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ELIMINATING RACIAL DISCRIMINATION IN THE SUBPRIME MORTGAGE MARKET: PROPOSALS FOR FAIR LENDING REFORM

*By Winnie F. Taylor**

INTRODUCTION

Lending discrimination has been a national problem for decades. Before Congress enacted the Equal Credit Opportunity Act (ECOA) in 1974 to combat it, lenders routinely denied credit to potential borrowers because of their race, gender, age, marital status and other personal characteristics unrelated to creditworthiness standards.¹ For instance, some creditors based their lending decisions on stereotypical assumptions about whether women in certain age groups would have children or return to work after childbirth.² Others excluded minority communities from their lending areas by literally drawing red lines on maps around neighborhoods where mostly African Americans and Hispanics resided.³ The ECOA is a fair lending law that proscribes lending practices that impede credit opportunities for women, racial minorities and others who have

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¹ See Winnie F. Taylor, *Meeting the Equal Credit Opportunity Act's Specificity Requirement: Judgmental and Statistical Scoring Systems*, 29 BUFF. L. REV. 73, 74-81 (1980).

² See NATIONAL COMMISSION ON CONSUMER FIN., CONSUMER CREDIT IN THE UNITED STATES, 151, 152-53 (1972).

³ Gene A. Marsh, *Lender Liability for Consumer Fraud Practices of Retail Dealers and Home Improvement Contractors*, 45 ALA. L. REV. 1, 15 (1993) (discussing historical origin of the term "redlining").

historically experienced credit discrimination.

Credit discrimination issues have emerged from the rise and fall of the subprime housing market. The problems stem from the race-based practices of overzealous subprime lenders in the selling of home loans. This discriminatory lending behavior is one of many factors that contributed to the market's collapse. It is therefore imperative that policy makers concerned about preventing another crisis consider the impact that racial discrimination can have on igniting or exacerbating a mortgage lending disaster. Legal scholars and other commentators have highlighted the discriminatory underpinnings of the crisis,⁴ noting in particular that some subprime lenders aggressively targeted minority neighborhoods for the purpose of making unaffordable home loans that were destined for delinquency, default, and foreclosure.⁵ Because of these and other abusive lending tactics, racial minorities received the lion's share of subprime loans during the housing boom that preceded the crisis.⁶ After the bubble burst, massive foreclosures followed with a disproportionate share concentrated in minority communities. Consequently, these communities experienced the brunt of the devastation that resulted from the subprime

⁴ See Raymond H. Brescia, *Subprime Communities: Reverse Redlining, the Fair Housing Act and Emerging Issues in Litigation Regarding the Subprime Mortgage Crisis*, 2 ALB. GOV'T L. REV. 164 (2009); Brian Gilmore et al., *The Nightmare on Main Street for African-Americans: A Call for a New National Policy Focus on Homeownership*, 10 BERKELEY J. AFR.-AM. L. & POL'Y 262, 262-65 (2008) (discussing the impact of racial discrimination on the housing crisis).

⁵ Linda E. Fisher, *Target Marketing of Subprime Loans: Racialized Consumer Fraud & Reverse Redlining*, 18 J.L. & POL'Y __ (2009).

⁶ DEBBIE GRUENSTEIN BOCIAN ET AL., CTR. FOR RESPONSIBLE LENDING, UNFAIR LENDING: THE EFFECT OF RACE AND ETHNICITY ON THE PRICE OF SUBPRIME MORTGAGES (2006), available at http://www.responsiblelending.org/mortgage-lending/research-analysis/rr011-Unfair_Lending-0506.pdf; Christopher Mayer & Karen Pence, *Subprime Mortgages: What, Where, and to Whom* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 14083, 2007) (discussing subprime loan originations in 2005 and concluding that subprime mortgages during this time period were concentrated in locations with high proportions of black and Hispanic residents).

“meltdown.”⁷

Some creditors use unscrupulous marketing and underwriting practices that earn them the label “predatory lenders.”⁸ Among these lenders are “equal opportunity abusers,” that is, creditors who indiscriminately mistreat minority and non-minority borrowers. Others engage in race-based lending practices that are not only abusive but also illegal under the ECOA. For example, two loan originators employed by a major bank with a significant subprime department before the mortgage market collapsed, described in affidavits how the bank solicited African American customers and charged them more than necessary for mortgage loans because of their race.⁹ These former bank employees also reported how African American customers were

⁷ See Matthew Price, *Baltimore's Tale of Sub-prime Woe*, BBC NEWS, June 28, 2009, <http://news.bbc.co.uk/go/pr/fr/-/2/hi/business/8118376.stm> (describing the devastation to the Baltimore community).

⁸ The term “predatory lending” describes various onerous lending practices, which are often targeted at vulnerable populations. Predatory lending has been defined as a syndrome of abusive loan terms or practices that involve one or more of the following five problems: (1) loans structured to result in seriously disproportionate net harm to borrowers; (2) harmful rent-seeking; (3) loans involving fraud or deceptive practices; (4) other forms of lack of transparency in loans that are not actionable as fraud; and (5) loans that require borrowers to waive meaningful legal redress. See Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1259–1261 (2002).

⁹ See affidavit of Tony Paschal, an employee of Wells Fargo, describing practices where employees engaged in marketing specifically targeted at minorities, even going as far as printing out flyers in what they referred to as the “African American” language. Affidavit of Tony Paschal at ¶ 11, *Mayor of Baltimore v. Wells Fargo*, No. 1:08-cv-00062 (D. Md. June 3, 2009). Another employee described practices where Wells Fargo employees would push subprime loans onto minority customers who were eligible for the lower priced prime rates by deceptive practices ranging from convincing people it was the only way to get the paperwork finished quickly to offering a donation to the church of the customers’ choice. Affidavit of Elizabeth Jacobson at ¶ 12, *Mayor of Baltimore v. Wells Fargo*, No. 1:08-cv-00062 (D. Md. June 3, 2009). This same employee testified that once she received a referral for a customer, she was only permitted to offer them a subprime loan, even if they were eligible for a prime loan. *Id.* at ¶ 3.

sometimes steered to subprime loans¹⁰ even though such customers qualified for less expensive prime loans.¹¹ The ECOA specifically prohibits disparate treatment on the basis of race.¹²

This Article proposes action the federal government should take to better protect minority consumers in the subprime market from discriminatory lending practices. First, more impact litigation is needed to encourage compliance with the ECOA and to generate sanctions for subprime creditors who violate fair lending laws. Second, current fair lending laws and regulations designed to ferret out creditors who discriminate on the basis of race need to be revised to better assist federal prosecutors in their litigation efforts.

As explained more fully below, claims of racial discrimination in mortgage credit are not new; however, the context of the problem has changed. Initially, the primary concern was denial of home loans to residents of minority communities.¹³ Today, the dominant concern is excessive bad credit in these communities that is perversely tied to mortgage lenders who intentionally made improvident loans.¹⁴ As creditors become more creative in devising discriminatory practices, the

¹⁰ A "subprime loan" is a loan that features higher costs than a prime loan, both upfront and throughout the life of the loan. The defining characteristic of the subprime mortgage is the higher interest rate it carries over a prime loan. See Michael Aleo & Pablo Svirsky, *Foreclosure Fallout: The Banking Industry's Attack on Disparate Impact Race Discrimination Claims Under the Fair Housing Act and the Equal Credit Opportunity Act*, 18 B.U. PUB. INT. L.J. 1, 5 (2008) (discussing subprime loans). The higher rates are presumably to compensate lenders for the added risks associated with lending to borrowers with weaker credit histories. See ALLEN J. FISHBEIN & PATRICK WOODALL, SUBPRIME LOCATIONS: PATTERNS OF GEOGRAPHIC DISPARITY IN SUBPRIME LENDING 1 (2006), available at www.consumerfed.org/pdfs/SubprimeLocationsStudy090506.pdf.

¹¹ Prime loans are loans with interest rates and fees that conventional banks charge their best customers. See CAL. REINVESTMENT COALITION ET AL., PAYING MORE FOR THE AMERICAN DREAM, A MULTI-STATE ANALYSIS OF HIGHER COST PURCHASE LENDING, app. (2007), available at <http://www.calreinvest.org/system/assets/47.pdf>.

¹² See Equal Credit Opportunity Act, 15 U.S.C. §1691 (2006).

¹³ See *supra* note 3.

¹⁴ See *supra* text accompanying note 5.

federal response should include enhancement of fair lending enforcement and stronger consumer protection laws.

In exploring the proposals presented herein, the first part of this Article emphasizes the importance of government litigation as a means of combating lending discrimination in the subprime housing market. For almost two decades, ECOA enforcement authorities have litigated race-based mortgage lending claims. This section reviews that litigation and argues for more federal prosecution of subprime lenders that discriminate on the basis of race.

The second part argues for regulatory reform. Specifically, this part proposes amending Regulation C,¹⁵ which implements the Home Mortgage Disclosure Act (HMDA),¹⁶ by adding credit scores to the information subprime lenders must report to federal regulatory agencies regarding their home mortgage lending experience. Currently, certain lenders must collect and report demographic and pricing data that federal officials analyze to determine if discriminatory lending patterns exist that violate fair lending laws. Including credit score data in the analysis would enhance the ability of these officials to make this determination.

As explained in greater detail in Part II below, adding credit risk information to the HMDA reporting requirements might cause some lenders to make fewer subprime loans, especially those concerned about greater exposure to lawsuits and more regulatory scrutiny. However, if subprime lenders cut back significantly in making mortgage loans, credit-impaired borrowers, who are their primary customers, will be further limited in home financing options.¹⁷ To address this concern, I

¹⁵ 12 C.F.R. § 203 (2009).

¹⁶ 12 U.S.C. §§ 2801–2810 (2006).

¹⁷ The subprime lender specializes in issuing high-interest mortgages to families with few credit options. See Elizabeth Warren, *The Economics of Race: When Making It to the Middle Is Not Enough*, 61 WASH. & LEE L. REV. 1777, 1792–94 (2004) (discussing the history of subprime lending). Most subprime refinance borrowers use the collateral in their homes for debt consolidation and other consumer credit purposes. See FISHBEIN & WOODALL, *supra* note 10, at 1 (discussing subprime borrowers who refinance home loans).

argue that the federal government should provide funds to credit unions for the purpose of increasing their subprime lending. This public funding proposal is attractive for several reasons. First, if some subprime lenders reduce mortgage credit because the Federal Reserve Board (FRB) adds credit scores to their HMDA reporting requirements, credit unions may be able to fill the void by expanding their subprime lending to more qualified, higher-risk borrowers in under-served communities. Given their non-profit, quasi-governmental status, credit unions are unlikely to reduce subprime mortgage lending because of a new credit score reporting requirement.¹⁸ Second, expanding the credit union subprime market would provide potential borrowers with viable alternatives to abusive home mortgage providers. Third, such expansion would provide competition to predatory subprime lenders.

By focusing on remedies and strategies for combating the racial discrimination problem in subprime lending, this Article brings issues of race and ethnicity to the forefront of the mortgage crisis where they belong. Developing effective responses to prevent its reoccurrence demands consideration of all factors that led to the market's demise, especially those indicative of unlawful conduct.

I. IMPACT LITIGATION AND ACCOUNTABILITY

Congress gave ECOA enforcement authority to the FRB, the Department of Justice (DOJ), the Federal Trade Commission (FTC), and a number of other federal agencies.¹⁹ Claims of

¹⁸ See Ronald H. Silverman, *Toward Curbing Predatory Lending*, 122 BANKING L.J. 483 (2005); see also *infra* text accompanying note 107.

¹⁹ Enforcement authority under the ECOA is divided between federal agencies. The U.S. Department of Justice may initiate a lawsuit under the ECOA where it believes a creditor has engaged in a pattern or practice of discrimination. With respect to claims against national banks, and Federal branches, enforcement authority is with the Office of the Comptroller of the Currency (OCC); for claims against member banks of the Federal Reserve System (other than national banks), and commercial lending companies owned or controlled by foreign banks, enforcement authority is with the Board of Governors of the Federal Reserve System; for claims against banks

racial discrimination in the subprime mortgage market present the latest regulatory challenge to these authorities. In addition to investigating and examining creditors for fair lending compliance, government agencies should use litigation vigorously to address discrimination claims. Their sustained litigation efforts will likely encourage fair lending compliance by sending a clear message to the lending industry that ECOA violators will be relentlessly pursued, prosecuted, and held accountable for engaging in unlawful conduct.

The DOJ and the FTC already have experience litigating ECOA claims similar to many of those that have emerged from the mortgage crisis, including those involving discriminatory pricing. Some of their groundbreaking cases are summarized in the next section. All of the cases were settled. Nevertheless, these cases helped establish novel lending discrimination theories²⁰ and demonstrate that litigation can be an effective means of combating racial discrimination in mortgage lending. To achieve this end, litigation efforts must be relentless.

A. Redlining

At the federal level, efforts to eliminate home mortgage discrimination have been ongoing for almost two decades. In 1992, the DOJ filed its first ECOA mortgage-lending lawsuit against a Georgia bank. The complaint charged the bank with “redlining,” that is, refusing to make loans in certain geographical areas because of the racial composition of its residents.²¹ Specifically, DOJ attorneys alleged that Decatur Federal Savings & Loan “devised ways to avoid dealing with

insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System) and insured State branches of foreign banks, enforcement authority is with the Board of Directors of the Federal Deposit Insurance Corporation; for claims against credit unions enforcement authority resides with the Administrator of the National Credit Union Administration. *See* Equal Credit Opportunity Act, 15 U.S.C. § 1691c(a)(1)(A)–(C) (2006).

²⁰ *See* NATIONAL CONSUMER LAW CENTER, THE CREDIT AND SALES LEGAL PRACTICE SERIES § 12.4.1 (4th ed. 2005).

²¹ *See supra* note 3.

African Americans in the Atlanta area and avoided making mortgage loans in black communities.”²² To support the claim that Decatur Federal intentionally denied banking services to African Americans, the complaint further alleged that none of the bank’s 48 branch offices were located in predominately African American neighborhoods.²³ The consent decree that settled the case required the bank to pay \$1 million to compensate 48 rejected credit applicants and to take a series of corrective measures to ensure compliance with the ECOA, including opening up a branch office in a predominately black neighborhood.²⁴

Since 1992, the DOJ has filed and settled a myriad of redlining lawsuits against banks and other financial institutions. In one such case involving a bank in the District of Columbia, DOJ attorneys alleged that Chevy Chase Bank refused to market mortgage loans in predominately African American communities in Washington, D.C., because of the racial identity of those neighborhoods.²⁵ As it did in *Decatur*, the DOJ’s litigation strategy included focusing on the location of bank branch offices to support its contention that the bank intentionally excluded blacks from receiving its mortgage lending services. Accordingly, the complaint alleged that 70 of the 74 Chevy Chase branch offices were located in predominately white communities.²⁶ The settlement agreement required the bank to pay \$11 million to establish a special loan program so that mortgage-lending services could be provided to the neglected areas. The agreement also required the bank to open up branch offices in minority neighborhoods.²⁷

Similarly, the DOJ sued Albank for redlining in violation of

²² Complaint at ¶¶ 8–16, *United States v. Decatur Fed. Sav. & Loan Assoc.*, No. 92-CV-2198 (N.D. Ga. 1992).

²³ *Id.* at ¶¶ 4, 9.

²⁴ Consent Decree at ¶¶ 2–48, *Decatur*, No. 92-CV-2198 (N.D. Ga. 1992).

²⁵ Complaint at ¶ 12, *United States v. Chevy Chase Fed. Sav. Bank*, No. 94-CV-01829 (D.D.C. 1994).

²⁶ *Id.* at ¶ 13.

²⁷ Consent Decree, *Chevy Chase*, No. 94-CV-01829.

the ECOA. In this 1997 case, DOJ attorneys contended that the bank refused to take mortgage loan applications from areas in Connecticut and Westchester County, New York, with significant minority populations. Further, the government attorneys claimed that the bank could provide no reason for carving out minority communities from its lending areas.²⁸ The consent decree that ended this litigation required the bank to provide \$55 million in loans at below market rates to the communities that it refused to service previously and to implement a non-discriminatory lending policy.²⁹

More recently, the DOJ prosecuted two mid-western banks for redlining. In 2004, the agency resolved a lawsuit it filed against First American Bank. The DOJ attorneys claimed that the bank unlawfully failed to market its mortgage credit and other lending products to predominately minority neighborhoods in the Chicago and Kankakee, Illinois, metropolitan areas.³⁰ Additionally, the prosecutors alleged that of the nearly \$288 million in single family residential real estate loans that the bank funded between 1999 and 2001, only 4.5% went to properties located in minority census tracts.³¹ The terms of the consent order required First American to open four new full-service branch offices, three of which had to be located in majority African American census tracts in the Chicago area and one in a majority Hispanic census tract. Further, it required the bank to invest \$5 million in a special financing program for residents and businesses in the minority communities of the Chicago/Kankakee areas.³²

In 2006, DOJ attorneys filed the other mid-western bank case and subsequently resolved redlining allegations against

²⁸ Complaint at ¶ 14, *United States v. Albank, FSB*, No. 97-CV-1206 (N.D.N.Y. 1997).

²⁹ Consent Decree at § III(1), *Albank*, No. 97-CV-1206.

³⁰ *Id.* (consent decree). Complaint at ¶¶ 17-21, *United States v. First Am. Bank*, No. 04-CV-4585 (N.D. Ill. July 13, 2004) [hereinafter *First American Consent Decree*]. The DOJ's complaint alleged that all but four of the bank's 34 branches were located in a minority area. *Id.* at ¶ 15.

³¹ *Id.* at ¶ 28.

³² *First American Consent Decree*, *supra* note 30, at § III.

Centier Bank in Indiana. At the time of the litigation, Centier Bank was one of the largest residential lenders in the Gary, Indiana, metropolitan area.³³ The complaint alleged that the bank avoided serving the mortgage credit needs of neighborhoods where the majority of the residents are African American or Hispanic, especially in the cities of Gary, East Chicago, and Hammond.³⁴ The settlement agreement that ended this lawsuit required the bank to open or acquire at least two full service offices within designated African American and Hispanic areas. It also required the bank to provide the same services offered at its majority white suburban locations to all branches regardless of their location. Further, the bank had to invest a minimum of \$3.5 million in special financing programs for residential and small business loans.³⁵

The above redlining cases highlight the historical lack of conventional mortgage lending sources in minority communities and the efforts of government attorneys to remove racial barriers to minority homeownership and residential refinancing. They also demonstrate how racial discrimination can create a dual system of mortgage lending that can lock minority borrowers out of lower-cost mortgage credit that conventional lenders typically provide. When these lenders refuse to lend in minority neighborhoods, a void is created that abusive lenders fill by charging excessive rates and imposing other unfavorable loan terms. Thus, conventional lenders can play a significant role in making minority borrowers especially vulnerable to predatory subprime lenders. To prevent such exploitation, ECOA enforcement authorities must remain vigilant in combating redlining.

B. Reverse Redlining

In contrast to redlining, the claims of racial discrimination in

³³ Complaint at ¶¶ 3–6, *United States v. Centier Bank*, No. 06-CV-344 (N.D. Ind. Oct. 13, 2006).

³⁴ *Id.* at ¶ 10.

³⁵ Consent Order at ¶ 23, *Centier Bank*, No. 06-CV-344.

mortgage lending that emerged from the subprime crisis focus on an abundance of mortgage credit in minority neighborhoods; however, this credit has been notoriously burdensome. These “reverse redlining”³⁶ complaints allege that some predatory subprime lenders target minority neighborhoods for the purpose of making mortgage loans that are saddled with unfavorable terms, especially price inequities. Although federal prosecutors began litigating reverse redlining claims more than a decade before the subprime crisis, the foreclosure epidemic that has caused devastation to many minority neighborhoods³⁷ is likely to precipitate a notable increase in the filing of these cases. Importantly, the government’s reverse redlining cases have created a template that private litigants can use to structure arguments for proving disparate impact³⁸ and disparate treatment³⁹ lending discrimination claims.

³⁶ “Reverse redlining” is the practice of extending credit on unfair terms to specific geographic areas due to the income, race or ethnicity of its residents. *Assoc. Home Equity Servs., Inc. v. Troup*, 778 A.2d 529, 537 (N.J. Super. Ct. App. Div. 2001) (citations omitted).

³⁷ See Fisher, *supra* note 5.

³⁸ Disparate impact discrimination occurs when creditors use neutral policies or practices that have a disproportionate adverse affect on persons in the ECOA protected classes. This framework for proving lending discrimination has a burden-shifting approach. The first step under this approach requires the plaintiff to prove that a creditor practice or policy created a disparity on an ECOA prohibited basis. If the plaintiff establishes this *prima facie* case, the burden shifts to the creditor to prove that the policy is justified by a business necessity. At the final stage, the plaintiff prevails if there is sufficient evidence that an alternative policy or practice could serve the creditor’s same business purpose with less discriminatory effect. See *Griggs v. Duke Power Company*, 401 U.S. 424 (1971); *Albemarle Paper Company v. Moody*, 422 U.S. 405 (1975) (discussing the approach in the context of employment discrimination); see also *infra* notes 70–74 and accompanying text.

³⁹ Disparate treatment discrimination occurs when creditors treat some borrowers or potential borrowers less favorably than others because of ECOA protected class characteristics such as race or sex. Under this theory, proof of the lender’s discriminatory intent is crucial. In employment law, burden-shifting approach is used to prove disparate treatment cases. See *McDonnell Douglas Corp. v. Green*, 411 U.S. 792, 804–806 (1973).

In 1996, the DOJ brought a reverse redlining lawsuit against Long Beach Mortgage Company challenging its mortgage pricing policies. Long Beach is a subprime mortgage affiliate of Washington Mutual Savings Association.⁴⁰ The complaint alleged that the mortgage company directed its marketing efforts primarily toward persons and neighborhoods of color that lending officials believed might be susceptible to higher prices.⁴¹ Also, DOJ attorneys contended that the mortgage company's loan originators typically emphasized low monthly payment amounts when discussing loan prices with minority borrowers rather than interest rates, points, and annual percentages rates.⁴² Further, the complaint asserted that Long Beach allowed both its employee loan officers and its independent loan brokers the discretion to charge subprime mortgage borrowers a commission of up to 12% above the lender's base price for the loan amount.⁴³ The DOJ attorneys contended that this discretionary pricing policy resulted in disparate treatment of minorities and other borrowers protected under the ECOA. In particular, the DOJ alleged that African American females over the age of 55 were 2.6 times more likely than white males under the age of 56 to be charged fees and points under Long Beach's lending policies.⁴⁴

In the mortgage lending industry, pricing disparities often arise from "overages," that is, discretionary authority of employees or brokers who originate loans to charge higher rates than the lender's set rate.⁴⁵ Because they usually receive

⁴⁰ Some major banks engage in subprime mortgage lending through subsidiary companies. For instance, NationsCredit and EquiCredit are Bank of America's subprime affiliates and Citigroup is Citibank's subprime lending subsidiary.

⁴¹ Complaint at ¶ 18, *United States v. Long Beach Mortgage Co.*, No. 96 Civ. 6159 (C.D. Cal. Sept. 5, 1996) [hereinafter *Long Beach Complaint*].

⁴² *Id.*

⁴³ *Id.* at ¶ 15.

⁴⁴ *Id.* at ¶ 19.

⁴⁵ "Overage" or "yield spread," refers to the practice of allowing loan personnel to charge customers a higher interest rate than the lender's base or minimum rate. As an incentive for bringing in loans at a higher rate, lenders frequently share the overage with the loan originator. See NATIONAL

additional compensation when borrowers agree to pay prices above the lender's set rate, loan originators have an incentive to make loans at the highest rate possible. In *Long Beach*, the government claimed that the discretionary pricing policy resulted in disparate treatment of minorities and other borrowers protected under the ECOA.⁴⁶ Moreover, the DOJ claimed that the mortgage company was liable not only for the discriminatory pricing of its loan officers but also for that of the independent brokers. The DOJ concluded that the lender should be liable for the brokers' conduct because the mortgage company was ultimately responsible for underwriting the loans and hiring the brokers.⁴⁷ In settlement, Long Beach agreed to pay \$3 million to 1,200 borrowers and to spend \$1 million on educational programs.⁴⁸

In 1996, the DOJ again confronted the issue of discriminatory pricing in a reverse redlining case when it prosecuted two mortgage companies. The complaints alleged that loan officers at Fleet Mortgage Company in Brooklyn, New York, and Huntington Mortgage Company in Cleveland, Ohio, charged African American and Hispanic borrowers higher up-front fees for mortgages than they charged similarly situated white borrowers.⁴⁹ Further, the complaint alleged that the higher

CONSUMER LAW CENTER, THE CREDIT AND SALES LEGAL PRACTICES SERIES § 12.4.3.9 (3d ed. 2002).

⁴⁶ *Long Beach* Complaint, *supra* note 41, at ¶ 24.

⁴⁷ Settlement Agreement, *United States v. Long Beach Mortgage Co.*, No. 96-CV-6159 (C.D. Cal. Sept. 5, 2009) [hereinafter *Long Beach* Settlement]. Also, the role that independent mortgage brokers played in the subprime crisis is being scrutinized with an eye toward regulation and oversight. It is the alleged abusive conduct of brokers that has led to many proposals for regulatory reform in the subprime mortgage market. See Alan M. White, *The Case for Banning Subprime Mortgages*, 77 U. CIN. L. REV. 617 (2008); Lloyd T. Wilson, Jr., *Sometimes Less is More: Utility, Preemption, and Hermeneutical Criticisms of Proposed Federal Regulation of Mortgage Brokers*, 59 S.C. L. REV. 61 (2007).

⁴⁸ *Long Beach* Settlement, *supra* note 47.

⁴⁹ Complaint at ¶ 9, *United States v. Fleet Mortgage Corp.*, No. 96-CV-2279 (E.D.N.Y. May 7, 1996) [hereinafter *Fleet* Complaint]; Complaint at ¶ 9, 12, 14, *United States v. Huntington Mortgage Co.*, No. 95-CV-2211

prices, which resulted from a compensation incentive program similar to the one in *Long Beach*, could not have occurred by chance and were unrelated to the qualifications of the minority borrowers or the risk to the lender.⁵⁰ The DOJ attorneys did not challenge the legality of the employee/broker incentive program. Instead, they claimed that the two mortgage companies illegally used the program to extract higher prices from minorities because of their race.⁵¹ Private litigants have followed the lead of DOJ attorneys in making ECOA price discrimination claims against subprime lenders with broker/employee incentive programs like that in *Long Beach*.⁵²

In another high-impact, reverse-redlining lawsuit, three government agencies jointly prosecuted a major subprime lender. The three agencies—the U.S. Attorney for the Eastern District of New York (DOJ), the Department of Housing and Urban Development (HUD), and the FTC—filed a reverse redlining lawsuit against Delta Funding Corporation. At the time of this litigation, most of Delta's business was concentrated in the minority residential areas of Brooklyn and Queens, New York.⁵³ Among other allegations, the government claimed that Delta violated the ECOA by granting loans with higher broker fees to African American women than those of similarly situated white men, by allowing unreasonable broker fees, by engaging in asset-based lending, by paying kickbacks to brokers to induce them to refer loan applicants to Delta, and by approving loans without regard for the borrower's ability to repay.⁵⁴ Further, the complaint alleged that Delta targeted minority neighborhoods

(N.D. Ohio Oct. 18, 1995) [hereinafter *Huntington Complaint*].

⁵⁰ *Fleet Complaint*, *supra* note 49, at ¶ 10; *Huntington Complaint*, *supra* note 49, at ¶¶ 12–14.

⁵¹ *See Fleet Complaint*, *supra* note 49, at ¶ 11; *Huntington Complaint*, *supra* note 49, at ¶ 15.

⁵² *See Miller v. Countrywide Bank, N.A.*, 571 F. Supp. 2d 251, 253 (D. Mass. 2008); *Garcia v. Country Wide Fin. Corp.*, No. 07-CV-1161, 2008 U.S. Dist. LEXIS 106675, at *2 (C.D. Cal. Jan. 17, 2008).

⁵³ *Complaint* at ¶ 8, *United States v. Delta Funding Corp.*, No. 00-CV-01872 (E.D.N.Y. 2000).

⁵⁴ *Id.* at ¶¶ 12, 14–15, 17–19.

with abusive practices, thereby placing borrowers thousands of dollars in debt and exposing them to unwarranted risk of default and foreclosure.⁵⁵ The complaint described a number of Delta's victims as African American widows living in Brooklyn who had little or no outstanding debt before refinancing their mortgages at prices they could not afford.⁵⁶ The settlement agreement that ended the case required Delta to provide monetary relief of up to \$12 million to victims of its lending practices.⁵⁷

In 2008, the FTC filed an ECOA action individually against Gateway Funding Diversified Mortgage Services Corporation and its general partner, Gateway Funding.⁵⁸ Among the FTC's allegations was the claim that Gateway used discriminatory pricing practices in both prime and subprime mortgage loans that resulted in African American and Hispanic customers being charged higher interest rates and up-front fees than white customers.⁵⁹ The settlement required Gateway to pay \$2.9 million, however, all but \$200,000 was suspended because of Gateway's inability to pay.⁶⁰

C. Establishing ECOA Precedents

Private litigants have also filed reverse redlining lawsuits against subprime lenders with allegations similar to those in the above government cases.⁶¹ As these cases work their way up

⁵⁵ *Id.* at ¶ 17.

⁵⁶ Press Release, Dep't of Justice, Delta Funding Corporation Settles U.S. Charges for Fair Lending and Consumer Law (Mar. 30, 2000), available at <http://www.usdoj.gov/opa/pr/2000/March/154cr.htm>.

⁵⁷ Settlement Agreement at § 5, *Delta*, No. 00-CV-01872.

⁵⁸ Complaint, *FTC v. Gateway Funding Diversified Mortgage Servs., L.P.*, No. 08-CV-5805 (E.D. Pa. Dec. 17, 2008).

⁵⁹ *Id.* at ¶ 18.

⁶⁰ Final Judgment at § VI(A), *Gateway*, No. 08-CV-5805.

⁶¹ *See, e.g.*, *NAACP v. Ameriquest Mortgage Co.*, No. 07-CV-0794 (C.D. Cal. Jan. 12, 2009) (order denying defendants' motion to dismiss). The NAACP alleged disparate impact and disparate treatment discrimination in violation of ECOA.

through the courts, they may establish much needed precedent on the legal issues surrounding the targeting of minority neighborhoods. Precedential value could also come if government reverse redlining lawsuits lead to full-fledged litigation instead of settlement. Although the advantages of settlement (e.g., lower cost, certainty of outcome, expeditiousness) are important, it would also be tremendously beneficial for courts to decide whether the government's redlining and reverse redlining claims are meritorious. Established precedent can reveal gaps in the current laws and provide guidance regarding appropriate ways to fill them, such as whether new legislation is needed to further federal fair lending policy objectives.

There are additional advantages to having judicial opinions in reverse redlining cases. For instance, victims likely receive a psychological benefit when courts find lenders liable for discrimination. This benefit is absent when cases are settled because settlement agreements contain no admission to or finding of illegal conduct. Also, it would be helpful to know how courts would impose damages against subprime lenders found liable for targeting minority neighborhoods and engaging in discriminatory pricing practices in violation of the ECOA. The settlement agreements mentioned above require lenders to pay millions of dollars to compensate consumers and establish funding for various programs.⁶² These amounts seem to reflect both actual and punitive damages. However, if ECOA claims are fully litigated and lenders are subsequently found liable for discrimination, it is unclear whether courts could award similar damages.

Currently, ECOA violators are subject to civil liability for actual and punitive damages in individual and class actions. Liability for punitive damages is limited to \$10,000 in individual actions and the lesser of \$500,000 or one percent of the creditor's net worth in class actions.⁶³ In determining the amount of punitive damages, the Act requires courts to consider, among

⁶² See, e.g., *supra* text accompanying notes 48, 57, and 60.

⁶³ 15 U.S.C. § 1691e (2006).

other relevant factors, the amount of any actual damages awarded, the frequency and persistence of failures of compliance by the creditor, the resources of the creditor, the number of persons adversely affected, and the extent to which the creditor's failure of compliance was intentional.⁶⁴ Although courts may find that millions of dollars in punitive damages should be imposed against lenders in some reverse redlining cases, it is unclear whether the \$500,000 statutory ceiling will preclude such awards in actions brought by federal prosecutors. In private lawsuits, the ECOA specifically caps punitive damages at \$500,000. The statute is silent, however, on whether the cap applies when administrative agencies successfully sue lenders. The ECOA's statutory language merely states that the agencies may recover "relief as may be appropriate," including actual and punitive damages.⁶⁵

The Federal Reserve Board, which implements the ECOA through Regulation B,⁶⁶ should clarify whether punitive damages in administrative agency actions can exceed \$500,000. If the cap does apply, Congress should amend the ECOA to increase it or allow judges to decide each case without a cap. The \$500,000 ceiling on punitive damages is insufficient to punish subprime lenders who egregiously fail to comply with the ECOA by targeting minority neighborhoods for unaffordable loans that are likely to lead to foreclosure. Also, this amount is inadequate to deter other subprime lenders from devastating minority communities by engaging in reverse redlining lending practices. To determine an appropriate amount, consideration should be given to a lender's net assets. For instance, Bank of America's profits in the first quarter of 2009 were \$2.4 billion⁶⁷ and Wells Fargo had a 50% surge in net income during the same period, exceeding more than a billion dollars.⁶⁸ Also, during the second

⁶⁴ *Id.*

⁶⁵ *Id.* at § 1691e(h).

⁶⁶ 12 C.F.R. § 202 (2003).

⁶⁷ Dan Fitzpatrick, *For B of A, a \$4.2 Billion Profit Isn't a Fix*, WALL ST. J., Apr. 21, 2009, at C1.

⁶⁸ Matthias Rieker & Damian Paletta, *Banks Get Boost from Wells Fargo*, WALL ST. J., Apr. 21, 2009, at C1.

quarter of 2009, the profits for JP Morgan/Chase Bank were \$2.7 billion.⁶⁹ With quarterly profits like these, a \$500,000 penalty for an ECOA violation is grossly inadequate as a punishment or a deterrent.

*D. Litigation Challenges In Pursuing Reverse
Redlining Cases*

Government attorneys who litigate reverse redlining claims on the merits may have difficulty proving some of their allegations in court. For instance, claims that certain subprime lending practices adversely impact people and communities of color present litigation challenges. The primary challenge stems from the uncertainty about whether ECOA plaintiffs can use the disparate impact theory to prove their lending discrimination claims. As mentioned previously, disparate impact discrimination occurs when a lender applies a neutral practice equally to credit applicants but the practice has a disproportionate adverse effect on applicants from the ECOA protected groups.⁷⁰ To prove such claims, plaintiffs must demonstrate that there is a significant disparity in outcomes between minorities and similarly situated non-minorities.⁷¹

Recently, the United States Supreme Court decided that the disparate impact analytical framework is appropriate to use when proving age discrimination cases.⁷² However, the Court has not decided whether impact analysis can be used to prove lending discrimination claims. Although most federal courts allow ECOA plaintiffs to use statistical impact proof methods,⁷³

⁶⁹ Robin Sidel, *J.P. Morgan Posts \$2.7 Billion in Profit*, WALL ST. J., July 17, 2009, at C1.

⁷⁰ See *Griggs v. Duke Power Company*, 401 U.S. 424 (1971).

⁷¹ See *supra* note 38.

⁷² See *Smith v. City of Jackson, Miss.*, 544 U.S. 228, 239–240 (2005).

⁷³ See, e.g., *Smith v. Chrysler Fin. Co.*, No. 00-CV-6003, 2003 WL 328719 (D.N.J. 2003) (deciding that the ECOA permits disparate impact theory); *Coleman v. General Motor Acceptance Corp.*, 196 F.R.D. 315 (M.D. Tenn. 2000); *Osborne v. Bank of Am., Nat'l Assoc.*, 234 F. Supp. 2d 804 (M.D. Tenn. 2002). Cf. *Latimore v. Citibank Fed. Sav. Bank*, 151 F. 3d

commentators strongly debate whether the Supreme Court would reverse those decisions if given the opportunity.⁷⁴ Fully litigated reverse redlining lawsuits that use impact proof methods could present the Court with such an opportunity.

E. Summary

Vigilance in protecting homeowners from lending discrimination not only fosters a fair lending compliance environment, it also promotes public trust. It is therefore especially important for the federal government to prosecute egregious violators of the ECOA. Subprime lenders that cause devastation to individuals because of their race, and communities because of their racial composition, should know that government attorneys will sue them. Such impact litigation will signal to the public and the credit industry that eliminating racial discrimination in mortgage lending is a national priority.

II: LEGISLATIVE REFORM: INCREASED ENFORCEMENT AUTHORITY AND HMDA AMENDMENT

A. Reporting Credit Score Information

Congress enacted HMDA in 1975 due to its concern that disproportionate home ownership among various racial groups might stem from biased lending practices or other discriminatory conduct in the mortgage industry.⁷⁵ To address this concern,

712 (7th Cir. 1998) (rejecting ECOA disparate impact claim).

⁷⁴ See, e.g., Peter N. Cubita & Michelle Hartmann, *The ECOA Discrimination Proscription and Disparate Impact—Interpreting the Meaning of the Words That Actually Are There*, 61 BUS. LAW. 829 (2006).

⁷⁵ The Home Mortgage Disclosure Act (HMDA) was enacted by Congress in 1975 and is implemented by the Federal Reserve Board's Regulation C. This regulation provides the public loan data that can be used to assist in determining whether financial institutions are serving the housing needs of their communities; assisting public officials in distributing public-sector investments so as to attract private investment to areas where it is needed, and in identifying possible discriminatory lending patterns. See FEDERAL DEPOSIT INSURANCE CORPORATION, COMPLIANCE HANDBOOK, 9.1,

HMDA requires creditors to collect and report basic attributes of the mortgage applications they receive in metropolitan statistical areas.⁷⁶ Under Regulation C, which the Federal Reserve Board wrote to implement HMDA, lenders must disclose to federal regulatory agencies and the general public, information regarding the race, ethnicity, sex, and income of mortgage applicants and borrowers.⁷⁷ In addition to demographic information, Regulation C requires lenders to report certain pricing information.⁷⁸ Federal officials analyze the HMDA data to see if they identify mortgage lenders with racial or ethnic lending patterns that indicate discrimination in violation of the ECOA or other fair lending laws.

Initially, the FRB did not require lenders to report pricing information with other HMDA data. The FRB amended Regulation C in 2002 to add this information because it wanted insight into the possible connection between the cost of mortgage loans and the borrower's race.⁷⁹ The pricing information, coupled with HMDA demographic data, informs the FRB of not only who receives mortgage credit, but also who pays the most for it. Pursuant to the loan-pricing reporting requirement, lenders must now report information on "higher-cost" loans. Although both prime and subprime lenders must report the pricing data, this requirement primarily affects subprime lenders since most high-cost loans are made in the subprime market.⁸⁰

9.2 (2006).

⁷⁶ 12 U.S.C. § 2803(a)(1) (2006). The HMDA requires lenders to use census tracts to capture these data.

⁷⁷ 12 C.F.R. § 203.4(a)(10), (b)(1) (2009).

⁷⁸ *Id.* at § 203.4(a)(12)(i).

⁷⁹ Edward M. Gramlich, Governor, Fed. Reserve Sys., Remarks to the National Association of Real Estate Editors (June 3, 2005).

⁸⁰ Beginning with 2004 data, lenders are now required to compare the annual percentage rate (APR) on each loan made to the current interest rate on U.S. Treasury securities of the same maturity. If the difference ("spread") between the loan's APR and the interest rate on the Treasury securities is three percentage points or more (for a first-lien loan), then the spread for that loan must be reported in the lender's HMDA data." CAL. REINVESTMENT COALITION ET AL., *supra* note 11, app. In the lending industry, such loans are referred to as "higher-cost loans" or "higher-priced loans." *Id.* Many

By all accounts, the addition of pricing information to the HMDA reporting requirements has been a tremendous benefit to ECOA enforcement officials. In recent reports to Congress, the agencies have emphasized the importance of this information to their fair lending enforcement efforts, noting in particular how invaluable it has been in helping to identify lenders that may be engaging in race-based lending practices.⁸¹

However, the HMDA data do not include all variables lenders use to set loan prices, such as loan-to value ratios, debt-to-income ratios, or credit scores.⁸² Given this under-inclusiveness, the HMDA data are insufficient to determine whether a lender has actually violated the ECOA's anti-discrimination requirements. Thus, instead of proving discrimination, the data serve as a screening device to identify which lenders should be investigated and further scrutinized for

people use the terms "subprime loans" and "higher-cost" loans interchangeably, although there are many subprime loans (subprime because their interest rates and/or fees are greater than those of prime loans) with APRs that are below the HMDA-reporting threshold used to identify "higher-cost" loans. *Id.*

⁸¹ See, e.g., GRACE CHUNG BECKER, U.S. ATTORNEY GEN., THE ATTORNEY GENERAL'S 2007 ANNUAL REPORT TO CONGRESS PURSUANT TO THE EQUAL CREDIT OPPORTUNITY ACT AMENDMENTS OF 1976 6 (2008), available at <http://www.usdoj.gov/crt/housing/documents/ecoa2007.pdf>; LORETTA KING, U.S. ATTORNEY GEN., THE ATTORNEY GENERAL'S 2008 ANNUAL REPORT TO CONGRESS PURSUANT TO THE EQUAL CREDIT OPPORTUNITY ACT AMENDMENTS OF 1976 6 (2009), available at http://www.usdoj.gov/crt/housing/documents/ecoa_report_2008.pdf; *Rooting Out Discrimination in Mortgage Lending: Using HMDA as a Tool for Fair Lending Enforcement: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Financial Servs.*, 110th Cong. 38, 42, (2007) (statements of Sandra L. Thompson, Director of the Division of Supervision and Consumer Protection, Federal Deposit Insurance Corporation and Calvin R. Hagins, Director of Compliance Policy, Office of the Comptroller of Currency) [hereinafter *Rooting Out Discrimination Hearing*].

⁸² See Robert B. Avery et al., *New Information Reported Under HMDA and Its Application in Fair Lending Enforcement*, 91 FED. RES. BULL. 344, 385-87 (2005) [hereinafter Avery, *New Information*]. A credit score is a mechanically determined credit rating that signifies whether an applicant is creditworthy based on key attributes of the applicant and aspects of the credit transaction. See Taylor, *supra* note 1, at 88.

possible discriminatory conduct.⁸³ In short, HMDA data provide a list of suspects. But the omission of all credit risk criteria from HMDA analyses hinders the data's effectiveness, even as a screening tool. Lenders can capitalize on this shortcoming. For instance, if HMDA data show significant price disparities along racial lines, the subprime lending industry can point out that the findings are misleading because legitimate credit risk factors that are omitted from the analysis could possibly justify the result. More specifically, lenders can say that credit scores, rather than race or ethnicity, are the cause of the racial disparities.

Undoubtedly, credit risk factors can justify racial disparities in the HMDA data of some mortgage lenders and can help to identify others whose disparities result from discriminatory lending practices. Despite this benefit, there are no credit risk data in the HMDA analysis. The absence of such data makes it more difficult to determine which lenders are engaging in illegal conduct, since racial disparities, standing alone, do not prove discrimination. Because credit scores may easily explain the disparities, this credit risk information ought to be included in the HMDA data. The addition of credit score data would permit more nuanced analyses that would reveal more about whether race, credit risk or something else drives the observed differences in the price that people of color pay for mortgage loans.⁸⁴

Because credit history information will result in an analysis of HMDA data that is more indicative of where fair lending violations are likely to be found, the FRB should require the reporting of credit scores, at least for subprime lenders. More stringent scrutiny of this sector of the home mortgage market is needed because of the serious questions that have emerged regarding the link between the mortgage crisis and discriminatory pricing methods of predatory subprime lenders.⁸⁵

⁸³ Avery et al., *supra* note 82, at 387.

⁸⁴ Kathleen Engel & Patricia McCoy, *HMDA Reporting of Credit Scores*, CREDIT SLIPS, Dec. 12, 2006, http://www.creditslips.org/creditslips/2006/12/hmda_reporting_.html.

⁸⁵ See generally Melissa LaVenia, Note, *Predatory Lending's Role in the Subprime Mortgage Crisis*, 27 REV. BANKING & FIN. L. 101 (2008).

Allegations that these lenders targeted minority neighborhoods and intentionally made numerous unaffordable mortgage loans to their residents are among the frequently cited abuses.⁸⁶ There is public concern that these and other discriminatory lending practices played a significant role in the foreclosure catastrophe that devastated minority neighborhoods after the subprime market collapsed.⁸⁷ Moreover, for the fifth consecutive year since lenders began reporting pricing information to federal regulators, the HMDA data have indicated that a higher percentage of black and Hispanic borrowers have received high-cost home loans than have white borrowers.⁸⁸ These troubling outcomes reinforce the need for greater scrutiny of the subprime market.

By amending Regulation C to require subprime lenders to report credit score information, the FRB and other fair lending enforcement agencies can identify potential ECOA violators more accurately and therefore use their resources more efficiently to investigate subprime creditors for discriminatory lending practices. With a sharper tool to assist in identifying creditors who may be over-charging minorities for home loans, federal agencies will be able to make subprime lenders more accountable for their lending decisions. Banking regulators are apparently aware that credit score data can enhance their fair lending enforcement efforts. During the 2007 Congressional hearings on discrimination in mortgage credit, a representative from the OCC stated that the members of the Federal Financial

(analyzing the relationship between predatory lending and foreclosures of subprime mortgages).

⁸⁶ See, e.g., *Rooting Out Discrimination Hearing*, *supra* note 81, at 106–11.

⁸⁷ See Fisher, *supra* note 5.

⁸⁸ See *New Information*, *supra* note 82, at 376–82; Robert Avery et al., *Higher Priced Home Lending and the 2005 HMDA Data*, 92 FED. RES. BULL. 123, 158–165 (2006) [hereinafter *2005 HMDA Data*]; Robert B. Avery et al., *The 2006 HMDA Data*, 93 FED. RES. BULL. 73, 94–97 (2007) [hereinafter *2006 HMDA Data*]; Robert B. Avery et al., *The 2007 HMDA Data*, 94 FED. RES. BULL. 107, 135–39 (2008) [hereinafter *2007 HMDA Data*].

Institutions Examination Council (FFIEC)⁸⁹ intended to jointly purchase “an external database of credit scores” to help in the general assessment of fair lending risks.⁹⁰ Whether the agencies actually purchased the database and precisely how they are using it if they did, is unknown. What seems clear is that ECOA enforcement authorities recognize that credit scores can assist their efforts to combat discrimination in the subprime mortgage market. Thus, the FRB ought to require subprime lenders to report credit scores in addition to their current HMDA data reporting requirements.

B. Costs and Benefits

Before imposing an additional reporting requirement on subprime lenders, the FRB must weigh the costs and benefits of doing so. On the positive side, the credit risk information would permit federal regulatory agencies to focus their investigations more efficiently when investigating lenders suspected of mixing race and risk in violation of the ECOA.⁹¹ This information may benefit some subprime lenders as well, since the analyzed credit score data could partially explain some racial disparities in pricing. Although these explanations would not be conclusive, they could make some lending patterns with racial disparities look less suspicious.⁹²

⁸⁹ Federal banking examiners that comprise the FFIEC are the Office of the Comptroller of the Currency, the National Credit Union Administration, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision. About the FFIEC, <http://www.ffiec.gov/about.htm> (last visited Oct. 16, 2009). Congress established the FFIEC in 1979 as an interagency body to prescribe uniform examination procedures, and to promote uniform supervision, among the federal agencies responsible for the examination and supervision of financial institutions. *Id.* In 1980, Congress gave the FFIEC responsibility for public access to HMDA data. *See 2006 HMDA Data*, *supra* note 88 at 73.

⁹⁰ *Rooting Out Discrimination Hearing*, *supra* note 81, at 450 (response to questions submitted by Calvin R. Hagins).

⁹¹ *Id.* at 42.

⁹² The argument that the HMDA data do not prove discrimination cuts both ways. These data also do not exonerate lenders from discrimination.

Despite the advantages of including credit history information in HMDA data, limitations will continue to exist because the credit score is only one of many risk assessment variables lenders use to price loans. It must therefore be remembered that adding credit scores to HMDA data analyses will not transform these data into something other than the screening tool Congress envisioned. Yet the additional information will make the screening tool sharper in that it will be able to do a better job of identifying potential discrimination. This enhancement to federal oversight of the subprime market is appropriate given the concern that discriminatory practices are part of the foundation of the mortgage foreclosure crisis. Still, other concerns must be considered.

1. Increased Lender Vulnerability to Litigation

Credit score data would likely make some lenders vulnerable to fair lending lawsuits by individuals who believe that HMDA data, without more, conclusively identify discriminatory pricing. Even if lenders could successfully defend such lawsuits by providing additional credit risk or other explanations that sufficiently justify the pricing disparities, the expense of defending unsubstantiated claims can be costly.⁹³ Additionally, the reputational harm that could result from accusations of racial discrimination may be difficult to repair. Another negative consequence for subprime lenders would be the cost of adjusting their systems for the reporting of the additional HMDA data. This cost is unknown and certainly must be considered,

However, credit score data would reduce the possibility that racial disparities reflect discriminatory treatment. Also, some legal scholars question whether credit scores are racially biased. See Chi Chi Wu, *Credit Scoring and Insurance: Costing Consumers Billions and Perpetuating the Economic Racial Divide*, 1-18 (2007), available at <http://www.consumerlaw.org/reports/content/InsuranceScoring.pdf>.

⁹³ Engel & McCoy, *supra* note 84. Kathleen Engel & Patricia McCoy discussed the reporting of credit score information with a representative from the lending industry who implied that exposure to frivolous lawsuits was a downside to collection of these data. *Id.*

however, given the need for greater insight into the lending practices in the subprime market, this cost should not justify keeping credit score data from fair lending regulators at the time they receive the HMDA data.⁹⁴

2. Consumer Privacy

Consumer privacy concerns are sometimes cited as a justification for omitting credit score information from HMDA data reporting requirements.⁹⁵ Unfortunately, HMDA data can now be matched with other information (e.g., public records of property transfers) to determine the identity of individual borrowers. Adding credit score information to the HMDA data requirements could further compromise the privacy of borrowers because once the matching is done and the borrowers are identified, it would be possible to learn their credit scores. Obviously, consumers should not have to worry about their credit scores becoming publicly available because they applied for a mortgage loan. Given the validity of the privacy concern, it is difficult to argue that it is outweighed by the usefulness of the additional credit score data. This, however, should not end the discussion.

Efforts should be made to address consumer privacy concerns in a manner that is consistent with requiring lenders to report credit score information. What is needed is a solution to the credit score reporting issue that does not compromise consumer privacy. According to two legal scholars, the United States Census Bureau has developed ways to protect privacy so that researchers can gain access to individual level census data without reporting a respondent's identity.⁹⁶ The FRB should examine these methods to see if they are suitable for safeguarding consumer privacy in the context of reporting credit

⁹⁴ If credit score information is captured and analyzed with current HMDA data, banking regulators should be able to identify more expeditiously financial institutions with suspicious lending patterns. This approach may therefore reduce inefficiency in fair lending enforcement.

⁹⁵ See Gramlich, *supra* note 79.

⁹⁶ See *supra* note 84.

score data. Another approach that is ripe for exploration is for subprime lenders to report the credit score information to the FRB for its internal use only. The FRB analysts would crunch the data and initiate investigations if racial disparities persisted after taking credit histories into account.⁹⁷ By restricting the data disclosure to the FRB only, public disclosure is avoided and consumer privacy is maintained. Additionally, both the Census Bureau approach and the FRB internal use approach would avoid exposing lenders to frivolous lawsuits.⁹⁸

The FRB should explore these or comparable privacy safeguards that would remove barriers to obtaining credit scores at the same time demographic and other HMDA data are obtained. Adding credit scores would promote greater transparency of the lending practices in the subprime mortgage market and in turn will likely increase ECOA compliance efforts of subprime lenders. The HMDA analyses that include credit scores will help explain to banking regulators whether any racial disparities are due to legitimate nondiscriminatory factors or to illegal discrimination.⁹⁹

3. Access to Credit: The Government's Role

A credit score reporting requirement might cause some subprime lenders to curtail the availability of credit to higher-risk borrowers. The risk of bad public relations, litigation, and more regulatory scrutiny would undoubtedly influence these decisions. Yet racial minorities may be hurt if subprime lenders cut back on making loans, as would other ECOA group members who are protected by the fair lending laws.¹⁰⁰ To be

⁹⁷ *See id.*

⁹⁸ *See id.*

⁹⁹ *See Rooting Out Discrimination Hearing, supra* note 81, at 89 (prepared statement of Calvin R. Hagins).

¹⁰⁰ *Home Mortgage Disclosure Act: Newly Collected Data and What it Means: Hearing Before the Subcomm. on Financial Institutions and Consumer Credit of H. Comm. on Financial Servs.*, 109th Cong. 138 (2006) (prepared statement of Professor Michael E. Staten, Director, Credit Research Center, McDonough School of Business, Georgetown University)

sure, subprime lending is an important element of our financial system because it provides a way for many people with blemished credit records, minority and non-minority, to become homeowners or obtain home financing who may otherwise be unable to do so.¹⁰¹ Given their defective credit histories, and perhaps other vulnerabilities, subprime borrowers have few financial options available and thus are more susceptible to predatory lending practices.¹⁰² Paradoxically, the question becomes whether the “access to credit” concern outweighs the benefit of having HMDA data that can more accurately identify possible ECOA violators.

As discussed in Part I above, the legacy of redlining discrimination where traditional lenders have failed to serve minority communities is a contributing factor to the problem of predatory subprime lending and discrimination in these communities.¹⁰³ Denying loans to minority borrowers at reasonable and fair rates creates voids that can be quickly filled by predatory lenders that charge exorbitant mortgage rates and fees. In essence, a large part of the problem for minority borrowers who turn to predatory subprime lenders is that in many minority neighborhoods there is very little, if any, competition for mortgage loans.¹⁰⁴ These lenders sometimes use

[hereinafter *HMDA New Data Hearing*]. Professor Staten voices the concerns of Federal Reserve Board Governor Susan Schmidt Bies about reducing mortgage credit availability for higher-risk borrowers in his testimony on the misuse of the HMDA pricing data. *Id.*

¹⁰¹ See Mayer & Pence, *supra* note 6, at 3 (finding that subprime loans appear to provide credit in locations where credit might be more difficult to obtain); see also Christopher R. Childs, Comment, *So You've Been Preempted—What Are You Going To Do Now?: Solutions for States Following Federal Preemption of State Predatory Lending Statutes*, 2004 BYU L. REV. 701, 709 (discussing what is predatory lending and why it is harmful).

¹⁰² See Warren, *supra* note 17 (discussing the effects of predatory lending).

¹⁰³ See *supra* Part I.

¹⁰⁴ See *Problems in Community Development, Banking, Mortgage Lending Discrimination, Reverse Redlining, and Home Equity Lending: Hearings Before the S. Comm. on Banking, Housing, and Urban Affairs*,

abusive and discriminatory lending practices. But not all subprime lending is predatory or discriminatory, which means that all subprime borrowers are not victims.¹⁰⁵ As Federal Reserve Governor Susan Schmidt Bies admonished, if expanded HMDA data requirements lead to the “unwarranted tarnishing of a lender’s reputation, this could reduce the willingness of that lender or another to remain in, or enter, certain higher-priced segments of the market.”¹⁰⁶ Indeed, the possibility of cutting off some legitimate subprime mortgage credit sources of people with already limited credit options is something that must be carefully considered before expanding HMDA to include credit scores. On the other hand, adding credit score information to the HMDA reporting requirement of subprime lenders could help federal regulators better identify subprime lenders who use racially discriminatory lending practices.

One way out of this conundrum is for the federal government to provide subprime borrowers with additional mortgage credit sources. This approach addresses the diminished credit problem and consequently removes this obstacle to allowing regulators to obtain credit score data that could better assist them in overseeing the subprime mortgage market. Along these lines, Professor Ronald Silverman has proposed an attractive idea that merits serious consideration. He suggests that Congress tackle the predatory lending problem by providing funding to credit unions for the purpose of making additional subprime mortgage loans.¹⁰⁷ This proposal has several

103d Cong. 392 (1993) (written testimony of John B. Long and Thomas W. Tucker, Partners, Dye, Tucker, Everitt, Wheale & Long; and David E. Hudson, Partner, Hull, Towill, Norman & Barrett).

¹⁰⁵ The terms “subprime” and “predatory” lending are frequently and erroneously used interchangeably to refer to abusive and unscrupulous lending practices. While subprime loans certainly pose inherent financial risks, and lenders are susceptible to engaging in predatory practices, subprime loans are not inherently abusive or predatory but serve an appropriate function in the market. See Andre K. Gray, Comment, *Caveat Emptor: Let the Borrower Beware of the Subprime Mortgage Market*, 11 U. PA. J.L. & SOC. CHANGE 195, 195 (2008).

¹⁰⁶ See *HMDA New Data Hearing*, *supra* note 100, at 138.

¹⁰⁷ Silverman, *supra* note 18, at 585–87.

advantages. First, it would provide competition to predatory subprime lenders, including those who use discriminatory lending practices. As a result, subprime minority borrowers will have alternative means of obtaining mortgage credit through legitimate sources. This would help to eliminate racial discrimination in the subprime market. Second, credit unions are regulated at the state or federal level and are subject to the ECOA's anti-discrimination mandate. Consequently, the subprime lending that credit unions provide is already, and will continue to be, examined for fair lending compliance. Third, as non-profit depository institutions with a long history of providing financial services to people of modest means, credit unions are likely to imbue public trust.¹⁰⁸ Finally, as Professor Silverman so aptly notes, "a supportive government presence need not involve the federal government as the lender of either first or last resort."¹⁰⁹ Thus, the federal government would not become a mortgage bank under the credit union funding approach.

Congress should fully examine the idea of a government supported subprime mortgage loan alternative to predatory lenders. Buying a home is the most expensive purchase most consumers will ever make. Because of the substantial investment borrowers make when purchasing or refinancing a home, it is imperative that they enter mortgage transactions in an environment of trust and honesty. By providing funding to credit unions, Congress can assist minority borrowers in avoiding lenders that use abusive and racially discriminatory practices. At the same time, the FRB could move forward with requiring subprime lenders to report credit score data without jeopardizing home mortgage credit for subprime borrowers.

CONCLUSION

Predatory lenders are destroying the reputation of legitimate subprime lenders who provide valuable mortgage services to

¹⁰⁸ *See id.* at 582–585.

¹⁰⁹ *Id.* at 586.

various segments of the population that would otherwise be unable to afford or refinance a home. These predators bring to subprime lending not only abusive tactics but discriminatory practices as well—a combination that can wreak havoc on people and communities of color. As we continue to seek solutions to predatory lending, we should not forget the role that racial discrimination plays in the abusive subprime market. This persistent problem must be addressed if solutions for stopping the next subprime crisis are to be effective. Part of the solution at the federal level is to bolster enforcement of consumer protection laws. Accordingly, government attorneys should bring more enforcement actions against subprime lenders that engage in discrimination in violation of the ECOA. Additionally, the FRB should facilitate these litigation efforts by providing ECOA enforcement authorities with a better means of identifying predatory lenders that discriminate unlawfully. Requiring subprime lenders to report credit score data would be an invaluable tool in uncovering discriminatory conduct. Moreover, Congress can help solve this problem by changing the environment in which predatory lenders thrive, namely, in places where borrowers have few mortgage lending alternatives to unscrupulous home loan providers. By funding credit unions, the federal government can facilitate competition in the subprime market and thus provide viable mortgage funding options to vulnerable consumers. While growing calls for stopping predatory subprime mortgage lending are positive steps in the right direction, effective solutions must include holding subprime lenders liable and accountable for lending discrimination on the basis of race and other illegal factors.

