

SENATE JUDICIARY COMMITTEE
Senator Thomas Umberg, Chair
2021-2022 Regular Session

SB 1176 (Limón)
Version: March 30, 2022
Hearing Date: April 26, 2022
Fiscal: Yes
Urgency: No
AWM

SUBJECT

Department of Financial Protection and Innovation: loan-related activities: data analysis and practices

DIGEST

This bill requires the Department of Financial Protection and Innovation (DFPI) to conduct a peer-group analysis of the mortgage activities of specified financial entities; to seek information from regulators in other states that have enacted laws modeled after the federal Community Reinvestment Act (CRA) and determine the best practices for implementing a state-level CRA; to review its statutory authority to determine whether it has adequate authority to examine a licensed financial institution for how well it meets the financial needs of underserved communities; and to report on its findings to the chairpersons of specified legislative committees.

EXECUTIVE SUMMARY

Historically, people of color were not just inadvertently excluded from the credit and banking opportunities granted to white people – they were deliberately excluded by government programs. The result is an enduring racial wealth gap made worse by people of colors' missed opportunities to develop generational wealth due to the lack of, e.g., mortgages on fair terms, as well as reduced access to banking services that remains to this day. And while federal laws, including the federal Community Reinvestment Act (12 U.S.C. §§ 2901 et seq.), are intended to encourage equality of access to banking in low- and middle-income communities, data suggest that the disparity in access to banking and financial services remains in many parts of California.

This bill is intended to gather the data necessary to determine what, if any, steps California can take to address the pernicious and persistent inequality of access to banking and credit services among its residents. Specifically, this bill tasks the DFPI with analyzing the mortgages issued by state-regulated banks, savings associations,

credit unions, finance lenders, and residential mortgage lenders to determine, among other things, the frequency of home loans granted, and the terms under which they are granted, to persons based on income, race, and ethnicity. The bill also requires DFPI to gather information from states with state statutes modeled after the CRA, and relating to the implementation of the CRA, to determine the best practices for such a state program. Finally, the bill requires DFPI to review its own statutory and regulatory authority to determine whether it has the adequate authority to examine a covered financial entity for how well the entity meets the financial needs of underserved communities. The bill requires the DFPI to make its findings and conclusions public and available online, and to provide a summary report of its findings to the chairpersons of the Senate Banking and Financial Institutions Committee and the Assembly Banking and Financing Committee by dates that will be added to the bill after further discussions with stakeholders.

This bill is sponsored by the author and supported by the California Housing Partnership, the California Reinvestment Coalition, the Consumer Federation of California, East Bay Housing Organizations, NextGen California, the Office of Kat Taylor, The Greenlining Institute, and UnidosUS. There is no known opposition. This bill passed out of the Senate Banking and Financial Institutions Committee with a 7-0 vote.

PROPOSED CHANGES TO THE LAW

Existing federal law and regulations:

- 1) Establish the Community Reinvestment Act, which is intended to require each appropriate federal financial supervisory agency to use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions. (12 U.S.C. §§ 2901 et seq.)
- 2) Authorize the adoption of regulations to implement the CRA. (12 U.S.C. § 2905.)
- 3) Authorize the Board of Governors of the Federal Reserve System to implement the CRA and, among other things, evaluate the performance of institutions covered by the CRA and rate each institution as “outstanding,” “satisfactory,” “needs to improve,” or “substantial noncompliance” based on its performance. (12 C.F.R. pt. 228, §§ 228.11 et seq.)

Existing state law:

- 1) Establishes within the Business, Consumer, and Housing Agency the Department of Financial Protection and Innovation, which is tasked with the execution of state laws relating to, among other things:

- a) Banks or trust companies or the banking or trust business;
 - b) Savings associations or the savings association business;
 - c) Credit unions or the credit union business;
 - d) Finance lenders and brokers;
 - e) Residential mortgage lenders and servicers; and
 - f) Mortgage loan originators employed by or supervised by finance lenders or residential mortgage lenders. (Fin. Code, § 300.)
- 2) Authorizes the DFPI to oversee banks, trust companies, savings and loan associations, credit unions, and mortgage lenders and issue the relevant certification or authorization for such an entity conducting business in this state. (*See* Fin. Code, div. 1.1, §§ 1000 et seq., div. 2, §§ 5000 et seq., div. 5, §§ 14000 et seq., div. 20, §§ 50000 et seq.)

This bill:

- 1) Provides the following definitions:
 - a) "Department" is the Department of Financial Protection and Innovation.
 - b) "Licensee" means a bank, savings association, credit union, finance lender, or residential mortgage lender.
- 2) Requires the DFPI to conduct a peer group analysis of each licensee's mortgage-related activities as reflected in the data provided pursuant to the federal Home Mortgage Disclosure Act (12 U.S.C. § 2801, et seq.). The analysis must compare licensees within the same peer group along the following metrics:
 - a) Loan approval rates by income and by race and ethnicity.
 - b) Loan costs, including interest rates and closing costs, by income and by race and ethnicity.
 - c) The mix of loan types by income and by race and ethnicity.
- 3) Requires the analysis in 2) to use multivariate regression analysis or other statistical tools that control for applicant or borrower characteristics that affect outcomes identified in 2)(a)-(c), to the extent that such characteristics are available.
- 4) Requires the analysis in 2) to be made available to the public and posted on the DFPI's website.
- 5) Requires, on or before a date that will be added to the bill after further discussions with stakeholders, the DFPI to provide a summary report of its findings pursuant to 2) to the respective chairpersons of the Senate Banking and Financial Institutions Committee and the Assembly Banking and Finance Committee, submitted in compliance with section 9795 of the Government Code.

- 6) Requires the DFPI to seek information from other states that have enacted laws modeled after the federal CRA and identify best practices in administering such laws.
- 7) Requires the DFPI to review the federal rules implementing the CRA and provide recommendations on how the rules could be adapted and applied to examinations of licensees.
- 8) Requires that, if any amendment is proposed to a federal rule implementing the CRA before June 30, 2023, the DFPI must seek information from regulators that have enacted laws modeled after the CRA to determine how changes in the federal rule may have or may affect the implementation of state law.
- 9) Requires the information gathered and recommendations made pursuant to 6)-8) to be made public and posted on the DFPI's website.
- 10) Requires, on or before a date to be determined in a later committee after consultation with the DFPI, the DFPI to provide a summary report of its findings pursuant to 5)-8) to the respective chairpersons of the Senate Banking and Financial Institutions Committee and the Assembly Banking and Finance Committee, submitted in compliance with section 9795 of the Government Code.
- 11) Requires the DFPI to review its statutory authority, regulations, and processes related to the examination of a licensee and determine whether the DFPI has adequate authority to examine a licensee for how well the licensee meets the financial services needs of underserved communities, and provide a summary of its findings to the respective chairpersons of the Senate Committee on Banking and Financial institutions and the Assembly Committee on Banking and Finance by a date to be determined. The summary must be submitted in compliance with section 9795 of the Government Code.

COMMENTS

1. Author's comment

According to the author:

Disparities in access to financial services contribute to persistent gaps in household wealth between Black and Latino households compared to White households. While state regulators routinely examine our financial institutions for compliance with laws related to safety and soundness and consumer protection, California does not have a framework to evaluate whether financial institutions are meeting the financial services needs of our diverse communities, including communities of color and low- and moderate-income communities.

This bill would begin the process of establishing such a framework. The bill directs the Department of Financial Protection and Innovation (DFPI) to analyze the mortgage-lending data of state banks, state credit unions, and non-depository mortgage lenders to assess how well these companies are serving communities of color and low- and moderate-income communities. The bill also requires DFPI to identify best practices in other states that assess how well financial institutions serve underserved communities and for the department to review its existing authorities to identify opportunities for including questions of equity in routine exams. DFPI will report back its findings to the Legislature and the public, which will be valuable in informing future policy discussions.

2. The federal CRA and state-level CRAs

The regulation of financial institutions is split between the federal and state governments. Both the state and federal governments require banks and other financial institutions to comply with certain “safety and soundness” regulations, which relate to the financial health of the institution.¹ These requirements are intended to ensure that financial institutions do not collapse and take their customers’ money with them.

Bank regulations, however, have also been used to further white supremacy. “Redlining” – the practice by which neighborhoods with high percentages of non-white residents – was actually mandated by the federal government in the twentieth century in connection with housing loans under certain federal programs.² Redlining then extended beyond federal loans, resulting in Black individuals being “herded into the sights of unscrupulous lenders who took them for money and for sport,” which left many unable to build up the sort of property-based generational wealth at the core of much of the white middle class (who were able to take advantage of government-backed loans).³

In 1977, the federal government enacted the CRA as a means to address redlining and other historical injustices that led to inequality in banking and credit.⁴ The CRA was enacted in response to concerns that banks and other financial institutions were

¹ *E.g.*, 12 U.S.C. §§ 1811 et seq. (establishing the Federal Deposit Insurance Corporation and requiring certain reports regarding the financial health and deposit liabilities of branches); Fin. Code, §§ 50200, 50201 (establishing minimum tangible net worth requirements for state-licensed mortgage lenders and services and requiring licensees to submit an annual audit to the DFPI).

² Coates, *The Case for Reparations*, *The Atlantic* (June 2014) (hereafter *The Case for Reparations*), available at https://www.theatlantic.com/magazine/archive/2014/06/the-case-for-reparations/361631/?gclid=EAIaIQobChMIlf_3o5i36gIV5h-tBh0yUgN3EAAAYASAAEgJbAfd_BwE [last visited Apr. 10, 2022].

³ *Ibid.*

⁴ Pub. L. 95-128, Title VIII, § 802 (91 Stat. 1147); Michael J. Hsu, Acting Comptroller of the Currency, remarks to the National Community Reinvestment Coalition (Feb. 14, 2022), at p. 2, available at <https://www.ots.treas.gov/news-issuances/speeches/2022/pub-speech-2022-15.pdf> (last visited Apr. 10, 2022) (Hsu Remarks).

insufficiently serving the local communities in which they did business, particularly in low- and moderate income neighborhoods.⁵ Designed to complement the Equal Opportunity Act⁶ and the Fair Housing Act,⁷ the CRA gives the Board of Governors of the Federal Reserve System (the Board) the authority to evaluate how well financial institutions are serving their local communities, publish the Board's ratings for financial institutions' performance in the evaluations, and encourage financial institutions to help meet the credit needs of their local communities.⁸ The CRA also has provisions to encourage financial institutions to meet the credit needs of their communities, including low- and moderate-income communities.⁹

The CRA has been successful in increasing lending in low- and moderate-income neighborhoods.¹⁰ The lingering effects of redlining and other white supremacist policies, however, continue to leave a wide gap between the financial health of white families and Black and Hispanic families and other families of color.¹¹ In order to address the significant barriers to access to financial services and participation in the economy faced by these nonwhite families, the entities that implement the CRA have announced their plans to significantly reform the regulations implementing the CRA.¹²

In addition to the federal CRAs, several states implemented their own state-level CRAs. Massachusetts¹³ and New York¹⁴ adopted their CRAs shortly after the federal version was implemented, while Illinois enacted its CRA in 2021.¹⁵ The goals of the state statutes are similar to that of the federal CRA, but the state statutes impose a wider range of requirements to ensure that underserved communities are given better access to banking and credit. For example, Massachusetts's CRA requires the state, in connection with applications from a financial institution to establish a branch or take other actions in the state, to consider the institution's record of performance in providing banking and credit services to the local community and deny the application if the institution's record of performance warrants it.¹⁶ The Illinois CRA examines financial institutions' practices relating to online and mobile banking, and also requires an examination of whether covered financial institutions are, among other things,

⁵ 12 U.S.C. § 2901.

⁶ Pub. L. 92-261.

⁷ Pub. L. 90-284.

⁸ *Id.*, §§ 2901 et seq.

⁹ U.S. Office of the Comptroller of the Currency, *Community Reinvestment Act (CRA)*, <https://www.occ.treas.gov/topics/consumers-and-communities/cra/index-cra.html> (last visited Apr. 10, 2022).

¹⁰ Hsu Remarks, *supra*, at p. 3.

¹¹ *Ibid.*

¹² *Id.* at pp. 5-8.

¹³ Mass. Gen. Laws ch. 167, § 14.

¹⁴ N.Y. Bank. Law, § 28-b.

¹⁵ 205 Ill. Stats. §§ 735/35-1 et seq.

¹⁶ Mass. Gen. Laws ch. 167, § 14, 4th & 5th pars.

engaging in discriminatory practices and adequately working with delinquent customers to facilitate a resolution of the delinquency.¹⁷

Additionally, the state CRAs cover a wider range of financial institutions than are covered by the federal CRA, such as credit unions organized in the state.¹⁸

4. This bill requires the DFPI to gather information relating to the banking practices of state-based financial institutions and the best practices in administering a CRA

Studies show that communities of color in California do not have the same access to banking and credit as white families in California.¹⁹ The state also has a significant wealth gap, with Black and Latinos significantly underrepresented in the top income tiers and overrepresented in the poorest tiers.²⁰ The lack of access to financial services is a cause of the state's stark racial wealth gap, not just a symptom.²¹ Proponents of this bill argue that this means the federal CRA has not done – and is not doing – enough to ensure that all of the state's residents have equal access to banking and credit services. In particular, they note that the industry has shifted, so now many of the institutions providing mortgages to low-income lenders are not federally regulated banks, but are instead lenders licensed by the state. This means that a large portion of mortgage lenders are not covered by the CRA and are therefore not evaluated for how well they meet the needs of their local communities.

California does not currently have a state-level CRA. A prior version of this bill would have implemented certain aspects of other states' CRAs, such as requiring the Commissioner of the DFPI to, among other things, develop regulations for determining whether covered financial institutions in the state are adequately serving their local communities and the distribution of branches in rural areas and in communities of color. Because the federal government is undertaking an effort to modernize its CRA, however, the author amended the bill to similarly undertake an effort to ascertain certain information that would be useful if the state chose to adopt its own CRA.

To that end, this bill requires the Commissioner of the DFPI to:

- Conduct a peer group analysis of specified financial institution licensees' mortgage-related activities and compare licensees on specified metrics including loan approval rates by income and by race and ethnicity; loan costs by income

¹⁷ 205 Ill. Stats. §§ 735/35-10,

¹⁸ 205 Ill. Stats. § 735/35-5; Mass. Gen Laws, ch. 167, §§ 1, 14; N.Y. Bank. Law, § 28-b(4).

¹⁹ E.g., The Greenlining Institute, *Home Lending to Communities of Color in California 2020* (Feb. 2020) at pp. 1-2;

²⁰ E.g., Bohn & Thompson, PPIC, *Income Inequality in California* (Jan. 2020),

<https://www.ppic.org/publication/income-inequality-in-california/> (last visited Apr. 11, 2022).

²¹ Florant, et al., *The case for accelerating financial inclusion in Black communities*, McKinsey & Co. (Feb. 25, 2020), <https://www.mckinsey.com/industries/public-and-social-sector/our-insights/the-case-for-accelerating-financial-inclusion-in-black-communities> (last visited Apr. 11, 2022).

and by race and ethnicity; and the mix of loan types by income and by race and ethnicity.

- Seek information from regulators in other states that enacted their own CRAs and identify best practices for administering such laws, as well as review the federal rules implementing the federal CRA and provide recommendations for how the federal rules could be adapted. To the extent that the federal rules are proposed to be amended before June 30, 2023, the DFPI should seek information about how the proposed rules will affect the implementation of a state law.
- Review its statutory authority, regulations, and processes related to the examination of covered financial institutions and whether it has adequate authority to examine a covered institution for how well it meets the financial needs of historically underserved communities.

The licensees covered by the bill include a bank, savings association, credit union, finance lender, or residential mortgage lender regulated by the DFPI.

Upon completing the above analyses and reviews, the DFPI must make its findings public and available on its website. The DFPI must also provide a summary report of its findings to the chairpersons of the Senate Committee on Banking and Financial Institutions and the Assembly Committee on Banking and Finance. The author and the DFPI are discussing the due dates for providing the summaries and the reports, and will be added to the bill at a later date.

While the bill requires the DFPI to collect financial data that is, in part, broken down by race, the bill does not run afoul of the guarantees of equal protection of California's Proposition 209.²² "Governmental entities remain under a duty to eliminate the vestiges of segregation and discrimination."²³ While it is unclear whether strict scrutiny would be required for a state program for monitoring programs that collect data based on race or other protected characteristics, "a monitoring program designed to collect and report accurate and up-to-date information is justified by the compelling need for such information."²⁴ Given that this measure is intended to determine whether California's financial institutions are adequately serving populations that have been indelibly impacted by discrimination, this bill clearly falls within the bounds of justified race-based data collection.

²² See Cal. Const., art. I, § 31, added by initiative measure (Prop. 209, approved Nov. 5, 1996, eff. Nov. 6, 1996).

²³ *Connerly v. State Personnel Bd.* (2001) 92 Cal.App.4th 16, 46.

²⁴ *Ibid.*

5. Arguments in support

According to The Greenlining Institute, writing in support:

Homeownership forms the bedrock of generational wealth building, yet it remains out of reach for communities of color in one of the most racially diverse states in our country. Based on a study conducted by Greenlining of 2020 home lending data in California, communities of color face disparities in accessing home loans and more often than not, largely unregulated, state-licensed nonbank lenders are more likely to make home loans to low-income borrowers than traditional lenders. Unlike traditional lenders that are obligated to meet the needs of low-income borrowers and neighborhoods through the [CRA], state-licensed lenders do not have CRA obligations and can exacerbate the racial wealth gap through disparate lending.

Additionally, climate change is a risk multiplier that exacerbates racial and economic inequality. The legacy of redlining has resulted in neighborhoods that lack adequate investment by financial institutions also commonly bearing disproportionate environmental burdens, resulting in increased vulnerability to climate change. These vulnerabilities will only expand in scope and severity with time, and are likely to lead to a shift in the kinds of investments and financial services communities will need to be prepared and protected.

SB 1176 is an important first step in assessing home lending by state-licensed lenders and understanding the credit needs of California communities these lenders operate within to ensure they are being met. The Greenlining Institute supports the current language and looks forward to our continued work with Senator Limón analyzing the overlap between lending to underserved communities and environmentally impacted borrowers and neighbors. Additional analysis will reveal ways community reinvestments could be used within communities of color to achieve a “win-win” result of investment in underserved communities that also directly improves the resilience of those communities under climate change.

SUPPORT

California Housing Partnership
California Reinvestment Coalition
Consumer Federation of California
East Bay Housing Organization
NextGen California
Office of Kat Taylor
The Greenlining Institute
UnidosUS

OPPOSITION

None known

RELATED LEGISLATION

Pending Legislation: None known.

Prior Legislation: AB 1864 (Limón, Ch. 157, Stats. 2020) renamed the Department of Business Oversight as the DFPI and provided it with flexible authority to regulate and oversee providers of financial services and financial institutions.

PRIOR VOTES:

Senate Banking and Financial Institutions Committee (Ayes 7, Noes 0)
