating mutual may apply. Applicants who have not been allowed to file an application or have been discouraged from filing one, or applicants who have been granted loans with discriminatory terms cannot apply to the fund.¹⁶¹ In addition, because of the multi-tiered method of review, applications are not processed quickly.¹⁶²

IV. Disintermediation

"Intermediation" defines the function performed by financial institutions, commercial and mutual savings banks, savings and loan associations, and insurance companies. These institutions act as intermediaries between savers and borrowers.¹⁶³ "Disintermediation" occurs when savings deposits are withdrawn from financial institutions and are placed in other money market instruments with interest yields which are higher than those on deposits.¹⁶⁴ Individuals finance the economy directly during these periods, rather than through intermediary financial institutions.¹⁶⁵ Mutual savings banks ("mutuals" or "thrifts"), in response to charges of redlining and disinvestment, point to rising disintermediation. Mutuals assert that due to decreasing deposits, they have less money to invest in mortgages generally and therefore imply that they have invested

160. SCHAFER, *supra* note 1, at 13-44.

161. *Id.*

162. *Id.* at 45.

163. Financial institutions' investments are screened by a staff with expertise in investing. Thus, the depositor's investment involves less risk than it would if he had invested the money directly in alternative financial markets. This staff of experts also chooses investments which, at least theoretically, yield the most profit. As a result, savings are put to their most productive use, the economy grows, and depositors' dollars are safely invested. McKinney, *New Sources of Bank Funds: Certificates of Deposit and Debt Securities*, 32 LAW AND CONTEMPORARY PROBLEMS 71 (1967).

164. CUTLER, *supra* note 28, at 53-54. KILDOYLE, *The Financial Viability of Mutual Savings Banks in New York State*, in PUBLIC POLICY TOWARD MUTUAL SAVINGS BANKS IN NEW YORK STATE: PROPOSALS FOR CHANGE 137, 150-153 (L. Lapidus ed. 1974) [hereinafter cited as KILDOYLE]; KLAMAN, *Public/Private Approaches To Urban Mortgage and Housing Problems*, 32 LAW AND CONTEMP. PROB. 250, 253 (1967) [hereinafter cited as KLAMAN]; *Proposed Mortgage Interest Tax Credit as part of the Financial Institutions Act: Hearing before The Task Force on Tax Expenditures And Off-Budget Agencies of the Committee on the Budget, House of Representatives, 94th Cong., 2d Sess. 43-44 (1976)* [hereinafter cited as MITC] (statement of Dr. Patric H. Hendershott).

165. CUTLER, *supra* note 28, at 53.

no less in redlined or "disinvested" areas.¹⁶⁶ In this section the relationship between redlining and disintermediation will be examined. Also, the causes of disintermediation and its consequences will be discussed. In addition, the present structure of mutuals and the effects of disintermediation on this structure will be analyzed.¹⁶⁷

166. TWO YEARS LATER, *supra* note 13, at 6. In the alternative, bankers argue that lending to these areas involves greater risks. See TWO YEARS LATER, *supra* note 13, at 3. In essence, under either theory, banks argue that they do not redline because by definition redlining is based on the use of arbitrary rather than objective criteria. See note 1 *supra*.

To document disinvestment community groups often compare the amount of deposits which banks receive from the community to the bank's total assets, using the amount of deposits received from the community as a measure of the amount of money that banks should be returning to the community. TAKE THE MONEY AND RUN, *supra* note 1, at 6; SQUEEZING US DRY, *supra* note 1, at 17; TWO YEARS LATER, *supra* note 13, at 24-25.

In this context, assuming there has been an outflow of deposits from the communities which have suffered from redlining or disinvestment, disintermediation would be a direct answer to community groups' charges. See note 171 *infra*. However, there does not appear to be a direct relationship between disintermediation and redlining. The results of correlating disintermediation and redlining are equivocal. Disintermediation should bear no logical relationship to redlining because banks' arbitrary choices of where to invest should not be related to the amount of mortgage funds available. However, the mixed results shown, see note 171 *infra*, may be due to the enactment of the CRA and its attendant publicity. See note 167 *infra*. This cannot be documented, because information on deposits by census tract was eliminated from the G-107 Supervisory Procedure format in December 1979. *Supervisory Procedure, G-107, supra* note 4, at Appendix 8 (12/14/79); even prior to its elimination this information was not made public. *Id.*, §§ 107.6, 107.8 (5/31/77). The FDIC, however, lists deposits by branch office.

167. Banks have experienced disintermediation five times since 1960. In 1966 disintermediation lasted less than a year; as a result, many banks did not show a net outflow of deposits. KILDOYLE, *supra* note 164, at 152.

The following chart, see note 168 *infra*, shows the net growth or outflow of the fourteen banks chosen for this study, during these periods. During the latest period, banks experienced massive losses. In January 1980, Americans invested a record \$21 billion in high-yielding money market funds while savings and loan associations attracted only \$1.1 billion in new savings. This was the lowest inflow since 1970. All of the deposits were time deposits, i.e., six-month market certificates, 30 month certificates and large-denomination certificates of deposit, all tied to the general market. While the \$1.1 billion increase reversed the \$700 million outflow of December 1979, the January 1980 increase was \$3.3 billion less than that of January 1979. The New York Times, Feb. 28, 1980, at D9, col. 1. During 1979, New York Savings banks experienced a net outflow of five and one-half billion dollars in savings and time deposits. In the last quarter of the year, the outflow totaled more than two billion dollars. Statement by Muriel Siebert, New York State Superintendent of Banks, before the Committee on Ways and Means, United States House of Representatives 2 (Jan. 29, 1980).

A. The Present Structure of the Mutual Savings Banks

One of the causes of disintermediation is rising interest rates.¹⁶⁸ However, it is not rising interest rates alone, but rising interest rates combined with a ceiling placed on interest rates for savings deposits which cause depositors to withdraw deposits and invest in instruments with higher yields.¹⁶⁹ The second cause of disintermediation as it affects mutuals, is the rate of turnover of mutuals' assets as opposed to liabilities. The principal asset of

168.

NET GROWTH OR OUTFLOW OF DEPOSITS FROM 1960 THROUGH 1972

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972
Dime of New York	—	—	—	—	—	—	—	—	—	—	2,233,453	2,527,311	2,826,237
Lincoln	584,931	602,420	636,211	657,066	728,272	788,391	853,374	939,902	1,011,257	1,049,770	1,090,043	1,184,657	1,393,660
Greater New York	265,671	277,340	295,967	318,140	454,083	484,055	516,485	570,092	616,042	648,225	928,474	1,040,987	1,142,188
Williamsburgh	802,747	819,909	852,867	907,396	976,818	1,020,845	1,072,068	1,154,069	1,221,143	1,219,678	1,250,483	1,313,181	1,391,988
Brooklyn	311,675	341,134	359,935	381,656	412,542	429,425	446,391	486,907	528,819	551,832	605,847	704,339	799,562
Anchor	—	—	—	—	—	—	—	—	353,189	579,296	621,811	693,233	750,448
Metropolitan	154,703	159,187	170,586	188,244	209,821	225,953	238,813	262,671	279,427	511,583	896,105	810,975	1,008,709
Green Point	263,092	273,218	290,708	320,833	346,992	367,617	386,072	428,036	466,783	499,031	529,064	586,587	643,674
Independence	—	—	—	—	—	—	—	—	—	—	—	—	—
Franklin	276,016	296,107	302,468	322,900	357,589	385,326	418,854	472,203	507,723	519,268	538,020	1,008,792	1,069,643
East New York	570,221	577,646	598,393	624,407	659,123	678,890	689,305	718,451	734,393	722,417	725,704	767,573	865,690
Hamburg	181,927	190,183	201,878	221,696	246,124	265,142	284,943	312,063	334,008	350,046	363,312	393,036	433,317
Roosevelt	183,744	190,740	194,937	199,614	212,160	222,561	235,844	256,655	275,261	287,580	305,086	347,779	403,527
Dime of Williamsburgh	90,186	92,842	98,315	116,355	132,923	150,062	160,252	187,327	211,064	224,290	236,701	289,432	335,414

*Metropolitan Savings Bank and Fulton Savings Bank were combined in 1969.

Dollar amounts are in thousands

Source; Statements of Conditions of the Savings Banks of the State of New York for the years 1960-1965, 1967, 1968, 1971 compiled by the New York State Banking Department. Annual Report of the Superintendent of Banks, State of New York, 1966, 1969, 1970, 1972. Disintermediation occurred during 1966, *see* note 164 *supra*, however, no net outflows for the year is shown, because disintermediation commenced early in 1966 and ended prior to the year's end.

169. MITC, *supra* note 164, at 47-48 (statement of Dr. Patric H. Hendershott). The ceiling on deposit interest rates was first imposed in 1966. The regulation imposing the ceiling is known as "Regulation Q." *Id.* at 36.

mutuals, mortgage loans, mature more slowly than their most common form of liabilities, savings deposits. As a result, even if there were no ceiling on savings deposits, mutuals could not raise deposit rates quickly during periods of rising interest rates. Disintermediation is the result.¹⁷⁰ The consequences of disintermediation can be severe. One of these consequences is a shortage of credit.¹⁷¹

As the causes of disintermediation and its consequences demonstrate, inflation is not the sole cause of mutuals' present problems. The structure of mutuals must be overhauled. This section will first discuss the origins of mutual savings banks. Then its present structure and its disadvantages will be analyzed.

Mutuals were established to encourage the working man to save

170. *Id.* at 41; KLAMAN, *supra* note 164, at:253. MITC, *supra* note 164, at 41 (statement of Dr. Patric H. Hendershott).

171. MITC, *supra* note 164, at 41 (statement of Dr. Patric H. Hendershott); CUTLER, *supra* note 28, at 53-54. Another reason for scarce credit during such periods is federal monetary policy. During periods of inflation, the Federal Reserve often chooses to contract the money supply in order to increase the prime lending rate, thereby, raising the cost of borrowing which in turn decreases demand. The New York Times, Jan. 7, 1980, at D1, col. 4. KILDOYLE, *supra* note 164, at 151-152.

If banks' illiquidity becomes severe, they are sometimes forced to sell assets at large losses in order to maintain their operating earnings. Eight of New York City's 41 savings banks reported losses in both operating and net income in the fourth quarter of 1979. Net income is operating income after "nonrecurring" gains or losses such as loans that are not repaid or sales of securities held by the bank. Another bank showed only a loss in operating income while four others reported net losses, but operating earnings. Those reporting operating losses were the Dime of New York, Dollar, Dry Dock, Manhattan, Williamsburgh, Lincoln, Greenwich, Metropolitan, Greater New York, East River and Franklin. Reporting losses in net income were Dime of New York, Williamsburgh, Lincoln, Greenwich, Metropolitan, Greater New York and Franklin. The New York Times, Feb. 21, 1980, at D1, col. 3 and D9, col. 1. However, the following chart makes it clear that there is no direct correlation between redlining and disintermediation.

his earnings and to provide him with a source of mortgage funds.¹⁷² Mutuals' management policies have traditionally been conservative in order to protect the depositors' savings.¹⁷³ Unlike the holder of stock in a commercial bank, the depositor does not make his in-

	1977		1978		1979	
	Loans to Redlined Neighborhoods*	Net Outflow of Deposits	Loans to Redlined Neighborhoods	Net Outflow of Deposits	Loans to Redlined Neighborhoods	Net Outflow of Deposits
Dime of New York	1,449,686	1109	1,388,477	1341	1,159,221	3150
Lincoln	802,334	—	773,452	1366	656,295	540
Greater New York	823,189	492	793,462	1873	684,531	5059
Williamsburgh	606,896	—	581,067	2255	494,538	1712
Brooklyn	594,155	690	574,840	2542	485,833	3498
Anchor	610,058	38	597,621	334	498,517	102
Metropolitan	558,686	2013	698,842	—	596,291	387
Greenpoint	502,542	—	498,273	267	436,335	80
Independence	347,735	2976	340,752	3451	299,039	6375
Franklin Savings	311,109	72	314,065	0	257,931	28
East New York	290,056	502	264,081	0	227,507	116
Hamburg	276,107	503	263,750	53	238,817	0
Roosevelt	203,590	46	189,667	45	161,971	72
Dime of Williamsburgh	89,680	722	86,377	44	73,293	168

Dollar amounts are in thousands

See, FDIC Summary of Deposits for Kings County, June 30, 1977; June 30, 1978; June 30, 1979.

*For the purposes of this study the following neighborhoods are considered to be redlined: Boerom Hill, Brooklyn Heights, Carroll Garden, Clinton Hills, Cobble Hill, Downtown Brooklyn, Fort Greene, Gowanus, Crown Heights, East Flatbush, Park Slope. See Schafer, *supra* note 1 at vi. See also note 167 *supra*.

172. CUTLER, *supra* note 28, at 33; Bentley and Macbeth, *Mortgage Lenders and The Housing Supply*, 57 CORNELL L. REV. 167 (1972).

173. CUTLER, *supra* note 28 at 35.

vestment for its potentially large profit with its concomitant risks. Rather, the depositor opens an account because he can earn a small profit and the deposit is virtually risk-free.¹⁷⁴

In New York, mutuals are restricted in the types of assets they are allowed to acquire. Mutuals cannot issue credit cards or make consumer loans, and the investments they do make are restricted.¹⁷⁵ As a result, while these investments carry little risk, they also produce low yields.¹⁷⁶

Mutuals are also prohibited from issuing certain forms of liabilities. Mutuals can issue time or demand deposits,¹⁷⁷ but, until 1973, they could not issue bonds, notes or debentures.¹⁷⁸ The attitudes which have developed, and the legislation and regulations which have been enacted to ensure the safety of depositors' funds, are today outmoded for two reasons. First, the restrictions presently imposed upon mutuals, on entry and expansion, on lending, on borrowing and investing, and on deposit and loan interest rates, are no longer necessary. The establishment of the FDIC and the existence of comprehensive bank examination and supervision conducted by federal and state agencies, make these restrictions not only redundant but inapposite to the goal of increased mortgage

174. *Id.* at 73, 98.

175. The bank failures of the 1930's resulted in legislation which placed many restrictions on the structure and operating powers of mutuals to prevent future failures and safeguard depositors' funds. *Id.* at 72. See N.Y. BANKING LAW § 234.235 (McKinney 1971).

For example, mutuals in New York cannot invest in the obligations of a corporation, maturing within 270 days, unless these have received the highest rating of an independent rating service designated by the banking board. N.Y. BANKING LAW § 235 12-a (McKinney 1971). Similarly, mutuals cannot invest in interest-bearing obligations which are rated below the three highest ratings of rating services designated by the bank board and the aggregate amount invested cannot exceed one percent of the assets of the savings bank. N.Y. BANKING LAW § 235 21-a (McKinney 1971).

176. CUTLER, *supra* note 28, at 106; MITC, *supra* note 164, at 40 (statement of Dr. Patricia H. Hendershott).

177. N.Y. BANKING LAW § 234 1-a (McKinney Supp. 1979).

178. N.Y. BANKING LAW § 234 5-b (McKinney Supp. 1979). Today mutuals subject to the regulations and restrictions of the banking board may issue notes, bonds, debentures, or other obligations or securities subordinated to deposits. However, these securities cannot exceed 25% of the net worth of the bank. These obligations (though not counted for the purpose of determining 25% of the bank's net worth) are deemed to be a part of the bank's net worth. *Id.* at 1. Of course mutuals cannot issue common stock. See N.Y. BANKING LAW § 234 5-b (McKinney Supp. 1979). This is the main distinction between the capital structures of mutual and commercial banks.

lending.¹⁷⁹ Additional factors which make these restrictions unnecessary are mutuals' use of diversified portfolios and skilled professional staffs for both borrowing and lending.¹⁸⁰ Second and more important, the conservatism of mutuals' bank officers is no longer rationally related to sound management. The criteria which mutuals employ to screen mortgage loan applicants illustrates this.¹⁸¹ These criteria are arbitrary, demonstrating discrimination against individual applicants, and possibly demonstrating redlining.¹⁸²

179. CUTLER, *supra* note 28, at 94-101, 104-106, 112.

180. *Id.* at 106.

181. SCHAFER, *supra* note 1, at 13-11. Bentley and Macbeth, *supra* note 172, at 159-163.

182. According to statistical studies, marital difficulties do not account for a large portion of mortgage delinquencies and defaults. Nevertheless, several New Haven institutions candidly reported an interest in the steadiness and well-being of the applicant's marriage. One loan officer apparently encouraged open discussion of marital strife, while another visited applicants in their homes. Despite the difficulty of forecasting separation or divorce over the twenty or thirty-year period of a mortgage agreement, marital peace was considered by one lender to be "an almost determinative factor." This concern for marital stability seems to be derived from an overemphasis on avoiding foreclosure, which overlooks the fact that the cost of that contingency can be effectively covered by adequate security.

A number of New Haven institutions mentioned an assortment of considerations that, like marital instability, offer ample opportunity for the exercise of subjective judgment and sheer guesswork. One loan officer stressed "financial character," making it clear that in determining financial character he placed more weight on personal characteristics than on the individual's financial record reflected in credit bureau figures. Another institution was looking for borrowers who were "morally decent to the best of the bank's knowledge." A third simply stated that one of the initial decisions to be made about a loan applicant is "whether he is the type of person you want coming in the door in the first place." These considerations seem geared to maintaining a clubby atmosphere marked by warm relationships between the lender and its customers. Obviously such an emphasis can easily lead to homogeneity among borrowers and the exclusion of outsiders and minorities from the mortgage system.

Although relying heavily on subjective responses to the personal characteristics of the loan applicant and other irrelevant criteria, the New Haven institutions expended little effort in analyzing the property that would secure the loan, a major objective element in the loan package. Many loan officers had only a general notion of where the bulk of homes on which their institutions held mortgages were located. . . .

In effect, New Haven institutions appear to view the mortgage loan as no different from an unsecured loan. Disregarding that foreclosure need not result in financial loss, they tend to deny loans to persons who pose any risk of default, rather than give the loan applicant the benefit of the security.

Borrowers are not permitted to bid up the price of money; rather, the lender controls the rate and rations his funds among a select group by use of such standards as depositor status and subjective judgments as to the probability of default. The New

Mutuals' overemphasis on protecting deposits to the detriment of their function as mortgagees¹⁸³ raises a series of questions. Should mutuals combine mortgage and savings functions which cause them to "borrow short and lend long?" If so, should their structure be changed to allow for the acquisition of new assets and liabilities? Should mutuals modify their management policies to make greater use of liabilities which they have the power to issue at present, but do not often use? Should the safety restrictions on mutual's investments be kept? Most important, one must consider whether any of these reforms would reduce redlining and disinvestment.

Haven institutions were apparently little influenced by a desire to earn profits or even by a desire to make home ownership more widely available; they were motivated by a genuine aversion to having to "take a house away from someone." As might be expected, the result of this emphasis has been extremely low rates of delinquency, default, and foreclosure, in which the institutions take some pride.

The New Haven institutions have undoubtedly paid a price in earnings for satisfying their desire for smooth sailing. Yet their placidity is socially harmful as well as financially unproductive. Fear of taking a home away from someone may seriously limit an institution's willingness to make home mortgage funds available in cases where any modicum of risk is present, particularly when the loan officer is vested with full discretion in deciding whether or not to grant the mortgage. . . .

In contrast, Los Angeles mortgage lenders gave consideration to factors which are readily subject to quantification—income, outstanding debts, and the value of the security—and gave no consideration to factors that were of dubious relevance (depositor status), difficult to ascertain (marital stability), or hopelessly vague and subjective (good moral character). Mortgage lending in Los Angeles was bottomed on a view of the mortgage as a security device.

Bentley and Macbeth, *supra* note 176, at 160-63. Two possible conclusions can be drawn from the fact that New Haven loan officers only had a general notion of where properties, used as securities for loans, were located, and from their use of subjective criteria to determine a loan applicant's creditworthiness. One conclusion is that these institutions do not redline, because the location of the property is not a factor in their decisions to lend; a second conclusion is that these institutions do redline, because they base their cursory appraisal of the property upon subjective notions of the neighborhood where the property is located, just as they base their determinations of creditworthiness on subjective criteria.

The thesis of the Bentley and Macbeth study is that it is the form of the institution, mutual as opposed to stock, which causes loan officers to have an exaggerated concern for safety. *Id.* at 165-170.

183. Bentley & Macbeth, *supra* note 172, at 163-165.

V. Proposals for Legislation

A. Amendment of the Supervisory Procedure G-107 of the New York State Banking Department

Disclosure of the information on mortgage loans under the G-107 Procedure is far preferable to the prior methods of obtaining this information. However, several improvements can be made in the present regulation. Three proposals will be discussed here. First, a proposal to require banks to file the G-107 statistics sooner than is presently required will be analyzed. Second, a proposal to subdivide the statistics for multi-family dwellings into categories of initial or first mortgages on a building, and mortgages refinancing the building will be examined, and finally, the merits of a proposal to make public Appendix 7 of the G-107 forms will be discussed.

An amendment requiring the early disclosure of G-107 statistics has been proposed in the state legislature.¹⁸⁴ Unfortunately, a proposal requiring the banks to submit all appendices of the G-107 form sooner is not feasible. Banks do not keep records of all the required information, and need time to compile the information which is kept on file, in the manner proscribed by the G-107 Procedure.¹⁸⁵ However, because information pertaining to the number and dollar amount of loans is kept on file by banks, the only feasible proposal is one requiring banks to submit Appendix 9 which contains the information kept on file, to the Banking Department sooner than is presently required. A second proposal to the present G-107 format,¹⁸⁶ would require banks to divide the data on number and dollar amount of mortgage loans issued for multi-family dwellings into two categories: initial or first mortgages on a building, and mortgages refinancing the building.¹⁸⁷ Under a third proposal,

184. While banks keep records of the number and dollar amount of loans and the location of properties which are securities for the loans on hand, banks do not keep records of the denial or acceptance of all applications submitted. Telephone interview with William Wheelan, Research Director New York State Legislative Institute, Baruch College. (Sept. 12, 1980). Therefore, banks need the full nine months to gather this information and submit it to computer programmers. *Id.* Also, even the data on the number and dollar amount of loans must be "geo-coded"; that is, the address of the property must be matched to a census tract. *Id.* Smaller institutions which do not have in-house computer programmers must send the information out to data-processing firms. *Id.*

185. New York State Assembly Memorandum in Support of Legislation, Hirsch (1980).

186. *Id.*

187. See notes 56-58 *supra*.

the Banking Department should require banks to make public Appendix 7.¹⁸⁸ Appendix 7 should be made available in computerized form without the initials of the applicant or the loan application number. Omitting the latter information would protect the applicant's right of privacy.

B. An Administrative Hearing

An individual applicant who feels he has been discriminated against on the basis of race, sex, age or other personal criteria has legal and administrative remedies under both state and federal law.¹⁸⁹ Neither federal nor state law provides a mortgage applicant with a means of civil redress if he feels he has been discriminated against on the basis of the location of his property. Regulations promulgated under the Community Reinvestment Act only assuage the general public by denying a bank's application to expand its operations.¹⁹⁰ A bank only suffers a quasi-criminal penalty in the form of a fine if it violates state anti-geographic discrimination provisions.¹⁹¹ Therefore, a statute which provides for civil redress should be enacted.

One proposal which would provide for individual redress is similar in form to section 296-a of the Human Rights Law.¹⁹² An unlawful discriminatory practice is defined as discrimination by a creditor against an applicant for credit in the "granting, withholding, extending, modifying or renewing, or in the fixing of rates, terms or conditions of credit with respect to the purchase, acquisition, construction, rehabilitation, repair or maintenance of any housing accomodation" in areas where the creditor maintains offices.¹⁹³ In addition, under this proposal it would be unlawful for the creditor to use any of the above methods of discrimination against any applicant for credit "with respect to the purchase of certificates of stock or other evidence of ownership of an interest

188. See notes 44-52, 59-62 *supra*.

189. N.Y. EXEC. LAW §§ 297, 297-a (McKinney 1971); N.Y. EXEC. LAW §§ 296-a, 297, 297-a (McKinney Supp. 1972-1979); 12 C.F.R. §§ 202.1, 202.2(z) (1980).

190. See 12 U.S.C. §§ 2901-2905 (Supp. I. 1977); 12 C.F.R. § 345.1-102 (1980); N.Y. BANKING LAW § 9-f (McKinney Supp. 1979-1980); Regulation 76.1-3, *supra* note 75. *Contra* 12 C.F.R. §§ 202.1(c), 528.2 (1980).

191. N.Y. BANKING LAW § 9-f(1) (McKinney Supp. 1979-1980).

192. N.Y.A. Bill Draft No. 036432 (Dec. 10, 1979) 203rd Sess. at 3.

193. *Id.* at 3 (emphasis omitted).

in, and a proprietary lease from, a corporation formed for the purpose of the cooperative ownership of real property."¹⁹⁴ The proposal exempts from this definition of discrimination credit extended "pursuant to a specific public or private program designed to increase, within a specific neighborhood or geographic area,"¹⁹⁵ or a credit decision made upon the basis of "factually supportable objective differences in the applicants' overall creditworthiness, which may include reference to such factors as current income, assets and prior credit history of such applicants, reasonable analysis of the lending risks associated with the condition of the property in connection with which credit is sought or reference to any other relevant, factually supportable data."¹⁹⁶ However, despite these factors, no creditor could consider in evaluating the creditworthiness of an applicant, "aggregate statistics or assumptions relating to geographic areas,"¹⁹⁷ but rather he may consider the "structural condition of the property in connection with which credit is sought."¹⁹⁸ The definition used in this proposal is in consonance with language used in other sections of the HRL, in contrast to the present statute which simply prohibits geographic discrimination.

As under section 296-a, an aggrieved person can file a complaint with the superintendent of banks in lieu of filing a complaint with the division of human rights.¹⁹⁹ Pursuant to the proposal, unlike section 296-a, any not-for-profit community, neighborhood or public interest corporation or any civic association, claiming to be aggrieved by such discrimination may initially file a complaint.²⁰⁰ Also, unlike section 296-a, probable cause is specifically defined.²⁰¹

194. *Id.* at 4 (emphasis omitted).

195. *Id.* at 5 (emphasis omitted).

196. *Id.* at 5, 6 (emphasis omitted).

197. *Id.* at 6 (emphasis omitted).

198. *Id.*

199. *Id.*

200. *Id.*

201. *Id.*

The Superintendent must find probable cause if the creditor does not reinvest 25% of it's time and/or demand deposits received from the relevant county, census tract or ZIP code area in the form of mortgage loans on properties located in that area, if it is determined that there is a large unmet demand for mortgage loans within such area which such creditor, despite its asset size and the total amount of its time deposits and/or demand deposits, as compared to other banks, has not met.

Id.

An amendment to this proposal should be added, to empower the superintendent to enter an order in default, a provision absent from the present statute.²⁰² Ideally, the proposal should also require that the burden of proof be placed on the creditor.²⁰³ In all other respects the proposal prescribes the same procedures and empowers the superintendent to make the same orders as under section 296-a.²⁰⁴

VI. Tax Incentives Versus Subsidies

If redlining by definition is the refusal to lend in certain neighborhoods, based upon arbitrary criteria rather than upon objective considerations of risk,²⁰⁵ an incentive in the form of an income tax credit for the interest income earned from mortgage loans, should, theoretically, induce banks to make mortgage loans to these neighborhoods. The incentive-like other narrowly defined redlining legislation, would not force banks to make high-risk loans, but instead would induce them to abandon their bias by offering them a tax savings.

There are two traditional criticisms of tax incentives as compared to direct subsidies. The first criticism is that a tax incen-

202. See N.Y. EXEC. LAW § 296-a (McKinney Supp. 1972-1979).

203. Ideally the risk of nonpersuasion should be entirely shifted to the creditor, for two reasons. First public policy prohibits discrimination. JAMES & HAZARD, CIVIL PROCEDURE § 7.8 (2d ed. 1977); CLARK, CODE PLEADING 609-10 (2d ed. 1947). In light of the statistical conclusions of racial discrimination against individual credit applicants and that redlining exists, *see* note 9 *supra*, public policy would be promoted by requiring a respondent/creditor, to prove he has not discriminated against the complainant. Second, the creditor possesses the knowledge of whether or not discrimination has occurred. Because it is unlikely that Appendix 7 of the G-107 Supervisory Procedure will be made public, *see* notes 44-47, 59-62 *supra*, the knowledge as to why an applicant has been denied credit remains with the creditor and with the New York State Banking Department. JAMES & HAZARD, CIVIL PROCEDURE § 7.8 (2d ed. 1977); MAGUIRE, EVIDENCE, COMMON SENSE AND COMMON LAW 179 (1947); MORGAN, SOME PROBLEMS OF PROOF, 75 N.98 (1956); 9 WIGMORE, EVIDENCE § 2486 (3d ed. 1940).

Partially shifting the burden of proof is already common in cases involving discrimination. *Keyes v. School District No. 1*, 413 U.S. 189 (1973); *Swann v. Charlotte - Mecklenberg Bd. of Educ.*, 402 U.S. 1 (1971); *Dean v. Ashling*, 409 F.2d 754, 756 (5th Cir. 1969); *Chambers v. Hendersonville Bd. of Educ.*, 364 F.2d 189, 192 (4th Cir. 1966).

204. N.Y.A. Bill Draft No. 036432 (Dec. 10, 1979); N.Y. BANKING LAW § 296-a (McKinney Supp. 1972-1979). Under an alternate proposal, SONYMA would be given the authority to conduct such conferences and hearings and to prescribe and enter orders, exactly as described in N.Y.A. Bill Draft No. 036432. The SONYMA proposal is described in N.Y.A. Bill Draft No. 0622410 (Dec. 10, 1979) 203rd Sess.

205. *See* note 1 *supra*.

tive's cost is hidden;²⁰⁶ incentives, unlike direct subsidies, are not written into the fiscal budget and thus legislators find incentives a more palatable solution to social ills.²⁰⁷ Legislators, under the mistaken impression that a tax incentive does not cost anything, have too often seen incentives as the answer to a problem without fully understanding its ramifications. However, federal and state legislators have become increasingly aware that tax incentives are not a panacea for all social problems.²⁰⁸ On the federal level, evidence of this change in attitude is reflected in the insertion of tax incentives, like direct subsidies, in the federal budget.²⁰⁹

The second criticism of tax incentives relates to their cost and also to their attractiveness. Traditionally, incentives have been preferred over direct subsidies because they require less government interference in the private sector.²¹⁰ However, third party incentives, like direct subsidies, often require the creation of a bureaucracy to monitor the incentive program.²¹¹

206. Murphy, *State And Local Tax Incentives For Urban Growth: A Concept Whose Time Never Was?*, 6 FORDHAM URB. L.J. 457, 457 (1978); Spragens, *The Rehabilitation of Low-Income Rental Housing: A look at the Section 167(k) Program and the Direct Subsidy Alternative*, 28 CASE W. RES. L.J. 682, 699 (1978).

207. Murphy, *supra* note 206, at 457.

208. Spragens, *supra* note 206, at 699 n.100; P. HODGE & P. HAUSER, *THE FEDERAL INCOME TAX IN RELATION TO HOUSING* 96, 99 (1968), *cited in* 45 NOTRE DAME LAW. 121 n.114 (1969-1970).

209. Spragens, *supra* note 206, at 699 n.100.

210. See MITC, *supra* note 164, at 50 (statement of Dr. Edward J. Kane).

211. Spragens, *supra* note 206, at 700. A third-party incentive (or subsidy) is one granted to a party other than the one who is supposed to receive the benefit. Examples are the air pollution control tax incentive, I.R.C. § 169 (1980), the new jobs tax incentive, I.R.C. § 44B (1980), and the below-market-interest-rate subsidy (hereinafter cited as "BMIR") when granted to mortgagors who are landlords. Third party incentives do not necessarily require a greater bureaucracy to enforce them than first-party incentives. A larger bureaucracy is only necessary when the incentive does not directly induce the desired behavior. For example, a business which takes a new job, or air pollution deduction or investment credit, does so because it profits from reduced taxes; simultaneously the beneficiary, either the general public, or the new employee benefits. However, under the BMIR, while a landlord benefits from a reduced interest rate, tenants do not automatically benefit by having to pay reduced rents. This assumption, however, is invalid. MITC, *supra* note 164, at 51. See Whitman, *Federal Housing Assistance for the Poor: Old Problems and New Directions*, 9 URB. LAW. 14 (1977). Lower rents must be written into the legislation. 12 U.S.C. § 1715 (d)(3) (1970) as amended by § 101, Housing Act of 1961, Pub. L. 87-70, 75 Stat. 149; Housing and Urban Development Act of 1968, Pub. L. 90-448, 82 Stat. 476, 498, (codified at 12 U.S.C. § 1701(c) (1976)). Even if lower rents are written into the legislation a supervisory bureaucracy would have to be created to ensure that lower rents would be charged. Cf. MITC, *supra* note 164, at 53, 55-56 (statement of Dr. Edward J. Kane).

To ensure that the redlining incentive is effective, that is, to ensure that the intended beneficiaries of the incentive, redlined neighborhoods receive their benefits, a bureaucracy would have to be created.²¹²

In addition to the traditional criticisms of tax incentives, there are three other factors which must be considered before a redlining tax incentive could be enacted. First, such an incentive must be worded in language palatable to banks. Second, the credit would have to be large enough to reimburse the mortgagee for any perceived or real risks it would take by issuing the loan.²¹³ Yet the incentive should not be so large that it would create a windfall. Third, the effects of other factors, such as the depreciation on buildings still allowed by the federal income tax code, must be considered.²¹⁴

A bureaucracy would be necessary to check whether banks were requiring unnecessary collateralization in order to obtain more credits. *Cf.* MITC, *supra* note 164 at 56. This abuse should be no harder to detect in loans to multi-family dwellings than in loans to single-family dwellings. First, mortgages to apartment buildings often do not amortize the entire purchase. SCHAFER, *supra* note 1, at 3-82. Therefore, refinancing is often legitimate. Yet, determining whether the second mortgage covers more than the original principal would not be difficult. To receive the credit, a mortgagee bank would have to make a loan in a redlined area. The beneficiary, a purchaser of real estate in the redlined neighborhood, would simultaneously benefit.

212. First, a bureaucracy would be necessary to define redlining and to decide which neighborhoods are currently redlined. Addresses to which loans were made would have to be checked at random, to determine whether loans were made to redlined neighborhoods. Another potential abuse of such a credit by mortgagees (or mortgagors) would be increased collateralization. *Cf.* MITC *supra* note 164, at 55-56. Collateralization is unnecessary when the building is used to secure a loan which is not for the purpose of financing the building's purchase.

213. An added argument for creation of the incentive and for making it large might be that it would increase banks' revenues, particularly in times of disintermediation. I.R.C. § 167 (1979). However, if redlining is viewed strictly as the arbitrary refusal of loans based upon prejudice, one would be giving the banks an incentive to do what they should do without inducement, thereby placing the burden on the taxpayer. Instead, the costs of solving disintermediation should be placed upon banks as part of the free enterprise system. Obviously, the size of the incentive must also be taken into account when determining the incentive's cost.

214. Depreciation, still allowed by the federal income tax code, creates rapid turnover in the sale of multi-family buildings once the depreciation is complete; landlords have no incentive to invest money in repairs or rehabilitation. I.R.C. § 167 (1979). There are no statistics as to the number of people denied loans because of redlining or the number who simply have not applied for loans because of redlining. Nor are there any statistics, currently available to the public, as to the number of loan recipients given modified terms, or who are denied refinancing due to redlining. *See Supervisory Procedure G-107, supra* note 4, Ap-

Assuming a redlining incentive were enacted, serious questions about its effectiveness would be raised. First, one would have to consider whether a tax incentive would increase a bank's existing participation in the mortgage market in redlined neighborhoods.²¹⁵ Second, one must consider whether a tax credit would broaden participation in the mortgage market by inducing institutions which previously had not lent to redlined areas to issue mortgage loans in these neighborhoods.²¹⁶ A related question is whether a tax incentive should discriminate in favor of mutuals as opposed to commercials.²¹⁷

Finally, after balancing all the possible costs and benefits of a redlining incentive, one must examine the actual gains from the incentive. Too often, even a successful tax incentive will make only a small monetary or numerical dent in the statistics of the social problem it was created to alleviate.²¹⁸

If a redlining incentive by most counts would be inefficient and ineffective, it would not solve the problem of redlining, nor should the purpose of such an incentive be to solve other problems facing banks, such as the problem of disintermediation. Further, an incentive should not be created to induce the banks to do what they already should be doing.

A. Amendment of the Law Creating the State of New York Mortgage Agency

One must decide initially whether it is better to give a small subsidy in the form of SONYMA funds to the banking industry as is presently done, or to cure the problems which create the need for the subsidy. If the subsidy is favored, then the terms pursuant

pendix 7, at 8. Appendix 7 includes a statement by the lender explaining the decision denying the mortgage application; however, this appendix is not available to the public.

215. Cf. MITC, *supra* note 164, at 24-25 (statement of Dr. Patric H. Hendershott).

216. Cf. *id.* at 50, 57-58 (statement of Dr. Edward J. Kane, and excerpt from the JOURNAL OF BANK RESEARCH, by Dr. Edward J. Kane).

217. If the purpose of the incentive is to induce mutuals to resume their traditional role as mortgagees, then only mutuals should be given the incentive. MITC, *supra* note 168, at 24, 57-58 (excerpt from the JOURNAL OF BANK RESEARCH by Dr. Edward J. Kane). However, if the purpose of the incentive is to broaden participation in the mortgage market, then commercial banks should be given the incentive as well. *Id.*

218. See note 118 *supra*. The problem is compounded with respect to a redlined neighborhood, because the necessary statistics about redlining are not available. Therefore, the efficiency of an incentive cannot be examined.

to which the banks are obligated to issue new mortgage loans must be inserted directly into the statutes governing the operation of SONYMA, or a general prescription of the types of terms allowed should be inserted. Such a limitation should also require that a percentage of loans be issued specifically for apartment buildings. Ideally the amount of the subsidy should also be increased.

A better alternative is to empower SONYMA to originate low-interest mortgage loans for low-income housing.²¹⁹ SONYMA would be required to gain the expertise necessary to screen loan applications as bank staffs presently do. However, if one instead increased the subsidy to the banking industry and restricted the terms allowed for the new loans banks must issue the agency would still have to increase its duties. SONYMA, to check banks' compliance, would not only have to inspect banks' records, but also check sites of properties used to secure loans.²²⁰ Therefore, because SONYMA would have to increase its duties under either proposal, the former is preferable. As a mortgage originator, SONYMA can directly effect its stated goal of increasing the supply of low-income housing. Loans to low-income areas are precisely the type which pose a risk to the "safe and sound" operations of banking institutions.²²¹ Under the alternative proposal, as a subsidizer of the banking industry, SONYMA would instead jeopardize the safe and sound operations of the banks by forcing them to make just such high-risk loans. Therefore, the proposal empowering SONYMA to originate mortgages should be enacted, even if some of the proposals to cure disintermediation, discussed below, are enacted as well.

In addition, SONYMA should be allowed to make loans to those corporations who want to buy or build apartment buildings without the present limitations.²²² Such a proposal should also require that benefits be passed along to tenants; rent ceilings enforceable by city or state rent agencies would have to be included in any multi-dwelling mortgage. Either proposal should also include criteria that a certain percentage of SONYMA's available funds go to areas redlined in prior years or that a certain percentage of the

219. N.Y.A. 12217, § 66, 203rd Sess. (1980); N.Y.A. 12156, § 86, 203rd Sess. (1980).

220. See note 211 *supra*.

221. See notes 69, 166 *supra*.

222. N.Y. PUB. AUTH. LAW § 2405(3)(a)(b) (McKinney Supp. 1970-1979).

banks' new commitments go to these areas.

VII. Proposals to Modify the Structure of Mutual Savings Banks

Several proposals have been suggested to expand the powers of mutuals and to make greater use of existing powers. Use of these powers would enable mutuals to maintain greater liquidity in times of disintermediation.²²³ These proposals are also advantageous because they represent permanent organic reforms rather than a temporary fiscal change such as the tax incentive discussed above.²²⁴ In the past, some commentators have argued that inflation is cyclical and thus its adverse effects would be neutralized over time; therefore, organic changes in mutuals' structure were not necessary.²²⁵ However, today the opposite is true.²²⁶ Thus a temporary subsidy is no longer an appropriate remedy.²²⁷ Three proposals to modify the structure of mutuals will be discussed: (1) the use of variable rate mortgages ("VRM's") and price-level adjusted mortgages ("PLAM's"); (2) the issuance of credit cards and consumer loans; (3) the use of notes, debentures, bonds and mortgage-backed securities.

A. Variable-Rate and Price-Level Adjusted Mortgages

A mortgage instrument has three parameters: the term or contract period (which can be further subdivided into the amortization and interest periods), the principal, and the percentage of interest, or interest rate, to be paid upon the principal.²²⁸ In the standard mortgage instrument, the interest rate and the ratio of

223. See notes 238, 247, 251 *infra*.

224. See notes 205-217 *supra*.

225. Hyer and Kearn, *Legal Impediments to Mortgage Innovation*, 6 REAL EST. L.J. 211, 215-216 (1977-1978).

226. Hyer and Kearn, *supra* note 225, at 216-17. Inflation is both foreseeable and permanent, not a temporary abnormality. See note 167 *supra*. The increase in the rate of inflation in recent years has caused liquidity crises for a number of mutuals. See note 171 *supra*. Even if inflation is considered "cyclical," it requires long-term structural changes. Furthermore, the real cost of mortgages over times has not changed. Hyer and Kearn, *supra* note 225, at 217.

227. Hyer and Kearn, *supra* note 225, at 217.

228. *Id.* This is not the case with a "balloon" mortgage where amortization is not completed when the term of the loan is finished; instead the loan is renegotiated. See TAKE THE MONEY AND RUN, *supra* note 1, at ii.

payments of principal and interest is fixed over the term of the contract.²²⁹ Thus the borrower pays the last interest payment on the same date he completes the amortization for the loan.²³⁰ Under a variable-rate mortgage the interest rate is not fixed.²³¹ Rather than choosing to vary the term or principal parameters by lengthening the term or amortization periods, or increasing the principal, proponents of the VRM advocate changing the relationship between the term of the mortgage and the amortization period.²³² The mortgage becomes a series of shorter-term contracts for which the interest rate may or must be renegotiated.²³³

While other mortgage market participants, such as commercial banks and credit unions, can make VRM loans as long as state laws do not prohibit them, the Federal Home Loan Bank Board prohibits mutual savings banks and savings and loan associations from making such loans.²³⁴ At present VRM's are in effect in some states and abroad.²³⁵ In New York, their use by mutuals is prohibited²³⁶ but several proposals have been submitted to the state legislature which would allow their use.²³⁷ The main advantage of a VRM is that it allows a mutual to maintain an interest rate on mortgage instruments competitive with short-term interest rates.²³⁸

However, there are several obstacles which must be overcome

229. Hyer and Kearn, *supra* note 225, at 217.

230. *Id.*

231. *Id.*

232. *Id.*

233. *Id.*

234. Werner, *Usury and the Variable-Rate Mortgage*, 5 REAL EST. L.J. 155 (1976-1977).

235. Strum, *New York State Bar Association Real Property Law Section: Comm. 5533 on Mortgages, Report on the Variable Rate Mortgage*, 45 N.Y. ST. B.J. 112 (1973).

236. See N.Y. BANKING LAW §§ 235(6)(b), 380(1)(a)(4) (McKinney Supp. 1979). No such restriction is placed upon mortgages made by commercial banks. N.Y. BANKING LAW § 103 (McKinney 1958), or insurance companies, N.Y. INS. LAW § 81 (McKinney Supp. 1979).

237. First, the Federal Home Loan Bank Board ("FHLBB") proposed a regulation. 37 Fed. Reg. 16201 (Aug. 11, 1972), which was withdrawn in 1973. 38 Fed. Reg. 17023 (June 28, 1973). The same proposal was revived and withdrawn again. 40 Fed. Reg. 6870-74 (Feb. 14, 1975); 40 Fed. Reg. 51414-15 (Nov. 5, 1975). The Dime Savings Bank of New York recently introduced a renegotiable rate mortgage ("RRM") in the New York metropolitan area. N.Y. Times, Sept. 21, 1980, at § 8, 1, cols. 1-2, 4, col. 1. Bills allowing mutuals to issue VRMs were introduced in the state legislature during its last session. N.Y.A. 12156 § 51, 203 Sess. (1980); N.Y.A. 12217 § 45, 203 Sess. (1980); N.Y.S. 10191 § 48, 203 Sess. (1980). N.Y.A. 12217 passed in part in the Assembly. Only the Senate passed N.Y.S. 10191.

238. Hyer and Kearn, *supra* note 225, at 218.

before VRM's can be implemented in New York. Laws prohibiting usury present the most commonly cited legal problem.²³⁹ The second major problem in implementing VRM's is defining a suitable index to which to tie the mortgage loan's interest rate.²⁴⁰

There are several additional problems with VRM's as well. Mutuals may also lose the stability on long-term fixed rates and of course may lose money when interest rates are low.²⁴¹

Whether VRM's can generate funds sufficient to ease the consequences of disintermediation is questionable. First, VRM's may increase transaction costs, thus decreasing the funds saved through the use of VRM's.²⁴² Also unanswered is the amount of additional income VRM's would provide. The utility of VRM's as a method of eliminating either disintermediation itself or its adverse effects has

239. Strum, *supra* note 235, at 117; Werner, *supra* note 234, at 155; Hyer and Kearl, *supra* note 225, at 122. In New York an individual can be charged no more than 18% interest on any consumer loan. N.Y. GEN. OBLIG. LAW § 21 (McKinney Supp. 1979). Several arguments to avoid the charge of usury have been advanced. Hyer and Kearl, *supra* note 225, at 223-26. Strum, *supra* note 235, at 117-18. Werner, *supra* note 234, at 156-62. However, none of these arguments is persuasive. Moreover, the limited purpose of such arguments is to provide a defense for banks during litigation.

240. Due to the volatility of interest rates, a conservative measure should be used. Strum, *supra* note 235, at 113. Otherwise, frequent changes in the rate could add costs for both the lender and borrower, in the form of increased services required to continually renegotiate the loan. *Id.* In addition to the frequency of the change in interest rates, the percentage of change must be considered; if it is large, it can, of course, cause a burden on the borrower, particularly if his income is fixed, or at least not rising as rapidly as the interest rate. *Id.* at 117. Lenders may wish to restrict the percentage of change in the interest rate or set a minimum and maximum rate. *Id.* at 115. Several indices have been suggested. *Id.* at 113-15. The best of these is the national mortgage rate. The Federal Home Loan Bank Board and the Federal Housing Authority publish such indices. While the national rate might not reflect changes in the local mortgage money markets, it is an objective rate and one that could be easily checked by the mortgagor. *Id.*

241. Mutuals will lose the stability they gained by having fixed long-term investments in their portfolios. Strum, *supra* note 235, at 117. If all institutions do not use the VRM instrument, an institution which offered only VRM's might lose customers. *Id.*; LASDON, *Investment and Finance: Variable-Rate Mortgages*, 87 BANKING L.J. 762 (1970). When interest rates are low, banks would have to accede to customers' demands for fixed rate loans, Strum, *supra* note 235, at 120, and may also be forced to give an initial discount to make the mortgage more attractive, Lasdon, *supra*, at 762, or covenant to maintain the current rate on other mortgages. Strum, *supra* note 235, at 121. Statutes which require banks offering VRM instruments to decrease as well as increase mortgage interest rates, *see, e.g.*, CAL. CIV. CODE § 1916.5(a)(1) (West Supp. 1980), while the liabilities of mutuals remain fixed, that is, if mutuals cannot correspondingly decrease interest paid on savings deposits, the utility of a VRM may be lost.

242. *See* note 248 *supra*.

not been shown. In Great Britain, where sixty percent of all mortgages are VRM's, mortgage lending institutions have not been able to eliminate the effects disintermediation has during inflationary periods.²⁴³ The use of the VRM to redistribute income to depositors is suspect. Assuming no ceiling on deposit interest rates were to exist, it has not been demonstrated that mutuals could increase their revenues through the use of VRM's alone; enough to offer interest rates on deposits competitive with those on other investments. Therefore, VRM's alone may not be a practicable solution for preserving the assets of mutuals during periods of inflation.

An alternative to the VRM instrument is a price-level adjusted mortgage instrument. Under a PLAM the principal rather than the interest rate or term varies, so that the outstanding principal is readjusted periodically to reflect the "real" value of the outstanding debt. The index by which the changes will be measured is specified in the contract, as in a VRM instrument.²⁴⁴ An important practical consideration with the PLAM, as with the VRM, is which index to use; several have been suggested.²⁴⁵ Most of the problems which would arise when implementing PLAM's are the same as those that would arise when implementing VRM's.²⁴⁶ However, there is one major advantage of the PLAM as compared to the VRM. Unlike the VRM, the PLAM may be advantageous to both

243. Lasdon, *supra* note 241, at 763.

244. Hyer and Kearn, *supra* note 225, at 218.

245. The consumer price index, and several wage-income indices have been suggested. *Id.* The consumer price index has been suggested because it is objective. It is an index established by the federal government, not one established by an individual bank. Also, the public can obtain the consumer price index easily and can understand it. Strum, *supra* note 235, at 116.

246. As with the VRM there are several problems with the PLAM. First, some courts may consider an adjustment of the principal as additional interest and thus usurious. Strum, *supra* note 235, at 118. However, because the currency is being lent at its real value, it has been held not to be usurious. *Id.* A second legal prohibition in some jurisdictions is compounded interest. Hyer and Kearn, *supra* note 225, at 226-27. However, if a court considers a PLAM as several separate contracts with an option for the borrower to immediately pay the increase in principal, it might be held legal. *Id.* at 227-28. As suggested earlier in the discussion of VRM's, it would be more sensible to amend the laws proscribing usury and compound interest. See note 239 *supra* and accompanying text. A third obstacle may possibly arise in implementing PLAM. They may be void for reasons of public policy. Strum, *supra* note 235, at 116 nn.13, 15-16. Again, several arguments to avoid this interpretation have been suggested. Hyer and Kearn, *supra* note 225, at 230-31.

the borrower and the lender.²⁴⁷

VRM's alone will probably not bring in enough revenues to maintain mutuals' cash flow during periods of inflation.²⁴⁸ PLAM's, because they are more palatable to borrowers, may be more widely used by mutuals and thus bring in greater revenues. However, VRM's or PLAM's alone will probably not solve all of a bank's cash flow problems.²⁴⁹

B. Proposals to Expand Mutuals' Power to Lend to Consumers

A second series of proposals recommends enhancing the lending powers of mutuals' in order to protect against the adverse effects of disintermediation. The proposals most often mentioned would allow mutuals to issue credit cards and to make consumer loans.²⁵⁰ There are several advantages to such proposals. First, allowing mutuals to invest in shorter-term assets such as consumer loans with higher yields would enable mutuals to better match the terms and yields of their liabilities. Thus mutuals could maintain a more constant level of operating funds, even during periods of infla-

247. Hyer and Kearl, *supra* note 225, at 237-38. Under a standard instrument, the lender charges a higher fixed interest rate to account for inflation; thus, while the payment remains the same over the term of the mortgage, the biggest burden for a young upwardly mobile household whose income has not yet risen, is during the early years of the mortgage. *Id.* at 218. Under a PLAM, the payment rises with the rate of inflation; thus, the initial payment will be the same regardless of the rate of inflation and thus, lower than the initial payment under a standard mortgage contract under the same conditions. *Id.* That is, the lender will charge the real value of the principal and charge for the present-discounted value in either a standard or VRM instrument, but in addition, charge a higher interest rate to reflect the rate of inflation. Ideally, a PLAM could also be adjusted to reflect the income of an older household with payments starting above the real rate of payment and later falling below it. *Id.* at 219.

248. See note 243 *supra*.

249. *Id.*

250. N.Y.A. 12156 § 30, 203rd Sess. (1980); N.Y.A. 12217 § 30, 203rd Sess. (1980); N.Y.S. 10191 § 30, 203rd Sess. (1980). See Lapidus, *New Powers for Mutual Savings Banks*, PUBLIC POLICY TOWARDS MUTUAL SAVINGS BANKS IN NEW YORK STATE: PROPOSALS FOR CHANGE 229 (1974); Klamman, *supra* note 164, at 258. Pursuant to recent federal legislation, state-chartered banks may apply for federal charters. Financial Institutions Regulatory Control and Interest Rate Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 (codified at 5 U.S.C. § 5108, 12 U.S.C. § 27 (Supp. II 1978)). Under federal legislation enacted this year, federally chartered savings and loan associations and mutual savings banks are allowed to issue credit cards as proposed here. Federal Reserve Act, Pub. L. No. 96-221, 94 Stat. 132 (codified at 12 U.S.C. § 248 (1980)). Therefore a state-chartered mutual savings bank may now apply for a federal charter and thus gain the power to issue credit cards.

tion.²⁵¹ The second possible advantage to such proposals would be the broadening of the mortgage market among more financial institutions.²⁵² Commercials might invest more heavily in mortgages as mutuals become more competitive in the credit card and consumer loan markets. The burden of long-term mortgages would then be spread through a wider market.²⁵³

However, mutuals should not be allowed to exercise all the powers which commercials now exercise.²⁵⁴ Proposals which recommend that mutuals be given all the same powers as commercials have several faults. First, if mutuals were allowed to service corporate as well as consumer customers, funds would be diverted from the mortgage market.²⁵⁵ Corporate customers, because of their superior bargaining position,²⁵⁶ and their ability to bring mutuals more business,²⁵⁷ will divert substantial funds earmarked for mortgage loans.

Unfortunately, studies which analyze these proposals do not consider the possible diversion of funds within the consumer market from mortgage loans to consumer loans and credit cards.²⁵⁸ Consumer loans and credit cards provide higher yields,²⁵⁹ and are less labor-intensive.²⁶⁰ In other words, funds within the consumer mar-

251. MITC, *supra* note 164, at 39; Klamann, *supra* note 164, at 258. In addition to empowering banks to invest in short term assets with higher yields, proposals to remove interest ceilings have been made. It is argued that these additional powers would help mutuals reduce disintermediation during times of inflation. MITC, *supra* note 164, at 43.

252. Klamann, *supra* note 164, at 257.

253. *Id.*

254. Lapidus, *supra* note 250, at 246.

255. N.Y.A. 12156 § 29, 203rd Sess. (1980); N.Y.A. 12217 § 29, 203rd Sess. (1980); N.Y.S. 10191 § 29, 203rd Sess. (1980). Klamann, *supra* note 164, at 257; Lapidus, *supra* note 250, at 239-245, 246.

256. Lapidus, *supra* note 250, at 240-246. A businessman's demand for service from any particular bank is more elastic than a consumer's. His needs are not based upon the convenience of a bank's location as is the case with consumer's. The market for the business customer is more competitive, forcing banks to give such customers preferential treatment. Lapidus, *supra* note 250, at 240-41.

257. *Id.* at 240-41. Corporate customers provide additional business and are a source of deposits. *Id.*

258. See generally L. LAPIDUS, S. CUTLER, P. KILDOYLE & A. CASTRO, PUBLIC POLICY TOWARD MUTUAL SAVINGS BANKS IN NEW YORK STATE: PROPOSALS FOR CHANGE (1974).

259. N.Y. GEN. OBLIG. LAW § 501(1) (McKinney 1978); N.Y. BANKING LAW § 14-a(2)(a)-(b), (10) (McKinney Supp. 1979-1980).

260. See Bentley and Macbeth, *supra* note 172, at 161-64. A bank need only investigate the credit rating of an applicant for a personal loan or a credit card; however, a bank must

ket may be diverted from mortgage loans to personal loans. The failure to account for this possibility may be a major flaw in current analysis which detracts from the recommendations made by these studies.

C. Proposals to Expand the Use of Debt Securities

Another means to increase mutuals' funds for mortgages would be to expand their use of liabilities other than savings deposits. In 1973, the New York State Banking Law was amended to give mutuals the power to issue notes, bonds, debentures, or other obligations or securities subordinated to deposits. Such securities cannot exceed twenty-five percent of the net worth of the savings bank issuing them, and their issuance is subject to the regulations and restrictions of the banking board.²⁶¹

Borrowing, other than short-term borrowing by mutuals, has traditionally been discouraged.²⁶² Debt securities such as debentures were last issued in large quantities by commercial banks in the 1930's during a time of widespread bank failures.²⁶³ The debentures were sold to a corporation created by Congress to assist the recovery of the banks; these debentures were retired as banks reached financial stability.²⁶⁴ For this reason the use of debentures by commercials has often been associated with economic crisis both by the general public and by the agencies which regulate banks.²⁶⁵

In the past, the Board of Governors of the Federal Reserve System took the position that debentures involved considerable risk to issuing banks during periods of low earnings.²⁶⁶ The Board's fear of risk is applicable to present-day mutuals as well, because the overuse of debentures could also cause mutuals to fail. However, since the early 1960's commercials have used debt securities as an additional source of financing with some success.²⁶⁷ Therefore, a

(or should) examine the property in the case of a secured loan such as a mortgage. *Id.*

261. N.Y. BANKING LAW § 234 (5-b) (McKinney Supp. 1979-1980).

262. See MITC, *supra* note 164, at 47-48.

263. McKinney, *supra* note 163, at 86.

264. *Id.* at 85. Reconstruction Finance Corporation Act, Pub. L. No. 2, 47 Stat. 5 (1932) (codified at 15 U.S.C. §§ 82, 601 (1976)) (repealed in part).

265. *Id.* at 86-9.

266. *Id.* at 87-8.

267. *Id.* at 90-1.

change in attitude towards the use of these debt securities may also prove fruitful to mutuals. Debentures can be used as an additional source of funds or, in their subordinated form, as an additional form of capital.²⁶⁸

Another form of security, suggested to ease mortgage originators' liquidity problems is the mortgage-backed security. There are two forms of mortgage-backed securities, certificates which evidence ownership directly or indirectly in a mortgage loan or pool of mortgage loans, and an obligation secured, directly or indirectly by a single mortgage loan or by a pool of loans.²⁶⁹ Such an obligation may also be secured by a guarantee which is secured, directly or indirectly, by a mortgage loan or pool of loans.²⁷⁰

The use of mortgage-backed bonds has grown rapidly since 1970 when they were first introduced into the financial markets.²⁷¹ Commercial banks were the first financial institutions to issue these securities.²⁷² In 1975 the Federal Home Loan Bank Board amended its regulations to allow eligible insured savings and loan associations to issue mortgage-backed bonds.²⁷³

Additional uses of mortgage-backed securities have been suggested. First, federal credit unions which were given the power to make thirty-year mortgage loans in 1977, could use these securities to avoid potential liquidity problems.²⁷⁴ Second, commercial banks could also use mortgage-backed securities to re-enter the mortgage market or to expand their existing long-term mortgage lending because these securities allow investments in mortgage loans to be converted into cash.²⁷⁵ These suggested uses, to avoid illiquidity and to either re-enter or expand existing participation in the mortgage market, also make mortgage-backed securities ideal vehicles for mutuals.

268. *Id.* at 85. To counter the traditional fears concerning the issuance of debentures and other debt securities, mutuals should be required to join the Federal Reserve System and to keep reserves as commercials presently are required to do. McKinney, *supra* note 163, at 85.

269. Klamman, *supra* note 164, at 259-260; Strine, *New Commercial Devices—Mortgage-Backed Securities*, 13 REAL PROP. PROB. AND TR. J. 1012 (1980).

270. Strine, *supra* note 269, at 1012.

271. *Id.* The last widespread use of mortgage-backed bonds was in the 1920's.

272. *Id.*

273. 40 Fed. Reg. 17,982 (1975).

274. Strine, *supra* note 269, at 1044.

275. *Id.*

At present, however, mortgage-backed securities as issued in large denominations, are not intended to attract the sophisticated individual investor.²⁷⁶ Yet, disintermediation, caused by an outflow of deposits from savings banks into money market instruments, demonstrates the need for mortgage-backed securities competitive with other securities.²⁷⁷ Such a consumer-type, mortgage-backed security could be marketed in a variety of denominations and maturities like other open market securities.²⁷⁸

It has been argued that if mutuals are allowed expanded powers, and thus to compete directly with commercials, they should no longer retain the advantages given in the past to remain "competitive" with commercials.²⁷⁹ In other words, mutuals should be required to keep reserves.²⁸⁰ The tax advantages mutuals now receive should be discontinued,²⁸¹ and the higher interest rate mutuals can pay for savings deposits should also be eliminated.²⁸² Last, some commentators advocate the restructuring mutuals into stock corporations.²⁸³ The arguments that mutuals should not retain these advantages, are based on the notion of "being fair" to commercials, not upon logic or statistical analysis.²⁸⁴ Implicit in these arguments is the assumption that all the proposals analysed here, will produce a substantial increase in revenues for the mutuals.²⁸⁵ This increase must be large enough to allow mutuals to maintain their cash flow during periods of disintermediation, but in spite of the loss of all

276. Klamann, *supra* note 164, at 259.

277. *Id.*

278. *Id.* Such a mortgage-backed security should also be designed to minimize competition with savings deposits. *Id.* The last organic change in the structure of mutuals which has been suggested is also the most radical. It has been suggested that mutuals convert into stock organizations similar to commercials and some savings and loan associations. Lapidus, *supra* note 250, at 231, 259. The advantage of such a suggestion is that it would separate the risks involved when banks borrow short-term or issue debt securities. Furthermore, it would separate the risks of illiquidity associated with the banks' role as mortgagee and its role as a depository for savings. See text and notes accompanying notes 288-305 for a discussion of the use of credit unions, a stock form of organization, as mortgage originators in redlined areas.

279. Lapidus, *supra* note 250, at 259-260.

280. *Id.*

281. *Id.*

282. *Id.*

283. *Id.*

284. See notes 279-283 *supra*.

285. See notes 246, 250, 251, 255, 259 *supra*.

advantages they previously enjoyed. If this assumption is not true, mutuals will be forced to engage almost exclusively in short-term lending as commercials presently do. If this is the case, the purpose of all the proposals discussed above, to pour more funds into the mortgage market, would be defeated.

The above proposals are not founded on the premise that mutuals which are more competitive will be less prejudiced. It is arguable that in a system of perfect competition, more loans will be made to redlined areas.²⁸⁶ In a truly competitive marketplace, somebody will enter the market for mortgage loans to redlined areas because there is a profit to be made.²⁸⁷ However, redlining in the strict sense is irrational; considerations of risk versus profit does not exist within the realm of irrational thinking.

Instead, a premise of this Comment is that disintermediation indirectly affects redlined areas by decreasing the amount of funds which mutuals have to lend. The above remedies, expansion of mutuals' powers to issue VRM's, PLAM's, credit cards, consumer loans, and to make greater use of existing powers to issue debt securities will maintain mutuals' liquidity during periods of disintermediation without sacrificing the goal of safeguarding depositors' funds.

VIII. Community-Based Federal Credit Unions

Community-based federal credit unions have also been proposed as a means of solving the problems of redlining and disinvestment.²⁸⁸ Under federal law, a credit union is defined as a "cooperative association organized . . . for the purpose of promoting thrift among its members and creating a source of credit for provident and productive purposes."²⁸⁹ Credit unions were intended by Congress to provide a source of credit for persons of "small means" who are unable to borrow from conventional bank institutions.²⁹⁰

286. See P. SAMUELSON, *ECONOMICS* 62-63 (9th ed. 1973).

287. *Id.*

288. *Financial Reform Act of 1976: Hearings before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance*, 94th Cong., 2d Sess., Part 1 at 185 [hereinafter cited as *Financial Reform Act of 1976*].

289. Federal Credit Union Act of 1934, ch. 750, § 101 formerly § 2, 48 Stat. 1216, *renumbered and amended* Pub. L. 91-468 §§ 1(2), 2, 84 Stat. 994, 1015 (1970) (codified at 12 U.S.C. § 1752(1) (1976)).

290. S. Rep. No. 555, 73d Cong., 2d Sess. 1 (1934); 78 Cong. Rec. 12223 (1934).

Credit unions have the power to make loans for the purchase of residential real estate,²⁹¹ which must serve as the principal place of residence for the credit union member.²⁹² The union is obligated to extend credit up to and often in excess of the member's shareholdings.²⁹³ Also, the rate of interest on such loans may not exceed one percent per month on the unpaid balance of the loan, including all applicable service and administrative charges.²⁹⁴

Like mutuals, credit unions pool the small savings of members in order to obtain funds for use as credit.²⁹⁵ Unlike mutuals, federal credit unions issue shares to members;²⁹⁶ these members, also unlike depositors, have a "common bond of occupation, or association," or belong to a group "within a well-defined neighborhood, community or rural district."²⁹⁷ The purpose of this requirement is to create a group whose members are either already familiar with each other's reputations and thus would be willing to work together, or who all have a shared interest in their community.²⁹⁸

The irony of this proposal is that credit unions will simply replace the traditional savings and lending functions of mutual savings banks.²⁹⁹ However, in such credit unions, unlike in mutuals, the savings and lending functions are separated; members of the union would not necessarily have greater control of the union because of their ownership as shareholders than depositors have over mutuals.³⁰⁰ However, members might be able to obtain credit more easily because the union's credit committee would not stress overly conservative management policies for the sake of protecting deposits.³⁰¹ The union's main purpose in this proposal would be to extend credit for the purpose of rehabilitating a community by al-

291. 12 U.S.C. § 1757(5).

292. *Id.*

293. *Id.* § 1757.

294. *Id.* § 1757(5)(A)(vi), (vii). This rate was raised to 1.25% per month by the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 86-822.

295. NATIONAL CREDIT UNION ADMINISTRATION, *Changes in Federal Credit Union Common Bond Policy, A Policy Analysis: 1965-1974*, 2, Appendix A (July 1975).

296. 12 U.S.C. § 1757 (1976).

297. *Id.* § 1759.

298. See D. MELVIN, R. DAVIS & G. FISHER, CREDIT UNIONS AND THE CREDIT UNION INDUSTRY: A STUDY OF THE POWERS, ORGANIZATION, REGULATION AND COMPETITION 43 (1977).

299. See note 172 *supra* and accompanying text.

300. See note 182 *supra*.

301. See note 173 *supra* and accompanying text.

lowing the purchase of properties which traditional lending institutions will support.³⁰²

There are three major limitations to this proposal as well as several problems. Initially, individuals may experience difficulty obtaining enough capital to establish the credit union, and maintaining liquidity once the credit union is established. However, these problems are surmountable.³⁰³ Aside from the problems of capitalization and liquidity, there are three major limitations on this proposal. First, because federally chartered unions may only make loans for the purchase of properties which are the principal residences of the union members buying them, loans for the purchase of apartment buildings are probably excluded.³⁰⁴ Even if this were not so, the requirement that the loan be a first lien, would prevent loans refinancing the purchase of apartment buildings.³⁰⁵ Second, credit unions, like all financial institutions, could not make high-risk loans and still expect to remain solvent. Therefore, the use of credit unions in low-income neighborhoods is not feasible. Third, the proposal presupposes a cohesive community. Union members would have to have either enough confidence or financial ability to patiently support the union in its efforts to obtain additional funds and expertise. This presupposition may overwhelm reality, but without it the concept is of little use.

302. FINANCIAL REFORM ACT OF 1976, *supra* note 288, Statement of Credit Union National Association, Inc. at 156-60.

303. Although credit unions typically obtain initial capital from member shares, such shares may have a par value of as little as five dollars. 12 U.S.C. § 1757 (1976). Under the present law, a credit union may then obtain additional funds in two ways. First, once a charter is obtained, the union may join the National Credit Union Central Liquidity Facility with only a \$50 subscription. *Id.* § 1795(a)-(i). The union can then apply for credit to meet its liquidity needs. *Id.* § 1795(e). Second, to raise additional funds the union can sell its mortgages in the secondary mortgage market and can then invest in United States securities or in bank deposits of other financial institutions. *Id.* § 1757(7)(B)-(E). Three additional means of obtaining funds have also been proposed. First, the common bond requirement should be construed liberally to allow neighborhood businesses as members; they can provide additional funds. *Financial Reform Act of 1976, supra* note 288, at 88-89. Second, mutual and commercial banks could be required to extend credit to these unions. *Id.* at 137-39. Third, federal housing programs should be amended to allow funding of community credit unions. *Id.* at 136.

304. See note 292 *supra* and accompanying text.

305. *Id.* § 1757(5)(A)(i).

IX. Conclusion

The host of state and federal statutes and regulations enacted to remedy the problems of redlining and disinvestment have only been partially effective, and state legislation to remedy the lack of funds for low-income housing has been wholly ineffective. In addition, state legislation to subsidize banks during periods of disintermediation has satisfied only a small amount of the demand for mortgage funds.

Legislation to prohibit redlining, like legislation prohibiting any type of discrimination, is easy to enact but difficult to enforce. The goal of such legislation is not merely to order the economy, but to compel changes in attitudes, often long-set biases. Realistically, however, while discrimination of any kind should not be tolerated, it can never be truly "prohibited." Legislation mandating reinvestment also presents the larger question of the private sector's obligation to society. The CRA, though not highly successful, is an admirable attempt to answer the question. Last, the perennial problem of housing the poor is one which should be squarely confronted by state legislatures. While the likelihood of more government spending for low-income housing is not great,³⁰⁶ private industry should not be expected to tackle this problem. Nevertheless, the private sector in combination with SONYMA, must not be allowed to evade the purpose of legislation enacted to help house the poor.

While these laws in themselves may not be successful, their enactment and enforcement at least represents a consensus that the practice of redlining should not be allowed, and that banks should reinvest in local communities where they are located. The enforcement of the present CRA regulations and the equivalent state regulations must be continued, but if investment patterns remain the same in the future, stiffer sanctions should be imposed. In addition, the proposals recommended in this Comment, if enacted, would represent a consensus that the private sector should solve the problems of disintermediation and that the public sector should attempt to solve the problem of housing the poor. First, mutuals should be empowered to issue new forms of assets and lia-

306. See generally Kowinski, *The Squeeze of the Middle Class*, N.Y. Times, July 13, 1980 § 6 (Magazine) at 27, 49, cols. 1-2, 59, cols. 2, 60, col. 3-4.

bilities. These organic changes, if enacted together rather than singly, should increase mutuals' available mortgage funds. Second, legislation empowering SONYMA to originate mortgage loans for low-income housing should be enacted; while the subsidy which SONYMA would issue for low-income housing will never be enough, it should at least be efficient. Third, specific reforms in existing legislation should be made. Legislation which better defines redlining and gives mortgage applicants a civil remedy should be enacted, and existing regulations should be amended to require the disclosure of more detailed mortgage statistics sooner than is presently required.

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