

# **Preventative Measures: Avoiding Predatory and Discriminatory Lending Litigation**

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# Equal Credit Opportunity Act

- Prohibits discrimination based on:
  1. Race, color, religion, national origin, sex, marital status, or age (assuming capacity to contract).
  2. A person receiving all or part of income from any public assistance programs.
  3. A person exercising his or her rights under the Consumer Credit Protection Act.
  4. Comment in Regulation B interprets ECOA to allow for disparate impact claims based on legislative history
- Statue of Limitations: 2 years (private right of action may be brought within 1 year of commencement of enforcement action or civil action by the Attorney General).

15 U.S.C. §§ 1691 *et seq.*

# Fair Housing Act

- May not discriminate based on race, color, national origin, religion, sex, familial status or disability, including taking the following actions:
  - Refusal to make a mortgage loan
  - Refusal to provide information regarding loans
  - Imposing different terms on a loan (interest rates, fees, etc.)
  - Discrimination in appraising property
  - Refusal to purchase a loan
- Statute of Limitation: 2 Years for private right of action (tolls as provided by statute); 18 months for civil actions commenced by the Attorney General.

42 U.S.C. §§ 3601 *et seq.*

# Establishing Remedial Procedures Before There is a Problem

- The CFPB Manual makes clear that financial institutions should have systems for remedying violations quickly.
  - Internal Remediation:
    - Talking to employees
    - Changing advertising
    - Fixing loan procedures
  - External Remediation:
    - Working with borrowers
    - Educating local stakeholders about specific efforts to eliminate discriminatory practices
- CFPB will examine whether there are remediation procedures in place to fix discriminatory practices and will assess their strength.

# Preventive Measures

- Review internal manuals, credit underwriting guidelines, loan documents, and advertising.
- Understand the level of discretion employees have in granting loans and whether there is an opportunity to base decisions on discriminatory reasons.
- Perform self-audit using the ECOA Regulation B Examination Checklist.
  - Self-assessments should focus heavily on statistical analysis
  - Important to engage in statistical analysis before a CFPB exam or government investigation
  - Review policies and procedures, training and consider testing or mystery shopping

# Self-Tests and Self-Evaluations

- Use of self-tests and self-evaluations can identify violations of ECOA, but they are not the same.
  - Self-tests – Create new data that is not available in loan files. This information is privileged, unless the report is disclosed, which forfeits privilege (12 C.F.R § 202.15(b)(2) and 24 C.F.R. § 100.142(a)).
  - Self-Evaluations – Performing tests based on information already available in the loan files. This information is NOT privileged.

# Disparate Treatment vs. Disparate Impact

- The Dodd-Frank Act states that, in the mortgage context, the CFPB “shall prescribe regulations to prohibit . . . abusive or unfair lending practices that promote disparities among consumers of equal credit worthiness but of different race, ethnicity, gender, or age.” 15 U.S.C. § 1639b(c)(3)(C).
- Even if courts were to hold that disparate impact is invalid under ECOA and the FHA, the CFPB would still have this rulemaking authority.

# Disparate Treatment vs. Disparate Impact

- CFPB Bulletin 2012-04 re: Lending Discrimination (Apr. 18, 2012):
  - “[T]he CFPB reaffirms that the legal doctrine of disparate impact remains applicable as the Bureau exercises its supervision and enforcement authority to enforce compliance with the ECOA and Regulation B.”
- HUD’s Disparate Impact Rule (24 C.F.R. § 100.500) sets forth the disparate impact standard in FHA cases.
  - Plaintiff bear the burden of proving that “a practice results in, or would predictably result in, a discriminatory effect on the basis of a protected characteristic.”
  - The defendant must then show that the practice “is necessary to achieve one or more of its substantial, legitimate, nondiscriminatory interests.”
  - The burden then returns to the plaintiff to show that the “substantial, legitimate, nondiscriminatory interests could be served by a practice that has a less discriminatory effect.”

# Disparate Treatment vs. Disparate Impact

- To allege a disparate impact claim under the FHA, a plaintiff's complaint must:
  - Identify a specific practice or policy adopted by a defendant;
  - Demonstrate a disparate impact on a protected group; and
  - Show a causal relationship between the challenged practice and the alleged disparate impact.
- Opponents of the disparate impact theory assert that the law does not contain express language to permit liability based on effect, rather the language only supports liability based on intent to discriminate.
- FHA disparate impact claims often allege that lending practices and lenders' policies based on subjective, rather than risk-based, factors have the direct causal effect of minorities being disadvantaged.

# Disparate Treatment vs. Disparate Impact

- Lower courts have upheld use of disparate impact theory under the Equal Credit Opportunity Act and Fair Housing Act.
- The U.S. Supreme Court will be addressing these issues in *Township of Mount Holly, New Jersey, et al. v. Mt. Holly Gardens Citizens in Action, Inc.*
- *In Smith v. City of Jackson*, the Court held that when the statutory text lacks a provision creating a cause of action based on “effects” of actions, the statute does not permit disparate impact claims

# Case Studies: Facts Giving Rise to Causes of Action Under FHA and Predatory Lending Laws

- *NAACP v. HSBC*, 2:09-CV-01759 (C.D. Ca.)
  - Class consists of African Americans who either:
    - Were eligible for less expensive loans; or
    - Only qualified for loans based on lower initial interest rate, not the scheduled higher interest rates.
  - Relied on statistical evidence from studies that demonstrated discrepancies between treatment of African-Americans and Caucasians that were similarly situated.
  - Allegedly no review of loan application process to determine whether borrowers qualified for better loans.
  - Claims were brought under:
    - Fair Housing Act
    - Equal Credit Opportunity Act
    - Civil Rights Act
  - HSBC settled these claims.
- *U.S. v. SunTrust (DOJ, Sept. 2012)*
  - Alleged pricing discrimination based on the interest rates, fees, and costs paid by African-American and Hispanic borrowers on retail and wholesale mortgage loans.
  - Consent order called for payment of \$21 million to minority borrowers.

# Case Studies: Facts Giving Rise to Causes of Action Under FHA and Predatory Lending Laws

- *U.S. v. Wells Fargo Bank (DOJ, June 2012)*
  - Alleged that Discretionary product selection practices resulted in disparate impact against prime-eligible minorities, who were more likely than prime-eligible White borrowers to be placed in subprime mortgage loans. And that discretionary loan pricing led to minority borrowers paying more than similarly situated White borrowers.
  - Consent order entered into in December 2012 called for payment of \$234 million to minority borrowers.
- *U.S. v. Texas Champion Bank (DOJ, Feb. 2013)*
  - Alleged that the bank charged higher interest rates on unsecured consumer loans to Hispanic borrowers than non-Hispanic White borrowers.
  - Consent order called for payment of \$700,000 to minority borrowers.
- *U.S. v. Luther Burbank Savings (DOJ Oct. 2012)*
  - Complaint alleged that bank enforced a \$400,000 minimum loan amount policy for its wholesale single-family residential mortgage loan program, resulting in a disparate impact affecting African-American and Hispanic borrowers in California.
  - Pursuant to a consent order, the bank agreed to invest \$1.1 million in a special financing program for qualified borrowers seeking loans of \$400,000 or less in California. The bank will also spend \$900,000 on community partnerships.

# Hot Litigation Topics

- Indirect auto lending and dealer participation
- Third-Party/Vendor Due Diligence
- Student loan comparative default rates
- Mortgage servicing/loss mitigation
- Debt collection
- High Risk Areas:
  - Advertising/marketing
  - Product steering
  - Discretion in underwriting/servicing/collection
  - Employee incentive compensation
  - Potential implications of “Big Data”

# Predatory Lending and Bank M&A

- Part of the due diligence process of a bank acquiring a target bank should be the target bank's risk profile for predatory lending.
- Case study: *U.S. v. Citizens Republic Bancorp, Inc.*, 2:11-cv-11976 (E.D. Mich.) - On May 5, 2011, Citizens Republic Bancorp, Inc. ("CRBI") settled a redlining lawsuit brought by Department of Justice for \$3.6 million.
  - CRBI acquired Republic Bank. Republic Bank and Citizens Bank, the wholly-owned subsidiary of CRBI, had substantial presences in Michigan.
  - DOJ asserted claims under FHA and ECOA that the combined bank had catered to majority-white areas, while ignoring and failing to services majority-black areas.
  - Almost all of the bank's post-merger branches were located in majority-white census tracts. None of the branches were located in the City of Detroit.

# Addressing Predatory Lending Issues During the M&A Process

- Consider the profile of potential targets. If a target bank does not have a strong history of servicing minorities, consider the profile of the post-acquisition bank. Take steps early to improve relationships with under-served areas to reduce the post-acquisition risk.
- Designate a person from the target bank to compile information and identify important documents and practices about the target bank that could be helpful for defending future litigation stemming from the target bank's lending practices.
- Without proper preparation, a bank may be forced to settle cases solely because of its inability to obtain facts necessary to defend cases.

# Best Practices

- Document all interactions with borrowers.
- Limit oral communications on deal terms and approval and document the basis for accepting or rejecting loans and for choosing one loan product over another.
- Carefully draft agreements with mortgage brokers so that it is clear they are independent contractors, not agents or employees.
- Review procedures for maintaining REO properties.
- Maintain robust workout and foreclosure procedures. Identifying problem areas in the loan process and analyzing whether there exists a basis for disparate impact claims.
- Understand reputation risk and the practical implications of the loan process.
  - How are you marketing your consumer loans?
  - What is your reputation in the community?
  - What is the best way to balance the need to service communities and customers and to provide profitable services?

# Best Practices

- Compare demographics in office locations to demographics for the census tracts in which they are located. And compare company's number of applications submitted by protected classes to the demographics from areas where applicants reside to determine whether adequate outreach is in place to encourage applicants to apply.
- Developing an anti-discrimination policy:
  - Consider all aspects of banking and customer contacts
  - Perform due diligence on mortgage brokers
  - Different methods of educating employees (internal seminars, handbooks, social media)
- Routinely consult the CFPB Supervision and Examination Manual. It provides examination guidance on the Unfair, Deceptive, or Abusive Acts or Practices, the Equal Credit Opportunity Act, etc. The Manual provides Interagency Fair Lending Examination Procedures and includes checklists and appendices that provide guidance on how CFPB will examine financial institutions with consumer-protection laws.

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