RECOGNIZING THE 50TH ANNIVERSARY OF THE FAIR HOUSING ACT AND ITS IMPACT ON THE MORTGAGE LENDING INDUSTRY

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In April of this year, the Nation celebrated the 50th Anniversary of the Fair Housing Act. That law, which was amended significantly in 1988, is among our most important civil rights laws. Its implementation over 50 years has had a dramatic impact on the mortgage lending industry and guides much of the work that those attending the 2018 Wolters Kluwer CRA & Fair Lending Colloquium perform on a daily basis. The combination of enforcement lawsuits and meaningful efforts to comply voluntarily by you and your predecessors has occasioned major changes in the industry and benefited countless persons in the United States.

In this paper, and in an abbreviated oral presentation, I will describe the origins and background of this great law and its implementation over 50 years. It was difficult to get this law enacted and, for the initial 20 years of its life, the focus was not on mortgage lending. However, beginning in 1988, that all changed, and since then it is fair to say that the major and most controversial enforcement has been directed at the mortgage lending and consumer credit industry. As you all know, fair lending claims that have been filed over the years can be categorized in three broad areas: underwriting of loans, pricing of

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loans, and marketing of loans, with the final category of claims referenced as "redlining." I will describe the origins of each of these types of claims.

The federal responsibility for enforcing the Fair Housing Act in court rests with the Department of Justice (DOJ), and the work is accomplished by the Housing Section in the DOJ's Civil Rights Division (Division). I headed that program for almost a decade. Other agencies such as the Department of Housing and Urban Development (HUD) and the bank regulatory agencies also have played significant roles. A newer agency, the Consumer Financial Protection Bureau (CFPB), has an important role in fair lending, but its responsibility is to enforce the Equal Credit Opportunity Act (ECOA), not the Fair Housing Act, and thus, while the issues are very similar, my presentation will not encompass the important work of the CFPB.

I will walk you through the experiences and priorities of each presidential administration that has enforced the Fair Housing Act during the time period in which the focus has been on mortgage lending. I will add my own critiques and offer my thoughts on issues that still need to be resolved as well as some predictions as to what the future might hold.

I. Original Enactment of the Fair Housing Act in 1968

The decade of the 1960s was a time of great racial turmoil in the United Sates, but also the decade in which Congress and the president – all under President Lyndon Johnson – finally collaborated to enact the most important civil rights laws in the history of our country. Legislation to address discrimination in residential housing saw some prospects as the decade began, but it was the last of the important race-discrimination subjects to be addressed in law.

In 1960, John F. Kennedy, in campaigning for office, promised to prohibit discrimination in housing supported by federal funds "with the

stroke of a pen." Notably the promise was limited to federally supported housing, as it remained questionable whether Congress and the president could regulate the terms and conditions of the sale or rental of housing in the private market. In 1962, President Kennedy signed Executive Order 11063, titled Equal Opportunity in Housing, to achieve nondiscrimination in federally owned and funded housing—a very significant gesture but of limited consequences.

Southern states, even to this point in history, imposed segregation by law, and northern cities exhibited strong patterns of racial segregation, even if not mandated by the same types of invidious laws. Very few blacks in the south were allowed to register to vote, largely being told they failed various types of literacy tests that were not barriers to registration to illiterate whites. Alabama governor George Wallace famously declared in his January 1963 inaugural address: "Segregation now, segregation tomorrow, segregation forever." Later that year, the governor stood at the schoolhouse door at the University of Alabama to block the entry of black students who were escorted by federal officials.

The Civil Rights Act of 1964 was designed to outlaw and allow the federal government to challenge many of these invidious practices. In sweeping Titles, the law prohibited discrimination in public accommodations (such as lunch counters, movie theaters, and motels) (Title II), public facilities (such as public swimming pools and golf courses) (Title III), public education (Title IV), and employment (Title VII). It also prohibited discrimination by recipients of federal financial assistance (Title VI). The primary responsibility for enforcing most of the new legal provisions in court was assigned to the attorney general, who, in turn, delegated the authority to the Civil Rights Division. Notably, this sweeping new law did not address discrimination in housing.

The next year, in 1965, Congress enacted and President Johnson signed into law the Voting Rights Act. Much of the work of the Division in the early part of the decade had been focused on legal challenges to discrimination in voting. The efforts were directed both at public bodies that imposed discriminatory preconditions to registration, such as literacy tests, and challenges to those who interfered with and intimidated blacks trying to register, such as by evicting them from their farm land. The remedial provisions were sweeping, allowing federal officials to list persons for registration and requiring jurisdictions with an apparent history of discrimination to seek advance federal approval for any new changes in registration or election provisions. Once again, however, the law did not address housing discrimination.

The need for effective legislation addressing discrimination in housing was not unnoticed, and the person who was the assistant attorney aeneral for civil rights at the time, Stephen Pollak, recently described to me the events leading to the passage of the Fair Housing Act. He provided contemporaneous memoranda that I cite to you freely. Steve is a legendary figure in civil rights, leading the Division in some of its most important years and continuing in the struggle throughout his life, especially by aiding the Lawyers Committee for Civil Rights.

President Johnson proposed the enactment of fair housing legislation in his State of the Union address to Congress in 1966. In April of the same year, the president asked the "Congress to enact the first effective law against discrimination in the sale and rental of housing." He added that the law should be "constitutional in design, comprehensive in scope and firm in enforcement [and] will cover the sale, rental and financing of all dwelling units." A presidential task force was formed to consider various civil rights issues, with Steve Pollak serving as its working chair.

Early in 1968, President Johnson again urged Congress to enact fair housing legislation. He said: "A fair housing law is not a cure-all for the Nation's urban problems. But ending discrimination in the sale or rental of housing is essential for social justice and social progress."

The Senate overwhelmingly voted to enact a fair housing law in March of 1968. The House was more resistant. A large part of the concern can be summarized by a phrase dating back to at least the 16th century: "A man's home is his castle." Should not a man, or a woman, be permitted to do whatever they want with their home? Should not the person be allowed to sell or rent the dwelling to whomever they might want and refuse to sell or rent it to whoever they might want? What about "Mrs. Murphy" who rents rooms to others in the boarding house in which she lives? Should she be required to rent to people who she does not want to live with her? Can the federal government interfere with these inherently private transactions?

The legislative controversy continued until Dr. Martin Luther King was assassinated in Memphis on April 4, 1968. Rioting occurred in many of our Nation's major cities. More than 50,000 federal troops and members of the National Guard were dispatched across the country to maintain order. The assassination of Dr. King was the final straw. The very next day, President Johnson wrote to the Speaker of the recalcitrant House urging: "We should pass the Fair Housing Law when the Congress convenes next week." The House did approve the bill that previously had been enacted by the Senate, and President Johnson signed the bill into law on April 11, 1968. We are now recognizing the 50th year anniversary of that event.

The Fair Housing Act was a part of legislation sometimes referenced as the "Indian Civil Rights Act" since it largely dealt with that issue. Title VIII of the law constituted the Fair Housing Act. Even to this day, some are confused by the reference to Title VIII, thinking it shows the close link to Title VII (the employment discrimination law).

However, Title VII was a part of the Civil Rights Act of 1964 and the Fair Housing Act is a part of the Civil Rights Act of 1968.

While a landmark statute, the 1968 law did not have all of the teeth that President Johnson had advocated. HUD, an agency created just a few years earlier, was given authority to investigate complaints of discrimination, but its authority was limited to "try[ing] to eliminate or correct the alleged discriminatory housing practice by informal methods of conference, conciliation, and persuasion." The agency was not given authority, as the president had proposed, to issue "cease-and-desist orders" with review in federal courts. Thus, if HUD concluded that a violation of the law occurred, and its "persuasion" efforts were unsuccessful, the agency simply had to walk away.

The DOJ was given authority to file lawsuits alleging a "pattern or practice" of discrimination, but it could seek only preventive relief, meaning the DOJ could not seek monetary damages on behalf of any victims of discrimination.

The limitation of the DOJ authority to "pattern or practice" claims was modeled on the employment discrimination law, Title VII of the Civil Rights Act of 1964. One certainly could argue that the phrase is confusing. If a person is not permitted to rent a dwelling because of his or her race, it is logical to assume that the next person applying of the same race would face the same fate. Further, if the second applicant of the same race is allowed to rent the dwelling, the scenario seems to present compelling evidence that the first applicant was not denied the dwelling because of his or her race. In other words, is not all discrimination a "pattern or practice"? Logic aside, the obvious concern was that the resources of the DOJ should be reserved for the larger cases. .

The new law provided a private right of action in which damage claims were permitted, but awards of punitive damages were capped at

$1,000.00. The "castle" concerns were recognized to a limited extent by exemptions from the Fair Housing Act's prohibition for sale and rental by a private person owning no more than three homes and protection was afforded to Mrs. Murphy's boarding house.

The Act encouraged state and local governments to enact fair housing laws that are "substantially equivalent" to the federal law, by authorizing work-sharing and funding. And, in a provision that seemingly received little attention at the time but became important later, the Act authorized the Secretary to "cooperate with and render technical" and other assistance to "private agencies, organizations, and institutions which are formulating or carrying on programs to prevent or eliminate discriminatory housing practices."

The original law prohibited discrimination only on the basis or race, color, religion, or national origin, but a 1974 amendment added gender (referenced as "sex") as a prohibited basis of discrimination. It is common to reference the law as providing protections to certain *groups*, but in reality the law protects all persons from discrimination on certain *bases*. Blacks and whites, Hispanics and non-Hispanics, and men and women all are entitled to the law's protections, which prohibited discrimination in the sale, rental, and financing of housing.

The Act's strictures were to be phased in, applying immediately to government housing already covered by the Executive Order; other housing (i.e., private housing constituting the bulk of the housing stock in the United States) would not be subject to be the Act's strictures until January 1, 1969.

Prior to April 11, 1968, the Division had done virtually nothing to challenge housing discrimination, but it began to ramp up for enforcement of the new law. Yet, substantial hurdles remained. Housing discrimination, of course, was wide-spread throughout the country with some major newspapers continuing to categorize housing

ads under headings such as "colored property" or "integrated housing." Even if the Division waited until 1969, when the new law would apply to private housing, to file its first lawsuits, it feared that it might lose cases if it challenged conduct that occurred prior to the effective date of the Act. A December 7, 1968 memo from Assistant Attorney General for Civil Rights Steve Pollak to the attorney general states: "It was decided that attempts to bring pattern or practice litigation based on pre-coverage conduct would risk adverse decisions which would endanger any possibility of encouraging widespread voluntary compliance through selective litigation." Instead, Pollak proposed to ramp up for enforcement by outreach to fair housing groups, telephone contacts with other interested organizations, correspondence to major housing providers, and on-site investigations in major cities by Division lawyers. In the first month of 1969 the Division filed five lawsuits to enforce the new law.

It should be noted that the Division was a relatively small operation at this time, with less than 100 lawyers who had responsibility for enforcing all of the Titles of the 1964 civil rights law, the Voting Rights Act, and, as of 1968, the new Fair Housing Act. To help ensure a focus on all of its responsibilities, the Division was restructured in 1969, changing from a geographic structure, in which lawyers were responsible for enforcing all of the laws within an assigned geography, to a subject-matter structure. The Housing Section, with responsibility for enforcing the Fair Housing Act, was born.

The Housing Section rapidly became an important component of the DOJ civil rights enforcement program. Consistent with its statutory mission, it focused on the development of major lawsuits challenging patterns or practices of discrimination in the rental and sale of housing, with a heavy focus on claims of race discrimination. However, the restrictive enforcement authority allocated to both HUD and DOJ, coupled with the Act's provisions allowing HUD to provide assistance to private organizations, fostered the development of a vast network of

private enforcement agencies that conducted investigations and used private lawyers to file cases under the Fair Housing Act.

As time passed, housing discrimination became more subtle, and the private groups developed innovative, investigative techniques of using "testers" to detect discrimination. Volunteers of different races might inquire about the availability of rental housing on the same day, and with repeated similar tests, discrimination might be detected. More than 200 private fair housing enforcement agencies now exist under the umbrella of the National Fair Housing Alliance.

II. 1988 Amendments to Add Protections and Enhance Enforcement

After 20 years of experience under the law, Congress determined that certain adjustments were necessary. One issue was that new types of housing discrimination were becoming prevalent but were not prohibited by the law. Families with children were experiencing increased difficulty in securing housing, particularly rental housing, as an increased number and percentage of housing developments were catering to singles and prohibiting occupancy by families with children. As such, the Nation was becoming more cognizant of the housing needs of persons with disabilities, such as the need for accessible housing. Additionally, the holes in the government enforcement structure were obvious.

Thus, Congress enacted the Fair Housing Amendments Act of 1988 (1988 Amendments), signed into law by President Ronald Reagan on September 13, 1988. The 1988 Amendments prohibited discrimination on the basis of "familial status" (meaning families with children under the age of 18) but provided exemptions for certain types of "housing for older persons." The 1988 Amendments also prohibited discrimination on the basis of "handicap" and required housing providers to allow "reasonable modifications" and "reasonable accommodations" to persons with handicaps. It also required that

future construction of multi-family housing meet basic accessibility standards. The Americans with Disabilities Act was passed the following year, using the word "disability" instead of "handicap."

The other major change occasioned by the 1988 Amendments was to increase significantly the authority of the federal government to enforce the Fair Housing Act, even far beyond what was originally envisioned by President Johnson. HUD's role was expanded beyond efforts of "persuasion," and the agency was given the authority to charge discrimination when an investigation revealed reasonable cause. The charge would be presented to an administrative law judge (ALJ), who had authority to order injunctive relief, compensatory (but not punitive) monetary damages, and also to require the payment of civil penalties not to exceed established amounts.

As the administrative remedial structure was considered in Congress, concern arose that the ALJ's authority to award monetary damages might implicate a Seventh Amendment right to a trial by jury, and thus the final legislation provided that either party could elect to have the charge decided in a federal court civil action, which would be filed by the DOJ. In the event of an election, the available remedies differed somewhat from the administrative proceeding. The federal court could award compensatory and, significantly, could also award punitive damages, but the federal court could not award civil money penalties in an election lawsuit.

The DOJ also retained its authority to bring "pattern or practice" lawsuits, but the new law allowed DOJ, for the first time, to seek compensatory and punitive damages for victims of discrimination as well as civil money penalties. The "enforcement by private persons" was enhanced to remove the prior cap on an award of punitive money damages.

The 1988 Amendments added an expanded provision prohibiting discrimination in "residential real estate-related transactions," a term that was defined to include the making or purchasing of loans for purchasing, constructing, improving, repairing, or maintaining a dwelling as well as a loan that is secured by residential real estate. The residential mortgage lending industry clearly was in the crosshairs of the law.

Advocates supporting the proposed legislation were distrustful of the Division and its leader at the time, Wm. Bradford Reynolds, and favored the allocation of greater authority to HUD, an agency with which the groups had a closer relationship. Yet, the administration demanded that any federal court litigation under the new law be handled by DOJ lawyers and not HUD. The administration prevailed on that issue, but the tension is revealed by the language of the final enactment that provides that DOJ "shall" file a lawsuit when HUD enters a charge and an election is made; the language obviously was designed to preclude DOJ from second-guessing the decisions of HUD.

Also, although the courts of appeals had recognized that a violation of the Fair Housing Act could be established under a disparate impact approach, the administration maintained that a showing of discriminatory intent was a prerequisite for proving a violation. The language of the new law did not directly resolve that dispute, but kicked it down the road. The legislative history included support for the disparate impact approach, but President Reagan's signing statement said the legislation did "not represent any congressional or executive branch endorsement [of disparate impact]" and opined that the Fair Housing Act "speaks only to intentional discrimination."

III. Planning for Implementation of the Expanded Law and the Unexpected New Focus on Possible Discrimination in Mortgage Lending

I became the chief of the Housing Section in late June of 1988, after spending almost eighteen years in the Division, first litigating school desegregation lawsuits and then managing the Voting Rights Act litigation program. It was an ominous time to be assuming the new responsibilities. The Fair Housing Amendments Act was nearing passage in Congress and would impose significant new responsibilities on the Housing Section. Furthermore, new and very difficult issues regarding possible discrimination in residential mortgage lending were looming and would lead to dramatic changes in the focus of the Housing Section for decades.

A major starting issue was preparing for the implementation of the new law and actually implementing the law. The new legal structure required close coordination between the DOJ and HUD, and thus weekly (or at least biweekly) meetings were conducted between representatives of the Housing Section and representatives of HUD's Office of Fair Housing & Equal Opportunity and representatives of the HUD Office of General Counsel. The participants discussed approaches to effective implementation as well as legal theories and the types of cases to be pursued. The discussions were often difficult but meaningful progress was made.

The HUD officials strongly advocated that all violations of the law, however minor, should be charged, and they had legislative support for the position. DOJ officials often expressed concern about presenting the seemingly trivial issues in the already overburdened federal courts, believing that the approach would harm the enforcement program.

Another issue needing careful attention concerned the standards for determining the amount of monetary damages to be sought in cases

of discrimination. The new law would require the ALJs to determine the amount of damages to award, and the ALJs would have to support the conclusion with detailed factual and legal findings. I surveyed a number of respected private lawyers who had extensive experience in litigating under the original Act, asking how they determined the amount of money to seek. All seemed to be taken aback by the question but gave a relatively uniform response: "You get as much as you can get." While a truthful response, it did not help us much in developing the standards for applying the new law.

We were also unexpectedly hit with troubling new evidence of possible discrimination on the basis of race in the mortgage lending industry. Only weeks before I assumed my new position, the *Atlanta Journal – Constitution* published a series of articles entitled "The Color of Money" that raised troubling issues of possible race discrimination in residential mortgage lending in the Atlanta area. The author of the series, Bill Dedman, was awarded the Pulitzer Prize for Investigative Reporting in the year following the publication of the series. The articles were based largely on Home Mortgage Disclosure Act data, which, at the time, was limited to revealing the geographic locations of mortgage loans. The number of applications by race and their dispositions was not required to be reported. With vivid mapping and strong language, the articles revealed that most mortgage loans were originated in white residential areas and not in black residential areas. The implication, of course, was that banks and other mortgage lenders were discriminating on the basis of race in originating mortgage loans, which would raise serious issues under both the original and the nearly-completed Fair Housing Acts.

The local and national reaction was swift and strong. Julian Bond, then head of the Atlanta NAACP and later its national leader, accused the Atlanta-area lenders of "wicked practices" and demanded a federal investigation. The controversy continued for months and in January of 1989, the chair of the House Banking Committee accused the DOJ of

"dragging its feet on cases of credit discrimination" and called for a detailed investigation of the practices revealed by Dedman's articles. Civil rights groups made similar demands.

The Housing Section had not previously conducted investigations into these types of issues, but "The Color of Money" articles and the fall out after publication required consideration of new approaches. The Housing Section did begin an investigation shortly after the news articles, but, in hindsight, the initial approach was awkward and misguided. We began by sending letters to a large number of lenders (I recall the number being about 40) in Atlanta requesting that they voluntarily provide detailed information on underwriting procedures, loan applications and originations, and other material that might be relevant to investigating for possible discrimination. The Fair Housing Act does not provide subpoena authority to the DOJ, so voluntary cooperation was essential.

We got more than we probably wanted as huge quantities of documents soon arrived. We were challenged both by a limitation in resources to review all of the documents, as well as a lack of understanding of the lending business. We were aided greatly when we learned that the federal Office of Thrift Supervision had required the institutions that it supervised to provide data, by race, on important information such as applications and dispositions of the applications. This data allowed a focus on the institutions which showed the greatest disparities in rejection rates between black and white applicants. Although the investigation was designed to be confidential, the wide dispersion of requests soon leaked to the media. By early 1989, the DOJ confirmed to the media that an investigation, based on "The Color of Money" articles had been initiated shortly after the publication and remained underway with no mention of possible targets.

IV. Fair Housing Act Enforcement Against Banks Begins Under the Administration of President George H.W. Bush With a Claim of Discrimination in Underwriting

The Housing Section ultimately focused its investigation on the mortgage loan underwriting practices of Decatur Federal Savings & Loan (Decatur). This was before the time of today's automated underwriting engines, and judgmental underwriting was still in use. Loan files were reviewed but it became difficult to evaluate differences over a large volume of applications and decisions. Thus, the Housing Section lawyers used statistical techniques to control for the factors that the bank described as relevant to the underwriting decision and attempted to evaluate whether any remaining differences in unfavorable outcomes might be attributable to race. This type of multi-regression analysis had not been used previously in housing investigations, but had been used in employment investigations.

The Housing Section concluded that the facts and analysis supported a claim that black applicants were treated less favorably than white applicants in the underwriting of applications for mortgage loans. The differences often were subtle but could be confirmed by a return to the loan files. For example, a white police officer on the border of qualification might be asked if he or she receives overtime pay to increase the level of income, while a black police officer would not receive a comparable invitation.

This would be a new and novel claim and senior officials of the Division, including veteran and highly regarded civil rights lawyers, were skeptical. In particular, the focus was on the statistical analysis and whether it actually pointed to discrimination. Suggestions were made to hire an expert consultant to perform a more professional analysis instead of relying on the work of the lawyers. The Housing Section had not tried to cut corners with its work but rather had proceeded in the customary fashion of the Division. Usually, experts

were not brought into cases until a complaint was filed, which was a practice driven by budgetary considerations, since a separate expert witness fund could be tapped to cover the expense once a complaint was filed. Given the significance of the proposed lawsuit, a decision was made to retain an expert before filing to conduct a new statistical analysis. That analysis confirmed the conclusion that had been reached by the Housing Section. The attorney general approved the proposed lawsuit against Decatur, and the complaint and an accompanying consent decree were filed on September 17, 1992, more than four years after the publication of "The Color of Money" series. The bank agreed to pay $1 million to compensate 47 applicants that the Housing Section had determined to be victims of discrimination.

At the same time that the Division lawyers were pursuing the investigation of Decatur, they also attempted to coordinate with the banking regulatory agencies on the approaches being used to detect discrimination in the underwriting of loans. The agencies themselves were under pressure to tackle the issues raised in Atlanta, yet the level of support from the regulators for the Division's approach differed from agency to agency. The Federal Reserve Board initially was the most difficult. The Federal Reserve Board (Fed) disagreed with the analytical approach being followed by the Division and expressed substantial doubt about discrimination in underwriting of mortgage loans. The agency suggested deferring the discussion as the Federal Reserve Bank of Boston was in the process of conducting its own analysis of possible discrimination in underwriting, and the results of that analysis might provide additional guidance. They were correct, but the outcome was not as predicted.

The study entitled "Mortgage Lending in Boston: Interpreting HMDA Data" (Boston Fed Study) was released in October 1992, the month following the filing of the Decatur lawsuit. While Decatur focused on one institution, the Boston Fed Study was based on a survey of financial institutions operating in the Boston MSA, and represented

an amalgamation of data from many institutions. The Study concluded: "A black or Hispanic applicant in the Boston area is roughly 60 percent more likely to be denied a mortgage loan than a similarly situated white applicant." The final sentence of the Boston Fed Study reads: "In short, the results indicate that a serious problem exists in the market for mortgage loans, and lenders, community groups, and regulators must work together to ensure that minorities are treated fairly."

Thus, rather than squelching the controversy, the Boston Fed Study added fuel to the fire. No longer was Atlanta the main focus. The Fed itself faced intense pressure to address the issues in Boston that were raised by its own analysis.

V. Fair Housing Act Enforcement Against Banks Under the Administration of President William Clinton

A. Attorney General Reno's Efforts for Collaboration to Advance Voluntary Compliance

President William Clinton assumed the Oval Office shortly after the Decatur and the Boston Fed Study. There was some delay in having an attorney aeneral confirmed by the Senate, but on March 12, 1993, Janet Reno was sworn in as attorney general of the United States. Reno was more hands-on than previous attorneys general, and she promptly asked for briefings on the fair lending enforcement program. Although she was pulled in a lot of directions, fair lending enforcement quickly became one of her primary interests.

Attorney General Reno was supportive of the approach of developing lawsuits to advance fair lending, but she also demanded an increased effort to establish collaborative relationships to advance voluntary compliance. She offered to hold a meeting with representatives of the banking industry to discuss fair lending issues, explain the problems that had been identified in investigations, and

discuss changes in practices that might resolve the issues. Attorney General Reno asked me to try to arrange such a meeting.

I presented the attorney general's request to a representative of the American Bankers Association (ABA) with whom I had developed a collaborative relationship. I asked if the ABA could identify leading bankers who might be willing to join the attorney general for such a meeting. Relationships with the industry were still largely frayed, but I was told that the ABA would convey the request. Some time later I received the response. The ABA had identified bankers who would be willing to meet with the attorney general under one condition—that they be permitted to wear bags over their heads for the entire meeting. Of course, this was said in jest, although the statement is reflective of the feelings at the time. Finally, we all came to our senses and agreed that the best approach would be for representative of the various lending and banking trade associations to meet with the attorney general rather than individual bankers.

All of these issues merged somewhat as the year 1993 unwound. The Federal Reserve Board made a referral to the DOJ and the Federal Trade Commission (FTC) of apparent discrimination in loan underwriting by a lender in Boston, Shawmut Mortgage Co (Shawmut). DOJ and the FTC continued the investigation, found the complaint to be meritorious, and filed a lawsuit, along with a consent decree, against Shawmut on December 13, 1993. On the morning of the filing, the attorney general had a meeting with representatives of the ABA and seven other banking and lending trade associations to discuss the DOJ's efforts to end discrimination in lending, and to encourage their members to examine their lending practices and take remedial action before they become the subject of an investigation. Bank regulatory agencies also attended the meeting. And in the afternoon of December 13, 1993, the attorney general met with representatives of 15 civil rights and consumer advocacy groups to discuss the same issues.

Although principled disagreements remained, the efforts to establish collaborative relationships with the lending industry and promote voluntary compliance showed signs of success. By mid-1993 the ABA Board passed a resolution reaffirming a commitment to fair lending and authorizing the development of training materials. The ABA Fair Lending Toolbox was released in the fall of 1994, along with a memorandum beginning with this sentence: "Fair lending may be the most serious issue bankers face today."

Also, the federal agencies with authority for enforcing fair lending laws, including the bank regulatory agencies, DOJ, HUD, and the FTC increased collaborative efforts for uniform enforcement, leading to the April 15, 1994 publication in the *Federal Register of the Interagency Policy Statement on Discrimination in Lending* (Statement). The Statement explained the various approaches to establishing a legal violation and offered answers to questions that often had been presented.

One interesting point of the Statement was that it explained how the disparate impact theory might be applicable in lending lawsuits. A disparate impact violation does not require proof of intentional discrimination. Rather, the allegation is that a facially neutral business practices that is applied fairly and uniformly to all applicants has a disproportionate effect that is correlated with a prohibited basis – such as race – and is not supported by legitimate business considerations. The legal approach is designed to capture and prohibit business practices that operate as the functional equivalent of intentional discrimination.

The Clinton administration's endorsement of the disparate impact approach to establishing a violation represented a switch from the views of the prior Republican administrations, which argued that proof of intent was necessary to show a violation of the Fair Housing Act. The Statement treaded lightly into the debate by noting that "the precise

contours of the law on disparate impact as it applies to lending discrimination are under development." Actually, the 'disparate impact' issue was one of the most difficult to resolve in reaching agreement with all of the participants who joined the Statement. No one sought to challenge the administration's view on the applicability of the theory, but consideration of how it would apply in mortgage lending caused significant debate. A bank regulator might say: "Whoa! You mean a down-payment requirement could be challenged as discriminatory?" An agreement on examples of actual application of the theory was hard to reach. The final guidance provided an example of how a requirement of a minimum loan amount might cause an unlawful disparate impact and a somewhat confusing and illogical example of a lender's consideration of gross income versus net income.

To those of us effectuating the enforcement, these issues seemed largely academic. We viewed fair lending lawsuits as presenting claims of "disparate treatment" and not "disparate impact." This was not an effort to take sides in the continuing debate, but rather reflected our view of the type of evidence that was the basis for the claim; namely, that minority applicants were treated differently and less favorably than nonminority applicants. At the time, no one argued to the contrary.

B. The Origin of Fair Housing Act Claims of Discrimination in Loan Pricing and Continued Efforts to Advance Voluntary Compliance

Parallel to the efforts to collaborate with the lending industry, the bank regulators, and the enforcement agencies, the Division continued to develop lawsuits. Underwriting discrimination remained a primary focus but was difficult, and costly, to establish. Likewise, other types of discrimination were popping up. As bank regulators conducted examinations, they began to notice differences in the price of loans to minority and nonminority borrowers. In early 1994, the Division filed a

lawsuit against the First National Bank of Vicksburg following a referral from the Comptroller of the Currency (Comptroller) (pursuant to the Equal Credit Opportunity Act) that presented issues of discrimination in the pricing of unsecured loans. Other referrals and the Division's own investigations resulted in challenges to discrimination in the pricing of a variety of loans, both secured and unsecured. The allegedly discriminatory application of "overages" in home mortgage lending was one important issue that was addressed. At the time, loan officers had an opportunity to boost their income by charging a higher interest rate than the rate sheet might indicate (i.e., an "overage"). This practice ended when the regulatory agencies promulgated rules prohibiting loan officer compensation that is based on the terms or conditions of a loan.

C. The Origin of Fair Housing Act Claims of Redlining: The Controversial Lawsuit Against Chevy Chase Bank

With an enforcement focus on underwriting and pricing, concerns arose that the Division was focusing too much on lenders that made efforts to obtain applications from minorities and were actually making loans in minority areas. A constant criticism was that enforcement officials were ignoring lenders who were simply refusing to do business in minority areas, an invidious practice known as redlining. The criticism had merit. The Division devoted resources to the issue, and filed its first lawsuit alleging a pattern or practice of redlining against Chevy Chase Bank in Washington, D.C. on August 22, 1994.

The action again created a firestorm of controversy that harkened back to the Decatur filing. The argument was that the DOJ was essentially telling banks where they had to do business. The lawsuit was settled with a consent decree, and one of the most controversial provisions was that the bank and its mortgage company would open offices and a bank branch in minority areas of Washington, D.C. However, that remedial provision was tailored to the facts of the case.

The bank had a stated policy of opening branches and offices in areas that it intended to serve. Thus, the absences of offices and branches in the minority areas were evidence of the violation, and the remedy followed the violation. This was not meant to convey a requirement that banks have branches in any particular area. The main point of the Chevy Chase lawsuit was that the bank was failing to serve the minority areas with mortgage loans. That was best portrayed by maps showing the location of the bank's loans at the time the investigation began and the subsequent patterns after the bank took corrective action. The maps are appended to this document.

The controversy created by the Chevy Chase lawsuit continued for some time and required increased efforts for outreach to the industry. The *Wall Street Journal* published an article on February 7, 1995, with the headline: "Race and Mortgage-Lending in America – Angry Lenders: Federal Drive to Curb Mortgage-Loan Bias Stirs Strong Backlash – Banks Say Some Regulators Meddle in Their Business; a Few Agencies Agree – the Hot Case of Chevy Chase." The article focused on the Chevy Chase case and said that "financial regulatory agencies wonder whether Justice has gone too far." It was reported that the industry was searching for a bank willing to be a "test case of the Justice Department's legal theories" and that a "war chest" was being set up to assist in court cases.

Almost a year after the lawsuit's filing, the *Washingtonian Magazine* published an article in July 1995 about the case under the headline "Say Uncle: When the Feds Accuse You of Discrimination, It Can Be a Lose-Lose Situation, Chevy Chase Bank Decided Not to Fight." The article quoted an industry newspaper as saying that Chevy Chase "hit the mortgage industry like a thunderbolt." A trade association leader compared DOJ to a "ten-ton gorilla that 'owns the jungle'" and added: "I guess we need an elephant gun to get the gorilla."

Deval Patrick assumed the position of assistant attorney general for civil rights (i.e., the head of the Division) a few months before the filing of the Chevy Chase lawsuit, and he continued to advance the attorney general's objective of pursuing a collaborative relationship with and voluntary compliance from lenders. Shortly after the Chevy Chase filing, he met with the leaders of the ABA and six other banking trade associations to explain the Division's program and hear the industry's concerns. Much of the discussion focused on how the disparate impact legal theory would be applied. The Division considered the views expressed at the meeting, and on February 21, 1995, Mr. Patrick sent a ten-page letter addressing the issues raised. He explained that the fair lending program focused on discrimination in underwriting and pricing of loans as well as "limitations on access to credit," i.e., redlining. In addressing disparate impact he said: "our experience to date teaches us that lenders sometimes believe that neutral practices are having only a disparate impact, when in fact the lender's employees have been applying them differentially, resulting in disparate treatment." The letter is a thoughtful and balanced approach to fair lending issues and remains a useful guide for compliance.

D. The Origin of the Fair Housing Act Claim of Pricing Discrimination Arising from Actions of Independent Parties: The Controversial Lawsuit Against Long Beach Mortgage Company

A lawsuit filed in 1996 – the Division's first lawsuit against a non-bank lender – created a controversy that, in my view, resulted from a misunderstanding of the message the Division was attempting to send by the complaint and settlement agreement. The action was filed against Long Beach Mortgage Company (Long Beach) on September 5, 1996, alleging discrimination in the pricing of loans on the basis of race, national origin, gender and age (prohibited by ECOA). Long Beach originated mortgage loans in the B/C market (the subprime market), targeting loans to consumers with impaired credit. Normally these

types of operations were viewed as presenting consumer protection claims to be evaluated under the FTC's unfair and deceptive acts and practices (UDAP) concepts, but the investigation revealed pricing differences correlated with prohibited factors. Thus, the defense that "we charge high prices to everyone" did not hold.

An even more difficult issue arose because Long Beach made loans through its own employees (retail loans) and through independent mortgage brokers (wholesale loans). Pricing differences were observed in both channels. In the Division's view, the company lacked fair lending controls throughout its entire operations, but the difficult issue was whether Long Beach could be held liable for pricing differences caused by the fees that the brokers charged to their customers.

Substantial, but principled, debates took place within the DOJ as to whether the claim should be limited to the retail channel or also encompass the wholesale operation. My own view was driven by the borrower compensation component. With a total lack of fair lending controls, it seemed difficult to deny restitution to a borrower simply because of the channel by which the loan was originated. Based on the views expressed, I do not believe that the DOJ would have proceeded with this lawsuit if the pricing differences were observed only in the wholesale channel.

The DOJ sought to recognize these types of distinctions in the agreement that settled the lawsuit. Borrower restitution included borrowers receiving loans in both channels, but the injunctive provisions differed significantly by channel. Long Beach was required to develop a statistical model for monitoring the pricing of loans in the retail channel – but not in the wholesale channel – and the model required pre-approval by the DOJ. The injunctive remedy for the wholesale channel was limited largely to educational efforts targeted to brokers. Long Beach agreed to periodically conduct fair lending reviews of the wholesale channel, but the settlement provided that the results of

such reviews would be confidential and were not required to be disclosed to the DOJ. The settlement provided further that Long Beach was not even required "to disclose the identities of the wholesale brokers with whom it does business." The limitations of the settlement were designed to send signals of the DOJ's view on the legal obligations of wholesale lenders, but the distinctions have largely been lost over the years. In recognition of the significance of this lawsuit, on the day of the filing, Associate Attorney General John Schmidt met with representatives of the lending trade associations to explain the case and to express the continued willingness and desire of the DOJ to meet with the industry to discuss issues of importance.

E. Attorney General Reno Continues Efforts to Advance Voluntary Compliance in Underwriting, Pricing and Redlining, and Favorable Results are Evidenced

Shortly after the Long Beach filing, on October 3, 1996, Attorney General Reno met with representatives of all sectors of the credit industry, including consumer lenders, to listen to and discuss their concerns about fair lending compliance. Thirteen organizations were represented at the meeting. The genius of this meeting was a speech the attorney general had made to a major conference of the American Bankers Association in Boston in May. The interaction with the bankers in Boston was positive, but the questions presented caused the attorney general to conclude that there were still many issues, including issues in consumer lending, that warranted collaborative discussions. While explaining the enforcement program, the attorney general emphasized the efforts of collaboration with the industry, noting that DOJ officials had met with thousands of bankers and other lenders at industry conferences. She noted the positive results of the efforts as revealed by significant increases in lending to minorities, and referenced an article in the *American Banke*r saying that she was "almost gushing" about the data showing that home purchase lending to African-Americans had increased by 56 percent. Furthermore, as she

had previously, she listened to their concerns and considered their questions.

Another meaningful interaction with the banking industry occurred later in the same month, on November 8, 1996, when Attorney General Reno attended a breakfast meeting with the Federal Advisory Council to the Federal Reserve Board (Advisory Board) at the Park Hyatt Hotel in Washington, D.C. The Advisory Board consists of one bank CEO from each of the 12 Federal Reserve Board districts. I attended the meeting along with the attorney general. The attorney general's presentation was well-received. As the meeting neared an end, one bank CEO said that the group applauded the attorney general's efforts to rid discrimination from the industry but had only one request that was conveyed in words something like this: "Please make sure you are right before you file as lawsuit, because the reputational damage that you cause to a bank is far greater than any monetary penalty that the bank might have to pay." The attorney general commented to me on the significance of the statement on our return trip to the DOJ and it has stuck with me throughout my career both as a prosecutor and as a defense lawyer.

On November 21, 1996, Attorney General Reno again met with the bank regulators. The meeting was spurred by the release of a report from the Government Accounting Office (GAO) entitled: "FAIR LENDING: Federal Oversight and Enforcement Improved but Some Challenges Remain." At the time, the Division was concerned with the seeming inability of the regulators to detect discrimination in underwriting, and one option considered was to conduct joint investigations by the banking agencies and Division personnel. That option had been rejected previously by the regulators and was rejected again.

Despite the continued need for improvement, the efforts of all the players, including the DOJ, the regulators and the industry were

showing some positive results. On October 16, 1996, for example, the Comptroller wrote to the attorney general noting: "[n]ationally, the number of home loans to minorities grew more than 100% between 1995 and 1992."

During the Clinton administration, the Division filed a total of 18 fair lending lawsuits, most under the Fair Housing Act but some under ECOA when consumer lending was at issue. Even though discrimination on the basis of race in the underwriting of mortgage loans was such a heavy, and controversial, aspect of the enforcement program, these types of legal challenges largely disappeared from the enforcement landscape in later years. That is not to say that all discrimination in underwriting ended or that later administrations were lax in examining the issue. Rather the type of judgmental underwriting, which was the root cause of the initial lawsuits, was largely replaced with automated underwriting, which substantially narrowed discretionary decision making in the underwriting process.

VI. Fair Housing Act Enforcement Against Banks During the Administration of President George W. Bush

The administration of George W. Bush (in office from January 2001 until January, 2009) is often criticized for lax enforcement of fair lending laws. These were the years of the boom in subprime lending. In fact, the years represent the life span of subprime lending since products of this time largely ended in 2008 and 2009. Subprime lending at the time, however, was viewed mostly as a consumer protection issue. Were consumers being given the information needed to make an informed choice of whether the product is suited to their financial needs?

During these years, the Division filed only 11 fair lending lawsuits. There were some notable filings, however, which seemed surprising for a conservative administration and pushed some aspects of fair lending theory beyond that applied in the Clinton years. For

example, more than a third of the Division's filings presented claims of redlining against depository institutions.

This is surprising in light of the strong backlash, particularly from conservatives after the filing of Chevy Chase just a few years earlier. The Bush-era lawsuits applied the same legal theory as was so heavily criticized after Chevy Chase and a nearly identical remedial approach. At the time many commentators viewed Chevy Chase as an extreme example of left-wing enforcement, and yet the perceived right wing seemed to be adopting the approach as the main component of its fair lending enforcement program.

To some extent, however, this should not be a surprise. In my own career in government, I observed that Republican administrations seemed most moved by complaints, often from mayors of major cities, regarding a lack of financial investments in the cities. Redlining, to the extent the claims are valid, presents substantial barriers to opportunity in urban areas. Concerns of this type engender support for challenges to practices that might be viewed as redlining. It is easy to describe the problem with maps showing the location of loans, as well as the change that can be effectuated very quickly. The Chevy Chase before- and after- maps are one example. As noted earlier, the birth of the fair lending enforcement program was caused by the publication of "The Color of Money" series, which moved an earlier Republican administration to demand action and to devote the resources necessary to address the issue.

Another point of note from the Bush II years is that another third of the lawsuits concerned discrimination in auto lending. These cases present issues under ECOA, not the Fair Housing Act, but are worth noting because they rely on the same legal theory that is used to attach liability to lenders based on the conduct of independent third parties, such as mortgage brokers. The auto-lending actions represented an expansion of the fair lending enforcement program and would lead to an

even greater expansion, and questionable legal theories, in later years. The Clinton team had looked at auto-lending issues but the only filing was an *amicus* brief supporting private plaintiffs in a lawsuit alleging discrimination in auto lending. The Bush team got into the issue in a largely noncontroversial manner.

For example, in a lawsuit against Pacifico Ford filed on August 21, 2007, in federal court in Philadelphia, the Division alleged that the car dealer discriminated on the basis of race by imposing higher dealer-markups on loans to African-America buyers who were financing the purchase of a vehicle. The important point here is that the action was filed against the dealership that effectuated the markups and not the bank that actually made the loan. As explained later the Obama team would push these types of cases much further by targeting the claim at banks that received car loans from a large number of dealers.

VII. Fair Housing Act Enforcement Against Banks During the Administration of President Barack Obama

President Barack Obama assumed the Oval Office in January of 2009, but the fair lending enforcement program was slow in starting. Its first Fair Housing Act lawsuit was filed on September 30, 2009, against a bank in Alabama alleging both pricing discrimination and redlining, but the program ramped up quickly. It was among the highest priorities of the Division under President Obama, which filed 44 lawsuits under the Fair Housing Act and/or ECOA during the president's eight years in office.

The Division addressed new issues in underwriting such as alleged discrimination against women because lenders did not properly address income issues in connection with maternity leave, and alleged discrimination on the basis of disability because lenders took steps that the government alleged to be impermissible in an effort to document the expect continuity of disability income, such as requesting a note from a doctor. A few lawsuits were filed addressing these issues and the issues

dissipated when Fannie Mae, Freddie Mac, and HUD altered its guidelines to address these circumstances in underwriting loans.

Thomas Perez was confirmed as the head of the Division on October 6, 2009. He was a strong advocate for use of the disparate impact theory in enforcing the Fair Housing Act. As noted earlier, prior administrations had viewed fair lending violations as involving claims of disparate treatment, but Perez want to apply disparate impact even in fair lending lawsuits. Also, while prior Administrations had focused on the reform of business practices that were causes of fair lending violations, Perez focused to a greater extent on the monetary damages component of fair lending lawsuits, filing cases even when the offending practices had long ended. He also pushed the theories of legal liability beyond those used by earlier administrations.

One early example was a lawsuit that the Division filed against AIG Federal Savings Bank (AIG) on March 4, 2010. The claim was based on an old referral from the Office of Thrift Supervision during the years of the Bush administration. The defendants engaged in wholesale lending, meaning that they originated loans that were presented by independent mortgage brokers who charged a fee for their services, but the defendants exited the business about two years before the filing of the lawsuit. The Division made no claim that any broker discriminated unlawfully in charging fees but did contend that, when all the fees charged by all the brokers were amalgamated, the combined data showed that minorities, on average, were paying higher fees than non-minorities. The Division contended that the lender, AIG, was responsible for this "discrimination."

In a presentation to a conference of the National Community Reinvestment Coalition on April 15, 2011, Perez conceded that the claim could be brought only under a disparate impact legal theory and said that a "case of this nature would not have been brought in the previous administration, because disparate impact claims were not

allowed … .” The business “policy’ of the defendants challenged in the lawsuit was allowing the independent brokers “discretion” to establish the fees that they would charge to their customers. The lawsuit was patterned on the theory first described in the Long Beach lawsuit but took the theory farther in applying it to a totally wholesale operation, recognizing none of the limitations of the settlement in the Long Beach lawsuit. In announcing the lawsuit, Perez said: “[t]oday’s settlement is significant because it marks the first time the Justice Department has held a lender responsible for failing to monitor its brokers to ensure that borrowers are not charged higher fees because of their race. If necessary, it will not be the last time.”

He kept that pledge and the Division continued on its crusade to challenge wholesale lending under the disparate impact legal theory, never alleging that any broker discriminated unlawfully but contending that the lending was legally responsible because, on average, it appeared that minorities were seeking loans through brokers who charged higher fees to their customers. Approximately 10 lawsuits were filed against wholesale lenders.

The same approach was used by the Obama team to address perceived disparities in auto lending. As noted earlier, the Bush administration had waded into the issue of discrimination in dealer mark-ups, but whereas that administration focused the claims on the dealers who were effectuating the markups (and thereby engaged in disparate treatment), the Obama team focused the claim on the lenders that funded the loans for the dealers. That skipped the step of establishing that any dealer discriminated unlawfully and, like the broker claim, simply contended that, on average, minorities were obtaining car loans through dealers who were charging higher markups to their customers.

At the time that the Obama team was employing its aggressive use of disparate impact to challenge lenders and seek monetary

payment to borrowers, private actions under the Fair Housing Act were using a nearly identical approach. Like the DOJ approach, private class actions also alleged that lenders allowed "discretion" to employees and independent mortgage brokers and that this "policy" caused a disparate impact on minority borrowers. These types of lawsuits began in about 2007 and had achieved some degree of success in that they had survived motions to dismiss and it some situations achieved a settlement.

The private cases came to an abrupt end after the 2011 decision of the Supreme Court in *Wal-Mart Stores, Inc. v. Dukes*, an employment discrimination lawsuit which also alleged that a policy of "discretion" caused a disparate impact. In an opinion written by Justice Scalia, the Court observed that granting employees discretion is "a very common and presumptively reasonable way of doing business—one that we have said should itself raise no inference of discriminatory conduct" and rejected the application of the disparate impact theory to a company-wide policy of discretion. *Dukes* held that the challenged "'policy' of *allowing discretion* … is just the opposite of a uniform practice …; it is a policy *against having* uniform employment practices." Also, with a large number of persons independently exercise discretion in carrying out their job duties, there can be no presumption of "commonality" of decision making, and thus cases of this type cannot proceed in the class context. The Fair Housing Act class actions alleging disparate impact claims challenging an alleged policy of discretion in loan pricing decisions ended in the wake of *Dukes*.

The Obama administration took the position that its disparate impact challenges to lending policies that allow discretion could continue because they are not class actions. But there is a legitimate argument that the limitations of *Dukes* should apply to governmental claims of a "pattern or practice" of discrimination brought under a disparate impact theory, since such claims also are based upon an erroneous assumption of commonality in decision making. As the Supreme Court said in landmark 1977 decision in *Teamsters v. United*

States: "In a pattern-or-practice case, the plaintiff tries to establish … that … discrimination was the company's standard operating procedure, the regular rather than the unusual practice."

Further revealing its focus on monetary relief even after offending lending practices had long ended, the Obama team sued Countrywide Financial Corporation (Countrywide) on December 21, 2011, alleging that the lender had unlawfully steered minority borrowers to subprime loans. Countrywide had stopped originating loans more than three years earlier, and the subprime loan product was well in the rearview mirror of the entire industry. The focus on the claim was on money damages and the DOJ described the filing as "the largest residential fair lending settlement in history." It added: "This is the first time that the Justice Department has alleged and obtained relief for borrowers who were steered based on race or national origin . . . into subprime loan products."

The Obama team also placed a strong emphasis on challenging circumstances that they thought to constitute redlining. It is difficult to imagine redlining constituting anything but intentional discrimination, but the Obama team seemed to suggest, by the language of its complaints, that the disparate impact approach could be used in these cases also. The Community Reinvestment Act (CRA) always has played an important role in redlining analyses. Although the CRA does not itself address race or ethnicity, it requires depository institutions to define the area that will be served and thus provides a context for measuring performance of a racial or ethnic basis. Every redlining lawsuit that has been filed, through all the administrations, has been against a depository institution. It was widely rumored that the Obama team was conducting investigations to expand redlining claims to non-depository lenders, but it did not happen.

In later years of the Obama administration, some bank regulatory agencies did expand the redlining approach that was applied earlier by

evaluating a bank's lending performance in a geographic area broader than the CRA assessment area. The broader area was referenced as the Reasonably Expected Market Area (REMA) and was a geography largely defined by the regulatory agency. The REMA analysis is of questionable validity, particularly to the extent that it conflicts with the CRA requirement to concentrate lending within the assessment area. While this was upsetting to banks facing the regulatory scrutiny, the concept has not actually been applied in litigation.

Similarly, the Obama team took a hard look at loan servicing, including consideration of loan modifications, to see if they could bring claims of discrimination under the Fair Housing Act or ECOA, but that did not happen either. Fair lending reviews of servicing are complex and present markedly different issues than do reviews of underwriting, pricing, or redlining. In these traditional types of fair lending analyses, it is not difficult to distinguish between a favorable and unfavorable outcome. A denial of a loan application is an unfavorable outcome, and an approval of a loan application is a favorable outcome. Through the years of the Great Recession, loan servicers faced criticism in some circumstances, for allowing a loan modification, with arguments that the actions merely delay the inevitable of a foreclosure and were done to collect fees. In other circumstances the criticism was that a loan modification was not permitted. Also, decisions on issues like modifications to loan terms are largely driven by investor requirements, including waterfalls for relief dictated by Fannie Mae, Freddie Mac, and HUD. The servicer itself often has little discretion. The Obama administration did not file any Fair Housing Act claims alleging discrimination in loan servicing.

With its heavy emphasis on the use of disparate impact, the Division had to be concerned about whether the theory would be upheld by the Supreme Court, which had never addressed the validity of a Fair Housing Act disparate impact claim. At about the same time as the AIG controversy, a series of events began that proved embarrassing to the

Division but once and for all resolved the question of the application of disparate impact under the Fair Housing Act.

It all began in 2011 when the Supreme Court first agreed to consider (1) whether "disparate impact claims [are] cognizable under the Fair Housing Act" and (2) "[i]f such claims are cognizable, should they be analyzed under the burden shifting approach …, under the balancing test …, under a hybrid approach …, or by some other test?" The case presenting the issue, *Magner, et al., v. Gallagher*, *et al.*, came from the Eighth Circuit. The plaintiffs below were St. Paul, Minnesota landlords (or perhaps slumlords) who claimed that the enforcement of the municipal building code was creating additional expense that would have to be disproportionately borne by minority tenants who lived in their buildings. Advocates feared that the Supreme Court, particularly in these factual circumstances, would reject the application of a disparate impact theory under the Fair Housing Act.

Thus, after the case was fully briefed and ready for argument, Assistant Attorney General Thomas Perez orchestrated a settlement to moot the claims, thereby removing the case from the Supreme Court's jurisdiction. His actions were widely reported in the press and not controverted by the DOJ. Another component of the DOJwas prepared to file a lawsuit against St. Paul under the False Claims Act, but Perez proposed that the false claims lawsuit would not be filed if St. Paul dropped its case before the Supreme Court. St. Paul agreed to drop its appeal in February 2012, and filed a stipulation to dismiss the writ of certiorari in the Supreme Court. The decision to drop the appeal was applauded by fair housing advocates, with the National Fair Housing Alliance ("NFHA") issuing a statement saying the appeal was dropped "due to the potentially catastrophic, unintended consequences of a case challenging the 'disparate impact' theory under the Fair Housing Act."

Assistant Attorney General Perez's actions were remarkable. There seems to be no dispute that he agreed to a quid pro quo to

prevent the Supreme Court from deciding a case—even though the government was not a party to *Magner*. Throughout the history of civil rights enforcement, the Division has had concerns of how the Supreme Court might decide important issues in diverse areas of civil rights such as school desegregation, voting rights, and employment. However, never, to my knowledge, has a government official acted in a comparable manner to prevent the Supreme Court from deciding a case. The false claims action against St. Paul reportedly would have sought a recovery of over $180 million, but Perez was willing to abandon the claim if the City would drop its appeal. The only thing more remarkable than Perez's action is that it was condoned by the DOJ.

A parallel approach followed by the Obama team to preserve disparate impact was to focus on an administrative rule that would help cement the application of disparate impact to the Fair Housing Act. Supreme Court precedent requires courts to defer to agency rules, promulgated after affording an opportunity for public comment, regarding the interpretation of laws that the agency has responsibility to enforce. Thus, after providing the required opportunity for public comment, HUD promulgated a Final Rule on February 15, 2013, entitled "Implementation of the Fair Housing Act's Discriminatory Effects Standard" (Rule) The Rule concludes that the disparate impact theory is applicable to claims under the Fair Housing Act and explains HUD's views regarding the proper application of the standard.

The Rule, however, did not provide the finality that had been envisioned. In June of 2013, the Supreme Court, for the second time, agreed to hear a case out of the Third Circuit presenting the issue of whether "disparate impact claims [are] cognizable under the Fair Housing Act." The case, *Township of Mount Holly, New Jersey, et al., v. Mount Holly Gardens Citizens in Action, Inc., et al.,* concerned an effort to redevelop a housing project and the alleged impact on the minority residents in the area. As before, fair housing advocates and Perez's civil rights team feared an adverse decision that would prohibit the use of

disparate impact. The appeal was scheduled to be argued before the Supreme Court on December 4, 2013, but, as that date approached, the pressure on the township to settle the case, and thereby avoid a decision, increased.

The parties to the case announced a settlement in November 2013, and the Supreme Court dismissed the writ of certiorari on November 15, 2013. On November 19, 2013, the *Wall Street Journal* reported: "There's no evidence that the Obama Administration played a direct role in scuttling the case this time, but its housing allies did . . . the National Fair Housing Alliance [and other private organizations] contributed money to a developer who will build new homes for the plaintiffs and other private buyers. That led to the settlement."

However, the Supreme Court's interest did not wain with promulgation of the Rule or the two false starts in the attempted *Magner* and *Mount Holly* appeals. In 2014, for the third time in four terms, the Supreme Court again agreed to review a case presenting the issue of whether "disparate-impact claims [are] cognizable under the Fair Housing Act." The case, *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc.*, came from the Fifth Circuit. Below, the plaintiff organization contended that the State's method for distributing low-income housing tax credits had a detrimental impact on integration.

This time neither the federal officials nor the advocacy groups acted to prevent the Supreme Court from resolving the case. The Court's decision was issued on June 25, 2015, and, in a pleasant surprise for the advocates and the Obama team, held that a violation of the Fair Housing Act could be established under the disparate impact approach. The decision was close, with five of the justices voting to recognize the approach and four voting to reject it.

Justice Kennedy wrote the opinion for the majority and, while recognizing the validity of the approach, also held that "disparate-impact liability has always been properly limited in key respects that avoid the serious constitutional questions that might arise under the Fair Housing Act, for instance, if such liability were imposed based solely on a showing of a statistical disparity." Justice Kennedy's description of the limitations of disparate impact continued for five pages of the decision. He cautioned that such claims must be limited to challenge practices that are "artificial, arbitrary, and unnecessary barriers." He opined that businesses "must be given latitude to consider market factors." He required lower courts to "examine with care" such claims early in the case so as "to protect potential defendants against abusive disparate-impact claims." He held that "[r]emedial orders in disparate-impact cases should concentrate on the elimination of the offending practice."

After a fight that lasted for many decades, the final outcome is best classified as a jump ball. On the one hand, it has been determined with finality that the disparate impact approach is applicable under the Fair Housing Act. Only an act of Congress can now change that. But the limitations on the use of the approach are favorable to defendants who might face such claims. The decision also creates tension with the HUD Rule. Although the Rule was promulgated before the Supreme Court's decision, the limitations described by Justice Kennedy are absent from the Rule.

VIII. Fair Lending Enforcement Against Banks During the Administration of President Donald Trump

Donald Trump assumed the office of president on January 20, 2017. His administration has yet to file a Fair Housing Act lawsuit against a bank, but shortly after his inauguration, the Supreme Court issued another important Fair Housing Act decision in a private lawsuit. The Trump Administration has initiated a process to

reconsider the Disparate Impact Rule in light of the *Inclusive Communities* decision.

The private Fair Housing Act lawsuit is styled *City of Miami v. Bank of America Corp, et al.*, and the Supreme Court's decision was rendered on May 1, 2017. Miami was one of several cities and counties (referenced here as "cities") that, beginning in 2013, sought to use the "enforcement by private persons" provisions of the Fair Housing Act to bring lawsuits against the nation's largest banks to recoup money allegedly lost during the Great Recession. The cases were not the brainchild of the cities, but rather were solicited by private lawyers offering to represent the cities on a contingent-fee basis—the private lawyers would keep a percentage of whatever money they could win from the banks, and the private lawyers offered to cover all costs of the lawsuits and to indemnify the cities from any claims arising from the actions.

The complaints alleged that, as far back as 2004, the banks originated predatory and discriminatory loans, focusing on the subprime loan, which eventually led to defaults, which led to foreclosures, which led to vacancies, which led to blight and reduced values of foreclosed properties, which then led to a reduction in property tax revenue and an increased obligation to maintain and provide city services at the vacant properties. The Supreme Court described this as a "novel" use of the Fair Housing Act and an initial question was whether cities had standing to pursue this type of claim and what the limits of the claim might be.

The Supreme Court held that the cities had standing to pursue such claims under the Fair Housing Act, but the Court also held that the cities must satisfy a "requirement" of pleading and proving "direct" proximate causation to state a "claim" under the Fair Housing Act. To establish "direct" proximate cause, the plaintiff must generally show

that its asserted injuries do not extend "beyond the first step" in the causal chain that begins with the defendant's challenged conduct.

In providing direction to lower courts presiding over Fair Housing Act claims, *City of Miami* referenced settled "directness principles" established in the Supreme Court's prior precedent, including the principle that a plaintiff cannot establish direct proximate cause where the alleged harm may have been produced by independent factors, or where a "theory of liability" rests on "separate actions by separate parties." Indeed, the Supreme Court noted that: "[t]he housing market is interconnected with economic social life. A violation of the [Fair Housing Act] may, therefore, be expected to cause ripples of harm to flow far beyond the defendant's misconduct. Nothing in the statute suggests that Congress intended to provide a remedy wherever those ripples travel."

As of this writing, lower courts are evaluating and seeking to apply the Fair Housing Act's proximate cause standards as described by the Supreme Court. Two of the city cases have reached decisions on the merits. In lawsuits filed by the City of Los Angeles, both Wells Fargo and Bank of America were awarded summary judgment on the merits prior to the Supreme Court's proximate cause ruling, and the district court decisions were upheld by the Court of Appeals for the Ninth Circuit. Similarly, the District Court for the Southern District of Florida awarded summary judgment on the merits in the claim against Wells Fargo brought by the City of Miami Gardens. The city has appealed that final judgment to the Court of Appeals for the Eleventh Circuit.

The *City of Miami* decision may have consequences beyond the recent lawsuits filed by the cities. The requirement of direct proximate causation, for example, might impact both private and governmental lawsuits challenging a lender's so-called "policy" of allowing discretion to independent third-party businesses (such as mortgage brokers) to set

fees that are charged to customers since the independent actions of independent third parties may break the proximate causal chain.

The Trump administration has shown some desire to take a second look at some of the policies of the prior Administration. On June 20, 2018, HUD issued an Advance Notice of Proposed Rulemaking (ANPR) inviting comments on possible amendments to the Rule in light of the decision of the Supreme Court in *Inclusive Communities*. The comment period closed on August 20, 2018. HUD recently told a court in a related lawsuit that the agency received about 1900 comments on the proposed action and needs time to digest them all, so we may not see the results until near the end of the calendar year or later.

IX. <u>What Can Be Done to Avoid Future Claims and What Can We Expect in the Future?</u>

Many predicted that the Trump administration would return to lax enforcement of the Fair Housing Act. There is a reasoned basis for these views, but it still may be too early for accurate predictions. The president does not yet have a Senate-confirmed assistant attorney general for civil rights, and even the Obama administration did not ramp up enforcement activity until that important position was filled—although that did not take as long to accomplish. Part of the lesson from the Bush administration is that enforcement priorities can be unpredictable, such as the focus on redlining claims. HUD Secretary Carson's own background and interests in urban areas may provide some synergies for application of remedies under the Fair Housing Act to benefit urban areas.

Even if the Bush-era policies were perceived as a swing to the far right, the Obama-era policies represent a swing to the far left. These swings are harmful to the credibility of the law, and our industry would benefit from a balanced and understandable enforcement program that endures from administration to administration.

In these circumstances, it is important for lenders to remain vigilant and continue robust fair lending monitoring. It is disturbing to me when I hear of lenders suggesting decreased emphases on compliance because of their evaluation of the current administration. That is a mistake for a number of reasons. The current administration may surprise us, and other enforcers, including private advocacy groups and state and local governments, may step in if they perceive that federal officials are not doing their jobs properly. As the Obama administration demonstrated, a future administration may decide to reach back in time to seek monetary retribution even if challenged practices have long ended. The Division has expressed a view that there is virtually no limitation on how far it can reach back in history to obtain relief under its Fair Housing Act pattern or practice authority, even though a private party can reach back only two years.

The primary focus of Fair Housing Act compliance should be on ensuring that employees treat customers and prospective customers in a nondiscriminatory manner, without differences because of race, national origin, gender or any other prohibited factor. These types of considerations simply have no place in business. They are irrelevant to business decisions. At the same time, employees arrive each day at work with their own biases and prejudices so the challenge is ensuring that whatever personal views they might have are not reflected in the business decisions of your company. That requires regular training and strongly and frequently conveying the policy of nondiscrimination.

Disparate impact issues should not be overlooked, but require a different approach. Rather than employee focused, this type of compliance requires regular evaluation of the policies that the company applies and the impact on differing racial and ethnic groups. The difficulty is that prudent credit standards often impact racial and ethnic groups differently because of conditions in our society that are beyond your control; the Supreme Court expressly recognized this reality in its *Inclusive Communities* decision. For example, black persons in the

United State, on average, have significantly lower levels of wealth than do white persons. Thus, a down-payment requirement disproportionally impacts black applicants. These types of standards are prudent predictors of ability-to-repay and, to this point, federal enforcement officials and even private advocacy groups have stayed away from Fair Housing Act disparate impact challenges to basic credit standards.

There have been rumblings that some advocacy groups might want to lodge a Fair Housing Act disparate impact challenge to credit scoring, but it has not happened yet. Likewise, studies that have been conducted by federal financial institutions regulators of credit scoring have supported a conclusion that the standard models are predictive of repayment performance, are not proxies for race, and thus are likely to withstand any such disparate impact challenge.

The best advice is to look for policies that might be outside the norm of those commonly used in the industry. If you identify policies that are causing less favorable outcomes for racial or ethnic groups and are not commonly used in the industry, it may be more difficult to establish a business justification for the adverse effect.

Your continued best effort does not minimize the need for resolution of lingering legal issues that continue to frustrate all of us and which demand a resolution. One such important issue is the proper standard for applying disparate impact, and HUD's decision to reconsider the 2013 Disparate Impact Rule is a significant step. The Rule warrants revision for a number of reasons. First, it was promulgated prior to the Supreme Court's *Inclusive Communities* decision and has not been tested for conformity with the decision. The Rule has a number of flaws, starting with HUD's decision, at the time of promulgation, to reject the application of Supreme Court precedent that the Supreme Court itself relied upon in *Inclusive Communities*. HUD, in my view, impermissibly pirated a legal standard that Congress enacted for another law but had not applied to the Fair Housing Act.

HUD, of course, does not have legislative authority, and its role is to enforce the law as interpreted by the Supreme Court. Supreme Court precedent for application of disparate impact largely arises from employment law (Title VII) jurisprudence, yet HUD seemingly used Supreme Court decisions that it found favorable and rejected the application of those that it found unfavorable. That should not stand.

The industry needs a reasoned definition of disparate impact and meaningful guidance on the proper application of the standard. HUD can advance the ball by doing that in a regulatory Rule. The task should not be difficult since it is readily available from the Supreme Court precedent that HUD rejected previously and the *Inclusive Communities* decision. The essential elements of disparate impact are: (1) the identification of a specific, facially neutral policy of the defendant that is applied fairly and uniformly but creates an artificial, arbitrary, and unnecessary barrier to housing, (2) a significant, adverse, and disproportionate effect on minorities, and (3) a robust causal connection establishing the challenged policy, not something else, created the disproportionate impact. Guidance that the DOJ and bank regulatory agencies provided in the 1990s, even under a Democratic administration, answered most of the questions that are troubling today.

As noted, HUD pirated a revised Title VII standard that Congress applied only to Title VII, and the Supreme Court has already said the standard HUD used is not applicable to non-Title VII disparate impact lawsuits. Even then, the law that HUD copied is only applicable to Title VII claims that do ***not*** seek money damages, but HUD found it applicable to Fair Housing Act claims seeking monetary relief.

The flaws and contradictions of the Obama team's approach are confirmed by the *Inclusive Communities* decision, such as Justice Kennedy's admonition that "[r]emedial orders in disparate-impact cases should concentrate on the elimination of the offending practice." That

makes a lot of sense, since the elimination of the offending practice should result in the elimination of the alleged statistical disparity. Yet, the Obama team challenged many practices, such as subprime lending, long after they had been abandoned and focused only on monetary damages. It may be argued that these cases presented claims of intentional discrimination rather than disparate impact, but the focus at the time was on disparate impact.

It is equally important to continue to advocate for the proper application of the *Inclusive Communities* decision and other Supreme Court precedent in the federal courts. To this point, with some exceptions, the courts have not paid much heed to the HUD Rule but rather are focused on the proper application of *Inclusive Communities*. Again, the starting focus is on the fundamental concept of a disparate impact claim. Some plaintiffs in recent cases have said that disparate impact means the discriminatory application of a facially neutral policy. That is patently wrong and describes an allegation of disparate treatment rather than disparate impact.

Also, plaintiffs continue to pursue disparate impact claims that appear to be based solely on a statistical disparity, in contradiction of the admonition of *Inclusive Communities* that such claims cannot continue "solely on a showing of a statistical disparity." In an effort to avoid dismissal, the common assertion is that the alleged disparity is caused by a "policy" of allowing "discretion" at some point in the lending process. This type of claim, however, faces the headwinds of the Supreme Court decision in *Wal-Mart* and should not be permitted to proceed.

If the disparate impact theory is cabined to its proper application, it should not present a concern to the lending industry. To the extent that an isolated business policy is having a harmful impact on a racial or ethnic group, and the policy is not based on a justifiable business

reason, there is no principled reason to oppose the elimination of the offending policy.

We need to continue to focus on the proper elements for a claim of redlining. This is a very serious charge and should be reserved for banks that clearly are refusing to do business in certain areas because of the racial or ethnic composition of the areas. The charge should not be levied simply because a bank has operated in a suburban community that borders an urban area, so long as the bank properly serves all portions of its suburban assessment area. It is proper to retain the focus of redlining investigations on an analysis of performance with a bank's CRA assessment area, so long as the boundaries of the assessment area are drawn in a non-discriminatory manner. The push in recent years of some regulators to examine performance in an artificially broader area, called REMA, has no support in law and conflicts with the provisions of the CRA itself which require lenders to focus on lending within the assessment area.

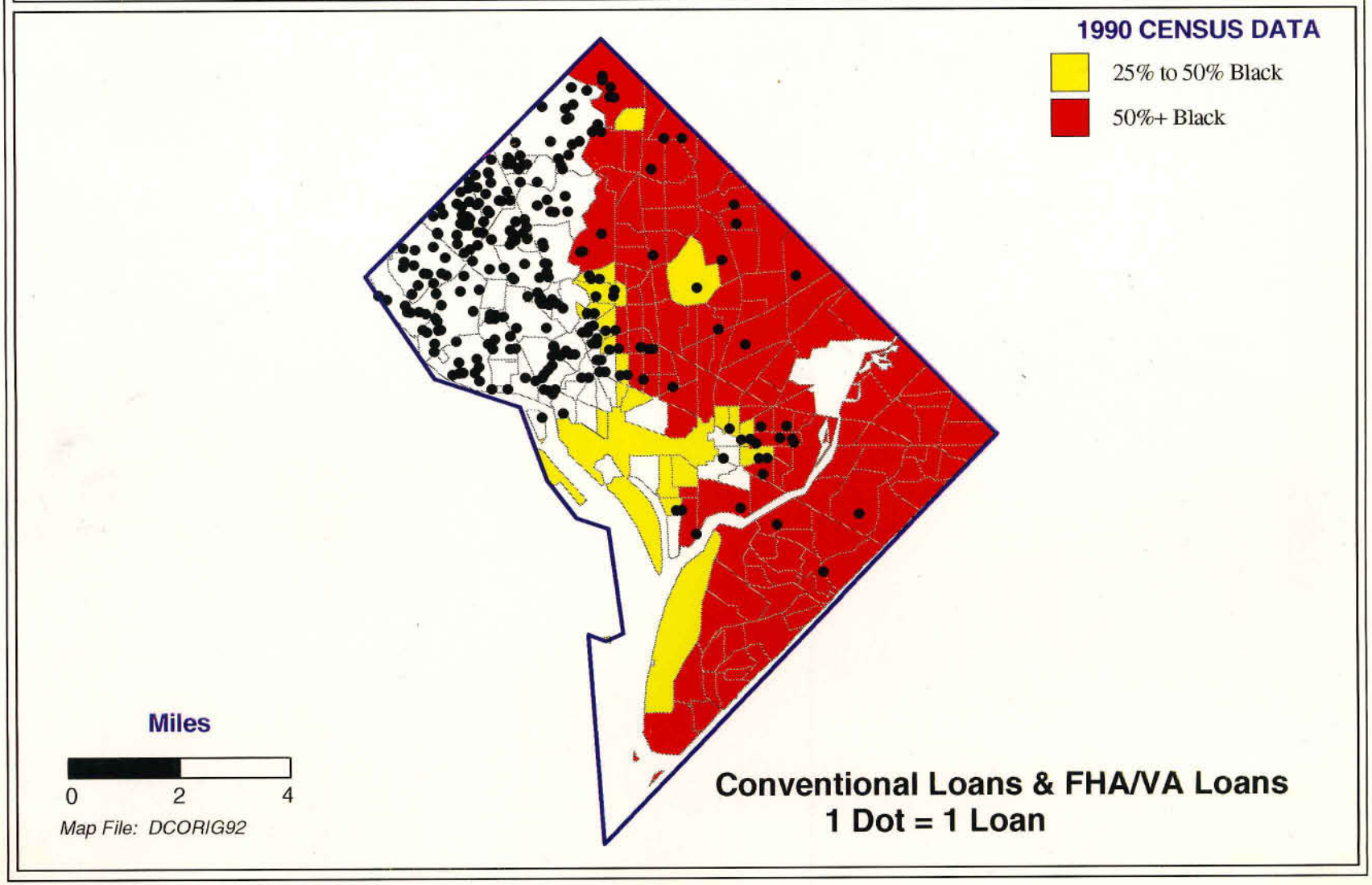
X. Conclusion

Since 1988, mortgage lenders and providers of consumer credit have been a major focus of the Fair Housing Act enforcement program. This has caused some contentious and painful times and the industry has been required to address very difficult issues, but the issues are of great public importance and the progress that has been made is unquestionable. Major advancements have been achieved toward fairness in lending without regard to factors – such as race, national origin and gender – which we all agree have no role in evaluating or treating applicants for products and services. The future rests largely in the hands of those responsible for compliance with the law. The government enforcement actions send signals that certainly are important; however, the progress to date would not have been achieved if industry compliance officials had not spread the word and ingrained the principles in the thousands of people who work in this industry.

This all comes together not because it is a demand from government, but rather from a widespread acceptance that it is simply the right thing to do. Keep up the good work!

Chevy Chase/B.F.Saul Mortgage Company

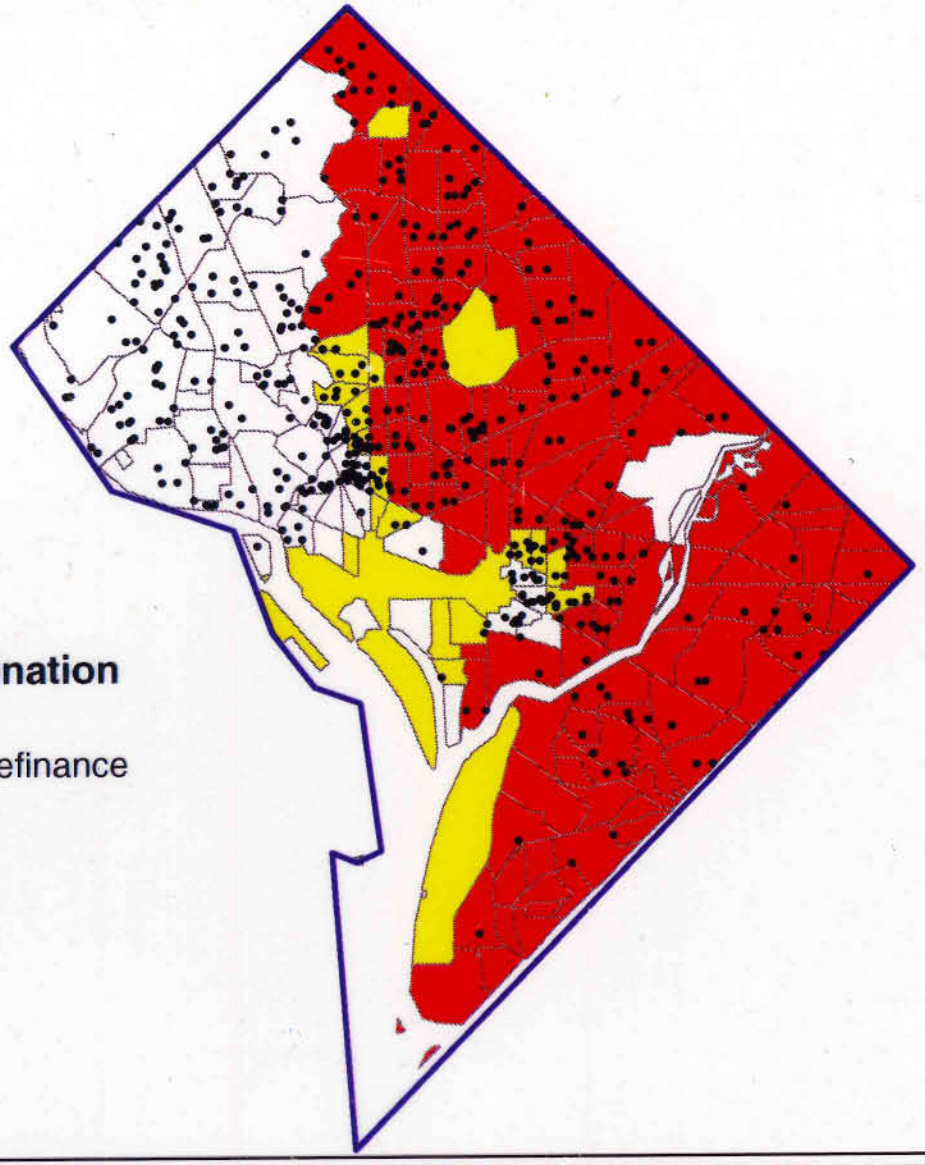
1992 Mortgage Lending (Washington D.C.)



Chevy Chase/B.F.Saul Mortgage Company

Washington, D.C.

Loan Originations, 1994



Percent Black

25.00 to	50.00
50.01 to	100.00

Conventional and FHA/VA Loans

One Dot = One Origination

Home Purchase and Refinance

Miles

0 2 4

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