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Modern-Day Redlining Enforcement: A New Baseline

Nanci L. Weissgold, Brian Johnson and Melissa Sanchez Malpass*

The Biden administration's focus on racial equity extends to many areas, and homeownership is the latest. This article analyzes new federal enforcement actions on alleged redlining to find patterns that can guide banks and nonbanks alike through to compliance.

Last fall, the U.S. Department of Justice ("DOJ") announced an aggressive new initiative, in collaboration with U.S. Attorneys' Offices throughout the country, to combat the practice of redlining.[1] In addition, the Consumer Financial Protection Bureau ("CFPB") was said to be hiring[2] up to 30 new enforcement attorneys to focus on redlining and other fair lending enforcement. While these developments are not surprising for an administration that has emphasized the importance of promoting racial equity, particularly in homeownership, this swift and purposeful action by federal regulators signals that these agencies mean business. Indeed, as evidence of this new priority, federal regulatory agencies have issued two multimillion-dollar[3] redlining settlements against financial institutions in just two months.

BACKGROUND

Since the early 1990s, federal regulatory agencies have recognized redlining as a type of illegal "disparate treatment"[4] (i.e., intentional) discrimination that

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[1] https://www.justice.gov/opa/pr/justice-department-announces-new-initiative-combat-redlining.

[2] https://www.housingwire.com/articles/cfpb-adds-firepower-to-enforcement-division/.

[3] https://www.consumerfinance.gov/about-us/newsroom/cfpb-doj-and-occ-take-action-against-trustmark-national-bank-for-deliberate-discrimination-against-black-and-hispanic-families/.

[4] https://www.fdic.gov/regulations/laws/rules/5000-3860.html.

violates federal fair lending laws such as the Fair Housing Act and the Equal Credit Opportunity Act ("ECOA"). For example, in 2009, the agencies defined[5] the term "redlining" as a form of disparate treatment discrimination where a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other protected characteristic of the residents of the area where the credit seeker resides or will reside or where the residential property to be mortgaged is located. As recently as 2019, the DOJ continued[6] to use the term "redlining" to refer to a practice whereby "lenders intentionally avoid providing services to individuals living in predominantly minority neighborhoods because of the race of the residents in those neighborhoods."

EARLY ENFORCEMENT ACTIONS

To that end, the earliest redlining enforcement actions were brought against banks whose alleged intent to discriminate could be the only explanation for the bank's geographic distribution of loans around, but not in, minority communities. As proof of a bank's intent to discriminate, the DOJ produced brightly colored maps to support its position that a bank had unnaturally drawn its service area boundaries to circumvent minority neighborhoods from its mortgage lending and then painstakingly adhered to this "red line" to avoid serving these neighborhoods.

In Atlanta, one bank allegedly drew a red line down the railroad tracks that divided the city's white and black neighborhoods, while in the District of Columbia, another bank allegedly drew its own line down the 16th Street corridor. Years later, in Detroit and Minneapolis-St. Paul, still other banks were alleged to have served a virtual "horseshoe" encompassing white neighborhoods while carving out minority neighborhoods. And again, in Indianapolis, a bank allegedly drew an "Indy Donut" that encircled and excluded the minority areas in the center of the city.

In these cases, given that the banks were required by the Community Reinvestment Act ("CRA") to define the areas they intended to serve, the DOJ pointed to the banks' use of different, and in some cases, oddly shaped, service area boundaries (as opposed to existing legal borders or contiguous political subdivisions) as evidence of intent to discriminate.

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[5] https://www.ffiec.gov/PDF/fairlend.pdf.

[6] https://www.justice.gov/opa/pr/justice-department-settles-suit-against-indiana-bank-resolve-lending-discrimination-claims.

EXPANDED APPROACH TO REDLINING

Today, the majority of mortgage loans in the United States are made by nonbank mortgage lenders that, while not subject to the CRA's requirements, remain bound by the antidiscrimination provisions of the Fair Housing Act and ECOA. In lieu of maps and service area boundaries, federal regulators now look to the loan application and origination data reported by the lender under the Home Mortgage Disclosure Act ("HMDA") as the starting point for a redlining investigation. If the HMDA data suggests that a mortgage lender's generation of mortgage loan applications or originations in majority-minority census tracts might not be as strong as that of its "peers" (e.g., similarly sized competitors), a federal regulator may initiate an investigation to determine whether the lender has violated fair lending laws.

Of course, because data about "racial imbalance" has been deemed by the U.S. Supreme Court to be insufficient for establishing a prima facie case of discrimination, a federal regulator must supplement the data with evidence that the lender's arguably weaker performance in minority neighborhoods may have resulted from an intent to discriminate by excluding or otherwise treating those areas differently.

Recently, however, the evidence cited by federal regulators to establish redlining has evolved and expanded significantly. Specifically, regulators appear to be relying on a "discouragement" theory of redlining that looks at the totality of the circumstances to determine whether a reasonable person would have been discouraged from applying for a loan product or service—perhaps regardless of whether the lender intended to discriminate. It is worth noting that this theory derives from ECOA's implementing regulation, Regulation B, which extends the statute's protections to "potential" applicants, and is not found in the language of ECOA itself.[7] While a lender is prohibited by Regulation B from making discouraging oral or written statements to an applicant on the basis of race or other protected characteristic, long-standing federal agency guidance indicates that a finding of discouragement necessarily requires some evidence of differential treatment on a prohibited basis.

Traditional examples of discouragement[8] have included the use of phrases such as "no children" or "no wheelchairs" or "Hispanic residence," or a

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[7] *See* 12 CFR § 1002.4(b), Comment 4(b)-1: "the regulation's protections apply only to persons who have requested or received an extension of credit," but extending these protections to prospective applicants is "in keeping with the purpose of the Act—to promote the availability of credit on a nondiscriminatory basis."

[8] https://www.hud.gov/program_offices/fair_housing_equal_opp/advertising_and_marketing.

statement that an applicant "should not bother to apply." In contrast, recent redlining enforcement suggests that federal regulators may be interested in the multitude of factors that could have contributed to a lender's observed failure to reach minority neighborhoods, which, when taken together, may prove the lender's intent to discriminate.

For example, federal regulators appear to be scrutinizing a lender's marketing efforts and strategies to determine whether the lender has sufficiently prioritized minority areas. Prior to 2020, redlining cases highlighted the lender's alleged failure to market in minority areas by intentionally treating these areas differently, either by allegedly excluding such areas from any marketing campaigns or using different marketing materials, such as solicitations or offers, for white versus minority areas.[9] The most recent redlining cases, however, suggest that lenders' marketing strategies might need to go beyond treating white and minority neighborhoods consistently.

RECENT REDLINING ENFORCEMENT

Specifically, in its summer 2021 Supervisory Highlights,[10] the CFPB called out a lender that had engaged in redlining by marketing via "direct mail marketing campaigns that featured models, all of whom appeared to be non-Hispanic white" and using only "headshots of its mortgage professionals in its open house marketing materials . . . who appeared to be non-Hispanic white." Notably, the CFPB did not indicate that the lender had marketed to, and conducted open houses in, white neighborhoods while excluding minority neighborhoods, nor that the lender had used different marketing materials for white versus minority neighborhoods. Rather, the CFPB's claim effectively acknowledges that residents of minority neighborhoods would have received the same marketing materials as any other neighborhood. Yet the CFPB's position appears to be that the use of white models and white employees in these

[9] For example, the Interagency Fair Lending Examination Procedures identify the following as "indicators of potential disparate treatment": advertising only in media serving nonminority areas, using marketing programs or procedures for residential loan products that exclude one or more regions or geographies that have significantly higher percentages of minority group residents than does the remainder of the assessment or marketing area, and using mailing or other distribution lists or other marketing techniques for prescreened or other offerings of residential loan products that explicitly exclude groups of prospective borrowers or exclude geographies that have significantly higher percentages of minority group residents than does the remainder of the marketing area.

[10] https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights_issue-24_2021-06.pdf.

otherwise neutral marketing materials would have discouraged a prospective applicant in a minority area, regardless of whether the lender intended to discourage anyone or not.

Indeed, recent redlining enforcement suggests that not only will regulators allege it insufficient to treat all applicants and neighborhoods the same, but a lender must undertake affirmative action to specifically target minority neighborhoods. This approach attempts to impose unprecedented, CRA-like obligations on nonbank mortgage lenders to proactively meet the needs of specific neighborhoods or communities and ensure a strong HMDA data showing—or else be subject to redlining enforcement.

For example, the July 2020 complaint filed by the CFPB against Townstone Financial Inc. claimed that the lender had "not specifically targeted any marketing toward African-Americans." Along the same vein, the August 2021 settlement between the DOJ, Office of the Comptroller of the Currency ("OCC"), and a bank in the Southeast resolved allegations that the lender had failed to "direct" or "train" its loan officers "to increase their sources of referrals from majority-Black and Hispanic neighborhoods." Of course, lenders understand that "specifically targeting" prospective customers or neighborhoods on the basis of race or other protected characteristic is not required by, and may present its own risk under, fair lending laws. Indeed, the CFPB has suggested that the industry might benefit from "clarity" of how to use "affirmative advertising" in a compliant manner.

Similarly, the CFPB's allegation that Townstone had "not employ[ed] an African-American loan officer during the relevant period, even though it was aware that hiring a loan officer from a particular racial or ethnic group could increase the number of applications from members of that racial or ethnic group" was not only irrelevant since the lender's main source of marketing was mass market radio advertisements but also presumptive and problematic from an employment-law perspective.

PRACTICAL CONSIDERATIONS

Setting aside the legal questions raised by this expanded approach to redlining, mortgage lenders will also face practical considerations when assessing potential fair lending risk. Given the mortgage industry's extensive use of social media, lead generation, artificial intelligence, and other technologies to carry out marketing strategies and disseminate marketing material, an inquiry by a federal regulator into potential discouragement of certain applicant groups or areas could be endless. Could every statement or omission made by an employee on any form of media be relevant to a redlining investigation? How many statements or omissions would it take for a federal regulator to conclude

that a lender has engaged in intentional, differential treatment based on race or other protected characteristic? To that end, could personal communications between employees, which are not seen by the public, and thus could not have the effect of discouraging anyone from applying for a loan, nevertheless be sought by a federal regulator to further a case of intentional discrimination? The language of recent redlining cases suggests that a regulator may find these communications relevant to a redlining investigation even if they do not concern prospective applicants.

Ultimately, both federal regulators and mortgage industry participants must work together to promote homeownership opportunities in minority areas. But along the way, a likely point of contention will be whether enforcement should be imposed on a lender's alleged failure to develop and implement targeted marketing strategies to increase business from minority areas, such as expanding the lender's physical presence to minority areas not within reasonable proximity to the lender's existing offices, conducting marketing campaigns directed exclusively at minority areas, and recruiting minority loan officers for the specific purpose of increasing business in minority areas. Such an approach might overstate the meaningfulness of physical presence and face-to-face interaction in the digital age, when lenders rely heavily on their online presence.

CONCLUSION

Of course, there may be legitimate, nondiscriminatory business reasons for a lender's chosen approach to its operations and expansion. It remains to be seen whether those reasons will be sufficient to assure a federal regulator that the lender's arguably weak performance in a minority area was not the result of redlining. However, given that nearly all precedent regarding redlining has been set by consent orders and has yet to be tested in the courts, the outcome of any particular investigation will greatly depend on the lender's willingness to delve into these issues.