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FTC Imposes \$2.9 Million Fair Lending Judgment on Mortgage Lender

A residential mortgage lender has recently agreed to settle Federal Trade Commission (“FTC”) allegations of price discrimination, at a hefty price. According to the FTC’s December 16, 2008 press release, the FTC charged the lender with violating the Equal Credit Opportunity Act (“ECOA”), Regulation B and Section 5(a) of the FTC Act by charging African-American and Hispanic borrowers higher prices for mortgage loans than similarly situated non-Hispanic white borrowers.

The FTC’s complaint against Gateway Funding Diversified Mortgage Services, L.P. (“Gateway”), and its general partner, Gateway Funding, Inc., based in Horsham, Pennsylvania, alleged that Gateway’s policy and practice of allowing its retail loan officers to charge applicants discretionary price overages caused price disparities unfavorable to Hispanics and African Americans in 2004 and 2005. According to the complaint, the overage differences were “substantial” and “statistically significant,” and could not be explained by legitimate underwriting risk factors or credit characteristics of the applicants.

Gateway originates both retail and wholesale loans across the country. The FTC complaint alleges that Gateway’s loan officers were permitted to charge mortgage applicants a loan price that exceeded the risk-based price, through a higher interest rate and/or higher up-front charges. The loan officers’ compensation included a flat percentage of the amount of each mortgage loan they originated plus a percentage of the overage charged on the loan. Loan officers had “nearly complete discretion” to determine the amount of overage to charge a borrower.¹ Gateway allegedly placed no limits on the total amount of overage a loan officer could charge, except for the overage and fee caps that are set forth in federal regulations relating to loans purchased by Fannie Mae or insured by the Federal Housing Administration.² Moreover, Gateway allegedly did not review or monitor for price discrimination in the loan prices and overages its loan officers charged borrowers.

Gateway did not admit liability but agreed to settle the matter. The settlement order includes the following elements—

(1) An injunction.

Among other things, the settlement permanently enjoins the company from discriminating against loan applicants based on race or national origin through either its retail or wholesale channel.

(2) Implementation of a fair lending monitoring program.

Gateway is required to:

(a) Develop and implement policies and procedures to ensure compliance with ECOA and Regulation B;

(b) Institute a comprehensive system to perform detailed, periodic fair lending monitoring analyses and reviews, including an examination of whether there are price disparities unfavorable to Hispanics and African Americans and not justified by the applicant’s underwriting risk or credit characteristics, in Gateway’s (i) overall

retail lending; (ii) overall wholesale lending; (iii) retail lending within each branch; or (iv) retail lending by each loan originator; and

(c) Develop and implement policies and procedures for corrective actions if unjustified pricing disparities are revealed. Possible corrective measures include counseling; fair lending re-training; enhanced scrutiny of loans originated by the branch and/or loan originator; limiting pricing discretion; termination; and consumer refunds.

(3) Mandatory, fully documented fair lending training program for branch managers and loan originators.

Fair lending training will be mandatory for all loan officers and branch managers, and must specifically address ECOA's prohibition on discrimination; fair lending monitoring; remedial options; and the contents of the settlement order itself.

(4) A comprehensive data integrity program.

Gateway must establish a fully documented data integrity program to ensure the accuracy and completeness of data and other information it collects regarding applicants, loan officer compensation, and mortgage loan pricing. Under the settlement terms, Gateway must promptly and thoroughly correct any data integrity problems.

(5) A \$2.9 million judgment.

The \$2.9 million judgment for equitable relief is suspended in part due to Gateway's financial condition, provided Gateway pays \$200,000 to the FTC within 5 days of the settlement order. Because Gateway demonstrated an inability to pay, the FTC did not seek civil penalties pursuant to the FTC Act.

(6) Annual compliance reporting and record keeping requirements.

Gateway must document its efforts to comply with the settlement order and must report to the FTC the results of its periodic fair lending monitoring analyses and reviews.

In the past, fair lending compliance has been guided in part by settlement agreements between mortgage lenders and government agencies, and this particular settlement agreement offers new guidance for mortgage lenders to evaluate. The settlement seems to focus on the conduct of retail loan originator employees and retail Gateway branches, and does not address how Gateway should control the pricing of loans originated through non-employee brokers. However, as has previously been confirmed by other enforcement officials, the settlement supports the view that wholesale pricing should be analyzed separately from retail pricing.³

Consistent with other federal and state pricing settlements, the Gateway settlement does not prohibit overages. It does, however, require the company to monitor for, and take corrective action in connection with, price disparities that are "not justified by the underwriting risk or credit characteristics of the applicants." In contrast to recent Justice Department settlements involving auto loan pricing, this requirement does not explicitly provide for price differences that are attributable to borrower negotiation.

Interestingly, the settlement terms require Gateway to establish a robust program to ensure the accuracy and completeness of the information it collects, including information about loan originator compensation, mortgage loan applicants, and mortgage loan pricing. Data integrity issues are common in pricing investigations. Not all mortgage lenders have the resources or technology in place to guarantee the accuracy and completeness of varying types of system data, which can require significant investments of time and money. In the current climate, however, it may be well worth the expense for a mortgage lender to put in place systems to detect problems that are not overt.

If you have any questions about the Gateway settlement, please contact Melanie Brody, Paul Hancock, Stephanie Robinson or any other member of K&L Gates' Mortgage Banking and Consumer Finance Group.

Endnotes

- 1 Complaint for Permanent Injunction and Other Equitable Relief, *FTC v. Gateway Funding Diversified Mortgage Servs., L.P.*, filed in E.D. Pa., ¶ 16.
- 2 *Id.*
- 3 For example, see our summary of the 2006 New York Attorney General settlement with Countrywide Home Loans, Inc. Melanie Brody & Paul Hancock, *NYAG Settlement Focuses on Both Fair Lending and Fairness in Lending*, Mortgage Banking/Consumer Finance Commentary (December 2006), available at www.klgates.com.

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