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Fair Lending Panel

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Topics

- Fair lending overview and history
- Fair lending enforcers
- Early fair lending enforcement actions by U.S. Department of Justice
- Evolving theories and policy of fair lending enforcement
- Disparate impact claims

Fair Housing Act Overview

- **"What's past is prologue."** - William Shakespeare, *The Tempest*
- **"Those who don't know history are doomed to repeat it."** – Edmund Burke
- **"Those who cannot remember the past are condemned to repeat it."** – George Santaya, *The Life of Reason (Vol. 1)*

Fair Housing Act Overview

Fair Housing Act of 1968

- Prohibits discrimination concerning the sale, rental, and financing of housing based on race, religion, national origin, gender (1974 amendment), and handicap and family status (1988 amendment)
- From 1966-1967, Congress regularly considered a fair housing bill, but failed to garner majority for its passage

Fair Housing Act Overview

- Following April 4, 1968 assassination of Dr. Martin Luther King, President Johnson urged passage as a memorial to his work.
- According to a Supreme Court opinion, Congress intended the FHA to “contribute to the elimination of ghettos by reducing discriminatory housing practices.” (*Trafficante v. Metropolitan Life Insurance Company*, 409 U.S. 205 [1972], cited in Board of Governors, Consumer Compliance Handbook [1995]).

Fair Housing Act Overview

FHA Section 805:

- Applies to the financing secured by residential real estate
- Protected classes: race, color, religion, national origin, handicap, familial status, or sex of the loan applicant

Fair Housing Act Overview

- FHA Section 805:
 - Prohibits:
 - Denials
 - Terms and conditions (e.g., pricing)
 - “Otherwise make unavailable or deny” (e.g., redlining)
 - Other key statutes: ECOA, HMDA and CRA

Fair Housing Act Enforcers

- Before Dodd-Frank, HUD and DOJ were the primary fair lending enforcement agencies.
- HUD may take enforcement actions against lenders based on individual complaints or on its own initiative.
- Individuals, or organizations representing individuals, may pursue civil court actions.
- DOJ may bring “pattern and practice” cases or individual cases originating with HUD (“election” cases).

Fair Housing Act Enforcers

- The federal bank regulatory agencies also enforce the FHA.
- FDIC; Federal Reserve; Office of the Comptroller of the Currency (OCC); Office of Thrift Supervision (OTS)—“R.I.P.” 10/11; National Credit Union Administration (NCUA)
- FHA silent about their enforcement responsibilities.

Fair Housing Act Enforcement

- Sparse pre-1988 litigation and enforcement activity
- FHA's prohibitions against discrimination extend to "redlining" (*Laufman v. Oakley Building and Loan Co.*, 408 F. Supp. 489 (S.D. Ohio, 1976])
- Employment standard from employment jurisprudence (*McDonald Douglas*) applies to lending discrimination matters when evaluating creditworthiness (*Gross v. U.S. Small Business Admin.*, 669 F. Supp. 50 [N.D. N.Y., 1987]):

Fair Housing Act Enforcement

- To prove lending discrimination based on a denied application Plaintiff must show: (1) she is a member of a protected class, (2) she attempted to get a loan and met all relevant qualifications for doing so, (3) the lender refused to make the loan despite the plaintiff's qualifications, and (4) that, after his rejection, the bank continued to make loans to equivalently qualified applicants.
- Standard later applied to different terms and conditions (e.g., pricing)
- Basis for "side-by-side" comparisons

U.S. DOJ Enforcement

- Civil Rights Division, Housing & Civil Enforcement Section
- HCE section created following passage of FHA
- Substantially expanded following 1988 amendments

U.S. DOJ Enforcement

- Reports to Assistant Attorney General for Civil Rights, who reports to the Attorney General
- Section responsible for bringing individual cases referred from HUD and “pattern and practice” cases
- Staff includes attorneys, paralegals and statisticians

U.S. DOJ Enforcement

- Pre 1988 Amendment
 - DOJ enforcement limited under the FHA (and ECOA) to injunctive relief; no power to seek monetary awards
 - 1988 amendment granted DOJ authority to seek monetary damages and civil penalties
 - A 1991 amendment to the ECOA similarly expanded the types of relief the DOJ could seek in fair lending cases brought under that statute

U.S. DOJ Enforcement

- Pre 1988 Amendment
 - Before these amendments, little enforcement activity resulting in small out-of-court settlements.
 - At least one lending discrimination case brought by the U.S. Justice Department went to trial (*U.S. v. American Future Systems, Inc.*, 743 F.2d 169 (3d Cir. 1984)).

U.S. DOJ Enforcement

- Four eras of enforcement:
 - 1990-2000
 - Policy: Expand homeownership and address industry wide policies and practices
 - Aggressive prosecution of denial and redlining cases
 - Increased use and development of regression analysis

U.S. DOJ Enforcement

- 2001-2006
 - Policy: Enforcement of referrals from prudential regulators
 - Tempered prosecution; significant turnover in Civil Rights Division

U.S. DOJ Enforcement

- 2008-2012
 - Policy: Predatory lending: reverse redlining, pricing discrimination, unfair and deceptive acts
 - Focus on approved borrowers who (a) were not qualified or (b) received unfavorable terms and conditions
 - Emphasis on expansion of credit disappears
 - Increased use of disparate impact

U.S. DOJ Enforcement

- 2013-current
 - Policy: ?
 - Joint-agency enforcement, including CFPB
 - Dogmatic focus on disparate impact
 - Focus on expansion of credit unclear

U.S. DOJ Enforcement

- Traditional DOJ referral sources
 - Prudential regulators
 - Regular examination process (e.g., safety & soundness exams)
 - Special studies (see *Fleet Mortgage*)
 - Individual complaints
 - Self-reporting
 - CRA challenges to merger

U.S. DOJ Enforcement

- Traditional DOJ referral sources
 - HUD
 - Largely limited to individual complaints
 - Pre-CFPB : non-bank lenders supervision responsibility
 - Public sources, e.g., newspaper articles
 - Individual DOJ attorney investigation
 - HMDA analysis
 - Use of all of the above

Early U.S. DOJ Enforcement

- Early DOJ enforcement actions directed at broad policy concerns and priorities, including the expansion of homeownership
- Early actions addressed lending industry-wide policies and practice
 - Loan broker discretion to set policy
 - Underwriting standards and discretion
 - Wholesale lender liability
- Early actions also considered lending to Native Americans

Early U.S. DOJ Enforcement

- Early actions did not rely solely on disparate impact; disparate impact used as evidence of disparate treatment
- DOJ developed side-by-side review process as well as regression analysis investigation plans
- Efforts to develop fair lending guidelines and standards with bank regulators

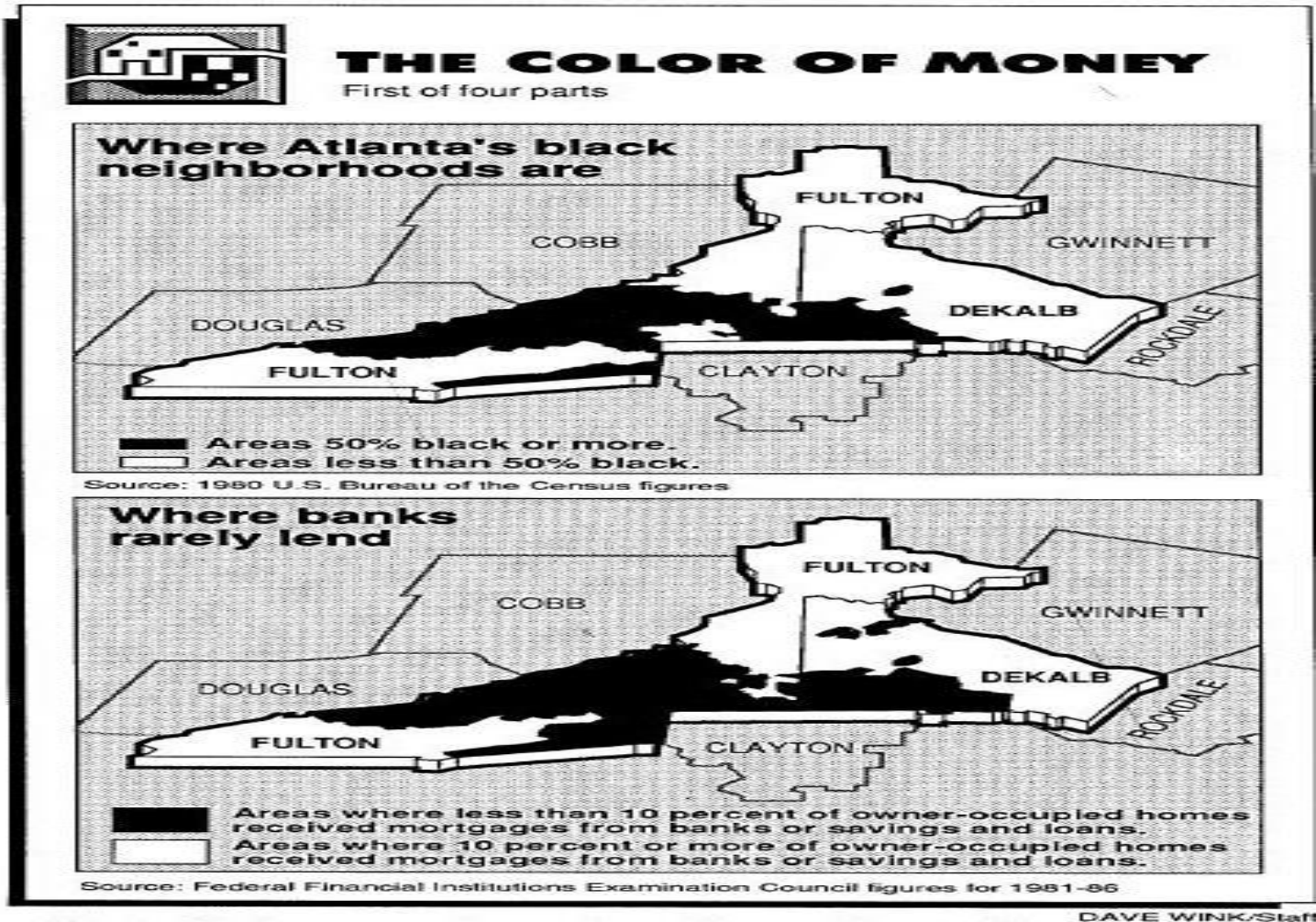
Early U.S. DOJ Enforcement

- Key enforcement actions
 - Decaüter Federal Savings Bank
 - Source: The Atlanta Constitution – *The Color of Money* (1988-1989)
 - Bill Dedman Pulitzer Prize winning investigative report regarding mortgage redlining in post-Civil War Atlanta

Early U.S. DOJ Enforcement

- Wrote that Atlanta's banks and savings and loans made loans in even the poorest white neighborhoods, but did not lend in middle-class or more affluent black neighborhoods
- *The Color of Money* also investigated denial ratios; concluded that African American applicants denied at substantially higher rates
- HMDA amended not long after to require reporting of applicant's race, sex, and income

U.S. DOJ Enforcement



U.S. DOJ Enforcement



Available at: <http://powerreporting.com/color/> (May 1, 2014)

DOJ Enforcement Actions

- *Chevy Chase FSB (and B.F. Saul Mortgage Co.) (1994)*
- Investigation prompted by Washington Post article
- Primarily a redlining case
- Alleged that lender avoided doing business in certain D.C. areas and Prince George's County, Maryland

DOJ Enforcement Actions

- Settlement included monetary component (\$11M) and opening of branches
- Extensive use of computer mapping
- Included CRA component
- Not a disparate impact case

Early DOJ Enforcement Actions

- *Shawmut Mortgage Company* (1993)
- Allegations included nearly all available liability theories
 - Requiring a higher level of documentation from minority applicants
 - Failing to make the same level of effort to obtain documentation of minority applicants' qualifying information

Early DOJ Enforcement Actions

- Rate differentials
- Approving white but not minority borrowers who failed to meet underwriting standards (exceptions)

Early DOJ Enforcement Actions

- *Fleet Mortgage Company (1996)*
 - Investigation prompted by Federal Bank of Boston and Federal Reserve study/referral
 - Alleged differential pricing largely resulting from pricing discretion given to loan officers
 - Settlement included changes to mortgage company's pricing and loan officer compensation system

Early DOJ Enforcement Actions

- *First National Bank of Dona Ana County (New Mexico) (1997)*
 - Alleged that the bank failed to make mobile home loans to Hispanic applicants
 - Based on DOJ's internal investigation
- *First National Bank of Gordon (Nebraska) (1997)*
 - OCC referral
 - Alleged the bank charged American Indian borrowers higher rates

Recent Enforcement Efforts

- AIG FSB and Wilmington Finance (2010)
 - Higher fees on wholesale loans charged to African Americans
 - 2003-2006 period

Recent Enforcement Efforts

- Countrywide Settlement (2011)
 - \$335M
 - During "mortgage boom"
 - Lender "steered" Hispanic and African-American borrowers to subprime loans
 - Placed similarly situated white borrowers in prime loans.

Recent Enforcement Efforts

- Luther Burbank Savings (Sept. 2012)
 - \$400,000 min loan amount found discriminatory
 - Disparate impact
 - Settlement includes \$1.1M special financing "to increase" available credit.

Recent Enforcement Efforts – Disparate Impact

- CFPB and HUD statements on disparate impact
- Supreme Court’s effort to address: *Mount Holly & Magner*
- The arguments on applicability of disparate impact
- “Third time a charm?” – Supreme Court’s recent acceptance of disparate impact/FHA case

Recent Enforcement Efforts – Disparate Impact

- HUD’s Disparate Impact Rule (Feb 2013)
- HUD statutorily charged with interpreting FHA
- Key statements in regulation:
 - HUD and every federal appellate court recognizes disparate impact
 - “Decades old substantive law” that does not add costs to lenders
 - FHA does not include disparate impact standard
 - Establishes three-party burden shifting test

Recent Enforcement Efforts – Disparate Impact

Burden shifting elements:

1. Plaintiff first bears the burden of proving its prima facie case that a practice results in, or would predictably result in, a discriminatory effect on the basis of a protected characteristic.
2. If the plaintiff proves a prima facie case, the burden of proof shifts to the defendant to prove that the challenged practice is necessary to achieve one or more of its substantial, legitimate, nondiscriminatory interests.

Recent Enforcement Efforts – Disparate Impact

3. If the defendant satisfies this burden, then the charging party or plaintiff may still establish liability by proving that the substantial, legitimate, nondiscriminatory interest could be served by a practice that has a less discriminatory effect.

Recent Enforcement Efforts – Disparate Impact

Plaintiff/Enforcers argue:

- Eleven federal circuits have upheld the cognizability of disparate impact claims under the FHA based on their Supreme Court's Title VII jurisprudence (employment discrimination).

Recent Enforcement Efforts – Disparate Impact

- *Griggs v. Duke Power*, 401 U.S. 424 (1971): Power company's neutral requirement that all employees have a high school education regardless of whether it was necessary for their job was discriminatory under Title VII because it had a disparate effect on African-Americans.
- Disparate impact claims are consistent with the purposes of the FHA.

Recent Enforcement Efforts – Disparate Impact

Lenders (and Supreme Court?) argue:

- Title VII disparate impact grounded in specific statutory text
- *Smith v. City of Jackson*, 544 U.S. 228 (2005): Employment-related disparate impact claims are grounded in Title VII’s specific statutory text prohibiting “affect.”
- “The plain language and purpose of the FHA differs significantly from the plain language and purpose of Title VII, making disparate impact claims under the FHA inappropriate.” *Mt. Holly* Petition for Cert.

Recent Enforcement Efforts – Disparate Impact

- By contrast, the FHA does not contain comparable language regarding “effect” or the “affect” of certain actions.
- “Discriminatory housing practice” is defined in the FHA as “an act that is unlawful under section [sic] 3604, 3605, 3606, or 3617 of this title.” Those referenced sections include no language addressing discriminatory effect.
- Since *City of Jackson*, no federal court guidance as to whether the FHA’s statutory text permits disparate impact claims.

Predictions

- Use of implicit bias data (See Tim Wise *Color Blind*)
- Supreme Court will finally address use of disparate impact in *The Inclusive Communities Project Inc. v. Texas Department of Housing and Community Affairs*
- Continued focus by Capitol Hill
 - House Financial Services Committee inquiry to CFPB on disparate impact
- Tension between access to credit and disparate impact brought to light

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