



Legal Counsel to the
Financial Services Industry

Fair Servicing:
The New Frontier

Are You Prepared?

Jonice Gray Tucker
Partner
BuckleySandler LLP

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Overview

- Unprecedented levels of defaults and foreclosures have triggered heightened scrutiny of mortgage loan servicing by government agencies, legislators, consumer rights organizations, and private litigants.
 - Attention increased by foreclosure documentation crisis which has sparked nationwide, multi-jurisdictional examination of entire default servicing process.
- Focus on issues related to “fairness” in servicing has been emerging trend over past year. Key issues include:
 - “Fair servicing” for protected classes, including loan modifications, foreclosures, and short-sales.
 - Newer focus on differential maintenance of REO properties based on racial composition of neighborhood.

Fair Servicing: The New Frontier

- Foreclosure crisis is seen as hitting minority communities harder.
- Significant public pressure to ensure that borrowers who are members of racial/ethnic minority groups have a fair opportunity to prevent foreclosure.
 - Legislators and private parties interested in disaggregated HAMP modification data.
- Growing focus on ensuring that minority neighborhoods are not eroded by aftermath of defaults.

Fair Servicing: The New Frontier (cont.)

- Consumer advocacy groups shifting focus to race-based disparities in servicing, including workouts and, of late, the handling of REO properties.
 - NCRC study suggests that among HAMP eligible borrowers 36.4% of Caucasian borrowers received loan modification approvals in contrast to 32.3% of Hispanic and 24.3% of African-American borrowers.*
 - NFHA study suggests that in three of four metro areas studied, banks maintained properties in Caucasian or stably-integrated areas in a better manner than in African-American and Latino areas.
- Recent Federal Reserve Bank of San Francisco study shows that minority borrowers were slightly more likely to receive a loan modification and less likely to re-default after the modification.

* National Community Reinvestment Coalition, HAMP Mortgage Modification Survey 2010 (April 2010).

Fair Servicing: The New Frontier (cont.)

- Pro-consumer studies and heightened focus on application of traditional fair lending principles to mortgage servicing will be springboards for enforcement action and private litigation.
 - Equal Credit Opportunity Act (“ECOA”) and Fair Housing Act (“FHA”) likely to be primary legal hooks.
- New Fair Lending Unit within DOJ Civil Rights Division headed by Assistant Attorney General Tom Perez.
 - Analyzing potential discrimination in loan modifications by examining HAMP data.
 - Partnering with other Federal Agencies as well as State AGs.
 - Census tract likely to be a driver for race-based discrimination analysis.
 - Additional focus on access for Spanish-speaking borrowers.

Fair Servicing: The New Frontier (cont.)

- Banking Regulators also prioritizing fair servicing, particularly in default context.
 - OCC has revised Fair Lending guidelines to prohibit treating borrowers differently in servicing a loan or invoking default remedies based on prohibited factors.
 - OCC and Federal Reserve Board conducting non-public fair servicing reviews.
 - Self-monitoring now the expectation, but challenging because of absence of concrete guidance.
- Consumers beginning to advance claims regarding servicing discrimination in private litigation and HUD complaints. See, e.g., *Estate of Davis v. Wells Fargo Bank*, 633 F.3d 529 (7th Cir. 2011).
 - Litigation largely unsuccessful thus far.

Fair Servicing: The New Frontier (cont.)

- Significant factual impediments to the viability of fair servicing actions alleging workout disparities, but same challenges make self-policing difficult.
 - Servicers rarely have race and ethnicity data as a matter of course.
 - High non-compliance by borrowers with HAMP race data collection.
 - Numerous challenges to useful and reliable statistical analysis.
 - Borrower comparisons difficult. *All loan applicants want a loan, but all delinquent borrowers may not want to stay in homes.*

Fair Servicing: The New Frontier (cont.)

- Discretion likely to be key area of focus in litigation and enforcement actions.
- Discretion is a double-edged sword with respect to success of modification programs.
 - Some of the servicers with the most successful modification programs provide greatest discretion for customer service and workout personnel.
 - Historically, discretion has been used against financial institutions by regulators in fair lending context.
 - If past is prologue, the greater the level of discretion, the higher the potential for race-based disparities in outcomes.
 - Imperative to strike the right balance.

Risk Mitigation Strategies

- Carefully craft loss mitigation policies, especially where greater discretion is permitted.
 - Emphasis on robust documentation, particularly exception documentation.
- Prioritize procedural and fair lending compliance training for all personnel given new emphasis on loan life cycle.
 - Provide clear guidance on training expectations for third parties.
- Implement comprehensive internal procedures for monitoring legal and regulatory compliance.

Risk Mitigation Strategies (cont.)

- Conduct privileged self-assessments of workout data.
 - Examine outcomes by race, national origin, and other prohibited bases. Also consider analysis by minority percentage at census tract level.
 - Analysis should include range of workout possibilities.
 - Examine frequency, terms, and speed of outcomes.
 - Employ “match-pair plus” approach in analyzing individual files.
- Monitor consumer complaints and litigation, analyze trends, and adjust practices in a timely manner.
- If managing REOs, integrate privileged self-assessment procedures designed to monitor maintenance by minority census tract percentage.

For Further Information

Jonice Gray Tucker
Partner

BuckleySandler LLP
1250 24th St. NW, Suite 700
Washington, DC 20037
202.349.8000

jtucker@buckleysandler.com

www.buckleysandler.com