THE REVIEW OF
BANKING & FINANCIAL SERVICES
A PERIODIC REVIEW OF SPECIAL LEGAL DEVELOPMENTS AFFECTING LENDING AND OTHER FINANCIAL INSTITUTIONS

Vol. 38 No. 12 December 2022

PRE-PUBLICATION ISSUE

THE RECENT ONSLAUGHT OF FAIR LENDING LITIGATION AGAINST MORTGAGE INDUSTRY PARTICIPANTS

In this article, the authors explore exemplars of a recent onslaught of government and private fair lending litigation against mortgage industry participants. The litigation arises in a variety of contexts, including claims challenging "modern-day redlining;" loan origination, servicing, and marketing practices; the use of machine-learning algorithms in advertising; and appraisal issues. They identify best practices for institutions that seek to proactively manage fair lending risk in this litigious environment.

By Olivia Kelman and Lanette Suárez Martín *

The Biden administration announced a clear policy directive days after the president's inauguration: "The Federal Government has a critical role to play in . . . enforcing Federal civil rights and fair housing laws" and, to fulfill that role, "the Federal Government shall work with communities to end housing discrimination, to provide redress to those who have experienced housing discrimination, [and] to eliminate racial bias and other forms of discrimination in all stages of home-buying and renting[.]"[1]

With the passage of nearly two years, it is clear that the federal agencies responsible for enforcing laws that prohibit discrimination in residential real-estate related transactions have actively carried the torch, filing numerous fair lending lawsuits against many different types of mortgage industry participants to challenge a broad assortment of conduct. Private parties — including advocacy organizations, individual persons, and local government entities like cities and counties — have similarly increased their pursuit of aggressive fair lending claims in courts. The mere accusation of discrimination frequently involves significant tangible and reputational costs, and in this environment, mortgage industry participants must be on notice that fair lending represents an area of heightened risk.

[1] The White House, *Memorandum on Redressing our Nation's and the Federal Government's History of Discriminatory Housing Practices and Policies* (Jan. 26, 2021).

* *OLIVIA KELMAN is a partner at K&L Gates LLP, and LANETTE SUÁREZ MARTÍN is an associate at the firm, handling government enforcement, litigation, and compliance matters, with a concentration on fair lending and fair servicing. They regularly counsel clients on issues arising under the federal Fair Housing Act, Equal Credit Opportunity Act, Community Reinvestment Act, Home Mortgage Disclosure Act, and consumer protection laws prohibiting deceptive, unfair, and abusive practices. Olivia serves as practice group coordinator for the firm's financial institutions and services litigation group. Resident in the firm's Miami office, the authors may be contacted at olivia.kelman@klgates.com and lanette.martin@klgates.com, respectively.*

INSIDE THIS ISSUE

-

RSCR Publications LLC Published 12 times a year by RSCR Publications LLC. Executive and Editorial Offices, 2628 Broadway, Suite 29A, New York, NY 10025-5055. Subscription rates: $650 per year in U.S., Canada, and Mexico; $695 elsewhere (air mail delivered). A 15% discount is available for qualified academic libraries and full-time teachers. For subscription information and customer service call 609-683-4450; fax 609-683-7291; write Subscriber Services, RSCR Publications, PO Box 585, Kingston NJ 08528; e-mail cri.customer.service@comcast.net; or visit our website at www.rscrpubs.com. General Editor: Michael O. Finkelstein; tel. 212-876-1715; e-mail mofinkelstein@gmail.com. Associate Editor: Sarah Strauss Himmelfarb; tel. 301-294-6233; e-mail sarah.s.himmelfarb@gmail.com. To submit a manuscript for publication contact Ms. Himmelfarb. ISSN: 1051-1741.

This article explores some of the recent fair lending lawsuits involving government and private claims against a variety of mortgage-industry actors challenging a variety of mortgage-industry practices, and underscores the reasons why all entities engaged in any aspect of the mortgage business should engage in a frank fair-lending risk assessment. From claims challenging "modern-day redlining," to claims challenging loan origination and servicing practices under theories of disparate treatment and disparate impact, to claims challenging the use of algorithms in advertising, to claims challenging bias in the appraisal process, the risk of a fair lending violation can arise from many sources — from unmonitored reliance on employees to make fair decisions, from aspects inherent to certain business models, from the use of machine-learning technology (or from contracting with third-party vendors who use such technology), and from operational failures in the implementation of policies, to name just a few such sources that jump out from recent fair lending litigation. Board members, senior management, compliance officials, and legal departments are better equipped to identify, escalate, and mitigate possible fair lending risks when they have a solid understanding of the types of claims that are being filed and the facts that are being offered to support them.

THE FEDERAL GOVERNMENT'S ATTACK ON MODERN-DAY REDLINING

Government claims of "redlining"[2] are not new — the U.S. Department of Justice ("DOJ") brought the first redlining lawsuit against a bank over 25 years ago.[3] But following through on promises to take aggressive action against what it describes as "modern-day redlining,"[4] as of September 26, 2022, the DOJ under the Biden administration has filed three redlining lawsuits on its own and in partnership with state attorneys general and other federal agencies, including the Consumer Financial Protection Bureau ("CFPB") and Office of the Comptroller of the Currency ("OCC").[5] While these recent suits have involved factual assertions that are similar in many respects to DOJ's historical redlining cases, they have also involved new types of allegations that provide important signals for entities seeking to gauge their own redlining risk.

As context for the onslaught and expansion of claims, in October 2021, Attorney General Merrick B. Garland announced the launch of a "Combatting Redlining Initiative," committing the DOJ to "making far more robust use of our fair lending laws."[6] For example, the DOJ advised that it would, for the first time, expand its "analyses of potential redlining to both depository and *non-depository* institutions."[7] Prior to this announcement, neither the DOJ, nor any other enforcement agency, had ever before filed a redlining lawsuit against a nonbank mortgage lender, but just nine

[2] The federal agencies responsible for fair lending enforcement define "redlining" as "a form of illegal disparate treatment in which a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the credit seeker resides, or will reside, or in which the residential property to be mortgaged is located." FFIEC, *Interagency Fair Lending Examination Procedures*, at 29 (Aug. 2009), https://www.ffiec.gov/pdf/fairlend.pdf.

[3] Compl., *U.S. v. Chevy Chase Fed. Sav. Bank*, No. 1:94-cv-01829 (D.D.C. Aug. 22, 1994).

[4] DOJ, *Justice Department Announces New Initiative to Combat Redlining* (Oct. 22, 2021).

[5] Compl., *U.S. v. Trustmark Nat'l Bank*, No. 2:21-cv-2664 (W.D. Tenn. Oct. 22, 2021), https://www.justice.gov/crt/case-document/file/1445246/download; Consent Order, *Trustmark Nat'l Bank*, https://www.justice.gov/crt/case-document/file/1445181/download; Compl., *CFPB & U.S. v. Trident Mortg. Co. LP*, No. 2:22-cv-02936 (E.D. Penn. July 27, 2022), https://www.justice.gov/opa/press-release/file/1522166/download; Consent Decree, *Trident Mortg. Co.*, https://www.justice.gov/opa/press-release/file/1522171/download; Compl., *U.S. v. Cadence Bank, N.A.* No. 1:21-cv-03586-JPB (N.D. Ga. Aug. 30, 2021), https://www.justice.gov/opa/press-release/file/1428611/download; Consent Decree, *Cadence Bank*, https://www.justice.gov/opa/press-release/file/1429196/ download.

[6] *Supra* note 4.

[7] *Supra* note 4 (emphasis added).

months later, the first nonbank lender was publicly sued for redlining.[8]

These actions leave no room for doubt that the DOJ will continue to prioritize investigating claims of potential redlining and initiating public lawsuits in circumstances where the DOJ believes it necessary. Financial institutions can take a proactive approach to evaluating their own redlining risks by dissecting the recent complaints to better understand the DOJ's methodology for building a redlining case.

The Geographic Scope of a Redlining Analysis

The geographic area in which a lender's minority-area lending performance will be measured is a threshold issue for a redlining review, which evaluates an institution's provision of mortgage credit in areas with different racial compositions. Depository institutions are subject to the Community Reinvestment Act ("CRA"), which requires a bank to delineate the communities that it serves by self-identifying an "assessment area." DOJ redlining complaints against depository institutions have explained that "regulators look at a bank's assessment area in evaluating whether an institution is meeting the credit needs of its entire community," and the redlining claims have been based on allegations that the defendant bank "served the credit needs of majority-white neighborhoods but did not serve the credit needs of majority-Black and Hispanic neighborhoods in its [] *assessment area*."[9] Thus, in its redlining suits against banks, the DOJ has typically used the bank's assessment area, so long as it is drawn in a non-discriminatory manner, as the geographic boundary for purposes of conducting an analysis of potential redlining.[10]

Unlike depository institutions, nonbanks are not covered by the CRA and are not required to delineate "assessment areas" that provide an easy definition of the geographies they intend to serve. The first redlining lawsuit against a nonbank lender provides some guidance to nonbanks regarding the views of the DOJ and CFPB as to considerations relevant to defining the geographic scope for a redlining analysis. The first nonbank lender complaint indicated that the lender's "self-defined lending footprint" or "market area" consisted of "the entire Philadelphia" metropolitan statistical area ("MSA").[11] The complaint also alleges that the lender "received 80% of its mortgage applications" in the Philadelphia MSA, signaling that regulators may also consider a nonbank's overall lending volume in scoping the geography for a redlining analysis. Lenders frequently may have policies, strategic plans, or other formal or informal documentation that describe a "footprint" or "market area," and compliance teams should carefully review the accuracy of those statements.

Defining the Minority Communities Subject to a Redlining Analysis

The "minority" communities being reviewed in a redlining analysis are not subject to a rigid definition and may depend on the racial and ethnic makeup of the particular geographic area at issue. In a case focused on the Philadelphia market, redlined "minority" communities have been defined as those where 50% or more of the population "identified as Black, Hispanic, Asian, Native American, Native Hawaiian, or Pacific Islander in the U.S. Census."[12] This definition of "minority" communities may reflect the melting pot nature of the Philadelphia MSA, which the complaint describes as 20% African American, 10% Hispanic, 6% Asian, and 61% non-Hispanic white. In other redlining cases, minority communities have been defined more narrowly to focus on the provision of credit to "majority-Black and Hispanic" areas.[13] To properly evaluate redlining risk, institutions must be aware of the unique demographic makeup in the areas where they do business and tailor their analyses of serving minority communities appropriately.

Identifying an Institution's Peer Lenders for a Redlining Analysis

Redlining analyses typically involve comparing a lender's relative performance in serving minority communities to the performance of other lenders in serving the same minority communities. Such an analysis frequently will compare the percentage distribution of a lender's loan application and origination

[8] Compl., *Trident Mortg. Co., supra* note 5; DOJ, *Justice Department and Consumer Financial Protection Bureau Secure Agreement with Trident Mortgage Company to Resolve Lending Discrimination Claims* (July 27, 2022), https://www.justice.gov/opa/pr/justice-department-and-consumer-financial-protection-bureau-secure-agreement-trident-mortgage.

[9] *E.g.*, Compl. ¶¶ 15, 25, *Cadence Bank, supra* note 5.

[10] Of course, the CRA prohibits banks from delineating assessment areas in a discriminatory manner, such as in a manner that purposefully excludes minority neighborhoods.

[11] Compl. ¶ 58 & 13, *Trident Mortg. Co., supra* note 5.

[12] Compl. ¶ 3, *Trident Mortg. Co., supra* note 5.

[13] *E.g.*, Compl. ¶ 14, *Cadence Bank, supra* note 5; Compl. ¶ 16, *Trustmark Bank*, *supra* note 5.

volume between minority and nonminority areas with the percentage distribution of other comparable lenders' loan application and origination volumes between minority and nonminority areas. Statistically significant differences in the proportional distribution of loans in minority areas of an institution as compared to other lenders may be an indication of redlining risk. Identifying an institution's comparable lenders, or "peers," for purposes of conducting the statistical comparison can be one of the most challenging aspects of a redlining analysis.

In their recent redlining suits against banks, the DOJ and CFPB have defined "peer lenders" as "similarly situated financial institutions that received between 50 percent and 200 percent of the Bank's annual volume of home mortgage loan applications."[14] In contrast, the DOJ and CFPB complaint against the first nonbank lender to face a redlining lawsuit does not define the group of lenders that were identified as the nonbank's "peers," though it might be possible to reverse-engineer the peer group based on the lending statistics that are alleged.

Notably, recent redlining complaints have alleged that the institutions either commissioned or themselves conducted redlining risk assessments that compared their lending performance to that of "peers."[15] For example, the nonbank defendant allegedly received "at least six separate reports from third-party vendors" showing that its application volume in minority neighborhoods was "low relative to both the overall population and to the performance of its peers."[16] Whether an institution outsources fair-lending analyses to third-party vendors or conducts analyses in-house, compliance officials should carefully consider the peer groups used for comparison in those reviews, as they may be difficult to later dispute with a regulatory agency. Also, if the analyses show room for improvement, it is essential to properly elevate the issue to management and develop an action plan for minority market penetration.

The DOJ's Emphasis on Physical Locations, Service Offerings, and Loan Officer Assignments as Evidence of Redlining

When conducting a redlining investigation, the DOJ typically reviews an institution's physical presence in minority communities, the mortgage credit services provided at all locations in minority and nonminority communities, as well as the geographic assignment of loan officers. These types of facts may take on a heightened level of importance for any institution that observes statistically significant differences between the level of its applications and originations in minority communities and that of "peer" lenders operating in the same geography.

For example, redlining complaints frequently allege that a lender's branches were concentrated in majority-white neighborhoods, with few if any located in majority-Black and Hispanic neighborhoods. In one redlining case against a bank, the DOJ alleged that only one of the bank's 13 branches was located in a majority-Black and Hispanic area despite more than 56% of the census tracts in the bank's assessment area being located in majority-minority areas.[17] Similarly, in another case brought against a bank, the DOJ alleged that the bank maintained "only four of its 25 total branches in majority-Black and Hispanic areas."[18] From the nonbank perspective, the DOJ's complaint discussed that the nonbank's business model involved renting space in the offices of an affiliated real estate company and had a physical presence in 53 offices, but 51 were located in majority-white areas and only two were located in majority-minority areas.[19]

The DOJ also reviews the services provided at all locations in minority and nonminority communities. For instance, in a redlining case against a bank, the DOJ alleged that of the bank's physical branch locations, 18 were "full-service" branches that "offered the full suite" of the bank's "retail products and services" and "accepted mortgage loan applications."[20] The complaint further alleged that the bank had at most "7 . . . 'limited-service' branches, which offered only some products and services" and did not accept "residential mortgage loan applications." In majority-minority census tracts, the DOJ alleged that the bank maintained fewer "full-service" branches, which DOJ viewed as evidence of the bank's intent to avoid providing mortgage credit services in those communities.[21] Relatedly, DOJ has supported its redlining claims by alleging that a borrower would be required "to make an appointment in advance to meet with a loan officer" to apply for credit at a branch

[14] Compl. ¶ 39, *Cadence Bank*, *supra* note 5; Compl. ¶ 44, *Trustmark Bank*, *supra* note 5.

[15] Compl. ¶ 78, *Trident Mortg. Co.*, *supra* note 5.

[16] *Id.*

[17] Compl. ¶ 19, *Cadence Bank.*, *supra* note 5.

[18] Compl. ¶ 22, *Trustmark Bank*, *supra* note 5.

[19] Compl. ¶¶ 28, 30, *Trident Mortg. Co.*, *supra* note 5.

[20] Compl. ¶ 21, *Trustmark Bank*, *supra* note 5.

[21] *Id.* at ¶¶ 23-24.

located in a majority-minority area where loan officers are not regularly staffed.[22]

Loan officer assignment is another major focus in redlining complaints. The DOJ considers whether loan officers are assigned to branches located in majority-minority communities or to generate loans in majority-minority communities; such assignments may refute a claim of redlining by demonstrating an institution's commitment to ensuring access for the minority community members, and for general business development and recommendations in those communities. In one recent case, the bank defendant allegedly only assigned loan officers to branches located in majority-white areas, and "did not assign a single loan officer, even on a part-time basis, to the lone branch located" in a majority-minority area.[23] In another redlining case, the DOJ has alleged that the bank did not assign a single mortgage loan officer to any of its branches in majority-minority areas and "relied almost entirely on mortgage loan officers . . . to develop referral sources, conduct outreach to potential customers, and distribute marketing materials related to the Bank's mortgage lending services," which DOJ therefore concluded could have occurred in only majority-white neighborhoods.[24] The DOJ took the same evidentiary approach in its complaint against the nonbank lender where it alleged that the nonbank's loan officers were assigned to work in offices located in white areas. The racial and ethnic makeup of a lender's sales force may become relevant in DOJ's view — its complaints have included claims that 64 of an institution's 68 loan officers were white, and the nonbank allegedly generated business and hired new loan officers based on recommendations from its existing mostly white loan officers.[25]

In evaluating an institution's level of redlining risk, the recent redlining complaints confirm the importance of considering the racial composition of the area in which offices are located, the suite of services offered at each location, and the assignment of loan officers to work in particular locations and to serve particular consumer segments. Also considered are the racial makeup of an institution's sales force and its ability to generate business in all segments of the communities in which the business operates. Of course, the trend of online mortgage lending continues to be observed industry-wide, and the significance of the physical-presence and sales force issues will depend on each institution's business model.

Marketing to Minority Populations

Redlining actions have frequently involved allegations that the defendant institution's marketing excluded minority communities, failed to reach minority communities, or indicated a preference for certain customers on an impermissible basis. Methods of marketing and outreach vary greatly among institutions, but certain trends emerge from the recent redlining lawsuits that demonstrate areas of particular importance.

For lenders that substantially rely on loan officers to engage in marketing efforts, it is critical to consider how the institution can monitor such actions to document that efforts have been made to penetrate minority communities. A recent redlining complaint included allegations that the lender "did not monitor or document" the individuals "to whom loan officers distributed marketing or outreach materials related to residential mortgage lending services to ensure that such sources or distribution occurred in all neighborhoods[.]"[26] In a similar vein, conducting regular loan officer (and other employee) training is critical, as the DOJ has supported redlining complaints with allegations that a bank "neither directed nor trained its loan officers to increase their sources of referrals from majority-Black and Hispanic neighborhoods."[27]

For lenders that engage in print or digital advertising, it is important to consider whether such marketing effectively reaches minority communities. The DOJ has relied on factual allegations that "the majority of the Bank's print or digital advertising appeared in business-focused publications," and "did not regularly appear in media or platforms accessible to or targeted at majority-Black and Hispanic areas."[28] Even if print or digital advertising is "not [a bank's] primary form of marketing," it is important for compliance officials to evaluate the targeting and reach of such campaigns that are effectuated; indeed, the DOJ has bolstered a complaint with allegations that, in connection with "15 direct mail marketing campaigns" deployed over a three-year period, over 92% of the mailings were sent to majority-white areas.[29] Especially in communities with

[22] Compl. ¶ 29, *Cadence Bank, supra* note 5.

[23] Compl. ¶¶ 28, *Cadence Bank*, *supra* note 5.

[24] Compl. ¶¶ 30-34, *Trustmark Bank*, *supra* note 5.

[25] Compl. ¶¶ 37-42, *Trident Mortg. Co.*, *supra* note 5.

[26] Compl. ¶ 34, *Trustmark Bank*, *supra* note 5.

[27] Compl. ¶ 35, *Cadence Bank*, *supra* note 5.

[28] Compl. ¶ 36, *Trustmark Bank*, *supra* note 5.

[29] Compl. ¶ 44, *Trident Mortg. Co.*, *supra* note 5.

a meaningful Hispanic population, the DOJ has specifically alleged that a bank "did not advertise at all in Spanish" in order to reach the Hispanic population.[30]

Lenders developing marketing campaigns should ensure that their campaigns reach the entire population, including minority communities where the majority of population may not be native English speakers. Lenders should also take care to ensure that their marketing materials do not indicate an impermissible customer preference and should carefully oversee any third-party marketing vendors to confirm that campaigns are appropriately designed to reach all segments of the community, including minority and nonminority areas. Tracking the intended reach of your institution's marketing efforts by the racial composition of communities to which the efforts are targeted will be critical for developing a narrative to counter any identified redlining risk.

Egregious E-mails

In a recent case, the facts alleged by the DOJ and CFPB — which the nonbank denied in resolving the lawsuit — include assertions relating to e-mails that were received and distributed by employees containing language that the government viewed as racial slurs and evidence of overt discrimination in mortgage lending.[31] Compliance officials should be aware that investigations of illegal discrimination may now be more likely to involve reviews of electronically stored e-mail communications, which can be costly and burdensome. Regular training of employees on fair-lending compliance and on company policies regarding e-mail usage is critical.

FAIR LENDING LITIGATION BY A LOCAL COUNTY GOVERNMENT AS A PRIVATE PLAINTIFF

For almost a decade, a number of counties and cities have filed expansive lawsuits under the Fair Housing Act ("FHA") challenging large national banks' loan origination, loan servicing, and marketing conduct as supposedly "discriminatory." One such action, filed by a county in 2014,[32] was resolved this year at the trial court level on a motion for summary judgment. The federal district court judge issued a hefty opinion addressing the appropriate methodology for conducting fair lending analyses to test for possible discrimination and the evidence required to establish a claim of discrimination in court.[33] The court ruled in the bank defendant's favor on all claims of purported discrimination, and excluded the plaintiff's offered fair lending experts for advancing an unreliable methodology for analyzing potential discrimination. The plaintiff county has appealed the decision to the Seventh Circuit, and that appeal remains pending as of October 1, 2022, but the district court judge's decision provides guidance to all entities that are engaged in the mortgage industry (and thus are responsible for complying with the FHA).

Claims Alleging Loan Origination Discrimination

The claims regarding alleged loan origination discrimination involved multiple theories, including pricing discrimination and steering minority borrowers to loans with terms the plaintiff county labeled as unfavorable.[34] The court rejected these claims for multiple reasons. First, the court explained that the fair lending analysis offered as evidence "does not compare 'similarly situated' borrowers as courts construe that phrase when applying federal antidiscrimination laws" and held that "[i]n the context of fair lending, borrows are similarly situated if they have 'similar underwriting and borrower characteristics.'" It is essential to compare similarly situated borrowers in conducting a fair lending analysis for potential disparate treatment, because only in such circumstances can a court infer that any difference in the treatment of the borrowers is because of race as opposed to because of some other valid difference (such as a difference in credit scores). Additionally, the court rejected the "data set" that the plaintiff county used when testing for "putative discrimination in . . . loan origination practices [like] perceived disparities in the APRs" because it improperly included "loans originated by lenders other than defendants, which defendants purchased post-origination[.]" The court determined it was not possible to reach an inference of discrimination because the flawed methodology "analyzed loan data on an aggregated basis . . . across multiple lenders, multiple products, and multiple decades."

---

[30] Compl. ¶ 36, *Cadence Bank*, *supra* note 5.

[31] Compl. ¶ 52-57, *Trident Mortg. Co.*, *supra* note 5.

[32] *Cnty. of Cook v. Bank of Am. Corp.*, No. 1:14-cv-02280 (July 7, 2017), ECF No. 177.

[33] *Cnty. of Cook v. Bank of Am. Corp.*, 584 F. Supp. 3d 562 (N.D. Ill. 2022), *appeal*, No. 22-1407 (7th Cir. 2022).

[34] In particular, the plaintiff county claimed that the bank "charged higher Annual Percentage Rates ("APRs") to minority borrowers when compared to similarly situated White borrowers" and "[m]inority borrowers were issued higher-risk products at higher rates than similarly situated White borrowers." *Id.* at 582.

For entities conducting fair lending testing for potential loan origination discrimination, the court's decision underscores the importance of properly scoping the data set at the outset of the analytical process. When considering whether analyses reveal a risk of potential discrimination, institutions should ensure that they are comparing borrowers who are similarly situated with respect to the financial circumstances and loan terms that are relevant to the decisions at issue. To the extent that not all relevant characteristics can be accounted for in data, and to the extent that disparities are identified indicating a potential risk of different treatment, institutions should conduct reviews of loan files to evaluate any nondiscriminatory reasons for different outcomes. While these are longstanding principles of sound fair lending compliance, they have received important judicial validation in the trial court's decision.

Claims Alleging Loan Servicing Discrimination

The plaintiff county claimed that "minority borrowers received fewer loan modifications and work-outs than white borrowers," "were denied loan modifications . . . for which they were eligible," and "were placed in foreclosure at higher rates than white borrowers."[35] The court rejected the plaintiff county's modification-discrimination claims, finding "no facts to substantiate [] speculation that defendants might not have worked with minority borrowers as vigorously as they did white borrowers" in connection with their loan modification applications.[36] Even though the plaintiff county pointed to a few statistical tests that indicated a disparity that disfavored certain categories of minority borrowers in connection with certain servicing outcomes, the court stressed the importance of viewing the evidence holistically and noted that another test "shows that, in the aggregate, a lower percentage of white borrowers received loan modifications than minority borrowers." Further, the plaintiff county's analysis did not account for "individualized reasons" for borrower default, such as "reduction of income" or "unemployment," and failed to show that the borrowers "would have been any less likely to enter foreclosure if their loans or loan histories had none of the features" that were alleged to be "discriminatory."

Analyses to identify risks of potential discrimination in-loan servicing, including in-loan modification and foreclosure process, can be complex. For example, because loan servicers must follow servicing rules set by the investors who own the loans, loss mitigation outcomes may be driven by third-party requirements beyond the servicer's control. Another complication is that the most beneficial outcome for a particular borrower may not always be obvious — for example, while a home retention option may facially appear to be the best resolution for most borrowers, an expedient liquidation process might be more beneficial for an individual borrower that has had a permanent loss of income (such as due to a serious illness). The court's decision emphasizes the importance of controlling for individualized circumstances of borrowers when conducting a loan servicing analysis, as well as the importance of looking for patterns (rather than isolated disparities pointing in both directions) to reach a conclusion of discrimination.

Claims Alleging Marketing Discrimination

In stark contrast to the "modern-day redlining" claims filed by the DOJ and federal agencies (which allege insufficient marketing to minority communities),[37] the plaintiff county challenged the bank for its efforts to market to minorities.[38] The court found that there was no evidence "that soliciting business from minority prospects, or marketing in neighborhoods with a high concentration of minority residents, amounts to intentional discrimination in violation of the FHA[.]" Citing an example of redlining offered in the OCC's Handbook on Fair Lending, the court suggested the plaintiff county's claim turned fair lending principles upside-down, noting that "it is not difficult to imagine an FHA action premised on a lender's failure to [market to minority populations] while soliciting business from white borrowers and marketing in predominantly white neighborhoods."[39] Consistent with the court's rejection of the plaintiff county's claim and the remedies required in the DOJ's recent redlining consent orders, lenders should continue to focus on ensuring that their efforts to market home loans are appropriately tailored to reaching minority communities in the areas that they serve.

DOJ NOW CHALLENGING ALGORITHMIC DISCRIMINATION

With rapid expansions in technological capabilities, mortgage industry participants have increasingly relied on complex algorithms and machine-learning capabilities in many aspects of the home-buying process, including underwriting, pricing, and marketing. The

[35] *Cnty. of Cook, supra* note 35, at 568.

[36] *Id.* at 574.

[37] *Supra* Section I.E; *see also supra* note 4.

[38] *Cnty. of Cook, supra* note 35, at 571.

[39] *Id.* at 571 & n.6.

CFPB has noted that "[d]ata harvesting on Americans has become voluminous and ubiquitous" — through their usual activities such as checking social media, clicking an article online, or even using a navigation application — thus providing institutions "the ability to know highly detailed information about their customers before they ever interact with them."[40] While the CFPB has recognized that "machine learning can potentially identify relationships not otherwise discoverable through methods that have been traditionally used in credit scoring," and that such "innovations" may help consumers "see increased credit access or lower borrowing costs"[41] using algorithmic processes run by computers or artificial intelligence across a range of functions can amplify risks faced by financial institutions, including risks of unlawful discrimination.

The government has started to initiate fair lending litigation that challenges improper computational methods. In June 2022, the DOJ filed its first lawsuit challenging algorithmic discrimination under the FHA against Meta Platforms (*f/k/a* Facebook).[42] The DOJ alleged that the algorithms used to determine which Facebook users received or did not receive housing advertisements relied on bases prohibited by the FHA. Specifically, the DOJ alleged that Facebook's ad delivery system, which it designed and provided to advertisers, violated the FHA through the following three aspects: (1) "Trait-Based Targeting" that encouraged advertisers to target ads by "including or excluding Facebook users based on FHA-protected characteristics that Facebook, through its data collection and analysis, attributes to those users;" (2) "Lookalike Targeting" that made available to advertisers a "machine-learning algorithm to find users who 'look like' an advertiser's 'source audience' based in part upon FHA-protected characteristics;" and (3) "Delivery Determinations" that applied a "machine learning algorithm . . . to help determine which subset of the advertiser's targeted audience" would "actually receive the ad" based in part upon FHA-protected characteristics.[43] This lawsuit may fairly be considered low-hanging fruit, as the alleged conduct involves the overt inclusion of modeling inputs that fair lending laws prohibit regulated entities from considering at any stage of the home-buying process.

The *Meta* litigation highlights the need for companies to be mindful of fair lending risk when deploying complex models and machine learning in any part of a home lending business, as well as specifically when formulating their social media and other advertising plans. All model inputs should be regularly reviewed to ensure that no prohibited factors or proxies for prohibited factors are considered. Decisions based on machine-learning models should be regularly subjected to fair lending analyses. Institutions should also take heed to implement sufficient internal fair lending controls in connection with overseeing third-party vendors that may utilize algorithms and artificial intelligence tools.

GOVERNMENTAL AND PRIVATE FOCUS ON ALLEGED APPRAISAL BIAS

Home appraisals are a critical element of the home-buying and lending processes, as appraisals establish the value of the property serving as the collateral for a desired home loan. An appraisal must provide an independent and accurate estimate of a home's value — and significant problems may result from appraisals that are improperly inflated or devalued. On the one hand, the federal government has cited the "problem" of "inflated appraisals" due to "pressure [that] came most frequently from the mortgage brokers," but also "from real estate agents, lenders, and in many cases borrowers," as a factor contributing to the housing crisis and Great Recession.[44] On the other hand, an appraisal that values a property at an amount that is below the contract price in a home sale may result in significantly higher out-of-pocket costs for the homebuyer who must make up the difference at closing, and this unexpected,

[40] CFPB, *CFPB Acts to Protect the Public from Black-Box Credit Models Using Complex Algorithms* (May 26, 2022), https://www.consumerfinance.gov/about-us/newsroom/cfpb-acts-to-protect-the-public-from-black-box-credit-models-using-complex-algorithms/.

[41] CFPB, *An Update on Credit Access and the Bureau's First No-Action Letter* (Aug. 6, 2019), https://www.consumer finance.gov/about-us/blog/update-credit-access-and-no-action-letter/.

[42] DOJ, *Justice Department Secures Groundbreaking Settlement Agreement with Meta Platforms, Formerly Known as Facebook, to Resolve Allegations of Discriminatory Advertising* (June 21, 2022), https://www.justice.gov/opa/pr/justice-department-secures-groundbreaking-settlement-agreement-meta-platforms-formerly-known.

[43] *U.S. v. Meta Platforms, Inc., f/k/a Facebook, Inc.,* No. 1:22-cv-05187 (S.D.N.Y June 21, 2022), ECF No. 1 at 2.

[44] Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (2011), *at* 91, https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

out-of-pocket increase in the funds due at closing can often cause a sale to fall through.[45]

Property appraisals are an important issue for expanding homeownership in minority communities. U.S. Census Bureau data has revealed that, on average, minority households have less wealth than white households.[46] As a result, minority households, on average, may experience steeper challenges to come up with the necessary additional funds to obtain a home loan when confronted with an appraised value that is less than an agreed sales price. Concerns regarding possible bias and discrimination in home appraisals have been a major focus of the federal government in recent years, and fair lending litigation has ensued.

In September 2021, government-sponsored entity Freddie Mac conducted a study that evaluated "whether minorities are more likely to receive an appraisal value that is lower than the contract price during purchase transactions."[47] Freddie Mac found that "properties in Black and Latino tracts receive appraisal values lower than the contract price more often than those in White tracts[,]" and "as the concentration of Black or Latino in a census tract increases, the appraisal valuation gap increases."[48] For example, the study found that "the gap for properties in Latino tracts increases from 7.7% in the [50%-80%] bucket to 9.4% in the [80%-100%] bucket" as compared to "7.4% for those in White tracts."

Three months prior to Freddie Mac's appraisal-bias study, President Biden announced the creation of the Interagency Task Force on Property Appraisal and Valuation Equity ("PAVE"), which consists of senior leaders from the Cabinet and independent agencies within the federal government.[49] PAVE was tasked with evaluating concerns regarding possible appraisal discrimination, including the possible misevaluation and undervaluation of properties owned by families, and in communities, of color. In March 2022, PAVE released its "Action Plan to Address Racial and Ethnic Bias in Home Valuations."[50] The Action Plan details a set of commitments and actions by federal authorities to provide wide-ranging reforms to "advance equity in the home appraisal process," including making the "appraisal industry more accountable" by "identify[ing] and redress[ing] discrimination in appraisals" and preventing "algorithmic bias in home valuation" by including a "nondiscrimination quality control standard."[51]

The industry has observed an uptick in the pursuit of claims of appraisal discrimination by private parties in administrative channels, as well as in court. Claims have been brought against appraisers themselves, but also against lenders. For example, the U.S. Department of Housing and Urban Development ("HUD") approved a conciliation agreement with a national bank and a prospective homebuyer, resolving the complainant's claim that the bank relied on an appraisal that was alleged to have inaccurately valued the subject home at an amount lower than its actual worth because of race.[52] The bank agreed to provide monetary and nonmonetary relief, including training its employees on the reconsideration of value process and fair lending issues related to appraisals.[53]

The issue of alleged appraisal discrimination has also reached federal courts, with private plaintiffs asserting violations of the FHA, Equal Credit Opportunity Act, and various state antidiscrimination laws. For example, in *Connolly v. loanDepot.com, LLC*, two private

---

[45] Fannie Mae, *Housing Market Effects of Appraising Below Contract* (June 7, 2016), https://www.fanniemae.com/research-and-insights/publications/housing-market-effects-appraising-below-contract.

[46] The Federal Reserve Board reported in 2020 that the median wealth of white households was approximately $188,200, but was only $24,100 for Black families and $36,100 for Hispanic families. Neil Bhutta, *et al.*, *Disparities in Wealth by Race and Ethnicity in the 2019 Survey of Consumer Finances* (Sept. 28 2020), https://www.federalreserve.gov/econres/notes/feds-notes/disparities-in-wealth-by-race-and-ethnicity-in-the-2019-survey-of-consumer-finances-20200928.htm#fig1.

[47] Freddie Mac, *Racial and Ethnic Valuation Gaps in Home Purchase Appraisals* (Sept. 20, 2021), https://www.freddiemac.com/research/insight/20210920-home-appraisals.

[48] *Id.*

[49] PAVE, *Action Plan to Advance Property Appraisal and Valuation Equity*, https://pave.hud.gov/actionplan (last accessed Sept. 23, 2022).

[50] The White House, *Fact Sheet: Biden-Harris Administration Releases Action Plan to Address Racial and Ethnic Bias in Home Valuations* (Mar. 23, 2022).

[51] *Id.*

[52] HUD, *HUD Approves Agreement with JPMorgan Chase Resolving Claims of Race Discrimination in Appraisals* (Mar. 8, 2021).

[53] HUD, Title VIII Conciliation Agreement Between Complainant and JPMorgan Chase Bank, N.A., at ¶¶ 13-17 (Mar. 8, 2021), https://www.hud.gov/sites/dfiles/FHEO/documents/21Chase%20Conciliation%20Agreement_Redacted_Redacted.pdf.

plaintiffs filed suit against a real estate appraisal company and a home mortgage lender for alleged appraisal-related discrimination.[54] The suit has received significant national media attention.[55] The plaintiffs allege that the appraisal company intentionally discriminated on the basis of race (including because of the race of the borrowers and because of the racial composition of the census block adjacent to which the subject property was located) in connection with a low home appraisal that led to the denial of a refinance loan application. Specifically, the plaintiffs allege that the appraisal management company's appraisal returned a deflated value that was inconsistent with professional standards, and when the borrowers later "whitewashed" their home, it was valued $278,000 higher in a subsequent appraisal conducted by a different appraisal management company.[56] The claims against the lender defendant alleged that, after plaintiffs challenged the appraisal as racially discriminatory, their loan officer stopped answering the plaintiffs' calls and continued to rely on the allegedly discriminatory appraisal.

Evidence of this type — i.e., that a home was treated differently in the appraisal process when it presented as a home owned by Black family as opposed to when it was "whitewashed" to present as a home owned by a White family — has historically been offered to establish claims of fair housing discrimination. In 1991, the DOJ established the Fair Housing Testing Program ("DOJ Testing Program") within the Housing and Civil Enforcement Section.[57] A key investigative method for the DOJ Testing Program involves "matched-pair tests," where two individuals (such as one white and one black) pose as similarly-situated prospective customers, with similar personal and financial characteristics, and their experience in seeking credit or other housing services is evaluated to assess whether they are being treated differently because of their race or other protected characteristic.[58] Of course, a critical difference between the allegations made in the *Connolly* suit and the methodology employed by the DOJ Testing Program is that the DOJ evaluates *one service provider's* treatment of a matched-pair of customers to determine whether that particular entity treats people differently because of race (or other characteristic), while the allegations in the *Connolly* suit involve appraisals conducted by *two different companies*, raising potential questions about the probative value of such evidence in establishing discriminatory treatment by the defendant appraisal management company.

With the national spotlight on possible appraisal bias and discrimination, appraisal discrimination enforcement is likely to continue to be prioritized by the federal regulatory agencies as well as private plaintiffs, and potential lawsuits or administrative actions may be on the horizon. Lenders should take a proactive approach, including reviewing current policies and procedures, and providing their home lending advisors and client care specialists with fair lending training related to appraisals and processes for serving customers who question appraisal valuations. Appraisal companies and appraisal management companies should review their own policies for ensuring an appraisal process that complies with fair lending laws, and should ensure that appraisers receive regular training on fair lending issues.

CONCLUSION

There is no room for doubt that fair lending litigation is on the rise. Fair lending has been a top government enforcement priority, and private litigants have aggressively pursued claims in courts and with administrative agencies. Institutions that seek to avoid the steep reputational and monetary costs of being publicly accused of discrimination in a litigation should act now to assess their fair lending risk profiles and implement sufficient controls to mitigate risk. ■

[54] *Connolly v. Shane Lanham, 20/20 Valuations, LLC, and loanDepot.com, LLC*, No. 1:22-cv-02048-BPG (D. Md. Aug. 15, 2022), ECF No. 1.

[55] Debra Kamin, *Home Appraised With a Black Owner: $472,000. With a White Owner: $750,000*, N.Y. TIMES, Aug. 18, 2022, https://www.nytimes.com/2022/08/18/realestate/housing-discrimination-maryland.html.

[56] *Connolly*, *supra* note 56, at ¶¶ 52-71, 83-93.

[57] DOJ, *Fair Housing Testing Program*, https://www.justice.gov/crt/fair-housing-testing-program-1 (last updated Apr. 28, 2022).

[58] DOJ, *The DOJ Fair Housing Testing Program, Three Decades of Guarding Civil Rights*, at 4 (Apr. 2022), https://www.justice.gov/crt/page/file/1497551/download.