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NEW FAIR LENDING INITIATIVES

Warren W. Traiger*

The U.S. Department of Housing and Urban Development ("HUD"), the New York State Banking Department, and the Federal Trade Commission ("FTC") have emerged in 1998 as enforcers of the laws prohibiting lending discrimination on the bases of race, color, sex, religion, national origin, marital status, age (provided the applicant has the capacity to contract), receipt of public assistance, and the exercise of certain consumer rights. The actions brought by these regulators allege violations of the fair lending laws[1] during the pre-application, application, and underwriting components of the mortgage loan origination process.

The additional players complement and enhance the continuing fair lending efforts of the Department of Justice ("DOJ"), which since 1992 has brought a series of high profile actions charging banks and other creditors with lending discrimination on the basis of race or national origin.[2] Since more enforcers usually translate into more enforcement, lenders are well advised to review the HUD, New York, and FTC initiatives for indications of the future direction of non-DOJ fair lending initiatives.

HUD'S FAIR LENDING EFFORTS

HUD, which has primary jurisdiction for Fair Housing Act ("FHA") enforcement, has entered into five fair lending settlements with mortgage lenders in 1998. The settlements follow a September 1997 commitment by HUD Secretary Andrew Cuomo to crack down on hous-

1. "Fair lending laws" generally refers to the provisions of several federal statutes and their implementing regulations, particularly the Fair Housing Act, 42 U.S.C. §3601 et seq., prohibiting discrimination in residential real estate transactions; the Equal Credit Opportunity Act ("ECOA"),15 U.S.C. §1591 et seq., prohibiting discrimination in credit transactions generally; and the Community Reinvestment Act ("CRA"),12 U.S.C. §2901 et seq., requiring federally insured institutions to help meet the credit needs of their communities.

2. See eg., *U.S. v. Decatur Fed. Sav. & Loan Ass'n*, No. 1-92-CV-2198-CAM (ND Ga. 1992) (consent decree); *U.S. v. Shawmut Mortgage Co.*, No. 93-CV-2453 (D. Conn. 1993) (consent decree); *U.S. v. Chevy Chase Fed. Savings Bk.*, No. 94-CV- 1824-JG (D DC 1994 (consent decree); *U.S. v. The Northern Trust Co.*, No. 95- CV-3239 (ND Ill. 1995) (consent decree); *U.S. v. Fleet Mortgage Corp.*, No. 96- 2279 (EDNY 1996) (consent decree).

*WARREN W. TRAIGER is a principal in the law firm of Butler, Fitzgerald & Potter, P.C. Mr. Traiger, who served as Special Counsel to the New York State Banking Department for CRA, advises banks and other lenders on fair lending and CRA compliance.

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WARREN W. TRAIGER is a Counsel Attorney at BuckleySandler, LLP, in the New York, NY office.

ing discrimination and double the number of HUD fair housing enforcement actions.[3]

In each case, allegations of FHA violations were brought by the Fort Worth Human Relations Commission, a local organization under HUD contract to conduct fair lending tests. According to HUD, these tests, in which white and minority individuals posed as loan applicants, revealed disparate treatment of the white and non-white testers. For example, a white tester was allegedly told that he would qualify for a $158,000 loan, while a black tester who indicated higher income, greater savings, and less debt was told that he would qualify for a $100,000 loan.[4] Another black tester was told he was eligible for a loan $25,000 to $65,000 less than a white tester with poorer credit qualifications.[5]

The settlement agreements contain total mortgage loan commitments to minorities and low- and moderate-income borrowers of more than $3.5 billion. The mortgage lenders involved are AccuBanc Mortgage Corporation ($2.148 billion in commitments), BancOne Mortgage Corporation ($10 million), Overton Bank and Trust ($9 million), SFM Mortgage Corp. ($42.5 million), and Temple-Inland Mortgage Corp. ($1.35 billion).

In addition to the loan commitments, each mortgage lender committed itself to significant enhancements in its compliance program.[6] The enhancements provide important guidance for other lenders concerned with the sufficiency of their own efforts.

- AccuBanc, Overton, and Temple-Inland each agreed to develop and implement a written pre-application policy with "uniform procedures to be applied to all prospective home mortgage loan applicants regardless of race, color, religion, sex, national origin, handicap or familial status."[7]
- Each lender committed to extensive fair lending training. AccuBanc, Overton, and Temple-Inland agreed to employee training conducted by the Fort Worth Human Relations Commission, HUD, or the City of Dallas Fair Housing Office.[8] BancOne agreed to invite representatives of the agencies to attend its training program and to incorporate "any reasonable suggestions provided by these agencies to enhance the effectiveness of its Fair Lending Training Program."[9]
- The agreements include advertising and community outreach commitments, sometimes with precise dollar amounts, that obligate the lenders to market products to specific groups and neighborhoods.[10] In addition, the lenders committed to self-monitoring or self-testing to regularly assess their compliance with the fair lending laws.[11]

The HUD settlements are significant in another respect. As is typical in fair lending agreements, none of the lenders admitted to any fair lending law violations. However, the HUD press releases announcing the AccuBanc and SFM settlements contain the following substantially identical statements attributed to the lenders' respective presidents:

From SFM President Randie Wolzen: "SFM Mortgage recognizes that the [HUD] complaint...showed treatment by SFM employees towards African-Americans and Hispanics which did not meet the standards that SFM sets for itself — actions which may have violated the nation's fair housing laws."

And from AccuBanc President James Munford: "AccuBanc recognizes that the [HUD] complaints...showed treatment by AccuBanc employees towards African Americans and Hispanics which did not meet the standards that AccuBanc sets for itself - actions which may have violated the nation's fair housing laws."

These statements, apparently required by HUD as part of the settlements, chip away at the practice of lender denial that usually accompanies fair lending settle-

3. "Clinton Administration Cracks Down on Housing Discrimination with New Charges and $15 Million in Grants," HUD Press Release, Sept. 30, 1997.
4. "Texas Lender to Target $42.5M in Housing Loans to Minorities, Low- and Moderate-Income Families," HUD Press Release, Apr. 21, 1998.
5. "Cuomo Announces Record $2.1 Billion Lending Discrimination Settlement and Commemorates 30th Anniversary of Fair Housing Act," HUD Press Release, Apr. 3, 1998.
6. The SFM agreement was not available for review at the time this article was prepared.
7. AccuBanc Agreement at §3.1. Similar provisions are found at §2.11 of the Overton Agreement and at §3.1 of the Temple Inland Agreement.
8. AccuBanc Agreement at §4.1; Overton Agreement at §3.1; Temple Inland Agreement at §4.1.
9. BancOne Agreement at §II(B)3.
10. AccuBanc Agreement at §§6.3, 6.5; BancOne Agreement at §§II(A)4,10,11; Overton Agreement at §§4.4, 4.6; Temple Inland Agreement at §§6.5, 6.6, 6.8.
11. AccuBanc Agreement at §§7.1-7.4; BancOne Agreement at §II(A)(9); Overton Agreement at §§5.1-5.8; Temple Inland Agreement at §§7.1-7.4.

ments. A denial can foster the perception that a fair lending action was brought by an unreasonable or overzealous regulator, and that a decision to settle is nothing more than an economically sensible alternative to an expensive and time-consuming defense in court. The presidents' statements may be HUD's attempt to counter this perception and send a message to lenders that fair lending settlements result from well-founded evidence of discrimination.

THE NEW YORK INITIATIVE

The New York State Banking Department's remediation agreement with Long Island-based Roslyn Savings Bank and its wholly owned mortgage banking subsidiary, Residential First, Inc. ("RFI"), represents the first time a state has initiated a fair lending enforcement action without significant federal government involvement. The Banking Department's action follows its involvement last August in helping to settle federal allegations of mortgage redlining against an Albany-based mortgage lender.[12]

The February 1998 Roslyn agreement emanates from findings made at a regularly scheduled State CRA examination.[13] Such examinations routinely assess compliance with New York's Human Rights Law, which contains broad prohibitions against discrimination in relation to credit.[14] In assessing Roslyn's compliance, the Department found indications that African Americans, Asians, and Hispanics paid more for RFI mortgage loans than similarly qualified whites.

RFI compensated its loan officers and brokers based in part on an "overage" system, which pays greater remuneration to officers and brokers who close mortgage loans with rates or fees over the minimums required by the lender. Overage compensation is relatively common among mortgage lenders, and according to the DOJ "is not, in and of itself, unlawful."[15] However,

> [l]enders that choose to compensate their loan officers or other employees by allowing them to charge different prices to similarly qualified applicants for the same loan product do not necessarily violate the fair lending laws when the results are not the same for all groups. But, the Department of Justice will take a very close look to find out how differing results came about. The larger the difference, the harder we will look.[16]

Accordingly, a lender risks a fair lending violation if overages fall disproportionately on members of a protected class and the discrepancy cannot be explained by economic factors.

This was the ultimate finding of the Banking Department, which followed up Roslyn's CRA examination with a statistical analysis of loans closed by RFI from August 1995 through December 1996. According to the remediation agreement, the Department concluded that

> there were statistically significant racial and ethnic disparities in the frequency and amount of overages charged to these minority borrowers as compared to non-minority borrowers; and that the increased frequency and amount of overages charged were not based on differences in risk or other neutral factors.[17]

Roslyn admitted the disparity but maintained that it was caused by "non-discriminatory reasons." The bank and RFI denied any unlawful lending discrimination in the way overages were charged.[18]

Nevertheless, Roslyn agreed to settle by making $3 million in restitution to the alleged victims of its overage practices, suspending its overage compensation program, and, as did the lenders settling with HUD, implementing a comprehensive fair lending training program for its officers and employees. Roslyn also agreed to extensive Department oversight of its compliance with the terms of the settlement, including providing semi-annual reports to the Department through the year 2000.

The Department set strict guidelines for any future overage program, including a cap on the level of overages and the implementation of a disciplinary policy for Roslyn employees who violate the Human Rights Law. Any such program must also catalogue each overage by

12. *U.S. v. Albank*, (NDNY 1997) (consent decree).
13. New York Banking Law §28-b.
14. New York Executive Law §296-a.
15. Letter from Assistant Attorney General Deval Patrick to lender trade associations Feb. 21, 1995 at 6.
16. Id.
17. Remediation Agreement In the Matter of the Roslyn Savings Bank and Residential First, Inc., Feb. 18, 1998 ("Remediation Agreement") at 2.
18. Remediation Agreement at 2-3.

amount, related loan, borrower's race, and loan officer to allow for regular monitoring of the effect of overages on protected classes of borrowers.

The Banking Department has indicated that it is expanding its fair lending enforcement activities to mortgage bankers,[19] which make up an increasingly large part of the mortgage loan market.

FEDERAL TRADE COMMISSION ACTION

In January 1998, the FTC filed a complaint in United States District Court against Capital City Mortgage Corp., a sub-prime mortgage lender based in Washington, D.C.[20] The complaint alleges that the lender violated the Federal Trade Commission Act[21] by engaging in deceptive acts and practices that resulted in mortgage loan overcharges.

Specifically, Capital City is accused of deceiving elderly, minority, and lower-income mortgage borrowers by misrepresenting loan terms, imposing bogus charges, failing to pay taxes out of escrow accounts established for that purpose, and improperly foreclosing on borrowers who were current in their obligations. While the charges against Capital City emanate from more flagrant abuses than those alleged in the HUD or New York actions, the complaint includes significant charges under the Equal Credit Opportunity Act ("ECOA").[22]

The FTC alleges that Capital City violated the ECOA by failing to take written mortgage applications[23] and failing to request race, national origin, sex, marital status, and age information when written applications were taken.[24] The FTC signaled that it will be pursuing more fair lending actions by noting that "[w]ithout this required information, [it] cannot effectively monitor whether a lender is illegally discriminating in its lending."[25] Indeed, the agency specifically asserted that this action was brought not only to halt Capital City's deceptive practices, but also to inform the public about the negative consequences of deceptive mortgage lending "and to state that the Commission will act to halt such activity."[26] In Senate testimony delivered in March, the agency reiterated that it "is increasing its enforcement activities to halt subprime lenders who are engaged in abusive lending practices."[27]

IMPACT OF THE NEW INITIATIVES

The actions by HUD, New York, and the FTC suggest that more lenders, particularly non-bank lenders, will be subject to fair lending enforcement actions. All three agencies have promised an increased focus on fair lending and other regulators may follow their leads.[28]

The bases of the fair lending actions and the terms of the settlements suggest that lenders can avoid many fair lending problems by instituting meaningful policies and procedures designed to combat discrimination and to uncover potential problems in advance of the regulators. Prudent lenders may wish to consider implementing self-testing programs, establishing meaningful employee training procedures, evaluating existing compensation programs, and reviewing lending data and loan files to uncover and correct any potential problems. ■

19. *Roslyn to Pay $3M to Settle N.Y. Lending Bias Lawsuit,* American Banker, Feb. 18, 1998, p. 1.
20. *FTC v. Capital City Mortgage Corp.,* U.S. District Court for the District of Columbia (filed Jan. 30, 1998) ("Complaint").
21. 12 U.S.C. §§41-58.
22. The FTC has authority to enforce the ECOA with regard to non-bank lenders. 15 U.S.C. §1691c(c).
23. 12 C.F.R. §202.5(e).
24. 12 C.F.R. §§202.13.
25. "FTC Charges D.C. Mortgage Lender with Deception and Unfairness Against Borrowers," FTC Press Release, Jan. 30, 1998.
26. Id.
27. Prepared Statement of the FTC before the Senate Special Committee on Aging, March 16, 1998.
28. Commenting on the Roslyn settlement, the President of the Conference of State Bank Supervisors noted that state legislatures are increasingly authorizing their banking departments to enforce consumer protection laws. *Roslyn to Pay $3M to Settle N.Y. Lending Bias Lawsuit,* American Banker, Feb. 18, 1998, p. 1.