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Who's the Fairest Lender of Them All?

As government scrutiny intensifies, don't get snowed under by fair-lending laws

In the past few years, the federal government has devoted substantial resources to scrutinizing and litigating what it perceives to be unfair, deceptive or abusive mortgage-lending practices. Looking forward, all indications suggest that the government's level of attention to possible violations of fair-lending laws and regulations only will increase.

With that in mind, it's imperative for mortgage companies to become conversant with these issues and otherwise prepare themselves for what may be a major legal headache. Like many other regulatory issues, however, the devil is in the details when it comes to fair-lending laws. What does your company need to know to be the fairest lender in all the land?

The legal momentum is building for a sustained federal focus on violations of fair-lending laws and unfair, deceptive, or abusive acts or practices (i.e., UDAAP). According to Inside Mortgage Finance, the Department of Justice has settled nine fair-lending cases since October 2011, and these cases have yielded a total of more than $600 million in victim compensation.

Earlier this year, the Department of Housing and Urban Development (HUD)

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formalized its long-standing ban on practices that have the effect, even if not the intent, of discriminating against protected classes, acts that are known as "disparate impact" practices. The start of a new year is a good time to review the fair-lending laws that could impact your business and take a closer look at some of the steps that you can take to ensure your compliance.

Breaking down "fair"

Understandably, many mortgage banks and lenders are concerned by the vagueness and generality of statutory guidance with regards to what's proper — and improper — under governing laws. The Dodd-Frank Wall Street Reform and Consumer Protection Act states that "fair lending" means "fair, equitable, and nondiscriminatory access to credit for consumers." Of course, this raises the question: What exactly is "fair, equitable, and nondiscriminatory"? The answer begins with the two primary federal laws governing fair-lending practices: the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act.

Enacted in 1974, ECOA prohibits discrimination based on race, color, religion, national origin, sex, marital status, age and source of income, among other things. Similarly, the Fair Housing Act — which is part of the Civil Rights Act of 1968 — makes it unlawful for any lender to discriminate in any housing-related transaction against any person because of race, color, religion, national origin, sex, familial status or handicap. Mortgage professionals should note that state and local laws often include additional prohibited biases, such as sexual orientation. The Consumer Financial Protection Bureau (CFPB) wields the primary responsibility for enforcing ECOA, while in most instances, HUD retains primary responsibility for enforcing the Fair Housing Act.

Besides these two federal laws, there are other statutory minefields that mortgage banks and brokerages must navigate. One of them, the Community Reinvestment Act (CRA), encourages financial institutions to meet the credit needs of the communities that they serve. A poor fair-lending record can hinder a mortgage company's CRA rating and result in denial of applications to open new branches, relocate an office or acquire another financial institution. Additional risks of noncompliance include litigation risks, reputational damage, and regulatory risks such as adverse examination findings and formal or informal enforcement actions.

Mortgage professionals should know that fair- lending laws and regulations apply to all commercial credit products and services for both consumer and business purposes. They also cover the entire lifecycle of a loan, including its collections and servicing.

Broadly, regulators and plaintiffs seek fair-lending enforcement actions or litigation based on three different legal theories of lending discrimination:

1. **Overt discrimination:** These claims typically are based on alleged direct evidence that a lender intentionally discriminated on a prohibited basis. Overt-discrimination claims also can be founded on an allegedly expressed discriminatory preference, even if the lender never acted on that preference.
2. **Disparate treatment:** These claims tend to arise from circumstantial evidence that a lender intentionally treated similarly situated persons differently, distinguishing among them on a prohibited basis.
3. **Disparate impact:** This third type of claim is in many ways the most troubling for lenders. These claims can go forward despite evidence that a lender applied a neutral policy or practice uniformly to all credit applicants. The purported basis for attacking that neutral policy or practice is that it creates a disproportionately adverse impact on members of a protected group without a proper business justification.

Be aware that these three types of claims can be applied to a variety of alleged practices. "Redlining" claims, for instance, assert that a lender had a practice of denying credit to specific geographic areas because of race, ethnicity or some other protected-class characteristic of its residents. "Reverse redlining" is the opposite concept, claiming that protected classes were targeted for certain products with less favorable terms, conditions or pricing.

UDAAP

UDAAP violations also are prohibited by Dodd-Frank. This brand of compliance is a major concern of the CFPB, and mortgage companies should know that the interpretation of whether or not a company is compliant largely is left up to the CFPB itself, although its findings can be challenged in court. The definition of these practices can be one of the most powerful tools in the CFPB's arsenal; theoretically, almost any practice can be attacked — rightly or wrongly — under broad UDAAP standards.

When it comes to this brand of violation, there's again good reason for lenders' concerns about the standards' vagueness. Nevertheless, the mortgage industry has been given some preliminary guidance. "Unfairness," for instance, is used to describe a practice that causes — or is likely to cause — a substantial injury to consumers that is not reasonably avoidable. The injury must be one that is not outweighed by countervailing benefits to consumers or to competition. On the other hand, there also are strong indications that actual injury is not required and that a significant risk of concrete harm is sufficient.

"Deceptive" means that the given representation, omission, act or practice misleads or is likely to mislead the consumer. The consumer's interpretation of the representation, omission, act or practice must be reasonable under the circumstances, and the misleading representation, omission, act or practice must be material. Express claims made with respect to a financial product are presumed to be material. Implied claims also may be material when evidence shows that an institution intended to imply something. Intent to deceive, however, is not necessary.

Finally, the "abusiveness" standard pertains to something that does any or all of the following:

- **Materially interferes** with the ability of a consumer to understand a term or condition of a consumer financial product or service
- **Takes unreasonable advantage** of a lack of understanding on the part of the consumer of the material risks, costs or conditions

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- **Exploits an inability** of the consumer to protect that consumer's interests in selecting or using a financial product or service

The litigation consequences of alleged abusive practices can be staggering, particularly if qualified counsel is not engaged to protect your company's interests. Settlements of recent actions have featured bans on offering certain products or services, substantial monetary penalties, and even placing the defendant company into receivership with its assets frozen.

Compliance considerations

Although it's one thing for mortgage companies to be well-versed in lending laws, it's another thing entirely to be systematically prepared for compliance with those laws. Considering that, what are a few of the most important steps to staying fair and square?

In designing a meaningful compliance-management system, the CFPB has advised companies to focus on four critical components:

1. **Board and management oversight**, meaning involvement in the entire process (creation, implementation and review)
2. **A compliance program** administered independently of business lines that includes policies, training, monitoring and corrective action
3. **A consumer-complaint management program**
4. **Compliance audits** conducted by people distinct from the organization's compliance and business functions, people with the responsibility to report directly to the company's board of directors or top management

Mortgage banks and brokerages also should know that certain issues are of particular interest to the CFPB and other regulators. Be cautious, for instance, of describing similar services and products in a way that makes a comparison of them difficult. Presenting information in a manner that consumers cannot readily understand is a red flag, too, as is promoting terms not widely available elsewhere.

Some common themes also have emerged in allegations of discriminatory pricing or steering. These include broad use of discretion that allegedly resulted in a disparate impact on a prohibited basis. Common themes also include an alleged lack of clear policies or controls governing the exercise of discretion, little or no documentation on the rationale for discretionary pricing adjustments, and financial incentives for loan originators to charge higher fees or steer borrowers to higher cost products.

Be forewarned that potential liability for alleged fair-lending violations can extend several years into the past. Moreover, intrusive investigations and examinations can be spurred by a statistical disparity in a single geographic area, or from a single consumer complaint or consumer-interest-group study alleging discrimination. Lenders also face potential liability for the actions of third parties, including third-party originators.

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With the assistance of high-quality counsel, mortgage banks and lenders can steel themselves against complaints, investigation and litigation in several concrete ways. At a minimum, they should review and monitor policies, procedures and practices regarding their product offerings and pricing outcomes, and they should monitor any use of underwriter discretion. Additionally, it's crucial to document your organization's justification for any discretionary decisions. Keeping a close eye on industry regulations and carefully following these rules of thumb can help your company avoid undue government scrutiny. ●

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