

Fair Lending Update

Joseph M. Kolar
Benjamin B. Klubes

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Overview

- Fair Lending Principles
- Litigation and Enforcement Environment
- Mortgage Litigation & Enforcement
- Expanding Regulatory Authority

Fair Lending Principles

- Key Statutes - ECOA, Fair Housing Act, HMDA, and CRA

- No discrimination in “any aspect” of a credit transaction based on a “prohibited factor”
 - ◆ Race, color, religion, national origin, sex or marital status, familial status, or age (provided the applicant has the capacity to contract);

 - ◆ Because all or part of the applicant’s income derives from any “public assistance program”;
 - Includes (but is not limited to) rent and mortgage supplement or assistance programs, Social Security Income, and unemployment compensation.

 - ◆ Because the applicant has in good faith exercised any right under the Consumer Credit Protection Act.
 - Has exercised a “right of rescission” under TILA in the past

- Enforcement
 - ◆ Federal banking agencies, for banks
 - ◆ FTC, for lenders not regulated by federal banking agencies
 - ◆ DOJ
 - ◆ HUD – Fair Housing Act
 - ◆ Private actions

Fair Lending Principles

➤ Three Types of Proof of Discrimination:

- ◆ **Overt Discrimination** - a blatant and clear policy that directly impacts an applicant on a prohibited basis. e.g., refusing to lend to individuals who receive Social Security income or discounting such income.
- ◆ **Disparate Treatment** - a practice of treating a “protected” applicant less favorably than other similarly situated applicants:
 - A creditor provides information only on fixed rate products to minority applicants who request information about the creditor’s mortgage products, but provides information on a wider variety of mortgage products to similarly situated nonminority applicants.
 - A creditor provides more comprehensive information to men than to similarly situated women.
 - A creditor requires a minority applicant to provide greater documentation to obtain a loan than a similarly situated nonminority applicant.
 - A creditor waives or relaxes credit standards for a nonminority applicant but not for a similarly situated minority applicant.
 - A creditor intentionally makes higher priced, unaffordable loans to borrowers in minority neighborhoods (reverse redlining)
- ◆ Disparate treatment is unlawful **IF** the creditor lacks a legitimate nondiscriminatory reason for its action, or if the asserted reason is found to be a pretext for discrimination.

Fair Lending Principles

- **Disparate Impact** - a practice that is facially neutral, but in operation has a discriminatory impact on a prohibited basis and there is not a sufficient business justification for the practice, or if the practice does have a sufficient business justification, there are alternative practices that could serve the same business purpose with a less discriminatory impact.

- So must ask:
 - ◆ Does the practice have a disparate impact on a prohibited basis?
 - ◆ If so, does the practice meet a legitimate business need?
 - Factors that may be relevant to the justification could include cost and profitability
 - ◆ If it does meet a legitimate business need, is there a reasonable alternative that has a less disparate impact?

- The existence of disparate impact must generally be established by facts; frequently this is through a quantitative or statistical analysis.

- *Examples:*
 - ◆ Minimum loan amount – may have disparate impact on less wealthy minorities
 - ◆ Switching to gross income from net income in making underwriting decisions, and not distinguishing between taxable and nontaxable income - may have a disparate impact on individuals with disabilities and the elderly

- *Smith v. City of Jackson* – 2005 Supreme Court case held that the Age Discrimination in Employment Act lacks the necessary statutory language that permits disparate impact claims (without a showing of discriminatory intent). ECOA also lacks that same language. But lower courts have continued to apply disparate impact.

Litigation and Enforcement Environment

- Enforcement and bank regulatory agencies staffing up and increasing activity. E.g.,
 - ◆ On Jan. 14, 2010, DOJ announced creation of new fair lending enforcement unit in Civil Rights Division. DOJ already involved in at least 38 investigations, and with new unit, which will partner with other federal / state agencies, the number should increase.
 - ◆ According to public remarks by Assistant U.S. Att’y Gen. Perez, the new unit’s focus will include, among more traditional emphases, reverse redlining matters and scrutiny of servicing data.
- Congressional committees scrutinizing lender practices through hearings and inquiries
- State AGs increasing staffing and focusing more on banks as the post-preemption era begins

Mortgage Enforcement

➤ DOJ

- ◆ *ALG Federal Savings Bank /Wilmington Finance* (D. Del. 2010)
- ◆ *First United Security Bank* (S.D. Ala. 2009 – Consent Decree)
- ◆ *First Lowndes Bank* (M.D. Ala. 2008 – Consent Decree)

➤ FTC

- ◆ *Gateway Funding* (E.D. Pa. 2008 – Consent Decree; modified in Jan. 2010, requiring company to hire fair lending consultant)
- ◆ *Golden Empire* (C.D. Cal 2009 – Defendants' motion to dismiss denied Sept. 21, 2009)
- ◆ Jan. 2009 Letter from FTC to A. Sandler re: Homecomings

➤ NY AG

- ◆ *Consumer One and HCI Mortgage* (Jan. 2009 – Consent Decrees)
- ◆ *U.S. Capital Funding, LLC* (May 2009 – Consent Decree)

- Bank regulators have many active examinations and inquiries based on 2006-2008 HMDA outlier analyses

Broker Pricing

- *AIG Federal Savings Bank / Wilmington Finance Settlement (D. Del. 2010)*
 - ◆ DOJ complaint alleges that AIG FSB and WFI failure to supervise or monitor brokers in setting broker fees had a “disparate impact” on African American borrowers, who were charged higher broker fees than white, non-Hispanic borrowers on thousands of loans from July 2003 until May 2006
 - According to complaint, WFI and AIG FSB placed ceilings on the amount of the yield-spread premium that could be paid to a broker in connection with a loan, but did not place any ceiling on direct fees.
 - ◆ First time DOJ has held a lender responsible for failing to monitor its brokers to ensure that borrowers are not charged higher fees because of their race.
 - ◆ AIG to pay up to \$6.1 million in damages to minority borrowers

Mortgage Enforcement & Litigation – Redlining/Reverse Redlining

- Redlining / reverse redlining are key issues in investigations / exams
- Municipal Lawsuits:
 - ◆ *City of Baltimore* – reverse redlining (dismissed Jan. 2010). Court:
 - Rejected City’s causation theories;
 - Observed that City’s own papers showed Bank’s foreclosures were a “negligible portion of City’s vacant housing stock”; and
 - Noted many other factors contributed to City’s deterioration: “it was . . . unreasonable to infer that [the Bank] created the dysfunctional environment” or caused the alleged injuries.
 - ◆ *City of Cleveland* – nuisance (dismissed Summer 2009, on appeal)
 - ◆ *City of Birmingham* – reverse redlining (dismissed Aug. 2009)
 - ◆ *City of Buffalo* – nuisance (some defendants have settled)
 - ◆ *City of Memphis* – reverse redlining (filed Dec. 2009)

Mortgage Enforcement & Litigation – Redlining/Reverse Redlining

- Community group/organizational lawsuits
 - ◆ Multi-defendant cases – claims based on alleged nationwide pattern in the industry
 - ◆ E.g., *NAACP* (C.D. Cal. 2007 – in early stages of discovery)
- State AGs – increasing investigations, especially regarding reverse redlining. E.g., *Illinois AG* action.
- Congress – utilizing hearings (e.g., Joint Economic Committee’s June 2009 hearing on predatory lending and reverse redlining)

Mortgage Enforcement - UDAP Actions

- State AGs allege violations tied to origination, marketing and servicing practices and have sought (on the grounds that the original loan was “unfair”) to mandate loan modifications and enjoin foreclosures and/or institute foreclosure review processes.
 - ◆ *MA AG v. Fremont* (June 2009 – settled \$10 million)
 - ◆ *MA AG v. Option One* (Nov. 2008, foreclosures enjoined)
 - ◆ *OH AG v. New Century* (Nov. 2008 – settled \$250K)
 - ◆ *Mass AG v. Carrington* (October 15, 2009 - settled)

Mortgage Enforcement - UDAP Actions

- Other State AG matters in active litigation, including various recent matters initiated by the Ohio AG against servicers, alleging violations of CSPA:
 - ◆ Failure to investigate and resolve consumer complaints in a timely manner;
 - ◆ Failure to offer loss mitigation options to borrowers; and
 - ◆ Pressuring Ohioans into signing unfair, unreasonable and one-sided loan modification documents.

Mortgage Enforcement - New InterAgency Fair Lending Procedures (FFIEC – August 2009)

- New Pricing Discrimination Risk Factors
 - ◆ Financial incentives accompanied by broad pricing discretion
 - ◆ Disparities in incidence/volume of higher priced lending
- New Redlining Risk Factors
 - ◆ “Reverse-redlining” now included
 - ◆ Selection of CRA assessment area
- New Steering Risk Factors
 - ◆ Presence of discretion in determining product itself
 - ◆ Financial incentives to offer products with potentially negative consequences
 - ◆ Disparities in products, terms, conditions, and lending channels on a prohibited basis
- Broker activity must be part of fair lending risk/compliance analysis

Mortgage Litigation

- Claims against originators
 - ◆ 40+ Option ARM cases pending across country
 - ◆ FHA/ECOA disparate treatment and impact class action claims (pricing discretion)
 - ◆ Cases throughout country - seeking nationwide classes. Class certification likely to remain a high hurdle for plaintiffs
- Suits alleging predatory servicing practices

Mortgage – Proposed Rules

- **FTC Mortgage Acts and Practices Rulemaking**
 - ◆ UDAP regarding mortgage loans
 - ◆ Broad authority to FTC to define UDAP
 - ◆ Enforceable by FTC and State AGs

Expanding Regulatory Authority

- FRB – Implemented policy for consumer compliance supervision of nonbank subs of BHCs and FBOs (effective Sept. 15, 2009)
 - ◆ Includes investigation of consumer complaints
- Consumer Financial Protection Agency
 - ◆ House Passed legislation with independent CFPA on December 11, 2009
 - ◆ Senate – Sen. Dodd released new bill on 3/15/10 establishing Consumer Financial Protection Bureau
 - Independent director appointed by the President and confirmed by the Senate.
 - Independent Budget paid by the Federal Reserve Board.
 - Independent Rule Writing for consumer protections governing all entities – banks and non-banks – offering consumer financial services or products.
 - Authority to examine and enforce regulations for banks and credit unions with assets of over \$10 billion and all mortgage-related businesses (lenders, servicers, mortgage brokers, and foreclosure scam operators) and large non-bank financial companies, such as large payday lenders, debt collectors, and consumer reporting agencies. Banks with assets of \$10 billion or less will be examined by the appropriate bank regulator.
 - Consolidates and strengthens consumer protection responsibilities currently handled by OCC, OTS, FDIC, FRB, NCUA, and FTC

Fair Lending Forecast

- Courts continue to dismiss municipality lawsuits.
- No new federal enforcement agency operating in 2010.
- DOJ and bank regulators continue to become even more aggressive on fair lending activities.
- Five or more DOJ consent decrees / filed cases in 2010.
- Bank regulators increase use of cease and desist orders.
- Congress becomes permanent fixture in fair lending enforcement.
- State AG aggressiveness results in a number of litigated cases with banks.

For further information contact:

Joseph M. Kolar
Benjamin B. Klubes

BuckleySandler LLP

1250 24th Street, NW
Suite 700

Washington, DC 20037

(202) 349-8000

Jkolar@BuckleySandler.com

Bklubes@BuckleySandler.com