Consumer Finance Monitor (Season 5, Episode 47): Mortgage Redlining: A Look at the Ongoing Challenges for Banks and Non-Banks, with Special Guest Abby Hogan, Regulatory Attorney and Former Analyst in the Office of Fair Lending and Equal Opportunity, Consumer Financial Protection Bureau

Speakers: Alan Kaplinsky, Rich Andreano and Abby Hogan

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm. I'm your host, Alan Kaplinsky, the former practice group leader for 25 years, and now a Senior Counsel of the Consumer Financial Services Group at Ballard Spahr. And I'll be moderating today's program. For those of you who want even more information, don't forget about our blog. Also, call Consumer Finance Monitor. We've hosted our blog since 2011 when the CFPB goods stood up. So there is a lot of relevant industry content there, including the topic that we're going to be talking about today. We also regularly host webinars on subjects of interest to those in the industry.

So to subscribe to our blog or to get on the list for our webinars, please visit us at ballardspahr.com. If you like our podcast, let us know about it. Leave a review on Apple Podcasts, Google, or wherever you get your podcasts. Also, please let us know if you have ideas for other topics that we should consider covering, or if you want to identify other speakers that we should consider inviting to the show. So today, I am very pleased with both the topic we're covering and the highly qualified speakers that we have for the show. First of all, let me tell you the topic. We're going to be talking about mortgage redlining, and we're going to cover what the various federal agencies have been doing in that space and what to be looking for down the road. This is not an area that is going away anytime soon. It's an area of concentration and it's something that I would say has bipartisan support is isn't a Democratic or a Republican issue.

So let me introduce our speakers today. Very happy to have as a speaker Abby Hogan. Abby is regulatory counsel. She worked at the CFPB for nine years focusing on fair lending, including several dozen redlining examinations and enforcement matters. And she's worked on all three of the CFPB's public redlining settlements. Her background includes both legal and statistical work. She's an active member of both the D.C. and the Montana Bar Associations, has a master's degree in International Political Economy, and she previously held positions at the State Department, the Federal Communications Commission, and the White House. So before I introduce our other speaker, a very warm welcome to you, Abby.

Abby Hogan:

Thank you, Alan. Thanks so much for having me on the show.

Alan Kaplinsky:

Really a pleasure. And second, I'm also delighted to have on our show, I won't say is a guest because he's really a regular on the show, and that is Rich Andreano. Rich is the practice group leader of Ballard Spahr's Mortgage Banking Group. He's devoted over 30 years of practice to financial services, mortgage banking, and consumer finance law. Rich advises banks, lenders, brokers, home builders, titled companies, insurance companies, real estate professionals, and other settlement

providers on regulatory compliance and transactional matters. Federal housing administration issues and administrative exams, enforcement actions and investigations including fair lending matters. That is a very, very long list of areas of expertise.

Rich, I hope you don't add anymore. I almost got out of breath going through the litany of things that you have covered. Rich is the principal contact for the firm in his role as Federal Consumer Regulatory Council to RESPRO, which stands for the Real Estate Services Providers Council Inc. And Rich is also a major editor of our biweekly publication called Mortgage Banking Update. And if you're not a subscriber to that, you should be, and I guess Rich tell you in a minute when he gets to speak how you subscribe to Mortgage Banking Update. So we're ready to get into the heart of this webinar, and I guess the best way to begin is to build the foundation. We'll build from the ground up. And so Abby is our guest on the show. I'm going to let you go first. What is mortgage redlining?

Abby Hogan:

Let's just start from the beginning where the term comes from. And I think a lot of listeners on the show are hopefully already familiar with this, but this dates back to 1930s era New Deal policies under the home, it was called the Home Owners' Loan Corporation or HOLC, and also the Federal Housing Administration at the time. And so as a way to save these underwater mortgages, offer refinancing options, HOLC created these maps of neighborhoods, created by under the direction of their lead underwriter, who is a PhD economist named Homer Hoyt. And he had all these theories about how to preserve land values and property values, and how to get investment into neighborhoods to increase property values. He actually has one of the most highly cited PhD thesis of all time in which he advocates for racial segregation, racially restrictive covenants, and basically all of these other policies that became redlining.

So he created, or he advocated for the creation of these maps. So almost every major city in America has one of these redlining maps, and they're called that because they would actually outline in red where minority populations were most predominant. And at the time, of course, in the 1930s, minority meant something different than it means today. So it was basically anyone other than a white Northern European origin person. So that would include both what we think of today in terms of African Americans, Hispanics, but also extends to Southern Europeans. So Italians would be included in that. Jewish populations would be included in that. And I would recommend if you own a home in predominantly East Coast cities you're going to find this, that was built before 1930. Take a look at your deed, and your home's deed might actually have one of those racially restrictive covenants written into it.

And what those did was prevent the homes from being sold or rented to members of groups that Homer Hoyt, and by extension HOLC basically advocated would reduce property values. So they created these maps that hardened racial segregation, and then directed taxpayer funded investment away from those neighborhoods into predominantly white neighborhoods. And then also made it impossible to transfer wealth between those neighborhoods. So they said, "If you're in a white neighborhood, you can't sell to someone in a predominantly Black neighborhood and vice versa." So that's the origin of redlining, and I think we would really, really love to believe that that's over, that was 90 years ago. But we found just the opposite, there have been a lot of research articles coming out recently showing that actually these same HOLC maps, these redlining maps prove true today.

So you can see today the same patterns of the distribution of who's living in these neighborhoods. You can see the same disparities in investments, disparities in home values, disparities in health and education outcomes. So because of the lack of investment over those many, many decades between then and now, a lot of the consequences of redlining have only been hardened over time. And as we'll talk about, this is something that's still happening today.

Alan Kaplinsky:

Rich, I have a question for you, but before I do that, you tell everybody how they can subscribe to the Mortgage Banking Update if they're not already getting it.

Rich Andreano:

Sure. And you go to our website, ballardspahr.com, and look for our mortgage banking group page. And if you scroll down not too far on that, you can subscribe to the Mortgage Banking Update. And also, I think there's also a link there to subscribe

to the Consumer Finance Monitor as well. I think it's on that page as well as the Consumer Finance Group page. And then you'll get it, it's every two weeks that it comes out. So not like our blog, which is almost daily we'll have one or two, this is every two weeks. And it's a combination of prior blog posts and new material, including material from some of our other blogs such as the Anti-Money Laundering Watch, or our Labor and Employment blog, when they have things of interest to the mortgage industry, we include them as well.

Alan Kaplinsky:

Okay. Thank you. All right. So Abby has done a great job telling us about the origin of mortgage redlining. What is this concept of reverse redlining and does that happen in the mortgage context?

Rich Andreano:

It does not as much as it did, because fortunately the federal and state governments stepped in to stop a lot of the bad behavior. But what it is is the targeting often of minorities with unfavorable loan products. And a lot of that is what led to the mortgage crisis in the 1980s. Because there were products that were designed for near term affordability, and basically they only worked is if housing prices kept going up and an individual could refinance the loan into a more standard or common product. As we know, home prices stopped going up, and there was just a tremendous number of defaults and foreclosures as a result of that. As it was occurring though, you saw the federal government and state government starting to spot that there were some lending going on that they did not consider advantageous, that were really abusive to consumers, would strip them of equity they already had in their home if they were getting a second loan.

And so what you saw is under the Truth in Lending Act, first there was a higher price loan requirements were for more moderately priced loans, some protections for consumers, but particularly the very high cost loans. There was a special high cost loan law passed, and then regulations that prohibited certain abusive practices and also included a basic, the beginning of the concept of determining the ability of the consumer to repay the loan. That the creditor had to have a good faith belief that the consumer actually could repay the loan on the terms they were getting. A lot of states also jumped on board with their own high cost laws, and some of them also included a concept of a net tangible benefit. They were worried about constant refies, which were designed to just earn fees for the lender and not necessarily help the consumer. So this concept of net tangible benefit developed where the loan really had to be advantageous to the consumer for the lender to make the loan.

Well, then the mortgage crisis happens and we got further regulation with Dodd-Frank, which then put in the Truth in Lending Act a much broader concept of the ability to repay. So for pretty much any mortgage loan now the lender has to make a good faith reasonable decision that the consumer can pay the loan on the terms as it is written. And also with product and some other restrictions in order to be a qualified mortgage, which has a safe harbor or rebuttable presumption of compliance with the ability to pay requirements. That stopped a lot of the bad practices from occurring. But can it still happen? In more subtle ways, yes. One program that is actually a good program, but when used properly is the FHA loan program, which is designed for low to moderate income borrowers. But FHA loans tend to be more expensive than their conventional counterparts.

What you see sometimes is a concern that a lender will automatically place a minority individual in an FHA loan when there may be a conventional product that they qualify for. Particularly now with Fannie and Freddie, and banks having these community loan products that are designed for low to moderate income individuals but on more favorable terms than FHA loans, that would be the better alternative. But sometimes you'll see the lender just put them in the FHA loan and because of the mortgage insurance and premiums, it's more expensive. So they don't pay down the house as soon as they could possibly because of the expenses they're incurring. So it can still happen today and it is a concern, and regulators will look for it. They will look for lending patterns not only with redlining are you not lending, but are you making loans with more unfavorable terms that relate to prohibited basis characteristics.

Alan Kaplinsky:

So Abby, do you have anything you'd like to say about that?

Abby Hogan:

Yeah. I'll just echo Rich's really good point about FHA loans. I think those were originated as a product to help people who couldn't qualify for other loans. And just like he said, they often are targeted to consumers, often consumers of color who could qualify for a more advantageous loan. And I think some of those FHA loans would actually qualify under some of the definitions of subprime loans, even if you take a look at the fees involved. So something to think about further there. I'll also add in manufactured housing that I think we could do a whole podcast just on manufactured housing. It's a pretty fascinating area, but that is an area ripe for reverse redlining claim. Because if you look at interest rates in that space, a lot of those loans in some states are chattel loans, some states they're real property, and those interest rates are regularly over 12, 15% for manufactured housing. So that is an area that in the future we might be seeing some reverse redlining claim.

Alan Kaplinsky:

Yeah. I guess as a person doesn't practice in the area or never has, it just surprises me that there has not been more media attention paid to the fact that FHA mortgage loans are very often subprime loans. And that you would think a government product is by definition something that is good for everybody and it's not. I think very, it's a good idea that at least we focused on that today.

Abby Hogan:

And I'll just stand up for the FHA loans for a minute here. I don't think the product is on its face predatory, but I think it's how it's applied. It's when a lender assumes that a borrower might not qualify for a more advantageous loan, but I would argue there's still very much a place for FHA loans for borrowers who couldn't qualify for a conventional loan.

Rich Andreano:

And I actually refer to the FHA program as a subprime program, not being pejorative though. It is designed for people who can't meet your standard a loan characteristics, but it's built... While more costly, it has built in protections for the consumer. That's a big difference between the subprime that came before that, which were truly abusive in many respects to their consumer. But the one thing I keep saying with FHA was designed to prove that low down payment loans could work, that the Fedora rate might be a little higher, but they worked. And I said, "Well, it's proven that. It's now time for FHA to evolve into something else where we really get loans with down payment assistance. Where there's some investment, but if a consumer is proven that they could pay rent continually, they could probably make a mortgage payment that's the same amount, particularly when you get the tax affected benefits." So been waiting for HUD and Congress to evolve the FHA program into something more modern.

Alan Kaplinsky:

Yeah. All right. Let's go back to redlining again, not reverse redlining, which we've been talking about. And then, Abby, is redlining still happening today or is it a thing of the past? How common is this? Are there any new theories of redlining?

Abby Hogan:

Well, I think all of us wish that we lived in a time and place where it wasn't happening anymore. I think it's a really enticing thing to think that we've got moved beyond this. But I am sad to report it is very much still alive today. You can take a look at, I would highly recommend actually for the lawyers in the audience take a look at the complaints and the consent orders from some of the recent redlining claims. They all include some pretty tough facts in them. I was just rereading one of them this morning, one of the more recent actions from Trident. And the complaint has three pages in which they just go through the racist emails they found from the employees at Trident Mortgage.

And I would read through it on this podcast, but the language is such that I wouldn't feel comfortable reading it out loud here, which I think should be an indication of just the kind of feelings that folks still harbor. That's leading to this still being a practice that's alive and well. You can take a look. These most recent settlements, they're big settlements. This is a huge hit for the financial institutions that end up as the subjects of these investigations. Most of these financial institutions can no longer

operate under the trade names that the consent orders are against. And they often continue operating under new trade names because their businesses are so damaged reputationally from these actions. So I would say this is totally alive and well. And I think in the modern day we're seeing it's shifting, right?

It used to be more overt discrimination. It's much, much easier for the civil rights lawyers in the audience. It's a lot easier to bring a civil rights case if you have some smoking gun facts, if you have overt racism. And it's a lot harder to find that. But the fact that we're still finding that and Trident action was announced this year, this is 2022, and we have racial slurs in work emails from mortgage lenders. So that's rare and that's where you get these huge $20 million plus settlements from. But you can find this evidence in a lot of more subtle ways. And I think we're starting to see some movement in the digital redlining space, which is looking at actors like Facebook or Google that have the ability to target advertising based on demographic characteristics of consumers and based on physical location of consumers. And I think that's going to be a really exciting emerging area.

Rich Andreano:

Two areas. One, and I had seen, and there's also in Townstone, there were some communications that the government latched on. So I talked with all of our labor employment attorneys and said, "Is this a lender issue or is it an employer issue?" And they said it's an employer issue. Companies in general need to have good policies and procedures and training around what is permitted and what is not acceptable in internal email communications. And even it gets tougher in social media posts that gets a little harder to regulate. But in fact our group, they do conduct training and develop policies and procedures and I said, "What about monitoring?" It says, "It can be done. There's some privacy issues that you have to go through." But I said, "Had you have this in employment area?" Sure, allegation of toxic workplace, they'll find the emails that will support those allegations and the government says, "See, here's the proof right there."

So it's really important to have policies and procedures, and train on this because the government will take what will be... And they'll be clearly inappropriate, but it'll be a handful out of millions. But then they'll say, "They don't look good," and they'll say, "It's representative of a toxic or biased culture." So that's one point. The other with digital, CFPB Director Chopra, this is one of his mantras basically now on, as I said, the targeted advertising, which scares the heck out of me. Just because technology allows us to do something doesn't mean we should do it. It still has to be right and comply with the law. Also, they're looking at the automated underwriting engines and the thought is, well, this will remove subjectivity. That's true. But the argument is they've built into it these factors that are less favorable to minority populations.

And folks are starting to look at that now. I know there's one company that what they did is they built a model that didn't have access to racial data, and then built another that did. And when the one that didn't have access was treating minorities unfavorably, the one that had access was talking to it saying, "Hey, you're treating minorities unfavorably. Let's figure out why." So they're trying to develop more sophisticated artificial intelligence to get the root causes out of the system. And the third area related to a big issue nowadays, appraisal bias is the automated valuation methodology. And does that have discriminatory factors built into it, such as by location of the property relating to what the people look like in that location. So these are all new areas to look at. So redlinings become a much broader concept than what it used to be.

Abby Hogan:

Yeah. And just to add onto that with these data sets, that whole algorithmic bias and algorithmic underwriting is really fascinating from a data perspective. So if you're using, most of these algorithms use a training set on historical data. And if we know that we haven't been totally immune from racism in the past, but we're using these historical data sets that we know reflect some amount of discriminatory outcomes to build our algorithms going forward, then we have to do all this adjustment to make sure that they're not perpetuating the same racism and the same type of discriminatory outcomes. So that is definitely an emerging area, and there are a lot of players in the FinTech space trying to address this effectively.

Alan Kaplinsky:

Yeah. So Rich, another question for you. Can non-banks, non-depository lenders redline, and do you need to, I guess put differently, do you need to have a CRA area in order to redline? We're talking there about the Community Reinvestment Act.

Rich Andreano:

Traditionally redlining enforcement was something involving banks particularly I think where, because you'd see the CRA assessment area in a metro area and it would be the bank inviting the challenge where if their assessment area was a donut or a horseshoe and it carved out the minority areas of a metropolitan area. I said, "Just draft your own complaint consent order because it's coming." So that was the original focus. But some years ago we saw the bureau looking at non-bank mortgage lenders, and they were looking to bring the first case against a non-bank mortgage lender. And basically, the assessment is exactly the same, they don't care that non-banks are not subject to the Community Reinvestment Act. And they'll apply the same exact theories and they'll even compare, they do a peer lender comparison, which is anyone lending in an area that has between 50 and 200% of your application volume bank or non-bank.

So they really treat them the same. The first salvo was the Townstone complaint, which was filed in July 2020. That matter is still progressing through the court and they've been briefing that, and we'll see what happens there. This July there was the settlement with Trident Mortgage, which was the first actual consent order involving a non-bank mortgage lender. And we understand that there are other investigations involving non-bank mortgage lenders underway. So while it used to be just the banks were subject to this, now it's equal, banks and non-banks are equally subject to this. And we're even seeing concepts, states are doing it and there's always been debate, do we do it at federal level? Do they take community reinvestment type concepts and extend them to non-banks?

And we're seeing the states start to do the very thing even though the basis of the Community Reinvestment Act is completely separate. If you're taking deposits from an area and they're federally insured, well, we're going to attach that in obligation to serve the low and moderate income areas of where you're taking deposits from. Obviously non-banks don't have that, but moderate governments don't really care about that distinction. They say, "If you lend in an area, you should lend in the entire area and not exclude segments of the metropolitan areas that you're lending in." So it is now a clear issue for both banks and non-banks.

Abby Hogan:

Yeah. And I'll add on CRA areas are pretty fascinating as a subtopic, and I'll just share a few hard lessons I learned personally, one of which on an exam. There's a lot of gamesmanship with CRA assessments, and a number of financial institutions that have both a depository lender that's federally regulated, and then a non-depository mortgage company, which is common, and a lot of the larger mortgage banks. A lot of them will actually do this gamesmanship where they put all of their CRA credit eligible loans under the depository bank, so that they get the CRA credit and they'll leave them all out of their mortgage company. And so if you look at their risk profiles, the mortgage companies will light up when you do these risk assessments, because they're pushing all their CRA loans over to the banks.

And the result is that people have learned how to game these scores. So I think the latest published data was 92% or so of CRA ratings are satisfactory or higher. It's not a very high bar. Almost everyone passes, and it's something that the Federal Reserve is currently doing a rewrite for right now. So we can expect a lot of changes to the CRA down the road, and it's something that the states are also glomming onto. So New York recently announced a state CRA, which explicitly applies to both depository and non-depositories, folks operating in New York, that affects just about every market lender operating in New York State.

Alan Kaplinsky:

Okay. So Abby, what kinds of penalties, formal or informal could a financial institution, and by that I'm encompassing banks and non-banks face if it's investigated for redlining? And I guess right now let's focus on the federal area.

Abby Hogan:

Yeah. They're steep. If you compare penalties for different types of violations, even different fair lending violations, the redlining violations consistently from my experience have had the highest penalties. Typically, the fines are massive, on the federal level you're looking at a 10 to $30 million range for these federally regulated banks and non-banks. The reputational damage, I haven't seen a single financial institution come back from it. None of the big redlining enforcement cases, those

financial institutions and none of them are still operating under that trade name. They've all been bought and operating under a new trade name. So the reputational damage is massive. So the financial piece of it is there's some of it that goes into a civil money penalty fund. And then, there are also these loan subsidy funds that are basically funding.

It's saying, "You've deprived these communities of credit that they qualified for over many years, and now you need to create a fund to allow folks to make it easier to come up with a down payment to lower their interest payments over time," things like that. So there's that component. And then, I think one of the interesting controversial components of some of these consent orders is the requirement to create new branches in minority neighborhoods. Especially as we're seeing this industry-wide trend of consolidating physical branch locations. So being ordered by the federal government to create a new physical branch location in these underserved neighborhoods is a pretty fascinating one. So the penalties are pretty steep for these actions.

Alan Kaplinsky:

Yeah. I'd like to just clarify for everyone. Are we talking about in terms of the statutes that DOJ is focusing on or the CFPB, are we talking about the Federal Housing Act? Is that the statute? Or are we talking about other ones?

Rich Andreano:

Two, there are two main statutes that they're using. Equal Credit Opportunity Act, which applies to all credit including mortgage. And that is in the purview of the CFPB and also Department of Justice. And then, the Fair Housing Act which is with HUD, but HUD has to go to the Department of Justice to get a lawsuit file, and also the financial regulators can make referrals to the Department of Justice. Fair Housing Act is, it's both borough and narrow. It has to involve housing, but it involves all aspects, not only lending but brokerage, appraisal, insurance, pretty much any aspect of a residential real estate transaction, it prohibits discrimination in connection with. And in this area, there's an interesting issue that one day may end before the Supreme Court. It's the federal housing, the Fair Housing Act rather was designed to prohibit redlining. So it has specific language prohibiting making unavailable real estate, residential real estate related services in an area.

Because that's one of the things Congress was trying to stop was redlining in the Fair Housing Act. Its genesis was different. Its original Genesis was to prohibit discrimination against women, be single women or married women. The other demographic factors were added later. There's a question whether it applies to redlining, because the statute refers to discriminating against applicants. The regulation refers to discouraging prospective applicants. Although, my thought is there was a practice, and it unfortunately may still occur today, where minority applicant would be sitting for the loan officer and they said, "You're going to get denied anyway. You shouldn't really apply," and that went on, and that to me obviously is covered. Redlining is more, you're just not trying to get the applicant person in as an applicant. So I think there's a question whether it applies to redlining and some say, "Well, what's the difference if they get you under the Fair Housing Act isn't the same?

I say, "But Dodd-Frank expanded the statute of limitations of the Equal Credit Opportunity Act from two to five years." Fair Housing Act as a much shorter statute of limitations. There is a significant difference because of that. And also the bureau has a COA, HUD and Justice have the Fair Housing Act. So who the regulators are also differ in addition to the statute of limitations. The Townstone case, they've said it doesn't apply. I don't know if that's the vehicle that gets up to the Supreme Court. It's very expensive to bring a case up to the Supreme Court, and it usually takes quite a large player to do that.

Alan Kaplinsky:

So a CFPB has got no authority to enforce the Fair Housing Act, Rich?

Rich Andreano:

That's correct. But they can bring in their sister agency HUD, that's always something they could work together on. We've seen them do that and sometimes bring in another federal agency and/or a state agency when there may have been a jurisdictional issue, or the violations encompassed various statutes. So they brought in the agency that had the jurisdiction over that other statute.

Abby Hogan:

And I'll add on to here again for the civil rights lawyers in the audience, you already know civil rights law is probably one of the most complicated patch works of legal practice out there, or at least I would make that argument. And so in these complaints you might see, "Oh, this is an an ECOA claim," or, "This is an FHA claim." But there's this whole, that's the tip of the iceberg. That's what they're putting in the complaint. But there's all of this other stuff happening underneath that. So in civil rights law, of course something that affects consumer finance can also affect employment law, and vice versa, right? So a lot of our really important jurisprudence comes from employment law and other areas of Supreme Court jurisprudence. So a lot of these cases have references to other past cases. So Hazelwood is a really key case, and basically saying statistical disparities on their face. If you say, the odds of the statistical disparity happening absent some intent is so slim, we have to infer intent.

So you have that jurisprudence, you have Title VII, and then I think you'll also see these new claims being added. The bureau has announced its intention to include a UDAP, so unfair, deceptive, or abusive act or practice. So discrimination is unfair is the tagline. And of course they've already received a legal challenge on that saying it's overreaching the purpose of UDAP. But I think there are just so many regulations at play in all of these claims, and I think we're going to see more being added as that area develops.

Alan Kaplinsky:

Okay. So Rich, it seems like the federal government is all over this issue. At least I don't hear too much about anything happening at the state level. Anything going on there? And can states utilize the same federal statutes, or they have their own statutes they utilize?

Rich Andreano:

They have their own, and many of them are copied after the Equal Credit Opportunity Act and the Fair Housing Act. So they have their mini state versions of that, and they can be broader. Sometimes the prohibited basis of discrimination include other factors that are beyond the federal factors as well. So it's important to know the states you operate in and what additional factors they have. They can more clearly get to gender identification, veteran status, other things that aren't in the federal laws. In the Trident settlement, there actually were separate much smaller settlements with Delaware, New Jersey, and Pennsylvania. They were involved somewhat more behind the scenes, but they were involved.

And we're seeing more and more states look in this area with the adoption of community reinvestment type requirements. You could see they're looking at the concept of redlining and saying, "Non-banks, in addition bank, you need to lend to all areas of the communities that you're in." And I think once we get these substantive laws on place, then you're going to see the enforcement of those substantive laws by the states. But they're clearly looking at this, and I think again is if we get a different administration in 2024. I think after that we'll see what we did during the Trump administration, whereas a lot of the blue states, based on the perceived step back, will increase their efforts in this area.

Alan Kaplinsky:

Okay. So Abby, since you've spent nine years at the CFPB, the question I'm going to ask you should be an easy one and that is, what kinds of evidence do regulators look at when conducting an exam or bringing an enforcement action pertaining to redlining?

Abby Hogan:

Yeah. This is a great topic for any of the compliance folks listening in. I would highly, highly recommend if you are in a compliance shop of a mortgage company or a bank, grab a consent order, read it, and it's a checklist of what not to do, right? So I think some of the most egregious evidence has been advertising patterns, lending patterns. So you'll see in these huge enforcement actions, this distinct pattern of carving out specific zip codes or carving out specific neighborhoods for targeted advertising, hugely risky. Also, the content of the advertising. If you use human models on your advertising, they need to be diverse. If you send ads showing only white consumers to a predominantly minority area, there's actually quite a bit of good

case law showing that that is discouragement, and that will count against you for a redlining case. It's typically like a balancing factors test for redlining. It's not typically just one piece of evidence that makes a redlining case. It's disparities in advertising that lead to disparities in lending.

Typically, there are also disparities in branch locations, branch hours, branch services. You'll see often financial institutions that have been the subject of redlining matters often have very low diversity among their staff. So financial institutions say located, I don't know, in Birmingham, Alabama and they have no African American loan officers. How does that happen? How could that be an accident? So that's another risk area sometimes folks don't think about, but it goes to the mindset and the operations of the business of if you're excluding half the population of the area you're in from your employee base, then it lines up with you excluding in your advertising.

The employee emails, that's a more recent development. I would read through that. If you're a compliance officer for any mortgage operation, pull out the Trident complaint, read pages 11 through 13, and then try to go back to your office and not demand that you do the same email search of your own employees. It's really shocking. That complaint includes slurs for just about every ethnic, religious, racial group you can think of in there. Really offensive stuff that most of you probably haven't heard for several decades if at all. And just the thought that employees are sending that stuff around. It really is the nail in the coffin for a redlining case.

Alan Kaplinsky:

Rich, do you have anything to add?

Rich Andreano:

One thing, if you're not doing it now, you should be doing it is either internally or with a third party. Do an assessment of what the government will likely pick as your peers. And look at the HMDA data, because that's what the government looks at to see how do you rate in terms of getting in applications from minority areas and lending in minority areas, and compare it to the peer institutions. If you wait until the CFPB knocks on the door, it's too late. You have to have done the analysis. And then in particular, one thing the bureau notes in a lot of these settlements, the entity did the analysis but didn't do anything to remediate. They just, "Oh, we're behind to our peers." Okay. They didn't do anything to then, "Okay. Well, let's increase our outreach. Let's hire diverse loan officers. Let's send people into the communities. Let's get our applications and lending up."

So that's a good thing. You really need to be doing that. And I know it's expensive. It's now nearly as expensive as one of these settlements. So it's something to do, and there's even software more, it's easier to do than it used to be with technology. So I do encourage that people conduct those assessments internally.

Alan Kaplinsky:

Yeah. Yeah. Abby?

Abby Hogan:

Yeah. I'll just add on to what Rich was saying about doing those assessments ahead of time. I'll say several of the matters I worked on, institutions had received unfavorable results from their own auditors showing these egregious redlining maps. Their leadership for two, three years had been getting these failed audit results on their redlining risk and did nothing. And that's another nail in the coffin if your lending patterns are already showing a high fair lending risk or a high redlining risk, and then you show that the board or that the bank leadership knew about this and did nothing about it. That's totally different than if you get back bad audit results or bad compliance vendor results, and then you create a plan to fix it. I think regulators go a lot easier on financial institutions that are actually self-monitoring and doing that self-correction. And I think if the subjects of previous matters had done anything to address those bad results previously, the results might not have been so severe.

Alan Kaplinsky:

So Rich, the next question I'm going to ask you, I think you may have already answered, but there may be some additional things that you might want to add. And that is, what does remediation look like?

Rich Andreano:

And this is a fairly similar to the consent orders that what the agencies look at is, there's a blueprint basically for what they look at. There is also almost a blueprint for what you need to do. And as we mentioned before, the dollars first this large, because a lot of it, what I call the consumer redress part of it, we'll get into what that looks like. In the last three redlining, the federal government redlining matters, the total consumer redress was $38 million just in three matters. One of them interestingly didn't have a civil money penalty, but two of them did and it was four million each. So $46 million among three entities is that's a lot of money. And that doesn't include the costs of establishing new offices, hiring new people, implementing new programs, that there's obviously costs. One of the things they first do is, "Okay. We're going to have this loan subsidy fund set up, but you need to do a credit needs assessment to really see what is the need for credit in your area, and how can that loan subsidy fund best be used?

Would it be buying down the rate, providing down payment assistance, providing closing house assistance, paying the upfront mortgage insurance premium if it's an FHA loan, or the funding fee with the VA loan?" What would get the most bang for the buck in helping people to become homeowners? That's one thing. And you combine that with the loan subsidy fund, and that usually is the largest dollar total of the settlement that the government and the institutions both say, "Let's get the most dollars into the hands of consumers, because that's really going to remediate the issue." The advertising and outreach get into all the areas of community. "Hey, we're here. We are ready to make loans. Hire more diverse loan officers. Get them into communities, set up relationship with, they call it Community Development Partnership Plan to get out there into the community development organizations, into the churches, and other organizations to get the word out that we're ready to make loans.

You set up educational seminars, home buying seminars, just really to help people ready to become homeowners, and then letting them know you have credit there available for them. Get physical offices, in addition to sending people in, have some physical offices put in these areas where you can get a lot of traffic in through that way. And then, a lot of training of employees and executives. They do a lot of fair lending. I think that training needs to include diversity training as well, because a lot of the issues I think come in with the biases that we have all built into us and we don't realize that we're acting on, and that management and employees each need to be trained in that. I think that's an important factor. But a lot of these consent orders, it's the same exact approach that it's really starting to become a blueprint for how they solve what they perceive as the redlining.

Alan Kaplinsky:

Yeah. Let me ask you this, and I'm going to make a statement and I assume you're going to agree with it. It's not enough to do just all the reaching out that you've described to encourage applications. If you don't actually approve people for credit, I assume that you're still going to have a problem, right? I mean, you can't just go through the motions and that's not going to help you.

Rich Andreano:

Right. They're going to look at both, do your applications from minority areas increase? But also the proof in the putting, do the loans made in the minority areas increase? That in the end, and if what you're doing at first doesn't work, then it's, "Okay. What do we need to change to make it work?" So it's not just, we'll come up with a formula, implement it, and what happens happens. The goal is to increase the applications that increase the lending. Now, fortunately, what I think will make that easier going forward is you're seeing FHFA working with Fannie and Freddie to broaden their underwriting criteria to bring in more data, to bring in rental data. Recently now it's Freddie Mac's going to look at bank statement data, other things to show through non-traditional credit that someone has an ability to incur expenses and pay them on a timely basis, and use that as proof that they could pay a mortgage loan.

So I think we're going to get more flexible and frankly long overdue underwriting standards in this area. So it's not just the narrow little credit box you have to fit into. It's if someone occurs in an obligation, whether it's credit or non-credit, and they're always repaying that obligation, that shows responsibility. And I think that's where we're moving towards and doing underwriting.

Alan Kaplinsky:

Sure. So we're getting close to the end of our program today. But we would certainly be remissive, I didn't ask this last question and going to ask Abby to respond to it, and then find out if Rich wants to comment. And some of these things you've already talked about. But I think it's a good idea at the end of the program to bring it all together. How can a financial institution build a strong compliance program to prevent redlining?

Abby Hogan:

Yeah. This is maybe the most important thing we talk about today is how do we stop this from happening over and over again. So I think to start, the risk profile is very different depending on the type of financial institution. So I'll start there. I think often the very largest depository institutions have really solid compliance departments that are already doing the monitoring, testing, auditing to look out for this. And the very smallest institutions, some of the CDFIs, some of the MDIs, all of these community focused small banks, I would say they also are on the lower risk end of the spectrum because they know who they're lending to. They don't need some special vendor to come in and map it for them because they know all the people they're lending to.

So I think at the very large and the very small ends of the depositories, the risk is lower to start with. But it's those midsize, it's the regional depositories, and then also the non-repositories of all sizes where I would say the greatest risk lies. Because they don't have that one-on-one touchpoint with the folks they're lending to, and they don't have the huge budgets of the very largest banks to do the compliance work. So I think there are different risk profiles, and then different complexities involved in doing that fair lending monitoring. For those higher risk entities, I think it's really essential that they're doing some analysis of lending patterns that can be a simple map. Just look at a map of where your loans are going and look at a map of the population of the city where you live. That is not incredibly difficult to produce, hopefully your marketing department is doing that for you already, if not, you should talk to them.

But take a look at that, take a look at your denial disparity rates and see, are we denying folks with similar credit scores depending on where they live, or depending on demographic variables? Those are great risk indicators. Take a look at where your branches are. Do you have branches serving across your portfolio? Or are they concentrated in higher income or lower minority neighborhoods? Look at the diversity of your staff. Your staff should reflect the area that you're working in. If you work in a really diverse city and your staff doesn't reflect that same diversity, then I would go do some soul searching and realize you're missing out on a lot of expertise in your community. And I think that's what it bakes down to at the end, right? You're missing out on business opportunities, you're missing out on making loans to qualified borrowers.

So the goal here, it should be a shared goal of marketing and compliance. So this is a ripe area to find additional business opportunities, and to get credit into neighborhoods where folks haven't been adequately served in the past but do qualify. So I think there's a lot more that could be said. There are a lot of great compliance vendors out there. I think some of the cost of those might be out of reach for folks. And so some that's where the increase in mortgage fulfillment services providers are coming in is conglomerating like putting together all of those services. So you're sharing the cost of compliance, because that can be quite a large cost to do particularly fair lending compliance. I don't know. Rich, what else do you think on this?

Rich Andreano:

It's a lot. One thing, and I know it's harder for smaller entities, but those particularly regional. If they don't have a community lending type program and department, they really need to have one. And a lot of it says, "Oh, but the economics," well, you're not hiring your typical loan officer, a loan officer is a salesperson, what you're hiring is a consumer support person. Basically people who want to help consumers, and they get hired and they're paid a salary, maybe some bonuses, but they're not commission driven, and so the costs are more constrained. So you could make these products to low and moderate income people rather. And also think, obviously there's some fair housing aspects, so we do have a HUD interpretation. But look

about the implementation of special purpose credit programs. If you still are finding that certain people can't qualify, they need extra assistance to qualify, and what a special purpose credit program help do that.

You're seeing a lot of that done, particularly among the big banks, but also among the community type lenders looking more in that area where, is there something that's really stopping someone from being a homeowner? And we have to offer additional assistance, and we could do it through either a normal vehicle or a special purpose credit program vehicle. So those are things to all take a look at. In the future, we're going to have our regular lending arm, but we're going to have a community lending arm that really focuses on the low to moderate income areas, and getting loan products into people who right now can't qualify.

Alan Kaplinsky:

Okay. Well, we've come to the end of our program today. I know I learned a lot today and I hope our listeners learned a great deal about mortgage redlining and reverse redlining. So let me thank first of all our special guest, Abby Hogan, pleasure having you on the program. And I want to thank my colleague Rich Andreano for joining us today. And to make sure that you don't miss any of our future episodes of our podcast show, subscribe to our show on your favorite podcast platform, be it Apple Podcasts, Google, Spotify, or wherever you regularly listen to your podcasts. And don't forget to check out our blog, consumerfinancemonitor.com for daily insights of the financial services industry.

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