



COMMUNITY REINVESTMENT ASSOCIATION

of NORTH CAROLINA

July 16, 2004

Sue Costello
Vice President
Federal Reserve Bank of Atlanta
1000 Peachtree Street, N.E.
Atlanta, GA 30309-4470

VIA FACSIMILE: (404) 498-7302

Dear Ms. Costello:

The Community Reinvestment Association of North Carolina (“CRA-NC”) and the North Carolina Fair Housing Center (“Fair Housing Center”) respectfully submit additional comments in opposition to the application of SunTrust Banks, Inc. (“SunTrust”) to merge with National Commerce Financial Corporation (“National Commerce”) and acquire its subsidiaries. CRA-NC and the Fair Housing Center request an investigation into the lending policies and practices of National Commerce for discrimination in lending to African Americans.

National Commerce has a policy and practice of pricing home mortgage loans differently based on the size of the loan. Using a tiered system, the bank increases the interest rate as the loan size decreases. The interest rate increases by as much as 1/8 of a point (12.5 basis points) as the loan size decreases at each tier. The tiers are as follows: equal to or greater than \$75,000, \$150,000, and 200,000. As a result, a \$74,999 loan can cost 3/8 of a point (37.5 basis points) higher than a \$200,000 loan.

Under the Fair Housing Act and the Equal Credit Opportunity Act (ECOA), a lender may not use a prohibited factor to vary the terms of credit offered, including the amount, interest rate, duration or type of loan. Race is a prohibited factor. Lending discrimination includes disparate impact, which occurs when neutral policies disproportionately and adversely affect a person’s access to credit. A policy or practice that is applied equally has a disparate impact when it has a disproportionate adverse impact on applicants from a group protected against discrimination and the policy is not justified by business necessity.

CRA-NC and the Fair Housing Center assert that the lending policy of pricing interest rates based on loan size is a pattern and practice that has an adverse and disparate impact on African Americans, who disproportionately apply for mortgage loans in amounts less than \$75,000. This policy, which was implemented by National Commerce in North Carolina after its merger with Central Carolina Bank (“CCB”) in 2000, has an adverse impact on census tracts with high proportions of minority residents and has had a negative impact on lending to African American borrowers in North Carolina as evidenced by a drop African American application rates and loans to African Americans.

Disparate and Adverse Impact on African Americans

Although National Commerce’s tiered-pricing policy is non-discriminatory on paper, in practice it has a disparate impact on the protected class of African Americans, who disproportionately apply for loans under \$75,000, which have the highest rates. As a result of the tiered pricing based on loan size, African Americans are disproportionately paying more for their mortgage loans and Whites are paying less. According to Home Mortgage Disclosure Act (“HMDA”) data, in 2002, African American mortgage applicants at National Commerce in North Carolina were nearly twice as likely as White applicants to apply for a mortgage loan in amounts less than \$75,000. Statewide,

41.3% of African American applicants at National Commerce applied for a loan less than \$75,000, while 20.9% of White applicants applied for a loan less than \$75,000. (Exhibit A)

Throughout North Carolina, White applicants at National Commerce were more than two times as likely as African Americans to apply for a loan in amounts equal to or greater than \$200,000, which receive the lowest interest rates. In 2002, 10.7% of African American applicants applied for a loan worth \$200,000 or more while 22.7% of all White applicants at National Commerce applied for a similar size loan. (Exhibit A)

The largest disparities in applications between African Americans and Whites occur at the highest and lowest loan levels. However, statewide, White applicants at National Commerce are also more likely to apply for a loan between \$150,000 and \$200,000.

The disparate impact also occurs in loan originations, with African Americans disproportionately receiving higher cost loan amounts from National Commerce. In North Carolina in 2002, African Americans received 4.7% of all mortgage loans National Commerce. However, they received 6.5% of all mortgage loans originated for less than \$75,000. Statewide, 33.5% of loans originated to African American borrowers were for amounts less than \$75,000, while 19% of loans originated to White borrowers were for amounts less than \$75,000. (Exhibit A)

The disparate impact of tiered pricing is evident in specific metropolitan statistical areas (MSAs) served by National Commerce throughout North Carolina. (Exhibit B)

- In the Raleigh-Durham-Chapel Hill MSA in 2002, African Americans were 2.7 times more likely to apply for a mortgage loan of less than \$75,000 from National Commerce than Whites. African Americans were 2.2 times more likely than Whites to receive a loan for less than \$75,000 from National Commerce.
- In the Greensboro-Winston Salem-High Point MSA, 39% of the African American applicants at National Commerce applied for loans less than \$75,000, compared to 25% of White applicants.
- In the Charlotte-Gastonia-Rock Hill MSA in 2002, African American applicants at National Commerce were 1.7 times more likely than Whites to apply for loans less than \$75,000.

Disparate and Adverse Impact on Minority Census Tracts

CRA-NC and the Fair Housing Center are concerned that tiered pricing based on loan size has become a form of redlining neighborhoods where average home prices fall below the \$75,000 tier. Historically, these neighborhoods disproportionately have high minority populations.

In analysis of 2002 HMDA data, CRA-NC and the Fair Housing Center found that National Commerce mortgage applicants from high minority census tracts are more likely to apply for smaller loans that receive higher interest rates. CRA-NC and the Fair Housing Center defined "high minority" census tracts as those where the minority population comprised at least 50% of the total population in the census tract.

In the Raleigh-Durham-Chapel Hill MSA in 2002, National Commerce applicants from high minority census tracts were more likely to apply for mortgage loans in amounts below the \$75,000 level. While 6.5% of all National Commerce mortgage applicants were from census tracts with at least 50% minority populations, 20% of the borrowers applying for loans under \$75,000 were from high minority census tracts. Just 1.4% of borrowers applying for loans greater than \$200,000 were from similar high minority census tracts. More than 61% of all applicants living in high minority census tracts applied for loans less than \$75,000; just 6.4% applied for loans equal to or greater than \$200,000. (Exhibit C)

In Greensboro, where 42% of all applicants applied for a loan of less than \$75,000, more than 63% of applicants in high minority census tracts applied for a loan smaller than \$75,000. In Charlotte, nearly 73% of applicants from high minority census tracts applied for loans less than \$75,000. In comparison, slightly fewer than 43% of total applicants applied for loans under \$75,000. Only one applicant from a high minority census tract applied for a loan worth \$200,000 or more. (Exhibit C)

As a result of the pricing policy, National Commerce borrowers from minority census tracts are more likely to be paying higher rates for their mortgage loans. Similar to a policy not to extend loans for less than a certain amount,

the tiered-pricing policy closes the door to African Americans becoming a client of National Commerce since they will pay a higher rate because of the value of the houses in the areas in which they are likely to live.

The Broader Impact of Tiered Pricing

National Commerce's policy has a decidedly adverse and disparate impact on African Americans in North Carolina. Low-income African Americans face higher costs since they disproportionately apply for loans less than \$75,000. With the higher interest rates, they pay more for access to credit. Even small differences can cost a borrower thousands of dollars over the life of the loan.

The result of this loan practice has been a steady decrease in the application rate and number of loans by African American borrowers as evidenced in the North Carolina market. National Commerce had fewer African American applicants and dedicated a smaller percentage of its mortgage portfolio to African American households in 2000, 2001, 2002 and 2003 than CCB did in 1999. (See Exhibit D)

In 1999, CCB had 771 African American mortgage applicants throughout the state. In 2003, National Commerce had 732 African American applicants throughout the state – a 5% decrease. During the same time period, the total number of applicants statewide increased 6.7%. Statewide, the percentage of applicants who were African American fell from 6.8% to 6%.

During the same time period, the number of loans that National Commerce originated to African Americans in North Carolina fell from 570 to 477 – 93 fewer loans. Although the dollar amount loaned to African Americans increased from 1999 to 2003, the amount loaned to African American borrowers as a percentage of the total amount loaned fell from 5% to 3.7%.

National Commerce's Policy is Intentional

Although evidence of discriminatory intent is not necessary to establish that a policy or practice adopted by a lender has a disparate impact, CRA-NC and the Fair Housing Center argue that this policy is intentional. Analysis of the applicant pool in North Carolina and the MSAs served by National Commerce demonstrate that a pricing policy based on loan size will have an adverse impact on African American borrowers.

Analysis of 2002 HMDA data show that in North Carolina, African Americans are 1.5 times more likely than Whites to apply for mortgage loans in amounts under \$75,000. Nearly 45% of African American applicants applied for loans under \$75,000, compared to 28.7% of White applicants. African Americans comprised 7.2% of all mortgage originations statewide, but 11% of all originations for less than \$75,000.

In the Raleigh-Durham-Chapel Hill MSA in 2002, African Americans were nearly twice as likely as whites (1.88 times) to apply for loans for less than \$75,000. Nearly 28% of all African American applicants in the MSA applied for loans less than \$75,000 while 14.8% of White applicants applied for such loans. African American applicants, who comprised 11% of all applicants in Raleigh MSA in 2002, comprised fewer than 5% of applicants who applied for loans in amounts of \$200,000 or more. White applicants were 2.7 times more likely than African American applicants to apply for the larger loans. The statistics are similar for mortgage originations. (Exhibit E)

In the Greensboro-Winston Salem-High Point MSA market, African Americans are more likely to apply for loans totaling less than \$75,000 and less likely to apply for loans greater than \$200,000. Nearly 43% of all African American mortgage applicants in the MSA applied for loans under \$75,000, while 32% of White applicants applied for those loans. White applicants were more than two times more likely than African Americans to apply for loans of at least \$200,000.

In the Charlotte-Gastonia-Rock Hill MSA, African Americans are slightly more likely to apply for loans worth less than \$75,000. However, White applicants are nearly 3 times more likely to apply for loans more than \$200,000 than African American applicants.

CRA-NC and the Fair Housing Center expressed concerns about possible disparate impact of the tiered pricing system in a meeting with National Commerce executives on December 18, 2002. The concerns were restated in a January 2, 2003, letter sent to Richard Furr, Chief Operating Officer at National Commerce, after the meeting (see

Exhibit F). In its response, the bank agreed to review the impact of its tiered pricing policy on African Americans. The bank did not continue the dialogue and indicate whether such a review took place or share any findings if such a review occurred. The tiered-pricing policy continues, and continues to adversely affect minorities.

No Business Justification for Tiered Pricing Based on Loan Size

The tiered pricing policy is not a business necessity for National Commerce. Smaller loans generate smaller profits, but they are still profitable. Although there are greater margin of returns on larger loans, the cost of making the loan is the same regardless of the size of the loan. The pricing policy is not a business necessity; it is a pricing scheme that increases profits based on a disparate impact.

Tiered pricing based on loan size is not an element of risk-based pricing. Risk-based pricing is a method of underwriting that evaluates the applicant's risk factors and credit profile and adjusts the interest rate and possible discount points on a mortgage up or down based on this risk evaluation. Risk-based pricing uses a number of factors to determine whether an applicant is a higher risk, including lower credit rating, higher loan-to-value, and higher debt ratios. However, loan size is not an indicator of risk. In our attempt to better understand the National Commerce's pricing system, we asked National Commerce mortgage officers about loans with the same risk profile – same borrower, same income, good credit, 80% LTV. Despite all the same risk factors (or even lower risk factors for the smaller loan since debt ratios would be lower), we were informed that loans for less than \$75,000 would cost more than loans for \$150,000.

To examine the business necessity of pricing based on loan size, CRA-NC called a number of banks in North Carolina to ask about their policy. We found a range of responses. Several banks do not vary the interest rate by the size of the mortgage loan. Other banks charge higher rates for smaller mortgage loans in the \$20,000 to \$30,000 range. And, other banks charge different rates based on loan size through a tiered system similar to that of National Commerce. We intend to challenge those banks about the impact of that pricing system.

As a result of our informal survey, it is clear that the tiered pricing system for mortgage loans based on loan size is not universal and not a business necessity for all banks. Therefore, we question why it would be a business necessity for National Commerce. There is clearly a less expensive alternative: charge the same rate based on risk regardless of loan size.

Conclusion

CRA-NC and the Fair Housing Center are troubled by the mortgage pricing policy and practices of National Commerce. We believe that the policy of pricing mortgage loans by loan size is discriminatory because it has a disparate and adverse impact on a protected class. African Americans disproportionately apply for loans of smaller sizes and are underrepresented at larger loan sizes that receive the best interest rates. We request that the Federal Reserve Board and the Department of Justice pursue this investigation and take action on any findings of violations of fair lending laws.

Sincerely,

Peter Skillern
Executive Director
CRA-NC

Stella Adams
Executive Director
North Carolina Fair Housing Center

cc.

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th & Constitution Avenue, N.W.
Washington, DC 20551-0001

Steven H. Rosenbaum
U.S. Department of Justice
Civil Rights Division
950 Pennsylvania Avenue, N.W.
Housing and Civil Enforcement Section, NWB
Washington, D.C. 20530