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A Renewed Crackdown on Redlining

In the wake of the subprime implosion, the Obama Administration has stepped up its scrutiny of disadvantaged neighborhoods' credit access

By [Clea Benson](#)

Community activists in St. Louis became concerned a couple of years ago that local banks weren't offering credit to the city's poor and African American residents. So they formed a group called the St. Louis Equal Housing and Community Reinvestment Alliance and began writing complaint letters to federal regulators.

Apparently, someone in Washington took notice. The Federal Reserve has cited one of the group's targets, Midwest BankCentre, a small bank that has been operating in St. Louis's predominantly white, middle-class suburbs for over a century, for failing to issue home mortgages or open branches in disadvantaged areas. Although executives at the bank say they don't discriminate, Midwest BankCentre's latest annual report says it is in the process of negotiating a settlement with the U.S. Justice Dept. over its lending practices.

Lawyers and bank consultants say regulators and the Obama Administration are scrutinizing financial institutions for a practice that last drew attention before the rise of subprime lending: redlining. The term dates from the 1930s, when the Federal Housing Administration drew up maps using red ink to delineate inner-city neighborhoods considered too risky for lending. Congress later passed laws banning lending discrimination on the basis of race and other characteristics. "The agencies have refocused on redlining because, in the wake of the subprime explosion and sudden implosion, they are looking at these disadvantaged neighborhoods and not seeing any credit access," says Jo Ann Barefoot, co-chair at Treliant Risk Advisors in Washington, D.C., which consults with banks on regulatory issues.

The 1977 Community Reinvestment Act (CRA) requires banks to make loans in all the areas they serve, not just the wealthy ones. A Bloomberg analysis found the percentage of banks earning negative ratings from regulators on CRA exams has risen from 1.45 percent in 2007 to more than 6 percent in the first quarter of this year.

At the Justice Dept., a new 20-person unit dedicated to fair lending issues received a record number of discrimination referrals from regulators in 2010 and has dozens of open cases, according to a recent agency report. Potential penalties can reach into the millions of dollars. "We are using every tool in our arsenal to combat lending discrimination," Thomas E. Perez, the assistant attorney general for the Civil Rights Div., told a conference of community development advocates in Washington in April.

To some banks the crackdown has come as a surprise, say consultants and lawyers representing financial institutions in discussions with regulators. Like Midwest BankCentre, some lenders are being cited for failing to operate in minority and low-income census tracts near their branches, even when they have never done business there before. "If you put your branches only in upper-income areas, the regulators are not accepting that anymore," says Warren W. Traiger, a lawyer at BuckleySandler in New York, which advises banks on fair lending issues.

Mortgage refinancing activity doubled in white neighborhoods but dropped sharply in minority neighborhoods in a sample of major U.S. cities in 2008 and 2009, according to *Paying More for the American Dream*, an April study by a group of seven community development nonprofits. "The pendulum has swung back too far the other way," says Kevin Stein, associate director of the California Reinvestment Coalition in San Francisco, one of the report's authors.

Bank lobbyists say the stepped-up government scrutiny could backfire if financial institutions decide to shrink their operations rather than yield to pressure to do business in areas that don't make sense for them. "It would do a disservice to communities for a bank to suddenly pull back," says Robert Rowe, vice-president and senior counsel at the American Bankers Assn.

Meanwhile, in Missouri, things are starting to change. Midwest BankCentre Chairman Ronald T. Barnes recently announced the bank would open a branch in Pagedale, a town near St. Louis that is predominantly African American.

The bottom line: *Lenders have been caught off guard by stepped-up enforcement of laws to prevent discrimination against minorities and the poor.*

[Benson](#) is a reporter for Bloomberg News.



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