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Redlining In a Post Deregulation Era

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In the wake of the Trump administration's push to de-regulate the banking industry, there has been a steep decline in formal fair lending enforcement activity by both the Department of Justice ("DOJ") and the Consumer Financial Protection Bureau ("CFPB"). After announcing a $54 million dollar fair lending consent order on President Trump's inauguration day (January 20, 2017), the DOJ has only announced a single fair lending settlement since that time. In contrast, in the DOJ's 2016 Annual Report to Congress Pursuant to the Equal Credit Opportunity Act ("ECOA"), the DOJ reported significant fair lending activity under the Obama administration—33 open fair lending investigations and six fair lending settlements, including two redlining cases, one case involving pricing and underwriting discrimination, and three cases involving discrimination on the basis of familial status.

The CFPB has similarly appeared to scale back on its fair lending enforcement focus under the Trump administration, most notably, with Acting CFPB Director Mick Mulvaney transferring the Office of Fair Lending and Equal Opportunity from the Supervision, Enforcement, and Fair Lending Division to the Director's Office in early 2018. This move marks a dramatic shift from the approach under former CFPB Director Cordray and the imposition of significant high-dollar fair lending settlements, to a more amorphous focus on "advocacy, coordination, and education . . ." Further, on May 10, 2018, the Department of Housing and Urban Development ("HUD") announced that it will seek public comment as to whether its 2013 Disparate Impact Regulation is consistent with the 2015 U.S. Supreme Court ruling in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, again signaling a potential shift in HUD's enforcement approach.

As promised by Acting CFPB Director Mick Mulvaney, these actions appear to mark the end of "regulation by enforcement." Notwithstanding, this does not mean the end of fair lending. On the contrary, despite the apparent decline in formal fair lending enforcement activity by the DOJ, CFPB, and HUD, and a push for increased regulatory relief under the Trump administration, we have seen a recent uptick in focus on fair lending issues by the prudential banking regulators, such as the Federal Deposit Insurance Corporation ("FDIC"), Federal Reserve, and Office of the Comptroller of the Currency ("OCC") as part of recent examinations. As part of these examinations, the fair lending focus has been on redlining issues and concerns of inadequate policies and procedures to prevent and monitor against potential redlining risks, as well as lack of marketing and outreach efforts by institutions. As such, it is essential that institutions remain vigilant in their focus on fair lending. And if institutions have not recently evaluated their processes and procedures, it is essential they do so now, as those processes will likely be addressed as part of the next compliance examination.

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Indeed, this recent focus by the prudential banking regulators on redlining, and specifically marketing and outreach by institutions, is consistent with the approach taken by the DOJ in the single fair lending settlement reached under the Trump administration. On May 8, 2018, the DOJ reached a settlement with Kleinbank relating to allegations of redlining. The settlement stemmed from a complaint filed against Kleinbank on January 13, 2017— just days before President Trump's inauguration on January 20, 2017—alleging violations of the Fair Housing Act ("FHA"), 42 U.S.C. §§ 3601 et seq., and ECOA, 15 U.S.C. §§ 1691 et seq. The complaint alleged that statistical analyses of the bank's residential real estate-related loan applications and originations showed that the bank served the credit needs of the residents of majority-white census tracts to a significantly greater extent than it served the credit needs of the residents of majority-minority census tracts. The complaint alleged that these results were due to the bank drawing its Community Reinvestment Act ("CRA") assessment area to be horseshoe-shaped, to include majority white suburbs and carve out the urban areas with higher proportions of minority populations, specifically, Hennepin County.

Notably, the bank was not required to pay restitution or other monetary penalties, confirming the marked shift from prior DOJ fair lending settlements. Nonetheless, the bank was required to implement extensive enhancements to its residential mortgage lending business, in particular marketing and outreach efforts, including:

- Revising its main CRA assessment area to include all of Hennepin County;
- Opening one full-service brick and mortar office within a majority-minority census tract in Hennepin County, with a full-time, on-site residential lending officer whose work will include marketing and outreach to residents of majority-minority census tracts;
- Developing partnerships with organizations to help establish a presence in majority-minority census tracts in Hennepin County;
- Employing a full-time Community Development Office and an Executive Leader to oversee the development of the bank's lending in majority-minority census tracts in Hennepin County, including community outreach programs and programs aimed to promote financial education, financial counseling, and building relationships with community groups;
- Spending a minimum of $300,000 on advertising, outreach, education, and credit repair initiatives over a three-year period to assist in establishing a presence in majority-minority census tracts in Hennepin County;
- Increasing advertising and marketing directed to reach all majority-minority census tracts in Hennepin County that address the bank's full range of mortgage loan products;
- Providing at least two outreach programs annually for real estate brokers and agents, developers, and public or private entities regularly engaged in residential real estate-related business in majority-minority census tracts in Hennepin County to inform of products and services offered by the bank;

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- Providing consumer financial education and credit repair programs, including sponsoring at least two financial education events annually that cover credit counseling and financial literacy marketed towards residents of majority-minority census tracts in Hennepin County, and establishing at least one special purpose credit program intended to help residents of majority-minority census tracts establish or remediate consumer credit;

- Investing at least $300,000 over three years in a special purpose credit program that will offer residents of majority-minority census tracts in Hennepin County home mortgage loans and home improvement loans on a more affordable basis; and

- Providing fair lending training to all employees, including officers, with substantive involvement in mortgage lending, marketing, or fair lending or CRA compliance, or management responsibility over such employees.

Even in the absence of a monetary penalty, these requirements will undoubtedly be very costly for Kleinbank to implement, particularly with the requirements for a new full-service branch and the hiring of additional employees. These requirements also create a roadmap for the primary banking regulators with respect to the significant marketing and outreach expectations on institutions when it comes to fair lending. This settlement and the recent uptick in focus by primary banking regulators thus make clear that institutions must be proactive to avoid potential redlining issues, or else risk having their regulators unilaterally impose costly structural enhancements to their banking programs.

At a minimum, these efforts must include a focus on enhancing monitoring, marketing, and outreach to mitigate against potential redlining risks.

Monitoring:

As evidenced by the Kleinbank settlement, statistical analysis for potential disparities will certainly continue to be scrutinized, particularly with the heightened Home Mortgage Disclosure Act (“HMDA”) requirements that became effective January 1, 2018. Although the Economic Growth, Regulatory Relief and Consumer Protection Act was signed into law on May 24, 2018, which provided some HMDA relief for smaller lenders, the expanded data fields will undoubtedly be used by regulators to evaluate larger lenders for potential fair lending and redlining risks.

It is therefore essential that institutions periodically monitor their data for potential fair lending and redlining risks, rather than wait for their next compliance examination. In a redlining examination, regulators will analyze not only the institutions’ levels of applications and approvals in majority-minority census tract areas, but also compare that data against the institutions’ peer group. Accordingly, an institution’s monitoring (either conducted internally or through the assistance of a third party) must similarly include data comparisons to benchmarks (census and peer group), in addition to a more traditional review of application and origination numbers. Institutions should also consider being prepared to proactively demonstrate to regulators which entities should be considered “peers” and how the institutions’ data compares against those entities. By proactively monitoring for such risks, institutions can then make appropriate adjustments to address any perceived deficiencies in advance of their next examination, rather than being blind-sided with a negative exam finding.

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Outreach and Marketing:

Moreover, the Kleinbank settlement makes clear that an institution's outreach and marketing programs are critical, and regulators will undoubtedly use the settlement as a framework in evaluating what marketing and outreach efforts they deem sufficient. As a result, institutions must proactively engage in outreach and marketing that is tailored to reach all of an institution's assessment area, with particular focus on marketing and outreach in areas that could close any majority-minority census tract holes. Marketing materials must be regularly reviewed for content, diversity, and effectiveness by analyzing increases in majority-minority census tract and minority borrowers, preferably with such materials reviewed by outside counsel. And, as in the Kleinbank settlement, regulators will expect to see substantial outreach efforts and strategic partnerships by institutions within their communities, with the aim to increase the pool of loan applicants and loan penetration in majority-minority assessment areas.

In sum, while the post de-regulation era has certainly resulted in some relief in the number of formal fair lending enforcement actions, institutions are still expected to maintain robust fair lending policies and procedures. In the absence of such processes, the Kleinbank settlement has set the framework for the imposition of significant structural requirements on institutions by the primary banking regulators. Rather than having those requirements unilaterally imposed on institutions at a significant cost, it is critical that institutions are proactive in evaluating their processes so that they have the time and flexibility to work with outside consultants and counsel to implement enhancements in advance of their next compliance examination.

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