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UDAAP and Discriminatory Practices/Disparate Impact in the Mortgage Servicing Context: Dodd-Frank, CFPB Interpretations of Unfair, Deceptive and Abusive Practices, UDAAP and Fair Lending Enforcement, and Beyond

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DISCRIMINATORY PRACTICE CLAIMS IN LOSS MITIGATION AND FORECLOSURE

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FAIR HOUSING ACT

- Unlawful to make unavailable or deny a dwelling to any person because of race, color, religion, sex, familial status or national origin or handicap. 42 USCA 3604

- Unlawful for entity whose business includes residential real estate related transactions to discriminate against any person in making available such a transaction, or in the terms of conditions of such a transaction because of a protected class. 42 USCA 3605(a)

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EQUAL CREDIT OPPORTUNITY ACT

- It is "unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction on the basis of race, color, religion, national origin, sex or marital status, or age." 15 USCS § 1691

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"Fair lending requirements apply throughout life of loan"

- Mark Holtz, National Bank Examiner, OCC, Oct 2013

- Discriminatory lending practices prior to housing collapse led to minorities paying higher interest rates and into more sub-prime loans than non-minority borrowers
  - e.g. Dec. 2011: Bank of America agreed to pay $335 million dollars for alleged discriminatory lending practices of Countrywide
  - At greater risk of default and foreclosure by their very nature
- Courts have recognized potential applicability of Fair Housing Act in loan modification and foreclosure process:
  - "To the extent plaintiffs can allege that defendant improperly denied them a loan modification on the basis of race, such allegations could be sufficient to withstand a motion to dismiss their FHA claim" *Walton v. Wells Fargo Bank, N.A.*, 2013 U.S. Dist. LEXIS 87320, 2013 WL 3177888 (D. Md. June 21, 2013)

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OCC FAIR LENDING GUIDANCE

Possible risk factors for unlawful discrimination in servicing:

- foreclosure disparities between protected classes and others;
- consumer complaints alleging discrimination in loan servicing;
- poorly documented or undocumented servicing decisions; and
- high levels of litigation alleging loan servicing discrimination.

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NOT JUST RACE

- All protected classes:
  - Fair Housing Act: "race, color, religion, sex, familial status or national origin"
  - Equal Credit Opportunity Act: "race, color, religion, national origin, sex or marital status, or age"

- Disabilities:
  - April, 2013 - *HUD v. Bank of America*: Bank denied loan modification on basis that borrower did not present sufficient evidence of permanent disability
    - Borrower provided doctor's reports, employer letter re. leave of absence due to disability, insurance records for four years of medical treatments
  - Denied borrower opportunity to seek loan modification under HAMP based on her disability in violation of section 3604(f) of FHA
  - HUD Conciliation agreement: BOA to pay $26,000 to borrower and modify loan

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NOT JUST THE BORROWER

REO Properties:

- National Fair Housing Alliance filed HUD complaints against various lenders:
  - Foreclosing lenders violate the FHA by failing to maintain properties in minority neighborhoods while doing so in non-minority neighborhoods
  - Contributes to blight and reduces neighborhood property values
  - June, 2013: Wells Fargo agreed to pay $27 million to resolve complaints

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NOT JUST THE BORROWER

Municipalities:

- Municipal actions against lenders alleging violation of FHA in foreclosures:
  - Claim damages for loss of tax revenue and increased expenses for issues arising from vacant properties.
  - *City of Los Angeles v. Citigroup*, USDC CD Calif 13-cv-9009
    - City relying on statistics to show disparate impact (African American 2.273 times more likely to receive predatory loan).
    - City survived motion to dismiss - the Court finds no fault with L.A.'s ample allegations in the Complaint under a theory of disparate treatment. As L.A. points out, the Complaint is rife with allegations that Defendants targeted minority borrowers for unfair loan terms based on race or national origin.
  - *City of Miami v. Bank of America Corp.*, USDC., SD Fl, 13-24506
    - Dismissed - damages are "so marginally related" to the purpose of the Fair Housing Act that it cannot be assumed that Congress intended to permit the city's lawsuit.
    - October 7, 2014: Miami has filed notice of appeal to the 11th Circuit Court of Appeals.

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DON'T BECOME A TARGET

Best Practices: Uniformity and Self-Monitoring is Key

- Consistent and uniform policies in the loss mitigation and foreclosure process, and for different stages in the process.
- Document business justifications for policies and procedures.
- Minimize discretion in loss mitigation and foreclosure decision making.
- Set clear and detailed guidelines for appropriate use of exceptions.
- Maintain documentation of loss mitigation underwriting and exceptions for individual loans.
- Involve fair lending personnel in developing or revising loss mitigation standards and procedures.
- Implement systems to monitor for fair lending and equal treatment.
- Conduct statistical analysis for potential disparate impact results and address when disparate impact found.
- Monitor and audit servicers, and third party providers, for compliance with loss mitigation and foreclosure policies.
- Outreach: Promote loss mitigation programs in diverse neighborhoods.
- Not just lip service: Comply with National Settlement, HAMP and other program guidelines and deadlines.

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SUPREME COURT CHALLENGES TO USE OF DISPARATE IMPACT UNDER FAIR HOUSING ACT

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DISPARATE IMPACT

- Allows government or private plaintiffs to use statistics to show that seemingly race-neutral policies disproportionately harm minorities.

- Intention to discriminate not required.
  - "Effect, not motivation, is the touchstone." *Mt. Holly Gardens v. Township of Mt. Holly*, 658 f.3d 375 (3rd Cir. 2011). "Looks beyond such specious concepts of equality to determine whether a person is deprived of his lawful rights because of his race. Rather, a disparate impact inquiry requires us to ask whether minorities are disproportionately *affected*" by the activity.

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DISPARATE IMPACT IN FAIR HOUSING

- Traditionally used in employment discrimination.
- Disparate impact theory now being used in FHA and ECOA actions but FHA and ECOA do not explicitly provide for the use of disparate impact.

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TEST FOR DISPARATE IMPACT

Case law - three or four part test:

1. Plaintiff must establish prima facie case showing that action resulted in disparate impact on protected class.
   - "Facially neutral policy had significant adverse impact on members of protected minority group"
   - Intent to discriminate not required
2. Burden shifts: Defendant must show the practice is related to legitimate, non-discriminatory, objective.
3. Circuits diverge on remaining analysis:
   - 2nd/3rd : defendant must show no less discriminatory alternative
   - 5th/8th/10th: plaintiff must show less discriminatory alternative
   - 4th/6th/7th: four part balancing tests

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TEST FOR DISPARATE IMPACT

- Demonstrated by statistics
- May rely on proportional statistics rather than absolute numbers
- No single standard controls
- Whether borrower is a minority may not be clear on paper - Regulators use “proxies”
  - e.g. Census tracts, or surname proxies that identify the likely race of borrowers

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REGULATORS

- April, 2012: CFPB Bulletin - 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.

- March 2013: HUD "Disparate Impact" Rule (24 CFR 100.500)
  - Liability may be established under the FHA based on a practice's discriminatory effect even if the practice was not motivated by a discriminatory intent.

  - "Practice has discriminatory effect where it actually or predictably results in a disparate impact on a group of persons or creates, increases, reinforces or perpetuates segregated housing patterns because of race, color, religion, sex, handicap, familial status or national origin."

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REGULATORS

HUD "Disparate Impact" Test

- Adopted three part test:

1. Charging party has burden of proving that the practice caused or predictably will cause a discriminatory effect

2. Defendant then has burden of proving practice is necessary to achieve legitimate, nondiscriminatory interest
   - "Necessary" - not just a "legitimate business decision"

3. Plaintiff has burden of proving that the legitimate, nondiscriminatory interests could be served by another practice that has a less discriminatory effect

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EXAMPLES OF DISPARATE IMPACT

- Discretionary loan pricing resulting in higher costs incurred by minority borrowers than non-minority borrowers. *US v. Wells Fargo* (DOJ, June 2012), *US v. Countrywide* (DOJ Dec. 2011), *US v. SunTtrust* (DOJ, June 2012), *US v. National City Bank* (CFPB, Dec. 2013)
- Discretionary interest rates resulted in higher interest rates to minority borrowers. *US v. C&F Mortgage* (DOJ, Sept. 2011), *US v. GFI Mortgage* (DOJ, August 2012)
- Discretionary "dealer mark up" interest rates on auto loans led to higher rates charged to minority borrowers. *US v. Ally Financial* (CFPB/DOJ, Dec. 2013)
- Minority borrowers more likely to be sold sub-prime mortgages when discretionary product selection allowed. *US v. Wells Fargo* (DOJ, June 2012), *US v. Countrywide* (DOJ, Dec. 2011)
- $400,000 minimum mortgage led to disproportionately less minority loans. *US v. Luther Burbank Savings* (DOJ, October 2012)
- Lender credit to female and minority borrowers had disparate impact on white male and male/female couple borrowers. *US v. Community First Bank Pikesville* (OCC, May 2013)

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IT WILL COST YOU

LENDER	PAYOUT
Wells Fargo Bank	$335 Million
Countrywide/Bank of America	$98 Million
National City Bank/PNC	$35 Million
Sun Trust	$21 Million
GFI Mortgage	$3.5 Million
Luther Burbank Savings	$2 million

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SUPREME COURT CHALLENGES: 2011: *Gallagher v. Magner*

- Rental property owners sued City of St. Paul alleging aggressive enforcement of code violations in low-income properties disproportionately affected minority residents
- Disparate Impact:
  - City's code enforcement practice targeting rental properties increased costs for property owners that rent to low income tenants, resulting in less affordable housing; racial minorities make up disproportionate percentage of lower income households relying on low-income housing.
  - Legitimate purpose – safe and clean housing
  - Potential alternative – City had a prior program whereby officials worked with individual landlords to address code violations
- 8th Cir. Court of Appeals affirmed lower court rejection of disparate treatment because there was no evidence of intent but overturned summary judgment that rejected the "disparate impact" theory (619 F.3d 823)
- St. Paul appealed to USSC. City of St. Paul dismissed appeal when DOJ agreed not to intervene in two other federal cases against St. Paul

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2012: *Mount Holly v. Mt. Holly Gardens Citizens in Action, Inc.*

- Community activists filed suit claiming disparate impact in redevelopment of blighted neighborhood: replaced homes occupied by low-income residents with significantly more expensive housing units
- District Court granted summary judgment to City: Since 100% of the minorities treated the same as 100% of non-minorities, there is no greater adverse impact on minorities
- 3rd Cir. Court of Appeals: overturned summary judgment in favor of Township; Court erred "in rejecting the plaintiffs' statistical submissions"
  - 22.54% of african american households and 32.31% of hispanic households in the city will be affected by the project as compared to 2.73% of white households; only 21% of minority households can afford the new housing as compared to 79% of white households
- USSC granted certification to Township, but parties settled after briefing but before decision rendered

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OCTOBER 2014: CERTIFICATION GRANTED:

Inclusive Housing Communities Project v. Texas Dept of Housing and Community Affairs

- Advocacy group claims state's method for distributing low income tax credits results in concentration of low income housing in minority neighborhoods - Fosters segregation
- Federal Court of Appeals agreed disparate impact theory applies:
  - Burden shifting approach set forth in recent HUD regulations (24 CFR 100.500) provides appropriate standard for FHA disparate impact claim
- Texas appealed - Two issues:
  1. Whether disparate income claims are cognizable under the FHA
  2. If so, what standards and burden of proof should apply
- The USSC agreed to hear arguments on only the first issue

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ALL IN FAVOR

- Housing policies resulting in systemic differences based on race perpetuate segregation
- Protects against discretionary pricing policies resulting in higher cost loans to minorities
- FHA is a "broadly remedial statute designed to prevent and remedy invidious discrimination on the basis of race" *Mt. Holly Gardens v. Township of Mount Holly*, 658 F.3d 375(3rd Cir. 2011)
- Test is not limited to showing statistical disparity – must also show that there is an alternative means to achieve the same legitimate purpose of the activity

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ALL OPPOSED

- Disregards possible non-discriminatory causes for disparities
- Statistics can be manipulated and no clear guidelines as to thresholds
- Forces racial quotas - lenders forced to pay close attention to racial outcomes of even nondiscriminatory policies
- May force relaxed underwriting and loss mitigation standards for minority neighborhoods
- Government uses disparate income approach against lenders who are following legal practices to achieve government's desired social outcome, rather than creating social programs
- Compliance with Qualified Mortgage (maximum 43% DTI ratio) and Ability To Pay rules may result in disparate impact – no guidance or clear safe harbor
- Using disparate impact creates unnecessary lender compliance risk resulting in limited credit availability and driving up the cost of borrowing

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IMPLICATIONS IF USSC SAYS NO TO DISPARATE IMPACT

- Regulatory agencies no longer able to target banks, mortgage lenders, or other credit providers for non-discriminatory conduct that otherwise complies with the law
- May open door for more discretionary pricing
- Lenders should still have strong fair lending policies and monitor for disparate impact

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RECENT DEVELOPMENT: HUD DISPARATE RULE INVALID

Nov. 2014: *AIA, et al. v. HUD, et al*., No. 1:13-cv-00966 (D.D.C.):

- USDC, D.C. ruled the HUD Disparate Impact rule is invalid.
- Cited *Smith v. Jackson* which provides that the theory is only available "where statute evinced clear intention to bar effects-based rather than prohibiting merely intentional discrimination." 544 U.S. 228 (2005)
- "[E]xpansion of FHA to include disparate-impact liability would not only have wide-ranging disruptive effect on the pricing and provision of homeowner's insurance, but would also require insurers to collect and analyze certain types of race-based data on their clients and prospective clients."
- Case was "another example of an administrative agency trying desperately to write into law that which Congress never intended to sanction."
- CFPB: No impact - disparate Impact claims allowed under both FHA and ECOA.

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