

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

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Prepared By: Banking and Insurance Committee

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BILL: SB 558

INTRODUCER: Senator Siplin

SUBJECT: Discriminatory Lending Practices

DATE: March 23, 2006

REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Deffenbaugh	Deffenbaugh	BI	<b>Favorable</b>
2.			CJ	
3.			JU	
4.				
5.				
6.				

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## I. Summary:

Senate Bill 558 makes it a third degree felony for any employee of a financial institution who denies loans or restricts the number of loans made to the residents of a particular geographical area of a community based on the race, national origin, or income of the residents of that area.

Current federal law contains broad prohibitions on creditors discriminating on the basis of race and other factors with respect to any aspect of a credit transaction. Florida law prohibits racial discrimination with regard to loans on dwellings, but does not appear to prohibit racial (or other) discrimination regarding non-dwelling loans. Neither federal or state law prohibits financial institutions from using income as a factor in making loans. However, federal law requires regulatory agencies to assess each financial institution's record in meeting the credit needs of its entire community, consistent with safe and sound operations.

This bill creates an unnumbered section of the Florida Statutes.

## II. Present Situation:

### Regulation of Financial Institutions and Other Lenders

The Office of Financial Regulation (OFR) is responsible for the regulation of state-chartered financial institutions, finance companies, and mortgage lenders and brokers (among others).<sup>1</sup> The OFR is under the Financial Services Commission (commission), which consists of the Governor, Chief Financial Officer, Attorney General, and Commissioner of Agriculture.

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<sup>1</sup> Section 20.121(3)(a)1., F.S.

The federal Office of the Comptroller of the Currency (OCC) charters, regulates, and supervises all national banks. The Federal Reserve Board investigates consumer complaints received against state-chartered banks that are members of the Federal Reserve System. The National Credit Union Administration (NCUA) is the federal agency that charters and supervises federal credit unions.

The OCC regulations specify the types of state laws that are preempted and do not apply to national banks' lending and deposit-taking activities and the types of state laws that generally are not preempted. The regulation authorizes national banks to engage in real estate lending subject to such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order.<sup>2</sup> However, certain types of state laws are not preempted and would apply to national banks to the extent that they do not significantly affect the real estate lending operations of the national banks or otherwise inconsistent with national banks' federal authority to engage in real estate lending.

Mortgage brokers and mortgage lenders in Florida are regulated under the provisions of ch. 494, F.S. However, banks and bank holding companies, regulated under the laws of any state or the U.S. government, are exempt from regulation under ch. 494, F.S.

### **Federal Laws Prohibiting Discriminatory Lending Practices**

Various federal laws and regulations prohibit discriminatory lending practices, which apply to state and nationally chartered financial institutions and other lenders.

*The Equal Credit Opportunity Act (ECOA)* -- The ECOA makes it unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction, on the basis of race, color, religion, national origin, sex, marital status, age, or because the applicant receives income from a public assistance program.<sup>3</sup> The definition of "creditor" is very broad, and includes any person who regularly extends or arranges for the extension of credit.<sup>4</sup>

The ECOA provides for civil liability of any creditor who violates this prohibition. The aggrieved party may file a civil action in a federal district court to enforce the act's requirements. A creditor found to be in violation is liable for any actual damages sustained by the applicant, punitive damages of up to \$10,000, and an award of costs and a reasonable attorney's fee. In the case of a class action, the total recovery may not exceed the lesser of \$500,000 or 1 percent of the net worth of the creditor. The court may also grant such equitable and declaratory relief as is necessary to enforce the requirements of the ECOA.

The ECOA also provides for administrative enforcement by various agencies, depending on the type of creditor involved in the complaint:

- Nationally chartered bank -- Office of the Comptroller of the Currency
- State chartered bank that is insured by the FDIC -- Federal Deposit Insurance Corporation

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<sup>2</sup> 12 CFR 34.

<sup>3</sup> 15 U.S.C. 1691 *et seq.*

<sup>4</sup> 15 U.S.C. 1691a

- Federally chartered or federally insured savings and loan associations -- Office of Thrift Supervision
- Federally chartered credit union -- National Credit Union Administration
- Retailer, finance companies, mortgage companies, state chartered credit union, and other creditors not assigned to another agency -- Federal Trade Commission
- Complaints against all kind of creditors can also be referred to the Department of Justice (Attorney General) which is authorized to prosecute matters involving a pattern or practice of discrimination.<sup>5</sup>

Federal banking agencies are authorized to use their enforcement authority to address discriminatory lending practices, including:

- Enforcement actions that require both prospective and retrospective relief. Retrospective relief may include identifying customers who may have been subject to discrimination and offering to extend credit if the customers were improperly denied or requiring the financial institution to make payments to injured parties.
- Assess civil money penalties in varying amounts against the financial institution or any institution-affiliated party.
- Removal and prohibition actions against any institution-affiliated party where statutory requirements for such actions are met.

The ECOA requires the U.S. Attorney General to make an annual report to Congress concerning the administration of the Department of Justice functions under the act. The 2004 annual report<sup>6</sup> summarizes the settlement agreement with a Michigan bank for an alleged violation of the ECOA and the Fair Housing Act by unlawfully avoiding and refusing business and residential loans to Detroit's predominantly African-American neighborhoods. This was the Department's first small business lending lawsuit. The bank agreed to open three new full-service branch offices in Detroit; relocate the offices of its Detroit business group team to Detroit; invest \$3 million over three years in a financing program for businesses and residents of Detroit, of which two-thirds will be directed to small business loans; and invest at least \$200,000 for consumer education programs for small business planning and a home-buyer education program.

The Attorney General's 2004 report also described the consent order in Illinois alleging that a bank violated the ECOA and Fair Housing Act by unlawfully avoiding and refusing to make business and residential loans to minority areas of Chicago and Kankakee. The bank agreed to open four new full-service branch offices, three located in majority African-American census tracts in the Chicago area and one in a majority Hispanic census tract; invest \$5 million in a special financing program for residents and small businesses in the minority communities of the Chicago/Kankakee areas; invest at least \$300,000 for consumer education programs; and spend at least \$400,000 to advertise its products in media targeted to minority communities.

*Fair Housing Act* -- The Fair Housing Act prohibits discrimination based on race or color, national origin, religion, sex, familial status, and disability, in all aspects of residential real estate

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<sup>5</sup> <http://www.ftc.gov/bcp/online/pubs/credit/exoa.htm> (the Federal Trade Commission website, which includes facts for consumers regarding their rights under the EEOC).

<sup>6</sup> <http://www.usdoj.gov/crt/housing/documents/ecoa2004.htm>

transactions.<sup>7</sup> The U.S. Department of Housing and Urban Development (HUD) administers and enforces provisions of the Fair Housing Act to ensure equal access to housing and guarantee equal opportunity in all of the HUD programs. The act authorizes HUD administrative enforcement actions on behalf of victims of housing discrimination and allows the U.S. Justice Department to sue on behalf of victims in federal district courts. It also provides criminal penalties for violations.

*Community Reinvestment Act (CRA)* -- Federal regulations implement the (CRA) which requires that all federal regulators of banks and thrifts encourage those institutions to help meet the credit needs of the local communities in which they are chartered.<sup>8</sup> The CRA directs the regulatory agencies to assess each institution's record in the meeting the credit needs of its entire community, consistent with safe and sound operations. The CRA also requires these agencies to consider these records in evaluating the institution's applications for deposit facilities, such as mergers. Each bank is assigned a ranking based on its performance. Evidence of discriminatory practices adversely affects the evaluation of a bank's performance.

According to the Office of Financial Regulation, over the last five years (since 2001), only one financial institution in Florida, a relatively small bank, has received a less than satisfactory rating, rated as "needs improvement."

*Home Mortgage Disclosure Act (HMDA)* -- One of the purposes of this act is to identify possible discriminatory lending patterns and enforce antidiscrimination laws by requiring the collection and disclosure of data about applicant and borrower characteristics.

### **Florida Fair Housing Act of 1992**

The Florida Fair Housing Act, part II of chapter 760, F.S., which is modeled on the federal Fair Housing Act, prohibits discrimination on the basis of race, color, national origin, sex, handicap, familial status, or religion in the sale, rental, financing, appraisal, insuring, real estate brokerage service, or advertising of housing. Banks and other firms which make commercial real estate loans are expressly prohibited from denying a loan for purchasing, constructing, improving, repairing, or maintaining a dwelling (as defined), or from discriminating in the amount, interest rate, duration, or other term or condition of such loan, to a person on the basis of these factors. (s. 760.25, F.S.)

The Florida Fair Housing Act authorizes the Florida Commission on Human Relations (Commission) to investigate complaints and take action regarding discriminatory housing practices, including discriminatory lending practices related to a loan for a dwelling, as defined. (ss. 760.31-.760.34, F.S.). The Florida Fair Housing Act authorizes a person to bring a civil action for an alleged discriminatory housing practice (which the court must continue before bringing to trial if the court believes that the conciliation efforts of the Commission or local agency are likely to result in satisfactory settlement). If the court finds that a discriminatory housing practice has occurred, it must issue an order prohibiting the practice and provide affirmative relief, including actual and punitive damages, and reasonable attorney's fees and costs. There is also the option for an aggrieved party to pursue an administrative hearing and for

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<sup>7</sup> 42 U.S.C. 3601 et seq.

<sup>8</sup> 12 C.F.R. 228

a final order by the Commission prohibiting the practice and providing affirmative relief, including “quantifiable damages” and reasonable attorney’s fees. If the Commission finds there is reasonable cause to believe that a discriminatory housing practice has occurred, the aggrieved party also has the option of requesting the Attorney General to bring an action in the name of the state on behalf of the aggrieved person. (ss. 760.34 and 760.35, F.S.)

### **Florida Civil Rights Act (Not Applicable to Lending Practices)**

The Florida Civil Rights Act, part I of chapter 760, F.S., prohibits discrimination on the basis of race, color, religion, sex, national origin, age, handicap or marital status in the areas of employment, public lodging or food accommodations, and application for membership in private clubs. However, this act does not prohibit racial (or other) discrimination regarding loans or the extension of credit. Therefore, unless the loan is a dwelling loan covered by the Florida Fair Housing Act described above, there is no state law prohibiting discrimination on the basis of race or any other factor. Some states have civil rights laws or equal credit opportunity laws broader than Florida’s, that apply to loans and the extension of credit, such as Minnesota (s. 363A.16, Minnesota Statutes 2005).

Primary administrative authority and resolution of discrimination matters under the Florida Civil Rights Act lies with the Florida Commission on Human Relations (Commission). The 12-member Commission is authorized to receive, initiate, investigate (including issuing subpoenas), seek to conciliate, hold hearings on, and act upon complaints alleging discriminatory practices covered under the act. After the Commission makes its determination, the aggrieved person can file a civil action or request an administrative hearing. If a civil action is filed, the court may issue an order prohibiting the discriminatory practice and providing affirmative relief, and may award compensatory damages, including damages for mental anguish, loss of dignity, and other intangible injuries. Punitive damages of up to \$100,000 may also be awarded. The court may also allow the prevailing party a reasonable attorney’s fee. (s. 760.11(5), F.S.). If an aggrieved party files for an administrative hearing and a violation is found, the final order of the Commission may prohibit the practice, provide affirmative relief, and award the prevailing party a reasonable attorney’s fee. (s. 760.11, F.S.)

The Florida Civil Rights Act also gives the Attorney General independent authority to take civil action against discrimination arising in the areas of education, employment, housing, and public accommodations, as well as employment retaliation based on race, color, religion, gender, national origin, age, disability, or marital status. If the Attorney General has reasonable cause to believe that any person or group has engaged in a pattern or practice of discrimination as defined by state law; or has been discriminated against as defined by state law and such discrimination raises an issue of great public interest, the Attorney General can take civil action against those persons or groups. In addition to seeking damages and injunctive and other appropriate relief for the injured party, the Attorney General may also recover civil penalties up to \$10,000 per violation. The prevailing party is entitled to an award of reasonable attorney’s fees and costs.

### **Complaints of Discrimination**

The Office of Financial Regulation reports that over the last six years (Jan. 1, 2000 - March 21, 2006), it has received a total of forty-three complaints against financial institutions and other regulated entities classified as “discrimination,” all believed to be generally alleging racial discrimination. Of these, twenty were alleged against financial institutions (banks, credit unions,

etc.) and the remaining twenty-three were against other regulated entities such as mortgage lenders or brokers, check cashers, finance companies, and a few entities that are not lenders, such as consumer collection agencies. Over this time period, OFR estimates that hundreds of thousands, if not millions of loans or other extensions of credit have been made in the state.

Of the twenty complaints made against financial institutions, ten were made against federally chartered institutions for which OFR referred the complaint to a federal agency, (except for one listed as “no violation”). The other ten were against state chartered institutions, all of which OFR closed with “no action,” “no violation,” “settled,” or similar verbiage. Of the twenty-three complaints against other regulated entities, seventeen were closed as having “no violation,” “no action,” “settled,” or similar verbiage, three were closed as being referred to another agency, one was closed as “referred investigation,” and two remain open as “referred to examination” and “assigned pending,” respectively.

### **Lawful Lending Practices**

Each financial institution adopts underwriting standards for lending practices to ensure that their financial institution is operating in a safe and sound manner. In evaluating the creditworthiness of a potential borrower, a creditor evaluates the capacity of the person to repay the loan, the character of the person, and the collateral for the loan. Some of the factors a financial institution may include, but are not limited to, credit history, employment history, income, other financial resources, expenses, financial obligations, and whether someone rents or owns a home.

### **Federal Preemption of State Anti-Discrimination Actions Against National Banks**

In the recent case of *Office of the Comptroller of the Currency v. Spitzer*,<sup>9</sup> the U.S. District Court for the Southern District of New York issued an injunction against the Attorney General of New York, ruling that he did not have the authority to enforce state anti-discrimination laws against national banks. The court found that the National Bank Act and the regulations under the act adopted by the Office of the Comptroller of the Currency (OCC), preempted state authority to investigate and prosecute enforcement actions against the national banks, which was within the exclusive authority of the OCC. The Attorney General of New York, Elliot Spitzer, had been pursuing an investigation into the lending practices of the banks, to enforce the provisions of federal and state fair lending laws. But, the court permanently enjoined Spitzer from issuing subpoenas or demanding inspection of the books and records of any national banks in connection with his investigation into residential lending practices; from instituting any enforcement actions to compel compliance with the Attorney General’s already existing informational demands; and from instituting actions in the courts of justice against national banks to enforce state fair lending laws.

## **III. Effect of Proposed Changes:**

This bill makes it a third degree felony for any employee of a financial institution who denies loans or restricts the number of loans made to the residents of a particular area of a community based on the race, national origin, or income of the residents of that area.

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<sup>9</sup> 05 Civ. 5636, Oct. 12, 2005

The criminal penalty is applicable to an employee of the financial institution. Loan officers and other employees generally act under the delegated authority of the board of directors who establish lending guidelines, required to be consistent with applicable regulatory requirements addressing safety and soundness. However, if a board member is not deemed to be an employee of the financial institution, it would appear that the criminal penalty would not apply to that person.

The bill may be preempted by federal law as to its application to federally chartered financial institutions.

#### **IV. Constitutional Issues:**

**A. Municipality/County Mandates Restrictions:**

None.

**B. Public Records/Open Meetings Issues:**

None.

**C. Trust Funds Restrictions:**

None.

**D. Other Constitutional Issues:**

The application of the criminal penalty may be unconstitutionally vague, as applied, since the term “financial institution” is not defined.

#### **V. Economic Impact and Fiscal Note:**

**A. Tax/Fee Issues:**

None.

**B. Private Sector Impact:**

Employees of financial institutions found guilty of discriminatory lending practices prohibited by this bill would be subject to the penalties for committing a felony of the third degree, punishable by a term of imprisonment of up to 5 years, or a fine not exceeding \$5,000

**C. Government Sector Impact:**

Costs may be imposed on law enforcement and the judicial system due to the creation of a new criminal felony provision.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

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This Senate staff analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.

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## **VIII. Summary of Amendments:**

None.

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