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Joan Kane

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# THE CONSTITUTIONALITY OF REDLINING: THE POTENTIAL FOR HOLDING BANKS LIABLE AS STATE ACTORS

Joan Kane\*

## I. INTRODUCTION

Many Americans would argue that all individuals are treated equally. There are, however, no facts to support this assertion. Over one hundred years ago the Civil War Amendments declared slavery to be illegal.<sup>1</sup> Yet statistics show that minorities, especially African Americans, are categorically denied many of the basic rights guaranteed by the Constitution.<sup>2</sup>

The Fifth Amendment to the United States Constitution reads: "No person . . . shall be deprived of life, liberty, or property without due process of law."<sup>3</sup> Current data, however, reveal that a large portion of the American population is denied these basic constitutional rights, especially the right to property. Financial institutions effectuate this deprivation through the discriminatory denial of mortgage loans based upon the applicants race.<sup>4</sup>

A home is undoubtedly the most expensive, and perhaps the most important, purchase an individual will make in her lifetime. Unlike other possessions, a home takes on the personality of its owners and reveals

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\* J.D. Candidate 1994, Marshall-Wythe School of Law, College of William & Mary.

<sup>1</sup> The Thirteenth, Fourteenth, and Fifteenth Amendments to the United States Constitution are considered the Civil War Amendments. This name is derived from the passage of each amendment in response to the issues that led to and followed the Civil War, most notably, slavery. The Fourteenth Amendment was enacted because the states could not be trusted to protect the rights of individuals. Erwin Chemerinsky, *Rethinking State Action*, 80 NW. U. L. REV. 503, 515 (1985).

The Thirteenth Amendment reads: "Neither slavery nor involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall exist within the United States, or any place subject to their jurisdiction." U.S. CONST. amend. XIII, § 1.

The Fourteenth Amendment extends protection to citizens from the actions of the states. The most notable portions of this amendment are the extension of the Due Process Clause and the creation of the Equal Protection Clause. U.S. CONST. amend. XIV, § 1.

<sup>2</sup> Paulette Thomas, *Blacks Still Face a Host of Trying Conditions in Getting Mortgages*, WALL ST. J., Nov. 30, 1992, at A1.

<sup>3</sup> U.S. CONST. amend. V.

<sup>4</sup> See Thomas, *supra* note 2. See also Robert J. Bruss, *Loan Prejudice Still a Problem*, SAN DIEGO UNION-TRIB., Aug. 15, 1993, at H28.

much about its residents. To deny individuals the opportunity to own a home is, in some sense, to deprive them of their rights of individual development. Banks, however, use discriminatory lending practices to deny large segments of the population the right to be independent of landlords and to experience home ownership.<sup>5</sup>

Home ownership also has constitutional implications. Pursuant to the United States Constitution, there are basic rights relating to property.<sup>6</sup> These constitutional rights impose no affirmative obligation on the government to supply property to all people, but there is a right to equal opportunity for property.<sup>7</sup> Lenders deny individuals this opportunity when they discriminate on the basis of race.

Congress attempted to prevent discriminatory lending practices, or redlining,<sup>8</sup> by enacting legislation designed to reach all lenders in the mortgage market. Separate from the tangled web of financial institution regulation, these anti-discrimination laws fare poorly for the populations they were enacted to protect.<sup>9</sup> Legislation enacted to protect minority interests has failed to prevent banks from discriminating.<sup>10</sup>

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<sup>5</sup> "But for the availability of credit, it would be impossible for most Americans to . . . own a home . . ." Judith B. Henry, Comment, *Equal Credit Opportunity Act Amendments of 1976*, 12 U. RICH. L. REV. 203, 203 (1977), quoted in Winnie F. Taylor, *Meeting the Equal Credit Opportunity Act's Specificity Requirement: Judgmental and Statistical Scoring Systems*, 29 BUFF. L. REV. 73, 73 n.1 (1980). The Chairman of the Federal National Mortgage Association (Fannie Mae), James Johnson, stated, "We see evidence that there are a significant number of prospective home buyers in this country whose only barrier to achieving their dream of home ownership is not their economic status but their racial status." Thomas, *supra* note 2, at A1.

<sup>6</sup> See, e.g., U.S. CONST. amend. V (due process and takings protection); U.S. CONST. amend. XIV, § 1 (anti-discrimination).

<sup>7</sup> *Buchanan v. Warley*, 245 U.S. 60, 78-79 (1917). See also 42 U.S.C. § 1982 (1988) ("All citizens of the United States shall have the same right, in every State and Territory, as is enjoyed by white citizens thereof to inherit, purchase, lease, sell, hold, and convey real and personal property.").

<sup>8</sup> Redlining is the process of drawing or outlining a geographic area within which lending will be denied due to the composition or characteristics of the area. WARREN L. DENNIS & J. STANLEY POTTINGER, *FEDERAL REGULATION OF BANKING: REDLINING AND COMMUNITY REINVESTMENT* ¶ 1.02, at 1-4 (1980).

<sup>9</sup> See *infra* text accompanying notes 61-97.

<sup>10</sup> A 1992 *Wall Street Journal* study compiled and analyzed data from computer tapes provided by the Federal Reserve. These statistics detailed mortgage lending rates for banks in major metropolitan areas. In New York, where 26% of the population is African American, 12.9% of 1991 mortgage applications were submitted by African Americans. The ratio of rejection, compared to white applicants, was 1.89. In Chicago, where African Americans comprise 21.9% of the population, 8.3% of all applications were from African Americans, and the ratio of rejection was 3.08. This signifies that in Chicago, African Americans were denied mortgages three times as often as whites. Edward P. Foldessy, *Largest Metropolitan Areas*, WALL ST. J., Nov. 30, 1992, at A8 (table).

This Note will analyze the possibility of holding banks to a constitutional standard of equal protection when making mortgage decisions. First, the Note will trace the development of discrimination in mortgage lending, beginning in the early twentieth century. Next, the Note will explore the anti-discrimination regulations affecting the banking industry, a structure which has failed to protect minority interests. The Note will then explain why there is a need for an equal protection standard. Finally, the potential for holding banks liable as state actors pursuant to equal protection analysis will be discussed.

## II. HISTORICAL PERSPECTIVES ON REDLINING

### A. *Defining Redlining*

Senator William Proxmire, in a 1977 speech to Congress during debate on the Community Reinvestment Act, stated:

By redlining let me make it clear what I am talking about. I am talking about the fact that banks and savings and loans will take their deposits from a community and instead of reinvesting them in that community, they will invest them elsewhere, and they will actually or figuratively draw a red line on a map around the areas of their city, sometimes in the inner city, sometimes in the older neighborhoods, sometimes ethnic and sometimes black, but often encompassing a great area of their neighborhood.<sup>11</sup>

Although generally linked to the refusal of mortgages, statutes also define redlining to encompass acts short of the total denial of loans. The Department of Housing and Urban Development (HUD) defines redlining to include the following: the requirement of larger down payments, higher closing costs, higher loan interest rates, and the refusal to lend on property

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The metropolitan area faring best was Los Angeles, where the ratio was 1.40. *Id.* This low ratio, however, is attributable to the relatively high level of racial integration within the city. Robert Rosenblatt, *No Gains Seen in Minority Lending*, LOS ANGELES TIMES, Oct. 28, 1992, at D1. Most cities, including Atlanta, Detroit, and St. Louis, demonstrated ratios above 2.0. Foldessy, *supra*.

<sup>11</sup> 123 CONG. REC. 17,630 (1977) (statement of Sen. Proxmire), *quoted in* Jonathon P. Tomes, *The "Community" in the Community Reinvestment Act: A Term in Search of a Definition*, 10 ANN. REV. BANKING L. 225, 227 n.9 (1991).

over a certain age.<sup>12</sup> Since minorities often inhabit older neighborhoods, denying mortgages on older homes limits minority access to property.

Redlining may result from a lender's conscious decision to deny loans to a particular area.<sup>13</sup> If all banks in a particular area agree that minority neighborhoods are high risk credit areas, no bank will extend loans, fearing that the money will not be repaid. Redlining can be a legitimate practice, however, if the factors utilized in determining whether to make loans are truly predictive of risk.<sup>14</sup> Racial redlining does not rely on predictive factors, but rather makes discriminatory assumptions that minorities, by nature of race, are unable or unwilling to repay loans.<sup>15</sup> Caucasians, it appears, "enjoy a general presumption of creditworthiness" which does not extend to other racial groups.<sup>16</sup>

<sup>12</sup> U.S. DEPT OF HOUSING AND URBAN DEVELOPMENT, REDLINING AND DISINVESTMENT AS A DISCRIMINATORY PRACTICE IN RESIDENTIAL MORTGAGE LOANS pt. II, at 4 (1977). In analyzing Boston area mortgage applicants, the Boston Federal Reserve found that only 20% of mortgage applicants were completely qualified or unqualified. All other applicants fell somewhere between the ends of this spectrum. Thomas, *supra* note 2, at A1.

<sup>13</sup> DENNIS & POTTINGER, *supra* note 8, ¶ 1.02, at 1-4.

<sup>14</sup> For example, the location of property within a flood plain or on a fault line may create a risk beyond the level acceptable to lenders, leading to the denial of loans. *See id.* ¶ 1.02, at 1-7.

<sup>15</sup> One author advocated segregation for the maintenance of property values, stating that "race . . . can result in a very rapid decline." FRED BABCOCK, THE VALUATION OF REAL ESTATE 91 (1932).

<sup>16</sup> Mitchell Zuckoff, *Study Shows Racial Bias in Lending; Gap Cited in Boston-Area Banks*, BOSTON GLOBE, Oct. 9, 1992, Economy, at 1. *See* Jamie C. Mann et al., *Developments in Banking Law: 1992*, 12 ANN. REV. BANKING L. 1, 74 (1993). Opponents of theories of expanding credit believe Americans have become too dependent upon credit and too demanding of banks and other lenders:

Americans . . . need to be reminded that credit is available to them as a privilege, not as a legal right. Everyone who wants or needs credit cannot obtain it . . . . The decision to grant or deny credit is usually based on an evaluation of the applicant's creditworthiness, a process which generally involves evaluating a person's ability and willingness to repay the creditor.

Taylor, *supra* note 5, at 73-74. This assertion lacks credibility. Minorities are often held accountable for small, inaccurate blemishes on their credit reports, while white applicants receive assistance in attempts to clarify negative credit histories. *See* Thomas, *supra* note 2, at A1 (discussing Linsey family's denial of mortgage based on once disputed, but paid, medical bill and difficulties encountered in finally acquiring mortgage financing).

Redlining in real estate exists on a non-racial basis as well.<sup>17</sup> The 1978 Appraisal of Real Estate handbook states:

Redlining refers to the reluctance of lenders, investors, or insurers to make loans, invest, or issue insurance on usual terms in a particular geographic area because of some feature or characteristic in the area that is perceived as adversely affecting the utility or security and hence the value of individual parcels of property in the area.<sup>18</sup>

Racial redlining, however, creates larger problems with more long-term effects. Supporters of this theory point to “disinvested areas” with low to moderate incomes and older homes and the corresponding low lending rates.<sup>19</sup> These low lending ratios may stem from historic attempts to maintain segregated residential neighborhoods.

### B. Historical Development

Following World War II, large numbers of African Americans migrated north to industrial urban areas.<sup>20</sup> During this migration period, both lenders and realtors believed that integration led to the devaluation of property and therefore refused to lend or sell to minorities attempting to move into “white” neighborhoods.<sup>21</sup> This prejudicial policy, unlike the unwritten discriminatory policies that followed the Civil Rights Acts of 1964, was openly stated and followed. The discriminatory policy appeared

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<sup>17</sup> Following the toxic waste incident at Love Canal, New York, area banks denied mortgages on local properties based upon the fear of liability for future environmental problems associated with cleanup. After the Federal Housing Authority began insuring mortgages, banks began lending. The loans, however, were accompanied by a disclaimer making no guarantees as to the habitability of the premises. *National Public Radio: Morning Edition* (radio broadcast, Oct. 13, 1992).

<sup>18</sup> AMERICAN INST. OF REAL EST. APPRAISERS, *THE APPRAISAL OF REAL ESTATE* 111 (7th ed. 1978).

<sup>19</sup> DENNIS & POTTINGER, *supra* note 8, ¶ 1.02, at 1-4. Also, areas with integrated populations show lower lending rates than areas composed of all white residents. *Id.*

<sup>20</sup> See Richard Lacayo, *The Two Americas*, *TIME*, May 18, 1992, at 28.

The invention of the trolley car in the early twentieth century allowed for the creation of bedroom communities with easy access to the city. These “suburbs” experienced rapid growth in the form of “white-flight.” As immigrants and minorities, especially southern African Americans, entered northern cities, whites moved to the suburbs but continued to work in urban areas. See generally DENNIS & POTTINGER, *supra* note 8, ¶ 2.02, at 2-2 (discussing *United States v. City of Black Jack*, 408 F.2d 1179, 1186 (8th Cir. 1974), *cert. denied*, 422 U.S. 1042 (1975), and the doughnut-shaped racial composition of St. Louis, with minorities in the “hole” and whites in the outlying suburbs).

<sup>21</sup> DENNIS & POTTINGER, *supra* note 8, ¶ 2.02, at 2-3.

in many handbooks for realtors and lenders during the middle part of the twentieth century.<sup>22</sup>

Under segregationist policies, the growth of white suburbs demanded that African Americans inhabit the cities, where the quality of life and property conditions declined due to the onset of heavy industrialization.<sup>23</sup> These overt private policies of segregation continued into the latter half of the twentieth century. The statistical evidence available under the Home Mortgage Disclosure Act indicates that the written prejudices of the past have become the unwritten practice of today.<sup>24</sup>

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<sup>22</sup> Until 1950, the Code of Ethics of the National Association of Real Estate Boards provided that realtors should not aid in integrating neighborhoods. *Id.* This attitude was fostered and developed throughout this century. In 1923, authors McMichael and Bingham wrote:

Frankly, rigid segregation seems to be the only manner in which the [racial tension] difficulty can be effectively controlled. The colored people certainly have a right to life, liberty and the pursuit of happiness but they must recognize the economic disturbance which their presence in a white neighborhood causes and forego their desire to split off from the established district where the rest of their race lives.

STANLEY L. MCMICHAEL & ROBERT F. BINGHAM, *CITY GROWTH AND VALUES* 181-82 (1923). Additionally, this guide stated that "Property values have been sadly depreciated by having a single colored family settle down on a street occupied exclusively by white residents." *Id.* at 181.

A 1931 publication by McMichael, containing statements advocating segregation, was considered the "bible of the real estate man." DENNIS & POTTINGER, *supra* note 8, ¶ 2.02, at 2-5. The book contained a ranking of races and nationalities with respect to each group's beneficial effect on land values. It listed race as a highly influential characteristic in devaluing land. The most favored persons were English, Germans, Scotch, Irish, and Scandinavians; the least favored were African Americans and Mexicans. *Id.* ¶ 2.02, at 2-5 to -6.

<sup>23</sup> Lacayo, *supra* note 20, at 28.

<sup>24</sup> See Thomas, *supra* note 2 (detailing statistical findings from the 1992 Boston Federal Reserve Study as analyzed by the *Wall Street Journal*).

The term redlining also applies to insurance companies and their refusal to write policies in low income areas. ROBERT B. HOLTOM, *RESTRAINTS ON UNDERWRITING* 68 (1979) (quoting *Report of the Redlining Task Force of the D-2 Subcommittee of the National Association of Insurance Commissioners* (Oct. 11, 1977)). These low income areas are generally occupied exclusively or primarily by racial minorities, especially African Americans. WILLIAM G. GRIGSBY & LOUIS ROSENBERG, *URBAN HOUSING POLICY* 155, 166-67 (1975) (noting insurance company's refusal to write policies in inner city, where population was two-thirds African American).

The denial of insurance coverage stills occurs, most notably in cities experiencing wide-spread destruction. Such exclusion prevents the rebuilding of entire cities. An example of such insurance redlining occurred following the destruction of Los Angeles in the wake of the verdict of acquittal in the Rodney King beating. After the destruction of the predominantly minority neighborhoods of South Central Los Angeles, insurance companies paid the initial damages but declined to reinsure home and business owners. Crusader Insurance, for one, notified 1200 people that riot coverage would be canceled.

### C. Governmental Policies of Discrimination

Far more troubling than the prejudice of individuals is the prior discrimination by the Federal Housing Authority (FHA).<sup>25</sup> During the early part of the twentieth century, the FHA engaged in overtly discriminatory practices and embraced prejudicial policies.<sup>26</sup> In 1948, Assistant Authority Commissioner Lockwood stated that the FHA "has never had a housing project of mixed occupancy."<sup>27</sup> The FHA policy of single race projects remained in force until 1949, when the revised manual excluded references to inharmonious racial groups.<sup>28</sup>

Although the Federal Housing Authority facially altered its policy in 1949,<sup>29</sup> the effects of the FHAs prior policies were long-lived.<sup>30</sup> Unable to secure loans during government advocated segregation, minorities lacked credit ratings and therefore were unable to gain access to funds after

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*The MacNeill/Lehrer NewsHour* (PBS television broadcast, Apr. 7, 1993).

Redlining by insurance companies creates concern that the trend of withdrawing policy coverage is based on racial prejudice, not on concern over the loss of profits. More importantly for the purposes of this Note, the use of redlining in insurance may influence real estate lending by negatively affecting the value of property. The inability to acquire insurance on a parcel of land creates apprehension by lenders that the destruction of uninsured property will result in complete forfeiture by the borrower. HOLTOM, *supra*, at 73. See also Peter Kerr, *Riots Raise Concerns about Insurance Redlining*, N.Y. TIMES, May 4, 1992, at D2. "A lack of property insurance can strangle a neighborhood's economy. Banks usually refuse to give mortgages on uninsured property . . ." *Id.* By refusing to write policies in minority neighborhoods, insurance companies may be instrumental in the devaluation of property within these neighborhoods, leading to continued redlining in lending.

<sup>25</sup> The Federal Housing Authority was established by the federal government to combat the problems of the depression and to ignite the housing industry. The Authority unconditionally guaranteed loans in an effort to prompt construction. CHARLES ABRAMS, *FORBIDDEN NEIGHBORS: A STUDY OF PREJUDICE IN HOUSING* 229 (1971).

<sup>26</sup> The Federal Housing Authority insisted on racial homogeneity in areas where home purchases were possible through federally guaranteed loans. The Authority's goals included the prevention of infiltration by minorities and the enforcement of homogeneity within neighborhoods. *Id.* at 230.

<sup>27</sup> Letter from W. J. Lockwood to James Cassels, Executive Secretary, National Co-operative Mutual Housing Association, Nov. 19, 1948, *quoted in* ABRAMS, *supra* note 25, at 233.

<sup>28</sup> ABRAMS, *supra* note 25, at 232-33.

<sup>29</sup> The Authority's change to a non-discriminatory policy was not the result of free choice by the government, but rather resulted from protests by citizens. *Id.* at 234.

<sup>30</sup> Federal Housing Authority policy created a system under which almost all deeds contained racial covenants. *Id.* By unofficially espousing segregation, the government enabled the perpetuation of discrimination in housing long after the amendment of the Federal Housing Authority manual. *Id.* Individuals once precluded from borrowing money due to official discriminatory policies remained unable to secure loans and property.



official segregation ended.<sup>31</sup> The continued denial of loans created a vicious cycle from which minorities were unable to escape.<sup>32</sup>

In 1993, if one compares equally qualified whites and African Americans, African Americans are still more likely to be denied mortgages for the purchase of a home.<sup>33</sup> When mortgages are unobtainable, rents increase. Unable to acquire ownership in a home, individuals are forced to rely on landlords. Landlords with numerous tenants can increase rents and

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<sup>31</sup> See Zuckoff, *supra* note 16, Economy, at 1 (stating that minorities tend to have lower credit ratings and greater debt). Minorities are also less likely to have bank accounts, partially due to the lack of deposit facilities within minority neighborhoods. Thomas, *supra* note 2, at A8. Banks do not look favorably upon accepting large amounts of cash for down payments, further compounding minority credit rating and lending problems. *Id.* The denial of credit increases in importance as America becomes a society dependent on deferred payment for goods and services. "Credit has become a functional substitute for cash in our economy, and consequently credit decisions can greatly influence an individual's economic choices." John H. Matheson, *The Equal Credit Opportunity Act: A Functional Failure*, 21 HARV. J. ON LEGIS. 371, 373 (1984). The denial of credit limits access to consumer goods and capital investments, effectively placing a ceiling on an individual's ability to achieve the "American Dream."

<sup>32</sup> Since they could not secure loans for new homes outside of the city, African Americans became victims of the shortage of urban housing. ABRAMS, *supra* note 25, at 237. This residential shortage in the cities further destroyed already run-down housing facilities. Because minorities were forced to live in dilapidated areas without funds for improvements, deterioration continued. See Marshall Ingwerson, *Jackson Calls for More Fiscal Stimulus*, CHRISTIAN SCI. MONITOR, Feb. 26, 1993, at 2. This disintegration became a self-fulfilling prophecy, adding fuel to the fire of segregationists. See Alton Bennett, *Lending Practices Forcing Decay of Neighborhoods*, STAR TRIB., Nov. 18, 1991, at 3D. Such shortsightedness fails to realize that lending to minorities allows neighborhoods to experience growth and development. It has been argued, however, that banks are merely overlooking a potentially profitable area for lending, and should not be compelled to serve these areas, but rather competition should rule the marketplace. See generally Lawrence J. White, *The Community Reinvestment Act: Good Intentions Headed in the Wrong Direction*, 20 FORDHAM URB. L.J. 281, 282 (1993). Expanded growth and development may allow communities to avoid what some believe is the inevitability of neighborhood deterioration.

Sociologists believe that all neighborhoods will eventually reach a state of decline after which reinvestment will lead to redevelopment. "The data provided by [the Home Mortgage Disclosure Act] removes any doubt that redlining indeed exists, that many credit-worthy areas are denied loans. This denial of credit, while it is certainly not the sole cause of our urban problems, undoubtedly aggravates urban decline." 123 CONG. REC. 17,630 (1977) (statement of Sen. Proxmire).

<sup>33</sup> See Terrence O'Hara, *She Proved Bank Redlining in Md., Now Anne Shlay to Study Anew*, WARFIELD'S BUS. REC., Oct. 2, 1992, § 1, at 3. (Shlay stated, "I found that all other things being equal, race was an indicator of whether neighborhoods got credit."); Jerd Smith, *Banks Face Lending Complaints*, DENV. BUS. J., Dec. 18, 1992, § 1, at 1 (looking at First Banking System's mortgage rates in Denver for applicants with annual income of \$36,000 to \$40,000, and finding loan denial rates of 33% for African Americans, 25% for Hispanics, and 10% for whites).

decrease maintenance without losing inhabitants.<sup>34</sup> This pattern describes the plight of many minorities in America today.

### III. BANKING REGULATION

Realizing the oppression created by denying individuals the right to own property, Congress created a system of regulation for banks and lending institutions. This system of anti-discrimination legislation is interwoven with earlier legislation designed to ensure sound monetary policy. A basic understanding of banking regulation is necessary for determining whether banks can be held to a constitutional standard of equal protection.

The current regulatory structure is largely a product of the New Deal era.<sup>35</sup> There were federal banking regulations as early as 1791, however, when the first Bank of the United States was chartered.<sup>36</sup> Chartered by the federal government with capital from private and public sources, the first bank lasted only as long as its twenty year charter.<sup>37</sup> Prior to this time, banks were chartered and controlled by state law. In 1816, the federal government chartered a second bank.<sup>38</sup> This, too, survived only through its original charter.<sup>39</sup> During the thirty years following the expiration of the second Bank of the United States, the federal government was not involved in banking regulation.<sup>40</sup> Until after the Civil War, the currency generated throughout the young nation differed greatly between institutions.<sup>41</sup>

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<sup>34</sup> Bennett, *supra* note 32, at 3D.

<sup>35</sup> Howard H. Hackley, *Our Baffling Banking System*, 52 VA. L. REV. 565, 577-80 (1966) (detailing development of modern bank regulations).

<sup>36</sup> CARTER H. GOLEMBE & DAVID S. HOLLAND, *FEDERAL REGULATION OF BANKING 1986-87*, at 3 (1986).

<sup>37</sup> *Id.* at 4.

<sup>38</sup> Hackley, *supra* note 35, at 569-70.

<sup>39</sup> *Id.* at 570. The renewal of the bank's charter was vetoed by President Jackson. *Id.*

<sup>40</sup> GOLEMBE & HOLLAND, *supra* note 36, at 5.

<sup>41</sup> *Id.* at 6. Prior to the National Currency Act of 1863, state banks could issue currency without regard for consistency with other states. *Id.* The National Currency Act authorized the creation of national banks empowered to issue notes backed by government bonds. The primary motive behind the National Currency Act was to finance the Civil War. Hackley, *supra* note 35, at 570. The Union did not anticipate that the Confederacy could withstand a long war and therefore felt intense economic pressure in the midst of the Civil War that required the creation of a national currency to finance the war. See Stephen J. Friedman & Connie M. Friesen, *A New Paradigm for Financial Regulation: Getting from Here to There*, 43 MD. L. REV. 413, 414 (1984).

In 1863, the federal government reentered bank regulation by creating the current dual banking system.<sup>42</sup> Enacted by a provision permitting the chartering of national banks, the system allowed both state governments and the federal government to charter financial institutions.<sup>43</sup> Perhaps the most crucial portion of this provision was the National Currency Act,<sup>44</sup> which allowed federally-backed notes to be circulated.<sup>45</sup> In 1863, part of the National Bank Act created the position of Comptroller of the Currency to oversee banking regulation.<sup>46</sup>

Until the 1913 passage of the Federal Reserve Act,<sup>47</sup> the federal government had little control over state chartered banks.<sup>48</sup> Since the enactment of the Federal Reserve Act, which regulates monetary policy for a healthy national economy, the system of national regulation has developed to encompass almost all banks.<sup>49</sup> Until 1933, however, the federal government lacked widespread supervision of state chartered banks.<sup>50</sup> In 1933, the Federal Deposit Insurance Act<sup>51</sup> was enacted,

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<sup>42</sup> GOLEMBE & HOLLAND, *supra* note 36, at 3. At the time of the passage of the National Currency Act, the dual banking system was not an intended result. National banks were intended to replace state banks and the state system entirely. Hackley, *supra* note 35, at 571. *See also* GOLEMBE & HOLLAND, *supra* note 36, at 7 (“[T]he two banking systems were at war, with each seeking the extermination of the other.”).

<sup>43</sup> GOLEMBE & HOLLAND, *supra* note 36, at 6.

<sup>44</sup> Ch. 58, 12 Stat. 665 (1863).

<sup>45</sup> GOLEMBE & HOLLAND, *supra* note 36, at 6. The National Currency Act initiated the transition toward uniform currency, a necessity following the devaluation of Confederate currency in the aftermath of the Civil War.

<sup>46</sup> Hackley, *supra* note 35, at 571. The Comptroller was created to head a bureau within the Treasury Department. The Comptroller was to execute laws respecting “the issue and regulation of a national currency secured by United States bonds.” 12 U.S.C. § 1 (1988). The Comptroller is responsible for bank charters and is the primary regulator of national banks. GOLEMBE & HOLLAND, *supra* note 36, at 37. He serves as a member of the Federal Reserve Board. The Board, however, reserves the power to alter decisions of the Comptroller. Hackley, *supra* note 35, at 575.

The Comptroller of the Currency, the Federal Reserve Board, and the FDIC constitute the three main regulators of banking in America. GOLEMBE & HOLLAND, *supra* note 36, at 27.

<sup>47</sup> 12 U.S.C. §§ 221-552 (1988 & Supp. IV 1992).

<sup>48</sup> Hackley, *supra* note 35, at 573. The Federal Reserve Act was the congressional response to the financial hardship of the early part of the century. Designed to create more effective supervision of banks, GOLEMBE & HOLLAND, *supra* note 36, at 8, the Act created a regional system of bank monitoring. Hackley, *supra* note 35, at 574. The Federal Reserve created reserve requirements effectively commanding that a certain percentage of deposits be held, a necessity in light of the financial concerns of the early 1900s. *Id.*

<sup>49</sup> *See generally* Hackley, *supra* note 35.

<sup>50</sup> GOLEMBE & HOLLAND, *supra* note 36, at 8-9.

<sup>51</sup> 12 U.S.C. §§ 1811-1832 (1988 & Supp. IV 1992).

requiring all Federal Reserve banks to subscribe for deposit protection offered by the Federal Deposit Insurance Company (FDIC).<sup>52</sup>

Although not all banks are members of the Federal Reserve, large scale bank failure in the early 1930s made deposit insurance a necessity for all banks, regardless of how they were chartered.<sup>53</sup> Most banks, therefore, voluntarily subjected themselves to the regulations of the FDIC.<sup>54</sup> The decision to charter under either the federal or state system is made by carefully considering the applicable state and federal laws. The decision under whose authority to incorporate is not irreversible, however. Banks may reincorporate under a different jurisdiction, generally by vote of the shareholders, provided that all applicable legal requirements are met.<sup>55</sup>

In addition to the laws applicable to both state and national banks, numerous laws pertain only to national banks.<sup>56</sup> These laws comprise a

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<sup>52</sup> 12 U.S.C. § 1815(a) (Supp. IV 1992).

<sup>53</sup> GOLEMBE & HOLLAND, *supra* note 36, at 9. Although states had previously offered deposit insurance, this was the first such offering by the federal government. Hackley, *supra* note 35, at 577.

<sup>54</sup> Hackley, *supra* note 35, at 577-78. In 1985, there were 4976 national banks, 1070 state Federal Reserve member banks, 8425 nonmember insured banks, and 764 non-insured banks. GOLEMBE & HOLLAND, *supra* note 36, at 285, table 2.

The current regulatory structure of the federal banking system consists of numerous overlapping and interwoven policies. Banks are perhaps the most regulated industry in America. The current banking scheme recognizes four types of banks, which belong to two categories—national and state banks. See Hackley, *supra* note 35, at 566. This label designates the governing body that granted the charter for the operation of the bank. The state chartered banks are further categorized to include state member banks, non-member insured banks, and uninsured banks. *Id.* The term “member” denotes participation in the Federal Reserve program, a mandatory program for national banks. *Id.*

<sup>55</sup> 12 U.S.C. §§ 30, 35 (1988).

<sup>56</sup> All national banks must receive their charters from the United States government, *id.* § 27, and must include “national” within their name. *Id.* § 22. Unlike the chartering of a corporation, the granting of a charter to a national bank requires compliance with a variety of strict provisions. In the extensive regulatory structure of the federal banking system, new national banks must have a specified amount of capital and surplus, though the amount varies by location and population, and must continue to meet other delineated standards to remain in business. *Id.* § 51. Real estate loans are also subject to regulation. The Comptroller regulates the nature of acceptable collateral and the amount which may be lent. 12 U.S.C. § 371(a) (Supp. IV 1992). National banks are also limited in the amount available to any individual borrower. 12 U.S.C. § 84(a)(1) (1988).

Like all Reserve member banks, national banks are required to maintain reserves against their deposits as specified by the Board of Governors of the Federal Reserve System. 12 U.S.C. § 461 (1988 & Supp. IV 1992). The Federal Reserve Act also limits the amount of money that may be extended to officers and directors of the institution and the purposes for which such funds may be lent. 12 U.S.C. § 375a (1988). Further regulation under the Banking Act of 1933 requires that banks have no fewer than five and no more than 25 directors. *Id.* § 71a. In addition, two-thirds of the directors must live within 100 miles of the bank's location, and all directors must be United States citizens.

complex system, which extensively governs national banks and severely curtails their operating freedom.<sup>57</sup> This comprehensive regulation is an important aspect of proving national banks' constitutional accountability.

Although state chartered banks are subject to fewer federal regulations,<sup>58</sup> they are nonetheless highly regulated. State law restricts

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*Id.* § 72. Banks may not affiliate with securities companies and are subject to sanctions if found dealing in both securities and deposits. *Id.* § 37.

Banks, unlike corporations, are prohibited from expanding without governmental permission. All banks covered by Federal Deposit Insurance must receive approval before opening new branches, *id.* § 36, or merging with another institution. 12 U.S.C. § 1828(c) (1988 & Supp. IV 1992). No interest may be paid on demand deposits and checking accounts. 12 U.S.C. § 371a (1988). The federal government also regulates the advertisement of the rates for savings and time deposit accounts. 12 U.S.C. § 1831f(h) (Supp. IV 1992). Federal bank supervisory agencies must grant permission for all insured banks to reduce their capital stock. 12 U.S.C. §§ 59, 329 (1988). Beyond the scope of daily activities, no bank may be acquired by a holding company without first being granted permission by the Board of Governors of the Federal Reserve. 12 U.S.C. § 1842 (1988 & Supp. IV 1992). In addition to federal regulation, banks may also be restricted by state law, but congressional permission must be granted before states may pass laws affecting national banks. *See McCulloch v. Maryland*, 17 U.S. 316 (1819) (holding that states have no constitutional right to tax national banks, as national banks are entities of the government).

<sup>57</sup> In the early 1980s, it appeared that deregulation might occur within the banking industry. The wide-spread failure of savings and loan institutions, however, seems to have ended this trend. *Developments in Banking Law: 1991*, 11 ANN. REV. BANKING L. 1, 10-12 (1992). In 1991, 127 banks failed or stayed in business only through the use of government funds. *Id.* at 1.

<sup>58</sup> Because state laws regulate general operations, the applicable federal law is less extensive, though still significant. State banks may choose to become member banks by joining the Federal Reserve. The Board of Governors of the Federal Reserve requires that the banks maintain reserves of a certain percentage. 12 U.S.C. § 461(b)(2) (1988 & Supp. IV 1992). State member banks may not affiliate with securities companies and may not have interlocking directorates with other banks or with securities companies. 12 U.S.C. §§ 377, 378 (1988). The state member banks are not subject to the federal limitation on the amount available to one borrower. *Id.* § 329. *See Hackley, supra* note 35, at 587. All member banks are required to subscribe to the protections of the Federal Deposit Insurance Company. GOLEMBE & HOLLAND, *supra* note 36, at 9.

State banks that choose not to join the Federal Reserve, called non-member banks, may still opt to be protected by the Federal Deposit Insurance Company, making them non-member insured banks. Hackley, *supra* note 35, at 578. Because the need for deposit protection is so great, the FDIC regulates almost all banks currently chartered in the United States. GOLEMBE & HOLLAND, *supra* note 36, at 9. The FDIC protects deposits in the event of bank failure. For example, in 1985, all of the 120 banks that closed due to financial difficulties were insured by the FDIC. *Id.* at 113. Great latitude in investigatory procedures exists to ensure that depositors are covered by the insurance. The FDIC can arrange mergers with financially sound banks when banks are in distress and place institutions in receivership. *Id.* at 112. The FDIC also holds broad investigatory powers, *id.* at 40, in order to avoid large scale financial problems among member banks.

banking in many ways, often by making the requirements for incorporation more stringent than for corporations<sup>59</sup> and by setting requirements for operation.<sup>60</sup> Added to the regulations imposed by the federal government, the burden on state banks is quite large.

#### IV. REGULATIONS AGAINST DISCRIMINATION

Although banking regulations are designed and implemented to further the goal of fiscal responsibility, banks are also subject to laws requiring disclosure and equal opportunity lending. Congress enacted anti-discrimination legislation with an eye toward equal treatment for all borrowers. Although anti-discrimination laws have existed in some form since the 1860s,<sup>61</sup> a 1992 Federal Reserve study revealed that African Americans are repeatedly denied mortgages, while similarly situated whites receive loans.<sup>62</sup> Together, the anti-discrimination statutes create an

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<sup>59</sup> In California, for example, the character of the organizers and the need for additional banking facilities are among the considerations to be made before granting a charter. CAL. FIN. CODE § 361 (West 1989). The state also considers the character of the proposed shareholders, an imposition far beyond the requirements prescribed for other businesses. *Id.*

<sup>60</sup> In California, the state assesses all banks a portion of the money required for funding the state's bank regulatory agency. CAL. FIN. CODE § 270 (West Supp. 1993). Pursuant to California state law, all banks must provide funds for their annual examination as well, and failure to pay on time can result in a bank losing its license to carry on banking within the state. CAL. FIN. CODE § 273 (West 1989).

<sup>61</sup> For example, the Civil Rights Act of 1866, ch. 31, §1, 14 Stat. 27 (codified as amended in 42 U.S.C. § 1982 (1988)) provided that:

[C]itizens, of every race and color . . . shall have the same right, in every State and Territory in the United States, to make and enforce contracts, to sue, to be parties, and give evidence, to inherit, purchase, lease, sell, hold and convey real and personal property, and to full and equal benefit of all laws and proceeding for the security of persons and property . . . .

*Id.*

The Act was designed to combat the vestiges of slavery by guaranteeing property and contract rights. *See Buchanan v. Warley*, 245 U.S. 60, 78 (1917). The Civil Rights Act of 1875, which provided that "any person" who denied to any citizen the rights granted in the Act could be civilly liable, ch. 114, § 2, 18 Stat. 336, 337 (1875), was not so well received, however. In the Civil Rights Cases, 109 U.S. 3, 17 (1883), the Supreme Court held that Congress could not enact legislation which prohibited private discrimination, as there was no assignment of such powers under the Tenth Amendment, and no state action was involved. Some theorists say the Court's decision indicates that "if a state did not provide adequate protection through its common law, then there was state action sufficient to justify federal intervention." Chemerinsky, *supra* note 1, at 516.

<sup>62</sup> Thomas, *supra* note 2. In 1991, mortgage rejection rates increased for all racial groups. African Americans and Hispanics, however, were denied mortgages more often during this period than were whites. *Id.* at A1.

additional network for eradicating discrimination. This network has failed, however, and additional legislation promises greater entanglement.

### A. Title VIII: The Fair Housing Act

Title VIII of the Civil Rights Act of 1968, the Fair Housing Act,<sup>63</sup> provides that it shall be illegal to deny a loan for purchasing, constructing, improving, or repairing a dwelling on the basis of race, color, religion, sex, handicap, or familial status.<sup>64</sup> Blockbusting, the process of convincing owners to sell because minorities are moving in, is also illegal, as is steering minorities to areas traditionally occupied by minorities.<sup>65</sup> The Fair Housing Act grants primary authority to the Department of Housing and Urban Development (HUD) to enforce these provisions.<sup>66</sup> Unfortunately, HUD failed to issue Title VIII regulations that sufficiently describe what constitutes prohibited discrimination by lenders; therefore, lenders have no standards to meet.<sup>67</sup> This failure prevents progress toward equal treatment in mortgage lending. HUD conducts few investigations into regulatory compliance and lacks the necessary enforcement power to ensure conformity with the statute.<sup>68</sup>

The lending disparity rate fluctuates between markets. In Boston, for example, African American neighborhoods receive proportionally twenty-

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<sup>63</sup> 42 U.S.C. §§ 3601-3631 (1988 & Supp. IV 1992).

<sup>64</sup> 42 U.S.C. § 3605 (1988).

<sup>65</sup> *Id.* § 3604(e).

<sup>66</sup> *Id.* § 3608(a). HUD's power, however, is limited to reconciliation through conference and persuasion. No judicial remedy is authorized for HUD. *Id.* § 3610. HUD's authority, in other words, is limited to attempts to extract voluntary compliance from lenders. If the victim does not seek judicial remedy, the Secretary of HUD may refer the case to an administrative law judge. *Id.* § 3612. The ALJ may order damages and assess civil penalties. *Id.* § 3612(g)(3).

<sup>67</sup> U.S. COMM'N ON CIVIL RIGHTS, THE FEDERAL FAIR HOUSING ENFORCEMENT EFFORT 5, 6 (1979) [hereinafter FAIR HOUSING].

<sup>68</sup> *Id.* Current statistics illustrate HUD's inability to demand compliance with federal standards of equality. Thomas, *supra* note 2, at A8-A9. The Fair Housing Act, along with all other federal anti-discrimination legislation, has been criticized repeatedly for its failure to result in equal credit and loan opportunities. "The greatest problem underlying the current housing situation . . . is a weak fair housing law which has been ineffective in the objective to eliminate housing discrimination." Michael Steven Bylsma, Note, *Is the U.S. Committed to Fair Housing? Enforcement of the Fair Housing Act Remains a Crucial Problem*, 29 CATH. U. L. REV. 641, 642 (1980). The creation of additional legislation serves only to further entangle the web of regulations and fails to eradicate the problem of discrimination. See generally White, *supra* note 32, at 283-84 (stating that discriminatory banking practices that are the result of overt discrimination should be addressed by tougher enforcement of anti-discrimination laws, not by the use of the Community Reinvestment Act).

four percent fewer home mortgage loans than white neighborhoods.<sup>69</sup> In Atlanta, a shocking 1988 study sparked widespread protest when it was reported that four times as many loans were extended to white middle income areas as African American middle income areas per single family structure.<sup>70</sup> Pursuant to the Civil Rights Act, individuals denied mortgages may pursue individual redress regardless of whether HUD or the Department of Justice chooses to pursue remedies against the financial institution.<sup>71</sup>

### B. *Equal Credit Opportunity Act*

The Equal Credit Opportunity Act (ECOA)<sup>72</sup> attempts to provide further safeguards for rights of minority loan applicants. The ECOA makes it illegal for any creditor to discriminate on the basis of race.<sup>73</sup> “The ECOA assumes that consumer credit is a positive and necessary aspect of our economy to which all qualified applicants should have equal access.”<sup>74</sup> The primary provision of the ECOA, Regulation B,<sup>75</sup> prohibits

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<sup>69</sup> Thomas, *supra* note 2, at A1.

<sup>70</sup> Stephen A. Fuchs, *Discriminatory Lending Practices: Recent Developments, Causes and Solutions*, 10 ANN. REV. BANKING L. 461, 469 (1991). The Department of Justice, in response to the disparity reported in the *Atlanta Journal and Constitution*, initiated an investigation into lending discrimination at city banks. Joseph D. Rich, *Housing Discrimination: The Enforcement Authority of the Department of Justice*, 44 CONSUMER FIN. L.Q. 256, 256 (1990). Only one lawsuit resulted from this investigation. The suit, which was against Decatur Federal, resulted in a settlement between the bank and the Federal Reserve Board. The settlement “mark[ed] the first time in U.S. history that a financial institution has been hit with penalties for its mortgage lending activities.” Jim King, *Decatur Federal to Settle Mortgage Bias Case; Thrift to Reimburse Those Affected*, ATLANTA J. & CONST., Sept. 17, 1992, at D1. Decatur Federal's lending ratio was 3.72. *Id.*

<sup>71</sup> Individuals may first apply to HUD for relief within thirty days of the discriminatory action. 42 U.S.C. § 3610(a) (1988). HUD then seeks voluntary conciliation by the lender. If HUD is unsuccessful, the Department of Justice may take over and seek judicial relief against the lender. *Id.* § 3614.

<sup>72</sup> 15 U.S.C. §§ 1691-1691f (1988 & Supp. IV 1992). The original version of the ECOA was designed to protect against sex and marital status discrimination. The prohibition against racial discrimination was added in 1976. Matheson, *supra* note 31, at 371.

<sup>73</sup> 15 U.S.C. § 1691(a)(1) (1988). The ECOA was designed to shield certain consumers from discriminatory credit practices on the basis of nonpredictive factors, including race. Matheson, *supra* note 31, at 372.

<sup>74</sup> Matheson, *supra* note 31, at 372.

<sup>75</sup> 12 C.F.R. §§ 202.1-202.14 (1993).



creditors from requesting any information with respect to race for use in lending decisions.<sup>76</sup>

The ECOA is enforced by a number of agencies overseen by the Federal Trade Commission.<sup>77</sup> The Attorney General is authorized to pursue civil actions, either independently or upon referral.<sup>78</sup> The ECOA allows for a private civil suit when a creditor is engaged in a pattern or practice of discrimination.<sup>79</sup> Like its predecessors and its followers, the ECOA provided great hope, and subsequently, vast disappointment to optimistic minority borrowers.<sup>80</sup>

### C. Community Reinvestment Act

Under the Community Reinvestment Act of 1977 (CRA),<sup>81</sup> regulated financial institutions must demonstrate that their deposit facilities serve the

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<sup>76</sup> *Id.* § 202.5(d)(5). This information, however, is reported for purposes of evaluating the success of the ECOA, effectively allowing creditors access to the disallowed information, which may then be the actual basis for the denial of a loan. Matheson, *supra* note 31, at 374 n.15.

Applicants denied credit must be informed of their right to request a report detailing the reason for the denial of credit. 12 C.F.R. § 202.9(a)(2)(ii) (1993). Once requested, the report must be furnished by the financial institution. *Id.*

<sup>77</sup> 15 U.S.C. § 1691c(c) (1988). The Board of Governors of the Federal Reserve is charged with promulgating regulations for enforcement of the ECOA. *Id.* § 1691b(a). Further enforcement is entrusted to federal agencies, while the Federal Trade Commission oversees the entire enforcement effort.

<sup>78</sup> 15 U.S.C. § 1691e(h) (Supp. IV 1992). The Attorney General received such "heightened" powers as a result of complaints that the original act lacked sufficient compliance mechanisms. Matheson, *supra* note 31, at 376.

<sup>79</sup> 15 U.S.C. § 1691e(b) (1988). Congress anticipated that private enforcement would be through class action suits and that such suits would provide the impetus for overall enforcement. S. REP. NO. 898, 94th Cong., 2d Sess. 13 (1976). Private suits, however, are few and far between. The plaintiff in an ECOA based suit carries a heavy burden of proof of both discrimination and actual damages. Scott Ilgenfritz, *The Failure of Private Actions as an ECOA Enforcement Tool: A Call for Active Governmental Enforcement and Statutory Reform*, 36 U. FLA. L. REV. 447, 457 (1984). See generally Matheson, *supra* note 31, at 378 (stating that lack of minimum damages creates a disincentive for private suits—victory guarantees no minimum return).

<sup>80</sup> "Creditors . . . must now refrain from utilizing traditional credit standards unless the criteria can be shown to be objective, equally applied, and determinative of creditworthiness. Hopefully, the antidiscrimination provisions of ECOA will work to erode the apparent credit discrimination which now exists in our society." Susan Anderson, *The Antidiscrimination Provisions of the Equal Credit Opportunity Act*, 12 UCC L.J. 248, 255 (1980).

The ECOA, like the Community Reinvestment Act, provided little relief to minorities. Between 1977 and 1984, fewer than fifty cases were reported under the ECOA, although 17,000 violations were found by the Federal Reserve Board during an eighteen month period. Matheson, *supra* note 31, at 377-78 (citations omitted).

<sup>81</sup> 12 U.S.C. §§ 2901-2907 (1988 & Supp. IV 1992).

needs of the community in which they do business.<sup>82</sup> The CRA, “the nation’s major anti-redlining law,”<sup>83</sup> received criticism for its failure to require compliance during the first decade after its enactment.<sup>84</sup> Unfortunately, little has been done toward enforcement, with few specific regulations to guide banks in the early years.<sup>85</sup> In the early 1980s, banks with low minority lending ratios received approval to open new branches and merge with other banks.<sup>86</sup>

No private cause of action exists under the CRA. Rather, the Act denies bank growth and development in an effort to demand equal treatment of all customers.<sup>87</sup> The primary source of CRA enforcement, however, is provided by community organizations seeking to prevent continued violations of the CRA.<sup>88</sup> A primary congressional motive behind the CRA was to assure that community members, especially minorities, have access to loans.<sup>89</sup> Banks, however, have complained

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<sup>82</sup> 12 U.S.C. § 2903 (Supp. IV 1992). The Act requires federal supervisory agencies to decide whether the bank fulfills community needs before approving an “application for a deposit facility,” *id.*, which includes extensions and mergers. *Id.* § 2902(3)(C), (E). “The CRA is premised upon the view that although they are privately capitalized, banks . . . are subject to underlying charter obligations to serve the banking needs of the local community.” Allen J. Fishbein, *The Community Reinvestment Act after 15 Years: It Works, but Strengthened Federal Enforcement Is Needed*, 20 FORDHAM URB. L.J. 293, 293 (1993).

<sup>83</sup> Peter Dreier, *America’s Urban Crisis: Symptoms, Causes, Solutions*, 71 N.C. L. REV. 1351, 1381 (1993).

<sup>84</sup> In the 1988 Senate Rehearings on enforcement of the CRA, Senator Proxmire said, “Regulators seem to think that we’re all living in Lake Woebegone. Like children of the fictional village, U.S. lenders are all above average.” *Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 100th Cong., 2d Sess. 7 (1988).

<sup>85</sup> Mario Alvarado, *Revisiting the Community Reinvestment Act in an Era of Mergers and Acquisitions*, 12 ANN. REV. BANKING L. 475, 479-84 (1993). There is no defined process for regulatory investigation. Rather, applications for mergers and expansions must be submitted to the appropriate regulatory agency. These agencies consider the bank’s minority lending ratios as part of the application process. Richard Marsico, *A Guide to Enforcing the Community Reinvestment Act*, 20 FORDHAM URB. L.J. 165, 171 (1993).

<sup>86</sup> Alvarado, *supra* note 85, at 482 n.47.

<sup>87</sup> See *Harambee Uhuru School, Inc. v. Kemp*, No. C2-90-949, 1992 U.S. Dist. LEXIS 15125, at \*11 (S.D. Ohio Sept. 30, 1992) (holding that the CRA does not “authorize a private individual to file suit or pursue other remedies for violation of any of the provisions of the Act”).

<sup>88</sup> See generally Marsico, *supra* note 85 (offering a guide for enforcement of the CRA, aimed at community based groups, and detailing strategies for exacting compliance).

<sup>89</sup> During the initial debate on the CRA, Senator Proxmire said, “[C]onvenience and needs does not just mean drive-in teller windows and Christmas Club accounts. It means loans.” 123 CONG. REC. 17,630 (1977).

that compliance with the CRA is overly burdensome and seek to avoid compliance.<sup>90</sup> Bankers deny the existence of mortgage discrimination.<sup>91</sup> These attempts failed to gain support within Congress, and thus all banks are required to comply with the Act.<sup>92</sup>

#### D. Home Mortgage Disclosure Act

To effectuate compliance with these anti-discrimination laws, Congress enacted the Home Mortgage Disclosure Act (HMDA)<sup>93</sup> in 1975. The HMDA requires banks with offices in metropolitan areas to reveal publicly the information regarding the geographic distribution of loans for home purchase and improvement.<sup>94</sup> In 1991, Congress amended the HMDA to require the compilation and publication of information regarding all applications, not just loans granted.<sup>95</sup> The HMDA requires that the race, national origin, gender, and annual income of all applicants be reported annually.<sup>96</sup> This information forms the basis for investigations into the lending practices of banks. The Federal Reserve, however, warns against over-reliance on the statistics in forming a presumption of discrimination.<sup>97</sup>

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<sup>90</sup> Alvarado, *supra* note 85, at 481. Bank complaints are supported by the lack of congressional or regulatory guidelines outlining whether a community's credit needs have been met. Marsico, *supra* note 85, at 171. Additionally, arguments have been made that "[either the CRA] is redundant, because serving the local community is profitable anyway; or it requires cross-subsidy, with above-normal profits from other services subsidizing the losses from the unprofitable service to the local community . . . . CRA obligations will cause banks to try to exit unprofitable communities completely . . . ." White, *supra* note 32, at 282.

<sup>91</sup> Chip Reichhart of the Maryland Mortgage Banker's Association stated, "I've been in the business for 20 years . . . . I've never seen any overt acts of discrimination. We are concerned that there's a perception that our industry discriminates . . . ." Terrence O'Hara, *Mortgage Bankers Air Reforms*, DAILY REC., Sept. 17, 1992, § 1, at 1.

<sup>92</sup> Thomas, *supra* note 2, at A8. See also Susannah B. Goodman, *Keep Reins Tight on Banks*, CHRISTIAN SCI. MONITOR, Mar. 11, 1993, at 19. Fifteen years after its enactment, the CRA continues to receive criticisms from both sides for being over burdensome and ineffective. *But see* White, *supra* note 32, at 283 (asserting that the relative absence of CRA complaints from effective communities indicates no lending problem).

<sup>93</sup> 12 U.S.C. §§ 2801-2810 (1988 & Supp. IV 1992).

<sup>94</sup> *Id.* § 2803. Three types of loans are covered by the HMDA: home purchase, home refinancing, and home improvement loans. 12 C.F.R. § 203.4(a) (1993) (defined in 12 C.F.R. § 203.2(f), (g) (1993)).

<sup>95</sup> 12 U.S.C. § 2803(j) (Supp. IV 1992).

<sup>96</sup> *Id.* § 2803(b)(4).

<sup>97</sup> Thomas, *supra* note 2, at A8.

## V. REMEDYING DISCRIMINATION IN LENDING

Unfortunately, the laws designed to prevent discrimination have failed to fulfill their goals. Statistics show the continued presence of prejudicial behavior by banks toward racial minorities.<sup>98</sup> The federal government, despite numerous laws and agencies, has failed to eradicate discrimination in lending. In a hearing of the Consumer Subcommittee of the Senate Banking Committee, Senator Dixon of Illinois stated:

[I]ts 21 years since passage of the Fair Housing Act. Fifteen years since the Equal Credit Opportunity Act was passed in the Congress, and 11 years since the Community Reinvestment Act became the law of this land, and still we have discrimination in lending. The problem today is not lack of laws, in my view, it is lack-luster enforcement.<sup>99</sup>

To eradicate discrimination in housing, greater demands must be placed on both banks and the government. To ensure protection of the rights due to all people under the United States Constitution, a new standard must be created for eliminating racial lines in lending.

The current banking regulatory structure fails to offer redress to victims of redlining. A greater standard of accountability is necessary to prevent the continued use of redlining. A constitutional standard allowing individuals remedies would shift the problem of redlining from the hands of executive regulatory agencies to the judiciary. Such a standard would also reform bank procedures to create objective lending criteria. A change in analysis is necessary, as the current problem extends far beyond the limits redressable within the existing regulatory scheme. Through use of strict scrutiny review, the remedies available to victims of redlining would not be limited to damages, but would also include an overhaul of the mortgage-lending process.

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<sup>98</sup> *Id.* While whites comprise 75.2% of the United States population, they account for 85.8% of the mortgage loans approved. African Americans constitute 12.1% of the population and receive only 4.8% of the mortgages granted. Edward P. Foldessy, *How the Mortgage Lending Pie Is Divided*, WALL ST. J., Nov. 30, 1992, at A8 (graph). The Department of Justice commented that the vast disparities in lending ratios "are statistically significant, could not have occurred by chance, and cannot be explained by differences in the relative qualifications of white applicants and black applicants for mortgage loans, or other non-racial factors." Thomas, *supra* note 2, at A9.

<sup>99</sup> *Discrimination in Home Mortgage Lending: Hearings Before the Subcomm. on Consumer and Regulatory Affairs of the Senate Comm. on Banking, Housing, and Urban Affairs*, 101st Cong., 1st Sess. 2 (1989).

The United States Constitution states that no person shall be deprived of life, liberty, or property without due process of law.<sup>100</sup> “[N]or shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.”<sup>101</sup> The Constitution protects individual rights, such as the right to property, from governmental intrusion. Constitutional analysis affords individual rights the greatest protection. The utilization of a constitutional standard for equal protection, however, is much easier said than done.

Equal protection claims arise under the Fifth Amendment Due Process Clause and the Fourteenth Amendment Equal Protection Clause. Under each amendment the analysis is the same, the only difference being whether the actor is the federal government or a state government.<sup>102</sup>

## VI. THE STATE ACTOR DOCTRINE

The United States Constitution offers no redress for discriminatory acts by private actors, no matter how wrongful.<sup>103</sup> In order to find that a bank has violated the United States Constitution by virtue of redlining, it is first necessary to find either that the bank is a state actor or that the government has acted in a discriminatory fashion. Originating in the latter part of the nineteenth century, the state actor doctrine has created considerable confusion and argument.<sup>104</sup> The state actor requirement remains an important issue in constitutional analysis, however. Professor Charles Black commented that the state actor requirement “is the most important problem in American law. We cannot think about it too much.”<sup>105</sup> Although not members of any branch of the government, banks are not strictly private actors. By virtue of their essential role in American life, banks are in essence extensions of the government.

State actor analysis lacks predictability. Three main tests, however, have developed.<sup>106</sup> The symbiotic relationship test seeks to establish state

<sup>100</sup> U.S. CONST. amend. V.

<sup>101</sup> U.S. CONST. amend XIV, § 1.

<sup>102</sup> *Miller v. Hartwood Apartments, Ltd.*, 689 F.2d 1239, 1243 (5th Cir. 1982).

<sup>103</sup> *See Public Util. Comm'n v. Pollak*, 343 U.S. 451, 461 (1952) (stating that the Fifth Amendment applies only to actions of the federal government).

<sup>104</sup> The doctrine is believed to have originated in the Civil Rights Cases, 109 U.S. 3, 11 (1883). No private cause of action arose under the Fourteenth Amendment, as courts believed that common law protected individuals from the discriminatory acts of private citizens or organizations. Chemerinsky, *supra* note 1, at 511-14.

<sup>105</sup> Charles L. Black, Jr., *Foreword: "State Action," Equal Protection and California's Proposition 14*, 81 HARV. L. REV. 69, 70 (1967).

<sup>106</sup> *See generally Miller v. Indiana Hosp.*, 562 F. Supp. 1259 (W.D. Pa. 1983) (outlining the symbiotic relations test, the nexus test, and the public functions test as the standards for determining the existence of a state actor).

involvement by showing that the allegedly private entity and the government are so intertwined that the actions of one are attributable to the other. The nexus test requires that the government involvement in discriminatory activity be in the form of encouragement. When the government allows or creates a situation where discrimination can occur, a private entity may be found to be a state actor. The final test is the public functions test. If a private actor fulfills a role generally reserved for the sovereign, the private actor may not act in a manner in which the government is forbidden from acting.

### A. *Symbiotic Relationship Test*

The first test is the symbiotic relationship test.<sup>107</sup> The symbiotic test looks for an overall interdependence between a private enterprise and a governmental entity.<sup>108</sup> If the relationship between the two is mutually beneficial, then the private enterprise, for the purpose of constitutional interpretation, may be considered a state actor.<sup>109</sup> This status is based on a significant interrelationship resulting in the appearance that the two organizations are one.<sup>110</sup> Once an interrelationship is established, it is not necessary for the individual plaintiff to show that the government is involved in the specific challenged action.<sup>111</sup> In the case of banking, extensive government regulation increases the possibility that a court would find banks to be state actors. Federal regulations touch all aspects of banking, from the formation and closure of banks to their growth and daily activity.

#### 1. *Does Regulation Equal "Interrelated"?*

Extensive regulation of an organization is generally not enough to find that a private group is a governmental actor.<sup>112</sup> The relationship between banks and the federal government, however, goes far beyond what is normally construed as regulation.<sup>113</sup> "Few other enterprises in the U.S. economy are saddled with the *obligation* to serve their local

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<sup>107</sup> *Id.* at 1275.

<sup>108</sup> *Burton v. Wilmington Parking Auth.*, 365 U.S. 715, 725 (1961).

<sup>109</sup> *Miller*, 562 F. Supp. at 1275.

<sup>110</sup> *Burton*, 365 U.S. at 725.

<sup>111</sup> *Hollenbaugh v. Carnegie Free Library*, 545 F.2d 382, 385 (3d Cir. 1976), *cert. denied*, 439 U.S. 1052 (1978).

<sup>112</sup> *Moose Lodge No. 107 v. Irvis*, 407 U.S. 163, 171-79 (1972).

<sup>113</sup> See *supra* notes 56-58 and accompanying text.

communities.”<sup>114</sup> When the nature of the governmental involvement extends beyond mere regulation, the actor may be held to the constitutional responsibilities of the state.<sup>115</sup>

The federal government participates even more fully in banking activities by depositing federal money in banks. Banks derive substantial benefits from these deposits, and much of this money applies toward the making of loans, especially mortgages.<sup>116</sup> Under HUD, the government backs loans made to low income applicants, thus increasing bank revenues and ensuring loan repayment.<sup>117</sup> The bank collects fees and interest on the loans while enjoying the security that accompanies a guaranteed loan.

Although the government does not supply the physical facilities for banking, it provides for and regulates almost all other aspects. This dependency relationship—banks relying on governmental permission and the government relying on banks to assist in the management of sound fiscal policy—satisfies the requirements of the state actor doctrine set forth by the Supreme Court in *Burton v. Wilmington Parking Authority*.<sup>118</sup>

In *Burton*, a private restaurant located within a public parking garage was deemed a state actor.<sup>119</sup> The restaurant was “physically and financially [an] integral” part of a public building, which was maintained with public funds.<sup>120</sup> The Court also held that state action is prohibited through any arrangement, including management, funds, or property.<sup>121</sup>

Although banks are not usually located in publicly owned buildings, they are financially dependant upon the government. From deposit insurance and federally backed loans to the printing and circulation of

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<sup>114</sup> White, *supra* note 32, at 287.

<sup>115</sup> See *Havas v. Communications Workers of Am.*, 509 F. Supp. 144, 148-49 (N.D. N.Y. 1981) (holding labor union to constitutional standard due to intertwining of federal government and labor organizations).

<sup>116</sup> FAIR HOUSING, *supra* note 67, at 212.

<sup>117</sup> 12 U.S.C. § 1702 (1988 & Supp. IV 1992). The federal government, in return for such security, asks that banks provide lending opportunities to all communities, a “quid pro quo” arrangement. Fishbein, *supra* note 82, at 293.

<sup>118</sup> 365 U.S. 715 (1961). The Court stated, “Only by sifting facts and weighing circumstances can the nonobvious involvement of the State in private conduct be attributed its true significance.” *Id.* at 722.

“Banks and bankers occupy a unique place in our society and economy. Bankers are, in effect, custodians of the economic resources of millions of citizens.” *FDIC Report on Preferential Bank Lending: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 95th Cong., 2d Sess. 16 (1978) (statement of Comptroller of the Currency John G. Heimann).

<sup>119</sup> *Burton*, 365 U.S. at 726.

<sup>120</sup> *Id.* at 723.

<sup>121</sup> *Id.* at 725. “By its inaction, the Authority, and through it the State, has not only made itself a party to the refusal of service, but has elected to place its power, property and prestige behind the admitted discrimination.” *Id.*

currency, banks would be unable to function without government assistance. The government determines whether communities are served by particular branches, and the extent of government permission necessary for banks to function is indicative of a relationship built upon mutual dependence.<sup>122</sup> Without government insurance, financing, and fiscal policy, banks would have a difficult time surviving. By limiting the number and location of bank branches, the government shields banks from the competitive forces of the market.<sup>123</sup>

Unlike in ordinary corporations, the effect of bank failure is felt by individuals outside of the ring of investors. Taxpayers and depositors share in the losses of failed financial institutions. Often, due to deposit insurance, the taxpayers carry the greatest load. “[Banks] well-being concerns not only the stockholders, but the depositors and public at large.”<sup>124</sup>

Pursuant to the symbiotic relationship test, there is no requirement that the government actually participate in the discriminatory activity.<sup>125</sup> There would be no need, therefore, for plaintiffs to show that the regulatory agencies required, requested, or encouraged the racial discrimination. Although the government provides both funds, through deposits, and insurance, this is not necessary for a showing that a private party is a state actor pursuant to the symbiotic relationship test.

## 2. *The Symbiotic Relationship Test and State Banks*

State banks, although subject to substantial regulation, are less likely to be state actors pursuant to the symbiotic relationship test. Although subject to regulation at the federal and state level, state banks are not likely restrained by the Due Process Clause of the Fifth Amendment. The Fourteenth Amendment, however, may apply. The Equal Protection Clause binds individual states to non-discriminatory behavior. In order to hold state banks responsible under equal protection, therefore, it is first necessary to find that state chartered banks are instruments of the

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<sup>122</sup> See *supra* notes 56, 58. Additionally, a government charter “conveys numerous economic benefits and in return it is legitimate for public policy and regulatory practice to require some public purpose . . . .” 123 CONG. REC. 1958 (1977) (statement of Sen. Proxmire concerning the CRA).

<sup>123</sup> Mann et al., *supra* note 16, at 180. Congress has now decided to remove this shield in the area of savings accounts by allowing the advertisement of interest rates for such accounts. *Id.* at 17-18. Such advertisements are constrained by requirements of the Truth in Savings Act. 12 U.S.C. §§ 4301-4313 (Supp. IV 1992).

<sup>124</sup> *German Baptist Orphans' Home v. Union Banking Co.*, 13 F. Supp. 814, 816 (W.D. Mich. 1935).

<sup>125</sup> *Hollenbaugh v. Carnegie Free Library*, 545 F.2d 382, 385 (3d Cir. 1976), *cert. denied*, 439 U.S. 1052 (1978).



chartering state. This relationship can be explored by looking at state regulations on banking.

Only state regulations applying to state banks, however, may be considered in determining whether a bank is an instrumentality of the particular state.<sup>126</sup> The relationship between fiscal management and the extensive dependency upon the state government, which exists between the federal government and national banks, is missing. If a relationship between the fiscal policies could be established, it could create a state actor responsible under the Fourteenth Amendment.

State banks are also subject to statutory restraints on discriminatory lending. Numerous state statutes contain provisions prohibiting discrimination in lending.<sup>127</sup> Unfortunately these laws, which are similar to Title VIII of the Civil Rights Act, have failed minorities much like their federal counterparts.<sup>128</sup> These regulations increase the likelihood that banks may be considered actors of the state. Such protections must be accompanied, however, by state constitutional protections mirroring the Due Process Clause of the United States Constitution.

### B. *The Nexus Test*

If the symbiotic relationship test fails, the nexus test should be applied in an attempt to find state action.<sup>129</sup> The question in the nexus test is

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<sup>126</sup> Federal regulations would tie a bank to the federal government and the Due Process Clause. State banks, in order to fall under the guarantees of the Equal Protection Clause, must be found to be actors of the state in which they operate. This relationship would require a tie between the state bank and the state government which parallels the relationship between national banks and the federal government.

<sup>127</sup> See, e.g., CONN. GEN. STAT. § 36-445 (1987); GA. CODE ANN. § 7-6-1 (1989); MASS. GEN. L. ch. 183, § 64 (1991); MICH. COMP. LAWS § 750.147a (1991); MO. REV. STAT. § 213.045 (1993); NEV. REV. STAT. § 207.310 (1992); N.Y. BANKING LAW § 9-f (McKinney 1982 & Supp. 1992).

<sup>128</sup> The poor lending ratios in these states indicate a lack of enforcement or effectiveness. The ratios for states with legislation similar to the CRA had the following lending ratios for 1991: Connecticut, 2.60; Georgia, 2.46; Massachusetts, 2.23; Michigan, 2.27; Missouri, 2.35; Nevada, 1.58; and New York, 2.16. Edward P. Foldessy, *State by State: How Blacks and Whites Compare*, WALL ST. J., Nov. 30, 1992, at A8 (table). Each state's 1991 statistics show a decreasing disparity in lending rates, but this may be the result of an increase in enforcement at the federal level. Thomas, *supra* note 2, at A9. Some states have stepped up enforcement, however, especially Massachusetts. Nevertheless, the disparity in lending continues, and each governmental unit attempts to pass the blame regarding enforcement of anti-discrimination laws. "Contrasting approaches—a nudge from the Fed and a slap from [Massachusetts Attorney General] Harshbarger—has highlighted a longstanding conflict over the best way to guarantee that minorities have equal access to credit." Mitchell Zuckoff, *Carrot or Stick in Lending Bias Fight?*, BOSTON GLOBE, Dec. 9, 1992, Economy, at 77.

<sup>129</sup> See *Miller v. Indiana Hosp.*, 562 F. Supp. 1259, 1275-78 (W.D. Pa. 1983) (including suggested order of advancing through the three state actor tests). The Supreme

whether “there is a sufficiently close nexus between the State and the challenged action of the regulated entity so that the action of the latter may be fairly treated as that of the State itself.”<sup>130</sup> The nexus test requires a plaintiff to show that the government is so involved in the specific act at issue that it has effectively encouraged the activity.<sup>131</sup> It is not enough that the government merely approve of the activity.<sup>132</sup> Yet the governments involvement need not be direct or extensive.

### 1. *Governmental Ratification of Discriminatory Behavior*

The primary case under the nexus test is *Jackson v. Metropolitan Edison Co.*<sup>133</sup> In *Jackson*, the Court held that a private utility company was not a state actor and therefore was not bound by the procedural due process requirements of the Fourteenth Amendment.<sup>134</sup> The Court rejected petitioners claim that because the state regulated utility company rates, the company was necessarily a state actor.<sup>135</sup> Petitioner claimed that a commissions consideration of the companys tariff procedures was equivalent to approval of the activity; the Court disagreed.<sup>136</sup>

In banking, the government has done more than approve of the discriminatory activity. The Community Reinvestment Act requires that different governmental agencies grant permits for merger and branch openings.<sup>137</sup> The granting of permits is based upon ratings regarding non-

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Court, however, refuses to designate any test for analyzing the state actor doctrine. *Burton v. Wilmington Parking Auth.*, 365 U.S. 715, 722 (1961).

<sup>130</sup> *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 351 (1974).

<sup>131</sup> *Id.* at 357; *Fitzgerald v. Mountain Laurel Racing, Inc.*, 607 F.2d 589, 595 (3d Cir. 1979), *cert. denied*, 446 U.S. 956 (1980).

<sup>132</sup> *See* *Blum v. Yaretsky*, 457 U.S. 991, 1004 (1982). Extensive governmental regulation alone is not sufficient to establish a nexus, but an entity bound by such regulation is more likely to be a state actor than an entity which is not so regulated. *Jackson*, 419 U.S. at 350-51.

<sup>133</sup> 419 U.S. 345 (1974).

<sup>134</sup> *Id.* *Jackson* claimed that because New York's tariff law granted the utility company the right to terminate power service under certain conditions, the government was implicated in the transaction, and due process was therefore necessary. *Id.* at 348. The court disagreed and held that the mere granting of a monopoly was not sufficient to show a state actor. *Id.* at 351.

<sup>135</sup> *Id.* at 350.

<sup>136</sup> *Id.* at 354.

<sup>137</sup> 12 U.S.C. § 2903 (1988 & Supp. IV 1992).

discriminatory loan disbursement.<sup>138</sup> The failure of federal agencies to ensure compliance results in the encouragement and continuation of past discriminatory policies.

The policies of the CRA in denying permits fall short of the regulation necessary to ensure that discrimination does not occur. Chairman Gonzalez, opening the field hearing on the CRA on September 29, 1989, stated that “[t]he Community Reinvestment Act . . . has become a monument to regulatory inaction.”<sup>139</sup> The lack of governmental enforcement also affects the ability of those discriminated against to seek redress, as individuals are often unaware that they have been victimized.<sup>140</sup>

Federal agencies appear unconcerned with the discrimination occurring in the mortgage industry. In 1988, a member of the Federal Reserve Board of Governors said, “[i]t’s not our job to allocate the credit geographically. We don’t have hard and fast lines on that.”<sup>141</sup> Although Congress enacted several laws requiring compliance and regulation, the agencies to which this responsibility was delegated failed to act within the required scope of the regulations, further expressing to banks that nondiscriminatory policies are not required.<sup>142</sup>

Although failure to ensure compliance is not an overt act of discrimination, the government has done more than merely ignore the problem. Congress specifically designed the CRA to eliminate redlining.<sup>143</sup> Initially, banks had no concern regarding enforcement because no standards existed by which to judge compliance. In the first twelve years of the CRA, ninety-seven percent of the rated institutions received one of the two highest ratings,<sup>144</sup> and only eight of 50,000 merger and expansion applications submitted were rejected.<sup>145</sup> It is impossible to believe that these ratings reflect the reality of mortgage lending. The statistics taken from the 1992 Boston Federal Reserve study show lending bias, both before and after the elimination of non-racial factors.<sup>146</sup> Although the situation is improving, the decision to grant a

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<sup>138</sup> See *supra* notes 82, 85.

<sup>139</sup> Fuchs, *supra* note 70, at 479-80 (quoting *Discriminatory Mortgage Lending Patterns: Field Hearing Before the House Comm. on Banking, Housing, and Urban Affairs*, 101st Cong., 2d Sess. 2 (1989)).

<sup>140</sup> *Id.* at 474.

<sup>141</sup> *Id.* at 480 (citation omitted).

<sup>142</sup> *Id.* at 479-82.

<sup>143</sup> Alvarado, *supra* note 85, at 477.

<sup>144</sup> Tomes, *supra* note 11, at 232.

<sup>145</sup> *Id.*

<sup>146</sup> The Boston Federal Reserve study removed all controlling economic factors. These included average income, the housing market, the mortgage market, neighborhood property characteristics, mobility, and development. Fuchs, *supra* note 70, at 467.

permit to merge or to open a new branch is usually challenged by citizen action groups, not the government.<sup>147</sup> In essence, the regulatory structure of the federal government allows mortgage discrimination to continue.

The government further fostered an atmosphere ripe for racial discrimination through the discriminatory legislative and judicial policies of the early twentieth century. As late as 1916, local ordinances required segregation by race in residential neighborhoods.<sup>148</sup> Throughout the 1930s, the Federal Housing Authority utilized discriminatory practices that allowed prejudice to continue long after the agency policies changed.<sup>149</sup> It is possible that the state action allows banks to continue to branch and develop without requiring compliance with the CRA and other anti-discrimination legislation. The question remains whether the granting of a permit to a discriminatory body is unconstitutional.<sup>150</sup>

Answering this question diverts the analysis from the banks liability and places responsibility on the governmental agency that fails to act. Banks then have no incentive to end discrimination or affirmatively work to avoid discriminatory lending rates unless agencies formulate and enforce rigid anti-discrimination requirements. Although this is a potential solution to the problem of discriminatory lending, it fails to address the direct prevention of discriminatory banking policies. As a result, this position shall not be explored further.

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<sup>147</sup> See Mann et al., *supra* note 16, at 70.

<sup>148</sup> See *Buchanan v. Warley*, 245 U.S. 60 (1917) (addressing ordinance that prevented lease or sale by a white person to a minority).

<sup>149</sup> State action may be found in official failure to protect private rights. See *McCabe v. Atchison, Topeka & Santa Fe Ry. Co.*, 235 U.S. 151, 160-62 (1914) (indicating that if an individual is denied service based on race under authority of state law, he may properly complain about the violation of constitutional law).

Although Congress enacted protective legislation, it took twenty years for Congress to realize that the system had failed. This type of inaction is deliberate. The state has a duty to ensure equal access to property in terms of access to funds.

<sup>150</sup> See generally Barbara Rook Snyder, *Private Motivation, State Action and the Allocation of Responsibility for Fourteenth Amendment Violations*, 75 CORNELL L. REV. 1053 (1993) (discussing that government failure to prevent discrimination is obviously state action). *But see* Cass R. Sunstein, *Lochner's Legacy*, 87 COLUM. L. REV. 873, 886 (1987) ("When the government fails to provide protection against private racial discrimination, the failure is said not to be 'state action' and thus raises no constitutional question.").

In *Shelley v. Kraemer*, 334 U.S. 1, 14-15 (1948), the Supreme Court held that a court order enforcing a racially restrictive covenant would provide the state action necessary for constitutional analysis. Regulatory action should fall under the same standards.

## 2. Banks as Quasi-Public Actors

Banks have also been labeled quasi-public actors by the federal courts. In *Knickerbocker Life Insurance Co. v. Pendleton*,<sup>151</sup> the Supreme Court stated, "A bank is a quasi-public institution . . . directly affecting the financial transactions of the general public."<sup>152</sup> This relationship is based upon the extent of control that banks have over the financial well-being of the national economy.

Federally chartered banks are more likely to be held to be actors of the federal government by virtue of the Supremacy Clause.<sup>153</sup> In the landmark decision of *McCulloch v. Maryland*,<sup>154</sup> involving the National Bank of the United States, the Supreme Court established that federally chartered banks are instrumentalities of the federal government.<sup>155</sup> *McCulloch*, however, involved the National Bank of the United States rather than a bank merely chartered by the federal government. This difference presents no problem, as federal courts have upheld the theory that federal banks are instrumentalities of the government long after the expiration of the National Bank of the United States.<sup>156</sup> The question whether banks are instrumentalities of the federal government generally arises when states attempt to tax national banks. Based upon the Courts ruling in *McCulloch*, unless specifically authorized by Congress, states may not regulate banks in any way that interferes with federal regulation.<sup>157</sup>

The Supreme Court extended the nexus test in *Department of Employment v. United States*,<sup>158</sup> by stating that the American Red Cross, like banks, is exempt from state taxation because it is an instrument of the government.<sup>159</sup> Justice Fortas stated:

<sup>151</sup> 115 U.S. 339 (1885). See also *Van Reed v. People's Nat'l Bank of Lebanon*, 198 U.S. 554 (1905).

<sup>152</sup> *Pendleton*, 115 U.S. at 344.

<sup>153</sup> U.S. CONST. art. VI. The Supremacy Clause prevents the application of state laws when they "stand[ ] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). Congress, however, cannot exceed the limits of its power under the Tenth Amendment. *McCulloch v. Maryland*, 17 U.S. 316, 423 (1819).

<sup>154</sup> 17 U.S. 316 (1819).

<sup>155</sup> The state, within which a branch of the National bank may settle, cannot, without violating the Constitution, tax that branch. *Id.* at 429.

<sup>156</sup> See *Des Moines Nat'l Bank v. Fairweather*, 263 U.S. 103, 106 (1923); *United Mo. Bank of Kansas City, N.A. v. Danforth*, 394 F. Supp. 774, 785 (W.D. Mo. 1975).

<sup>157</sup> *McCulloch*, 17 U.S. at 430. The Supremacy Clause, Article VI of the United States Constitution, states that all laws pursuant to the Constitution, made under the authority of the United States, shall be the "supreme Law of the Land" and are legally superior over conflicting state laws. U.S. CONST. art. VI.

<sup>158</sup> 385 U.S. 355 (1966).

<sup>159</sup> *Id.* at 360.

In those respects in which the Red Cross differs from the usual government agency—*e.g.*, in that its employees are not employees of the United States, and that government officials do not direct everyday affairs—the Red Cross is like other institutions—*e.g.*, national banks—whose status as tax-immune instrumentalities of the United States is beyond dispute.<sup>160</sup>

National banks' position as instrumentalities of the federal government makes them quasi-public actors that, under the nexus test, could be found to be state actors.

### 3. *State Banks and the Nexus Test*

Absent a showing of encouragement or authorization of discrimination by the state, state banks likely will not be held to be state actors. The main source of anti-discrimination regulation is the federal government, not the state government.<sup>161</sup> Anti-discrimination laws are in effect in many state jurisdictions, however. A majority of these laws dictate that no discrimination shall occur in the determination of housing loans on the basis of race.<sup>162</sup> The state systems of regulation are substantially less extensive than that of the federal government.<sup>163</sup>

In order to bind state banks under the Fourteenth Amendment, it is necessary to find that, by ignoring the deplorable minority lending ratio, state governments have encouraged discriminatory lending. The argument in this context is less convincing than in the federal realm, as state statutes generally lack the intricate "enforcement" mechanisms in place at the federal level.<sup>164</sup>

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<sup>160</sup> *Id.*

<sup>161</sup> See *supra* text accompanying notes 61-97.

<sup>162</sup> See CONN. GEN. STAT. ANN. § 36-52a (West Supp. 1993); D.C. CODE ANN. § 1-2414(a), (b) (1992); MASS. GEN. L. ANN. ch. 167, § 14 (West Supp. 1993); N.Y. EXEC. LAW § 296-a (McKinney 1983); OHIO REV. CODE ANN. 4112.02(h) (effective Jan. 1, 1994); WASH. REV. CODE ANN. § 30.04.510 (West 1986); W. VA. CODE ANN. § 31A-8B-1 (1988).

<sup>163</sup> Although states have enacted anti-discrimination statutes, the largest enforcement mechanism available in this realm is through use of HMDA information. The HMDA provides information about banks in large metropolitan areas. Although such information can then be transferred to the states for use in enforcing state laws, banks in rural areas are not required to comply. See 12 U.S.C. § 2803 (Supp. IV 1992) (addressing only banks in metropolitan areas).

<sup>164</sup> There are, however, certain instances in which states are directly responsible for creating "state actors" due to legislative enactments. In citizen referendum Proposition 14, under the guise of amending its Constitution, California granted citizens the right to

### C. *The Public Functions Test*

The third test utilized by the Supreme Court in determining whether the state actor requirement is met is the public functions test.<sup>165</sup> If the private actor fulfills a role typically reserved for the government, then constitutional provisions for equality may be applied to the actor.<sup>166</sup> It is not enough that a public benefit exists or that the goal of the activity is the public good.<sup>167</sup> Instead, the activity typically must be undertaken exclusively by the sovereign.<sup>168</sup> Because of the short-lived existence of the National Bank of America, it is difficult to imagine that banks fulfill a function typically reserved for the government. Looking again at *McCulloch*, however, banks may be the governments chosen method of achieving goals relegated solely to the government.

#### 1. *Allocation of Funds*

One primary legislative function is the allocation of funds. In *McCulloch*, the Supreme Court stated that:

A bank is a proper and suitable instrument to assist the operations of the government, in the collection and disbursement of the revenue; in the occasional anticipations of taxes and imposts; and in the regulation of the actual currency, as being a part of the trade and exchange between the states.<sup>169</sup>

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sell or lease property to anyone they chose. CAL. CONST. art. 1, § 26 (repealed 1974). The proposition allowed discrimination based on race by permitting landlords to cancel leases of minority tenants and by permitting denial of sale to minorities, which essentially created government-endorsed private discrimination. This legislation created hundreds of "state actors, because everyone who engaged in practices under Proposition 14 was acting with the government's encouragement. *See* *Reitman v. Mulkey*, 387 U.S. 369 (1967) (finding provision to be unconstitutional).

<sup>165</sup> *See* *Marsh v. Alabama*, 326 U.S. 501 (1946) (using public functions test to find that owner of company town could not deny constitutional rights of town's citizens).

<sup>166</sup> *See* *Evans v. Newton*, 382 U.S. 296 (1966) (involving city maintenance of a park donated by a private citizen for "whites only"). "[W]hen private individuals or groups are endowed by the State with powers or functions governmental in nature, they become agencies or instrumentalities of the State and subject to its constitutional limitations." *Id.* at 299. Constitutional limitations cannot be escaped by delegating authority.

<sup>167</sup> *Id.* at 299.

<sup>168</sup> *Rendell-Baker v. Kohn*, 457 U.S. 830, 840 (1982) (citing *Blum v. Yaretsky*, 457 U.S. 991, 1101 (1982)); *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 353 (1974).

<sup>169</sup> *McCulloch*, 17 U.S. at 325.

Congress allocates money for numerous causes, including the insuring and purchasing of mortgages.<sup>170</sup> Congress apportions funds for the insurance of mortgages to low income applicants, stepping in to pay when borrowers default. Although controlling a bank is not an exclusive government function, the allocation of government funds is the exclusive province of Congress.<sup>171</sup> Congress cannot violate due process in spending,<sup>172</sup> nor can those entrusted by Congress to carry out the management of a bank discriminate.

In levying taxes and providing for the expenditure of amounts collected as such, the government acts as debt collector and loan officer. Rather than creating and administering all social programs, the government creates semi-private corporations to ensure the efficient functioning of essential operations. The United States Post Office and Amtrak are examples of such corporations. These entities, like banks, are merely means for accomplishing government objectives.<sup>173</sup>

## 2. *Public Functions and State Banks*

State banks may be held liable for equal protection violations under the public functions doctrine only if the services provided are those generally provided by the state government. The circulation of currency and the control of fiscal policy are federal concerns, not state concerns. State banks, although assisting in state fiscal policy, are less dependent upon the state governments than upon the federal government.

Holding state banks liable for due process violations as actors of the federal government is more feasible. Because state banks assist in the distribution of capital created by the United States government, one link is established. State banks further national fiscal policy by following federally influenced interest rates and financing rates. Home finance rates are highly influential in regulation of the economy.<sup>174</sup> As a leading

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<sup>170</sup> Through the Federal Housing Authority and Fannie Mae, whereby the government backs the loans the Association purchases, federal funds are strongly tied to mortgage activities. See generally Tony Munroe, *Home-Loan Program for Poor Will Include D.C.*, WASH. TIMES, Feb. 26, 1993, at C1. Fannie Mae, in exchange for the government backed loans, is required to focus on loans for affordable housing. In 1991, however, only 2.5% of Fannie Mae loans were purchased in minority neighborhoods. Thomas, *supra* note 2, at A1.

<sup>171</sup> See U.S. CONST. art. I, § 8.

<sup>172</sup> See *Fullilove v. Klutznick*, 448 U.S. 448, 480 (1980).

<sup>173</sup> See generally *McCulloch*, 17 U.S. at 325 (stating that a bank is proper and suitable instrument to assist operations of government).

<sup>174</sup> See *The MacNeill/Lehrer NewsHour* (PBS television broadcast, Apr. 28, 1992); Dori Meinert, *Common Cause Links Lawmakers Actions to Real Estate Donations*, SAN DIEGO UNION-TRIB. Feb. 27, 1992, at A24 ("A healthy real estate industry is part and parcel included in anything that is going to stimulate the economy . . . .")



indicator of economic growth, low mortgage rates translate into a growing housing market, which increases job opportunities nationwide.<sup>175</sup> This development would be impossible if state banks were isolated from the influences of the federal government, because interest rates would vary between states, causing some regions to grow, while others floundered under the competition of the interest marketplace.

#### D. Arguments Against the State Actor Doctrine

It is impossible to predict which standard will be used by a court examining the state actor doctrine. Arguments exist that the Supreme Court has traveled away from and should continue to digress from this requirement and instead should balance the interests of the parties.<sup>176</sup> It does not appear, however, that the state actor doctrine will be replaced by a balancing test.<sup>177</sup> If the state actor component is retained as the threshold analysis, no further constitutional analysis is warranted. Absent a showing of direct government involvement, the failure of all state actor tests precludes the use of constitutional analysis. If a bank is found to be a state actor, the next question addressed is whether the bank's actions violate equal protection pursuant to the Fifth or Fourteenth Amendment to the Constitution.<sup>178</sup>

### VII. THE EQUAL PROTECTION OF MINORITY RIGHTS

The United States Constitution states that no person shall be deprived of life, liberty, or property without due process of law.<sup>179</sup> The equal

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<sup>175</sup> Real estate is one of four groups, comprised of 57 indicators that are deemed leading indicators. These indicators are used to predict anticipated economic change, in that an increase in these areas generally signifies that the economy will grow. *See Real Estate Rebound Will Occur Late Next Year*, 33 NAT'L REAL EST. INVESTOR 22 (1991).

<sup>176</sup> Professor Chemerinsky theorized that if the balancing test were used, "courts in each instance would determine whether the infringer's freedom adequately justified permitting the alleged violation." Chemerinsky, *supra* note 1, at 506.

Advocates of the balancing test insist that the impact of private actors is no less harmful than the acts of government, and therefore, the state actor doctrine fails to adequately protect the rights of individuals. *See generally id.* The expansion of constitutional rights during the twentieth century was not accompanied by a corresponding increase in common law protections. *Id.* at 517-19. Therefore, private discrimination may have a greater impact on society than ever before.

<sup>177</sup> *See generally* Sunstein, *supra* note 150 (discussing Sunstein's belief in a balancing approach and concluding that the Court will not abandon the state actor requirement); Snyder, *supra* note 150 (discussing purpose and need for retaining the state actor doctrine).

<sup>178</sup> 42 U.S.C. § 1983 (1988) gives individuals a cause of action for damages and injunctive relief against those who violate the Fourteenth Amendment under color of state law. *Monroe v. Pape*, 365 U.S. 167 (1961).

protection doctrine means that similarly situated people must receive equal treatment under the law.<sup>180</sup> When arbitrary and capricious decisions are made that affect an individuals constitutional rights, the Equal Protection Clause may be implicated. Victims of redlining, by virtue of the arbitrary nature of the process, deserve redress under the Equal Protection Clause. After finding that banks are state actors, further analysis is required to determine if redlining is unconstitutional.

#### A. *The Fifth Amendment and Equal Protection*

The Constitution, designed to protect individual liberties from government intrusion, extends to actions of both the federal and state governments. The Fourteenth Amendment, however, reaches only the acts of state governments or individuals acting under color of state authority.<sup>181</sup> The policies of federally chartered banks are not to be analyzed under the Fourteenth Amendment. Due to the limited contact between state governments and national banks, state actor analysis would fail, and banks would be exempt from the constraints of the Fourteenth Amendment.

In order to discuss the concept of equal protection when a federal actor is implicated, it is first necessary to find equal protection guarantees pertaining to the federal government. The Supreme Court, in *Bolling v. Sharpe*,<sup>182</sup> established that the Fifth Amendment, although without an equal protection clause, forbids “discrimination . . . so unjustifiable as to be violative of due process.”<sup>183</sup>

In *Bolling*, the Supreme Court held that school segregation in the District of Columbia violated the Due Process Clause.<sup>184</sup> Because the

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<sup>179</sup> U.S. CONST. amend. V, amend. XIV.

<sup>180</sup> *Dorsey v. Solomon*, 435 F. Supp. 725, 734 (D.C. Md. 1977) (referring to *Reed v. Reed*, 404 U.S. 71 (1971)).

<sup>181</sup> *Shelley v. Kraemer*, 334 U.S. 1, 13 (1948).

In *First Nat'l Bank in St. Louis v. Missouri*, 263 U.S. 640 (1924), Justice Vandevanter stated that the presence of a bank is “attributable to the national power, not to the state's permission.” *Id.* at 666 (Vandevanter, J., dissenting). Although national banks may be governed by state law, the scope of state regulation is limited.

<sup>182</sup> 347 U.S. 497 (1954).

<sup>183</sup> *Id.* at 499 (citations omitted).

<sup>184</sup> *Id.* at 498-99. The holding in *Brown v. Board of Education*, 347 U.S. 483 (1954), declaring separate but equal schools to be unconstitutional, was applied to schools in the District of Columbia. Although the District of Columbia is not a state, the Due Process Clause of the Fifth Amendment did not allow discrimination of this sort there. *Bolling*, 347 U.S. at 500.

District of Columbia is under the jurisdiction of the United States government, the Equal Protection Clause could not be relied upon.<sup>185</sup> Although the Court said that due process and equal protection ideas are not always interchangeable, the terms are also not mutually exclusive.<sup>186</sup>

### B. *Equal Protection and Due Process Analysis*

Discrimination in redlining violates the Due Process Clause. The process of redlining is inherently suspect as overinclusive. Redlining, even where some amount of caution in lending may be warranted, draws lines excluding individuals and neighborhoods that are not high credit risks. In order for plaintiffs in a due process/equal protection analysis to prevail, however, they must show that they were the victims of intentionally discriminatory treatment which infringed on or deprived them of a fundamental right.<sup>187</sup> Defendant banks may counter by showing that there is a compelling state interest in the action and that there are no less restrictive means for fulfilling this state interest.<sup>188</sup>

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<sup>185</sup> “[T]he District of Columbia is not a ‘State’ within the meaning of the Fourteenth Amendment.” *District of Columbia v. Carter*, 409 U.S. 418, 424 (1973). Congress serves as the municipal legislator for the District and in exercise of such legislative power, is subject to the Fifth Amendment Due Process Clause. *See Bolling*, 347 U.S. at 498.

<sup>186</sup> Equal protection is a more expansive safeguard. Due process is included within this notion, however. *Bolling*, 347 U.S. at 494.

<sup>187</sup> A neutral law cannot be enforced only against particular groups and withstand constitutional scrutiny. The unequal application of a law is a violation of the equal protection rights of those persecuted or excluded under the law when race is the determinative factor in enforcement. *Yick Wo v. Hopkins*, 118 U.S. 356, 373-74 (1886) (holding that enforcement of fire code against Chinese laundries was unconstitutional due to discriminatory administration by public officials).

Fundamental rights are those which are guaranteed by the Constitution, either explicitly or implicitly. *Price v. Cohen*, 715 F.2d 87, 93 (3d Cir. 1983), *cert. denied*, 465 U.S. 1032 (1984) (citing *Plyler v. Doe*, 457 U.S. 202, 217 n.15 (1982)). The right to property is an enumerated right under the United States Constitution, found in both the Fifth and the Fourteenth Amendments. U.S. CONST. amend. V, amend. XIV, § 1. Included in the right to property is the right to acquire and enjoy property. *See Holden v. Hardy*, 169 U.S. 366, 390-91 (1898) (“Property is more than the mere thing which a person owns. It is elementary that it includes the right to acquire, use and dispose of it. The Constitution protects these essential attributes of property.”). The use of discriminatory factors in granting mortgage loans denies access to property, denying the fundamental rights of minority applicants. The Due Process Clause “adds nothing to the rights of one citizen as against another. It simply furnishes an additional guaranty against any encroachment by the States upon the fundamental rights which belong to every citizen as a member of society.” *United States v. Cruikshank*, 92 U.S. 542, 554 (1875).

<sup>188</sup> *See infra* text accompanying notes 197-198.

### C. Intent

Proving discriminatory results is not difficult. Discriminatory intent, however, is difficult to show absent proof of motive. When lines are drawn on the basis of race, as with redlining, the action of the government is analyzed under strict scrutiny review.<sup>189</sup> Lending rates and disparity statistics are available to the public for all banks and all branches under the Home Mortgage Disclosure Act.<sup>190</sup> Reported to the Federal Reserve annually, these statistics provide each banks lending ratio information. Using this information, plaintiffs may prove that a particular bank has a disparate lending ratio.<sup>191</sup>

This disparate ratio, however, is not enough. The information provided through the HMDA is generated without removal of non-racial factors. Only under specialized studies, like that of the Boston Federal Reserve,<sup>192</sup> can the figures point to disparities that must be the result of racial discrimination. It is possible, however, that if these factors are removed, and these results point to discrimination, intent may be inferred. The Supreme Court has stated that “an invidious discriminatory purpose may often be inferred from the totality of the relevant facts, including the fact, if it is true, that the law bears more heavily on one race than another.”<sup>193</sup>

This ties directly into the next requirement. There is no indication that bank loan procedures were devised with a discriminatory intent. The showing is rather that lending policies are not adhered to in a uniform way and are applied in a discriminatory fashion against minorities. This subconscious intent to discriminate is determinable by the disparate lending rates to whites and African Americans, who, other than race, are similarly situated.

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<sup>189</sup> *City of Richmond v. Croson*, 448 U.S. 469, 493-97 (1989).

<sup>190</sup> 12 U.S.C. § 2803 (1988 & Supp. IV 1992). Information provided pursuant to the HMDA is utilized by both community groups and the government, including the Federal Reserve, to effectuate anti-discrimination legislation.

<sup>191</sup> O'Hara, *supra* note 33, § 1, at 3 (discussing how Anne Shlay used figures provided by HMDA to challenge bank mergers under Community Reinvestment Act).

<sup>192</sup> The Boston Federal Reserve study removed factors to determine whether credit applicants were truly similarly situated. Absent such specialized data, however, banks would be able to hide behind theories that minorities were less creditworthy.

<sup>193</sup> *Washington v. Davis*, 426 U.S. 229, 242 (1976) (finding that such statistical proof can raise an inference of discrimination). The use of statistical disparity resulting from a neutral law in which no subjective criteria are utilized, however, will usually be inadequate to support a claim that equal protection rights were violated. *Id.* Lending discrimination is based largely on subjective factors utilized by lending officers in making their decisions.

#### D. *Similarly Situated Treated Differently*

Minority plaintiffs must also prove that similarly situated whites were granted loans or granted loans under more favorable terms. Any individual denied, under authority of the State, a facility or convenience that is furnished to another under substantially the same circumstances, may properly complain that his constitutional rights have been violated.<sup>194</sup> Failure to prove this element or the existence of overt policies of racial discrimination would allow banks to claim that, although there is a disparity in lending rates, this disparity results from more minority applicants who are less qualified.

Pursuant to the HMDA, information regarding all loans and applications must be available to customers.<sup>195</sup> Using this information, minorities injured by the discriminatory policies of banks may find support for their assertions of discriminatory lending practices.<sup>196</sup>

#### E. *Compelling State Interest*

Defendant banks may assert that the state actors—banks—have a legitimate compelling interest in setting mortgage lending standards.<sup>197</sup> This argument becomes clouded when the alleged compelling state interest is defined. A compelling state interest is one in which the state actor has a legitimate concern of significance to the entity. It may be said that banks have a special interest in ensuring that borrowers are in a financial position to repay the loan. Banks do not operate to serve as charitable organizations, but rather they operate for the profit of shareholders. This profit motive is no reason to deny loans solely on the basis of race, however.

On the other side, there is an argument that no compelling state interest can be found for denying loans to minorities. This is a correct assertion as well. The denial of loans to minorities is tied to no interest of the government, and there is no legitimate reason why financially qualified African Americans should not receive mortgage loans. This argument, however, should not be necessary, because lines drawn on the basis of race are inherently suspect,<sup>198</sup> and therefore, banks would be required to show

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<sup>194</sup> *McCabe v. Atchison, Topeka & Santa Fe Ry. Co.*, 235 U.S. 151, 161-62 (1914).

<sup>195</sup> 12 U.S.C. § 2803(a)(1) (1988).

<sup>196</sup> See *Thomas*, *supra* note 2 (discussing evidence of discrimination from compiled data).

<sup>197</sup> See *Loving v. Virginia*, 388 U.S. 1 (1967) (establishing that when a racially-based classification violates equal protection and due process rights, government must prove that it has a compelling interest in the classification and that the classification is necessary to accomplish the interest).

<sup>198</sup> *Id.* at 11; *McLaughlin v. Florida*, 379 U.S. 184, 191-92 (1964). “I cannot conceive of a valid legislative purpose . . . for a . . . law which makes the color of a person’s skin

this interest exists. Furthermore, any concerns may be alleviated by examining the least restrictive means portion of equal protection analysis.

#### F. *Least Restrictive Means*

The least restrictive means test is utilized once a compelling state interest has been shown. The least restrictive means test requires that the method of racial classification be as narrowly tailored as possible in order to accomplish the goal.<sup>199</sup> Adhering to the test requires that the focus of the government action not be overly broad. In order for banks to meet the least restrictive means test, the standard for determining when a person will be granted a mortgage must be narrowly tailored to reliably determine the true risk associated with lending to a particular person. The location of property within an area generally occupied by minorities is not a factor indicative of high risk but rather indicates the banking industry's willingness to perpetuate the myths of the past and engage in discriminatory behavior.

The process of redlining targets entire neighborhoods deemed high risk, regardless of the creditworthiness of individuals applying for loans. Because these neighborhoods are almost always comprised of racial minorities, African Americans, Latinos, and other minorities who have a good credit rating will be left without access to the housing market. The overinclusiveness of this type of policy fails to adequately satisfy the least restrictive means test.<sup>200</sup>

By holding banks to a constitutional standard of equal protection, the process of mortgage lending will change. The current banking regulatory structure allows lending decisions to be made on the basis of both objective and subjective criteria. The policy of relying on nonpredictive factors in the allocation of loans cannot persist. By implementing constitutional standards, the procedures for determining loan eligibility would receive greater governmental scrutiny. Careful examination of the current decision making process of banks reveals a reliance on factors unpredictable of risk. Governmental interference and the use of standardized

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the test of whether his conduct is criminal offense." *Id.* at 198 (Stewart, J., joined by Douglas, J., concurring).

<sup>199</sup> The classification or treatment must be necessary for achievement of the legitimate government goal. The unequal treatment of minorities is unnecessary for achieving healthy lending policies. The principals of lending must be applied neutrally in terms of creditworthiness, and the factors used to determine creditworthiness must be drawn from nondiscriminatory factors that take into account past credit prejudices.

<sup>200</sup> See *McLaughlin*, 379 U.S. at 191-93. See generally DENNIS & POTTINGER, *supra* note 8, §§ 1.01-.04 (discussing different concepts of redlining and different theories of the effects on minorities).

objective criteria are essential to ensure that minorities are not denied access to loans.

### G. *The Right to Be Free From Discrimination*

Redlining denies minorities the opportunity to own homes and denies them the chance for the personal development associated with home ownership. In a speech before being elected, President Lincoln spoke of the intent of the signers of the Declaration of Independence:

They did not mean to say all were equal in color, size, intellect, moral development, or social capacity. They defined with tolerable distinctness in what respect they did consider all men created equal—equal with “certain unalienable rights, among which are life, liberty, and the pursuit of happiness.”<sup>201</sup>

Lincoln intended that there was a need for equal treatment under the laws through equality of opportunity.<sup>202</sup>

The denial of mortgages is the type of denial of opportunity that President Lincoln intended to eradicate. Minorities have the right to be free from racial discrimination. No individual should be denied the opportunity to become a homeowner on the basis of race. Equality of opportunity means the right to be free from arbitrary external constraints.<sup>203</sup> The government is not obliged to give people the financial resources necessary to secure homes, but it must ensure that there are no obstacles of discrimination standing in their path.<sup>204</sup> Professor Tribe states that “in the contemporary view, the function of the Fourteenth Amendment, and specifically the equal protection clause, was to guarantee racially equal access to these rights.”<sup>205</sup>

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<sup>201</sup> Abraham Lincoln, An Address Delivered at Springfield (June 26, 1857), in *THE IDEA OF EQUALITY: AN ANTHOLOGY* 185 (George L. Abernethy ed., 1959).

<sup>202</sup> Kingsley R. Browne, *Liberty v. Equality: Congressional Enforcement Power Under the Fourteenth Amendment*, 59 *DENV. L.J.* 417, 439.

<sup>203</sup> See generally *id.* at 439-40 (stating that equality of opportunity is philosophically compatible with the negative form of freedom).

<sup>204</sup> Equal protection guarantees under the Fifth Amendment are not substantive, but rather are the right to be free from invidious discrimination in statutory classifications. *Harris v. McRae*, 448 U.S. 297, 322 (1980).

<sup>205</sup> LAURENCE TRIBE, *AMERICAN CONSTITUTIONAL LAW* 1152 n.14 (1978).

### VIII. CONCLUSION

Deprivation of the equal protection rights of minorities by denying access to loans essentially eliminates the potential for minority home ownership. This denial of a fundamental right by virtue of bank's discriminatory lending policies cannot be allowed to continue. Banks must be held to a constitutional standard of equal protection in an effort to prevent the continuation of racial discrimination. The current regulatory structure fails to compel bank compliance with federal guidelines for nondiscriminatory loan disbursement. In an effort to completely eradicate the discrimination of the past, a new constitutional test of loan procedures must be developed and utilized.

A constitutional standard is possible because national banks are instrumentalities of the federal government. As such, national banks cannot be allowed to assert their quasi-public status in order to avoid taxation, while failing to fulfill the obligations associated with the status of being a state actor. The promulgation of further non-constitutional regulations will merely add to the confused package of statutes currently failing to regulate lending practices adequately. Because the rights of equal protection and property are essential to individual liberty, a new standard, a strict scrutiny standard, is needed to judge the procedures of banks for processing mortgage applications.