

Bank Acquisitions and Fair Lending

What You Don't Know Can Hurt You

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Introduction

When performing due diligence prior to a bank acquisition, it is critical to understand the target's fair lending risk. **Because of the almost unprecedented shifts in the regulatory structure, the landscape for managing bank risk has changed dramatically in recent years and, specifically, increased focus has been given to fair lending issues.** For instance, the Department of Justice (DOJ) Civil Rights Division has a very active Fair Lending Unit and the Consumer Financial Protection Bureau (CFPB), vested with broad authority to regulate banks, has made fair lending compliance a high priority and will subject banks' lending practices to much closer scrutiny. During the due diligence phase, a buyer must assess the potential liabilities of a target for any potential fair lending violations and begin planning how to limit such liabilities post-acquisition.

RISING RISK OF FAIR LENDING LITIGATION

Fair lending risk is rising for financial institutions. One need only review the CFPB's Supervision and Examination Manual – Version 2 (the “CFPB Manual”) to see that fair lending laws are one of the primary focal points of the CFPB's regulatory efforts.¹ The CFPB Manual adopts the Interagency Fair Lending Examination Procedures² to analyze potential violations of the Equal Credit Opportunity Act and the Fair Housing Act³ — a clear indication that fair lending practices will be an important component of the CFPB's examinations.

While the CFPB is developing its fair lending enforcement strategies and priorities, the DOJ has also increased its enforcement of fair lending laws. During the DOJ Fair Lending Unit's first 24 months of operations, it filed or

resolved 16 lending matters.⁴ In comparison, from 1993 through 2008 the Civil Rights Division had filed or resolved only 37 lending matters.⁵ In 2012, the DOJ continued this trend by investigating and pursuing a broad range of potential fair lending violations, including for pricing discrimination, redlining, and reverse redlining.⁶

The DOJ's focus has already had a direct impact on bank acquisitions. Most notably, in December 2011, Bank of America's subsidiary Countrywide Financial Corporation (“Countrywide”)⁷ settled a discriminatory lending lawsuit with the DOJ related to practices employed by Countrywide both before and after it was acquired by Bank of America in 2008.⁸ The DOJ asserted that Countrywide had discriminated against over 200,000 individual minority borrowers, and that it had violated the Equal Credit Opportunity Act and the Fair Housing Act.⁹ Countrywide,¹⁰ which by then was no longer originating loans,¹¹ settled with the DOJ for \$335 million, the largest residential fair-lending settlement in history.¹²

EFFECTIVE DUE DILIGENCE

Identifying the Risks

During the due diligence process, there may not be sufficient time to perform in-depth studies of a target's lending practices and pricing trends among different racial and ethnic demographics, but a buyer should investigate a target's lending practices to the extent possible to understand the potential risk. **Leveraging regulatory guidance can help a buyer focus on the most important indicators of discriminatory lending practices.** The CFPB Manual can be a roadmap for lending issues to investigate before an acquisition, as it identifies the areas that the CFPB will review to assess

fair lending compliance. Likewise, the CFPB's other reports can be instructive for assessing a target's lending practices. For example, the CFPB has highlighted the importance of fair lending compliance programs and has noted features that are common in well-developed fair lending compliance programs, such as assessments for the marketing of loan products and review of lending policies for fair lending violations.¹³ These indicators could form the basis for a due diligence review process to assess the quality of a target's fair lending compliance program.

Addressing Problem Areas During and After the Deal

Assuming a buyer does not walk away from a deal after discovering lending practices that may violate fair lending laws, it must consider how best to mitigate potential liabilities. In most bank acquisitions, the deal team lawyers charged with overseeing the acquisition are different both in focus and in skill set from the litigation team that will handle allegations of fair lending violations in the future. Consulting with litigation and compliance counsel early in the due diligence process can add value during and after the acquisition. **In addition to simply identifying the existence of the liability, litigators and compliance attorneys can provide input for implementing remedial measures and creating a system that will better allow a buyer to defend future fair lending claims and to address regulatory concerns.** Such a strategy may include:

- *Having key people organizing and documenting the target's credit practices.* When litigation is filed years after a deal, it can be difficult to locate the information necessary to defend the case. Years after an acquisition, a buyer can be forced to settle defensible lawsuits because there is no one remaining from the target who understands the details of the target's lending practices prior to the acquisition. To avoid such settlements, the buyer should identify and designate a person (or multiple people) from the target to organize information about the target's lending practices and procedures after the acquisition that will be easy to reference for any future litigation.
- *Developing a plan to increase involvement in underserved communities.* A bank completing an acquisition may be able to reduce its risks

of fair lending litigation by taking preemptive measures. Settlements with the DOJ can involve investments in local neighborhoods and increased lending in locations with high concentrations of minorities.¹⁴ Taking the initiative to improve the post-acquisition bank's profile in underserved communities may prevent the DOJ from filing a claim or provide a basis for early settlement if a claim is filed.¹⁵ Early action thus provides a bank with the opportunity to generate goodwill and potentially to reduce its liability.

- *Utilizing the acquisition application to communicate to regulators any plans about increased involvement in underserved communities.* A buyer's plan to increase a target's role in underserved communities can be incorporated into the acquisition application process for the institution's primary regulator. For example, investigating opportunities for investment in underserved communities may show a commitment to increased involvement in such communities. Coupled with the buyer's existing efforts in underserved communities, developing plans

to increase a target's involvement in such communities could help the buyer establish a commitment to compliance with the target institution. This could impact how the acquisition is viewed prior to the closing by the primary regulator and how the regulator views the buyer after the closing.

CONCLUSION

In the current regulatory environment, a buyer's due diligence process should include analyzing a target's lending practices for compliance with fair lending laws. By identifying potentially discriminatory practices early in the acquisition process, a bank acquiror positions itself to make better decisions about whether to purchase and at what price. If a buyer makes the decision to acquire a bank that has utilized discriminatory lending practices in the past, strategic use of the due diligence process can enable the buyer to stop any such practices that still exist and to implement measures to minimize its liability post-acquisition, thus increasing the likelihood of a successful acquisition.

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¹ CFPB, SUPERVISION AND EXAMINATION MANUAL – VERSION 2 (OCTOBER 2012), available at http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf.

² The Federal Financial Institutions Examination Council adopted this version of the Interagency Fair Lending Examination Procedures in August 2009 for use by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, the Office of Thrift Supervision, and the National Credit Union Administration.

³ The CFPB may discover Fair Housing Act violations as part of the process of examining for violations of the Equal Credit Opportunity Act. While the CFPB does not have supervisory authority over the Fair Housing Act, it can refer violations of the Fair Housing Act to the U.S. Department of Housing and Urban Development and a bank's prudential regulator. See CFPB Manual, *supra* note 1, at ECOA 2 n.4.

⁴ Thomas E. Perez, Assistant Attorney General for the Civil Rights Division of the United States Department of Justice, THE ATTORNEY GENERAL'S 2011 ANNUAL REPORT TO CONGRESS

PURSUANT TO THE EQUAL CREDIT OPPORTUNITY ACT AMENDMENTS OF 1976 at 2, available at <http://www.justice.gov/crt/about/hce/documents/ecoareport2011.pdf> ("DOJ Report").

⁵ *Id.*

⁶ *Id.* at 8.

⁷ The lawsuit was brought against Countrywide Financial Corporation and its subsidiaries Countrywide Home Loans, Inc., and Countrywide Bank. The complaint generally refers to the conduct of Countrywide without specifying among the three entities. Complaint, *U.S. v. Countrywide Financial Corporation*, CV 11 10540 (C.D. Cal. Dec. 21, 2011) ("Complaint").

⁸ Bank of America acquired Countrywide on July 1, 2008. *Id.* at 5. The DOJ alleged that the discriminatory conduct continued until December 2008. See, e.g., *Id.* at 10, 19.

⁹ *Id.* at 2.

¹⁰ All three Countrywide entities were signatories to the Consent Order resolving this lawsuit. Consent Order, *U.S. v. Countrywide Financial Corporation*, CV 11 10540 (C.D. Cal. Dec. 28, 2011).

¹¹ Department of Justice, *Justice Department Reaches \$335 Million*

Settlement to Resolve Allegations of Lending Discrimination by Countrywide Financial Corporation, available at <http://www.justice.gov/opa/pr/2011/December/11-ag-1694.html>.

¹² *Id.*

¹³ CFPB, *Supervisory Highlights: Fall 2012* at 6, available at http://files.consumerfinance.gov/f/201210_cfpb_supervisory-highlights-fall-2012.pdf.

¹⁴ See, e.g., Department of Justice, *Justice Department Reaches Settlement With Citizens Republic Bancorp Inc. and Citizens Bank Regarding Alleged Lending Discrimination in Detroit* (noting that the settlement consisted of partnering with the City of Detroit to aid in neighborhood stabilization, creating a program to increase lending in majority African-American areas, and outreach to educate people about finances and products available to them), available at <http://www.justice.gov/opa/pr/2011/May/11-crt-576.html>.

¹⁵ One of the factors which may lead the DOJ to decline to pursue litigation is "[t]he practice has ceased and there is little chance that it will be repeated." DOJ Report, *supra* note 4, at 13.