

Mortgage Lenders Must Prioritize Anti-Bias Compliance

By **Paul Hancock, Olivia Kelman and Lanette Martín** (December 8, 2022)

President Joe Biden's administration has accelerated its anti-discrimination campaign against financial institutions in 2022, raising claims of discrimination on the basis of race and ethnicity that present great monetary risk — and even greater reputational risk — to financial institutions.

Legal exposure can be lessened through strong compliance programs, which must start in the C-suite and permeate throughout the company.

This year the U.S. Department of Justice has followed through on its commitment, first announced in October 2021, to challenge what it believes to be modern-day redlining by lenders who allegedly provide an insufficient level of mortgage credit in minority communities.

Redlining claims traditionally were limited to bank lenders because of banks' obligations to service an entire community under the federal Community Reinvestment Act, or CRA. The government expanded such claims to private nonbank mortgage lenders, with a July 2022 redlining lawsuit against Trident Mortgage Company requiring the lender's remedial expenditure of many millions of dollars.

As of November 2022, the DOJ had filed five redlining lawsuits under the modern-day program, with three cases occurring in the latter half of 2022. In November, government officials speaking at Wolters Kluwer CRA & Fair Lending Colloquium in Las Vegas stated many similar investigations are continuing, and more legal actions can be expected.

A related hot-button issue concerns alleged racial bias in residential property appraisals. In March 2022, the Interagency Task Force on Property Appraisal and Valuation Equity created by Biden released its action plan to address racial and ethnic bias in home valuations.

Advocacy groups, such as the National Fair Housing Alliance and the National Community Reinvestment Coalition, have released similar analysis. Complaints alleging unlawful discrimination in property appraisal have been filed with the U.S. Department of Housing and Urban Development, as well as in federal courts. The claims seek relief not only from appraisers but also from lenders who take action based on the alleged discriminatory appraisals.

Lenders may be viewed as the deeper pockets to satisfy claims for monetary relief. At the colloquium, government officials announced that they are investigating other home lending issues, such as discrimination in underwriting home loans, pricing home loans and the use of logarithmic models that are used to evaluate applicants.

Recent anti-discrimination enforcement extends beyond home lending with the Federal Deposit Insurance Corporation raising an issue of possible discrimination in student lending underwriting in a referral to the DOJ in March 2022. In addition, in June 2022, the Consumer Financial Protection Bureau said it is examining whether financial institutions



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are sufficiently meeting the financial needs of immigrant populations, including persons without legal status and persons with limited English proficiency.

Further, in October 2022, the CFPB issued stern warnings regarding what it believes to be junk fees that financial institutions charge to consumers, highlighting convenience fees charged for payments online or by phone, as well as nonsufficient fund fees and overdraft fees, and suggesting that many of the fees be eliminated.

State agencies have raised similar issues. Issues regarding consumer fees have been raised under the CFPB's unfair, deceptive, or abusive acts or practices authority rather than the anti-discrimination laws. But, in March 2022, the CFPB also said it would use its UDAAP authority to challenge practices that it views as discriminatory.

This might involve, for example, actions to protect groups not covered by existing anti-discrimination laws — e.g., illegal immigrants — or financial products not covered by the federal anti-discrimination laws — e.g., checking or savings accounts. This new enforcement approach and unimaginable compliance burden set off industry alarms, including the U.S. Chamber of Commerce and bank trade associations suing the CFPB in September 2022 alleging that the approach exceeds the CFPB's statutory authority.

All of the above activities have occurred in this calendar year, and should send a strong message regarding the urgency of an effective compliance program for managing anti-discrimination and UDAAP risk. The government demands that compliance be a premier focus of every financial institution, with boards of directors and senior management taking ownership of the issue.

Staff with responsibility for compliance warrant a place in the corporate structure that matches, if not exceeds, the marketing or business teams, recognizing the reality that unchecked and unmonitored business practices increase the risk of challenge by enforcement officials. An improper compliance structure can be an initial strike against a company that seeks to respond to challenges — credibility is easy to lose and hard to rebuild.

To lessen legal risk, it is important to understand the fair lending and UDAAP claims being raised —and the facts supporting those claims — by the many entities with responsibility for enforcement. It is then imperative to analyze all business practices to consider whether they could withstand scrutiny, or should be modified to lessen legal risks while still accomplishing business goals.

Options are available to improve performance in lending to minorities by using special purpose credit programs, which will be expanded through Fannie Mae and Freddie Mac as described in the government-sponsored enterprises' June 2022 racial equitable housing finance plans.

A strong compliance program focuses on reducing risks of violations, and thus an effective program applies conservative standards beyond preventing actions that clearly are illegal. However, enforcement overreach remains a valid concern, and at some point a company should be prepared to take a stand, changing from a conservative risk-reduction approach to demanding proof of a legal violation. An example is the recent lawsuit against the CFPB brought by the Chamber of Commerce.

Too frequently, CEOs learn the importance of a strong compliance program when the government comes knocking or a lawsuit is served. Business leaders understandably

express great dismay when accused of discrimination, recounting their own commitment to racial fairness, but also often discovering that compliance could have been a greater focus. No company is immune from these legal risks, but the ones that prepare in advance to address them are more likely to receive favorable outcomes.

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