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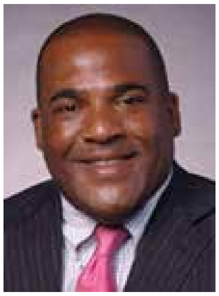
Patrice Ficklin
CFPB Director Fair Lending & Equal Credit Opportunity

FAIR LENDING LAW LITIGATION & COMPLIANCE: AN UNCERTAIN FUTURE FOR THE FINANCIAL SERVICES INDUSTRY

BY DANA LUMSDEN & BETHANY CORBIN



Dana Lumsden

Bethany Corbin

Discriminatory practices in the financial services industry have long been regulated by governmental entities tasked with promoting fair lending and ensuring equal opportunity regardless of race and gender. As early as the 1960s and 1970s, Congress enacted legislative initiatives aimed at guaranteeing non-discriminatory access to credit and housing as part of the Civil Rights movement. Specifically, two principal federal laws and corresponding regulations currently govern fair lending practices in the United States: (1) the Equal Credit Opportunity Act (ECOA) and Regulation B (15 U.S.C. § 1691 and 12 C.F.R. Part 1002), and (2) the Fair Housing Act (FHA) and the applicable United States Department of Housing and Urban Development (HUD) regulations (42 U.S.C. § 3605 and 24 C.F.R. Part 100). This Article offers a comprehensive overview of fair lending legislation and analyzes the future of disparate impact under the FHA and ECOA.

HISTORY OF THE EQUAL CREDIT OPPORTUNITY ACT AND REGULATION B

Congress began enacting consumer credit protection legislation in 1968 with passage of the Consumer Credit Protection Act (CCPA). Designed to "safeguard the consumer in connection with the utilization of credit," the CCPA established the National Commission on Consumer Finance (the Commission) to evaluate the financial services industry's interaction with consumers. The CCPA tasked the Commission with addressing three primary topics: (1) the adequacy of existing arrangements to provide consumer credit at reasonable rates, (2) the adequacy of existing supervisory and regulatory mechanisms to protect consumers from unfair practices and promote the informed use of consumer credit, and (3) whether the federal chartering of consumer finance companies made sense. While the Commission gathered information and held meetings from December

11, 1969 to December 31, 1972, it ultimately made no definitive findings concerning what forms of discrimination existed in the credit market. On December 31, 1972, the Commission nonetheless submitted its final report to President Nixon, which served as a catalyst for the eventual enactment of the Fair Credit Reporting Act, the Fair Credit Billing Act, the Fair Debt Collection Practices Act, and the ECOA.

The official enactment of the ECOA occurred in 1974 and prohibits discrimination based on race, color, religion, national origin, sex, marital status, age, source of income, and the decision to exercise rights under the CCPA. The ECOA applies to any person who regularly participates in credit decisions in the ordinary course of business. This includes banks, retailers, bank card companies, finance companies, and credit unions. In 1976, Congress substantially amended the ECOA to include the broader array of protections that exist today. In 1975, the Federal Reserve Board (FRB) issued Regulation B to implement the ECOA. The FRB continuously updated Regulation B to accommodate judicial rulings and amendments concerning ECOA, as well as changes in the financial industry until July 21, 2011, when the Consumer Financial Protection Bureau (CFPB) took over responsibility for the regulation.

THE KEY PROVISIONS OF REGULATION B AND JUDICIAL INTERPRETATION OF THE ECOA

The stated purpose of Regulation B "is to promote the availability of credit to all creditworthy applicants without regard to race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract); to the fact that that all or part of the applicant's income derives from a public assistance program; or to the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act." Regulation B bars discrimination on a prohibited basis before, during, and after an application for credit is submitted, and criminalizes the making of any oral or written statement that would discourage a reasonable person from applying for credit.

Generally, an existing or prospective borrower can establish a claim for credit discrimination under the ECOA by showing that the borrower is a member of a protected class, applied for credit from the defendant, was qualified for the extension of credit, and was denied credit by the defendant. This assertion of discrimination may take one of two forms: disparate treatment or disparate impact. Disparate treatment liability can occur where a creditor provides an inferior product or service to members of a protected class or exhibits overt discrimination against a protected class. In contrast, disparate impact can be established when the complainant shows that a creditor applied a facially neutral business practice consistently to all borrowers, but the practice had a disproportionately negative effect on members of a protected class. Although the ECOA does not expressly provide for disparate impact claims, eleven Federal Courts of Appeal have either interpreted the ECOA as prohibiting the application of facially-neutral practices that have a disparate impact on protected classes or have simply assumed that disparate impact claims are permissible under the statute.

THE FAIR HOUSING ACT AND HUD REGULATIONS

In comparison to the ECOA, Congress enacted the FHA in 1968 to address segregation in the residential real estate market and to prevent discrimination in that market, including advertising, lending, and brokerage services related to housing. Facially, the FHA prohibits discrimination in real estate-related transactions against any person because of that person's race, color, religion, national origin, sex, familial status, or disability. In particular, a lender may not discriminate against any person in the terms, conditions, or privileges of sale, rental, or financing of residential property. The ECOA applies to a broader range of products and services and includes more protected classes than the FHA.

Under the FHA, HUD possesses the primary authority and responsibility to administer and enforce the Act. In 1988, HUD acquired rulemaking authority through a congressional amendment to the FHA and recently enacted a rule granting the use of disparate impact as a vehicle for discrimination claims under the FHA. Comparable to the disparate impact theory under the ECOA, all Federal Courts of Appeals that have considered the issue of whether disparate impact is permissible under the FHA have approved its validity. ▷

DISPARATE IMPACT UNDER THE FHA: THE OBAMA ADMINISTRATION VS. THE D.C. DISTRICT COURT

In the coming months, the United States Supreme Court will have its third opportunity since 2012 to clarify the use of disparate impact under the FHA and, consequently, the ECOA. The magnitude of the Supreme Court's decision cannot be overstated and threatens to undermine the Obama Administration's use of disparate impact to extract large settlements from banks and mortgage lenders. To date, the Obama Administration has obtained $1.1 billion from home and car lenders under the disparate impact theory, and orchestrated behind the scenes settlements to prevent disparate impact cases from reaching the Supreme Court.

The most controversial settlement coordinated by the Obama Administration occurred as a direct result of the Supreme Court's grant of certiorari in Magner v. Gallagher, 132 S. Ct. 548 (2011). In Magner, anti-discrimination advocates accused the city of Minneapolis of aggressively enforcing housing codes to the detriment of minority residents. Faced with the Supreme Court's decision to hear the case, Secretary of Labor Thomas Perez struck a secret deal behind closed doors with St. Paul, Minnesota, Mayor Christopher Coleman and St. Paul's outside counsel, David Lillehaug in February 2012. In exchange for a settlement in Magner, Secretary Perez agreed that the Department of Justice would not intervene in a False Claims Act qui tam complaint pending against Minneapolis. By sacrificing the qui tam complaint, Perez forfeited the opportunity to recover up to $200 million in exchange for protecting the "lynchpin of civil rights"—disparate impact liability.

Complicating matters further, HUD proposed a disparate impact rule on November 16, 2011, just nine days after the Supreme Court granted certiorari in Magner. On February 8, 2013, HUD adopted a final version of the rule, which implemented the FHA's Discriminatory Effects Standard and established liability under the disparate impact theory. The rule's enactment faced universal opposition from housing and housing-related insurance industries, all of which challenged the scope of HUD's rulemaking authority. HUD, however, ignored these valid concerns in an effort to circumvent congressional inaction on updating the FHA's discriminatory provisions.

On November 3, 2014, disparate impact liability unquestionably took a hit when Judge Richard Leon of the United States District Court for the District of Columbia struck down the use of disparate impact liability under the FHA. In dismantling the disparate impact doctrine, Judge Leon looked no further than the plain language of the FHA itself. According to Supreme Court precedent in Smith v. City of Jackson, Miss., 544 U.S. 228 (2005), the use of disparate impact to prove discrimination is only appropriate where the statutory text contains clear language adopting the disparate impact framework. While the FHA actively uses the verb "discriminate," its plain meaning refers to differences in treatment based on categorical classifications, not discriminatory effects. Indeed, Judge Leon noted that the FHA does not reference effects-based language, despite Congress's inclusion of disparate impact remedies in Title VII of the Civil Rights Act of 1964 and the Age Discrimination in Employment Act of 1967. When Congress amended the FHA in 1988, it did not change the operative language of the discriminatory prohibition. In the early 1990s however, Congress enacted the Americans with Disabilities Act and authorized disparate impact upon a showing that a particular practice adversely affects a disabled employee. Similarly, Congress amended Title VII in 1991 to encompass disparate impact claims. Judge Leon found that these actions demonstrate Congress's ability to include disparate impact within a statutory framework, and further illustrate its intentional omission of disparate impact in the FHA.

THE FUTURE OF DISPARATE IMPACT: THE BEGINNING OF THE END?

While Judge Leon's decision represents a radical departure from the holdings of eleven Circuit Courts of Appeals, it is likely the Supreme Court will signal a permanent end to disparate impact under the FHA in 2015. On October 3, 2014, the Supreme Court granted review in the case of Texas Dep't of Housing v. Inclusive Communities, in which the State of Texas seeks to overturn a Fifth Circuit Court of Appeals ruling requiring it to allocate affordable-housing subsidies evenly between black and white neighborhoods in Dallas. A settlement orchestrated by the Obama Administration is unlikely in this case, and the Court's most probable course of action will be to nullify the

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disparate impact doctrine. This prediction stems from the reasoning behind Judge Leon's opinion and the likelihood that similar reasoning will be adopted by a receptive majority on the Court.. Furthermore, on appeal, plaintiffs have obtained positive outcomes in FHA disparate impact claims only 20% of the time, whereas defendants' positive outcomes have been affirmed 83.8% of the time. These statistics combined with Judge Leon's textual argument leave little doubt as to the Court's likely holding. Disparate impact has unquestionably begun its slow demise.

While it appears likely that the Supreme Court will strike down the doctrine of disparate impact under the FHA, and, by analogy, the ECOA, the need for the consumer financial services industry to continue focusing on compliance with fair lending practices remains. The CFPB continues to use disparate impact as a method to enforce what it perceives as discrimination under the ECOA and "fair servicing" enforcement will become an increased focus in the near future. Additionally, it may become common to tie alleged fair lending violations to the Unfair, Deceptive, or Abusive Acts or Practices Act (UDAAP). It is conceivable that consumers and regulators will argue that the effects of alleged discriminatory lending practices could result in unfair advantages prohibited by UDAAP. Thus, while the doctrine of disparate impact fights for survival, fair lending compliance and concerns about reputational risk for banks and creditors likely remain unchanged. MCM

Bethany Corbin is an associate at Bradley Arant Boult Cummings LLP in Charlotte. Her practice concentrates extensively on representing financial institutions and mortgage companies in a variety of litigation matters. She can be reached at bcorbin@babc.com.

Dana Lumsden is a litigation partner, a member of the financial services practice group, and Managing Partner of the Charlotte office of Bradley Arant Boult & Cummings. Dana can be reached at dlumsden@babc.com

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fair lender violations. In addition to this framework, a lender can take further steps to combat fair lending violations by acting in a completely transparent manner in its dealing with consumers.

ADVERSE EFFECTS OF FAILURE TO COMPLY WITH FAIR LENDING

To obtain the attention of the consumers and stay competitive in the mortgage market, lenders need to build a quality reputation by enhancing customer satisfaction. A great way to build good will among consumers is to comply with fair lending and this, in turn, builds a positive reputation for the lender. On the opposite end of the spectrum, when a lender fails to mitigate the risk of discriminatory practices in loan origination, such lender runs the risk of not only violating fair lending, but also of losing out on business and establishing a positive reputation with a variety of consumers.

Additionally, from a pure business standpoint, extra costs incurred from fines levied by regulatory agencies are another reason to comply with fair lending requirements. Finally, company growth plans, such as a merger or acquisition, can be hindered if there are poor fair lending compliance systems in place at either company.

In the past several years, there has been an increase in regulatory changes and enforcement practices, most of which have been consumer-centric. One of the regulatory enforcement priorities has been to intensify the scrutiny of fair lending laws. Regulatory agencies are showing no sign of slowing down examinations of fair lending practices, and, as they continue, enforcement actions will hold lenders accountable for fair lending violations. To effectuate fair lending practices and avoid the increasing mountain of enforcement settlements and fines, mortgage lenders need to be ready and take a proactive role to ensure compliance with these practices. MCM

Debbie Hoffman oversees the operation of Digital Risk's legal, compliance, corporate governance, risk and licensing functions. Debbie can be reached at DHoffman@digitalrisk.com.