The Consumer Finance Podcast: Illinois Federal Court Dismisses CFPB's First Redlining Case, Holding ECOA Doesn't Extend to Prospective Applicants
Host: Chris Willis
Guest: Lori Sommerfield
Posted: March 9, 2023

Chris Willis:

Welcome to the *Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper's consumer financial services regulatory practice, and today we're going to be talking about the implications of the recent district court decision dismissing the CFPB claims under the Equal Credit Opportunity Act against Townstone.

But before we jump into that topic, let me remind you to visit and subscribe to our blog, consumerfinancialserviceslawmonitor.com, where you'll get daily updates about everything happening in the consumer finance industry. And don't forget to check out our other podcast. We have lots of them. We have *FCRA Focus*, all about credit reporting, *The Crypto Exchange*, which of course is about crypto, and our privacy and data security podcast called *Unauthorized Access*. All of them are available on all popular podcast platforms.

And if you like this podcast, let us know. Leave us a review on your podcast platform of choice. Now, as I said, today we're going to be talking about the Townstone decision and its implications in the narrow world of mortgage redlining and then the wider world of potential credit discrimination more generally. I have a special treat today because I'm joined by partner Lori Sommerfield, who's one of our most accomplished fair lending lawyers. So, Lori, thanks for being on the podcast today and welcome.

Lori Sommerfield:

Thanks so much for having me, Chris. It's a pleasure to be here.

Chris Willis:

You and I like talk about the Townstone case all the time, so I feel like we're just going to take our own conversation now put it on the podcast feed. And I have to say I find it a little bit ironic that given the fact that a radio show and podcasts were such a central element of the allegations in the complaint in the Townstone case, now you and I are going to talk about the case on a podcast that's kind of like a radio show, so I have a big smile on my face as we're doing this.

Lori Sommerfield:

That is highly ironic.

Chris Willis:

Yeah, it really is. Why don't we just get started. Give us a little bit of background on what the Townstone case is all about in case people haven't heard about it or don't know all the details about it.

Lori Sommerfield:

Happy to do so, Chris. First of all, this case began back in 2020, specifically on July 15th, 2020, the CFPB filed a lawsuit in the Federal District court for the Northern District of Illinois against Townstone Financial, which was basically a non-bank retail mortgage lender based in Chicago. The Bureau alleged that Townstone had violated ECOA, and that's the Equal Credit Opportunity Act for all those of you who are not familiar with it, and Regulation B, which implements ECOA. They also have made some allegations about UDAAP violations, but the principal focus was really on ECOA and redlining concepts.

The CFPB alleged that Townstone had failed to engage in targeted marketing to African Americans in the Chicago MSA and that the company had engaged in acts or practices directed at prospective applicants then when looked at in their totality or even separately, had the effect of discouraging prospective applicants on the basis of race from applying for mortgage loans. Again, this is in the Chicago MSA.

And in part the CFPB based its allegations on a review of Townstone's HMDA data, which covered the period 2014 through 2017. And as you know, Chris, that's the traditional way that regulators approach redlining cases. They look at the lender's own mortgage lending data and patterns as well as comparing them to peers for any statistically significant differences in lending. And the CFPB noted that based on that HMDA data, Townstone didn't draw hardly any applications for properties in majority African-American neighborhoods in the Chicago MSA and very few applications from African Americans generally throughout the Chicago MSA.

But the CFPB primarily based its redlining allegations on a theory of marketing discrimination. First, the Bureau noted that Townstone hadn't engaged in any targeted marketing toward African Americans in the Chicago MSA, even though that population represented about 30% of the overall Chicago population. And second, the CFPB focused on Townstone's marketing practices because Townstone's business model was based on marketing and drawing mortgage loan applications primarily through radio advertising.

Townstone had its own sort of long form infomercial called Townstone Financial Show. It also had its own radio show and a podcast, further to your point that we are now discussing the Townstone case in a podcast. From those various efforts at radio and podcast advertising, they generated about 90% of their mortgage loan applications that way.

The Bureau alleged the Townstone regularly included statements about the characteristics of certain neighborhoods in Chicago such as the South Side, about those neighborhoods being unsafe or dangerous in a way that the Bureau felt would discourage prospective applicants from applying for mortgage loans. For example, the CFPB cited certain episodes of the Townstone Radio Show that disparaged majority African-American areas as hosting, "hoodlum weekends" and described them as being in a "war zone" or places to be driven through quickly. Townstone

also referred to a certain Jewel-Osco grocery store in the Chicago area, which was based in a majority minority neighborhood as being the "Jungle Jewel" and a scary place with patrons who packed the store from all over the world.

So, the Bureau basically leveraged these statements to create a finding that Townstone effectively discouraged prospective African American applicants from applying for mortgage loans. That's how the Bureau basically made its allegations in this redlining complaint.

Chris Willis:

Got it, thanks. And of course, the statement of facts that you just gave was from the CFPB's allegations. Nothing was actually ever proven because the case didn't make it past the motion to dismiss stage. And that's of course what we're here to talk about today. What happened in the case? In a very widely discussed order, the district court dismissed the CFPB's claims because the Bureau looked at the language that prohibits discrimination in the Equal Credit Opportunity Act. And just giving a paraphrase of it, it basically says it is illegal for any creditor to discriminate against an applicant on the basis of any of the protected characteristics like race or age or sex or marital status, et cetera.

And the district court said, "Well, hang on a second, there's no applicants here." The alleged people who were harmed by the conduct that the CFPB sought to attack in the complaint were people who never applied and who the Bureau alleges that Townstone deterred from applying or discouraged from applying. And so, the district court said, "Well, look, the statute says applicants and it even has a definition of applicant and these people aren't applicants. Case dismissed."

In doing so, the court also gave no wait whatsoever to a provision that's been in Regulation B, the implementing regulation for Equal Credit Opportunity Act, for a really long time in which the Federal Reserve a long time ago had interpreted applicant under the Equal Credit Opportunity Act to include prospective applicants and interpreted the statute to prohibit discouragement of people submitting applications on a prohibited basis. That's not in the statute, it's only in Reg B, but the court's take on it was, well, hey, you can't go amending the statute by putting something in a regulation and I'm not going to defer to an agency's sort of rewriting and expanding the scope of the statute under the guise of interpreting it in Reg B, so the court gave no weight to that because it was in the court's view contrary to the plain language of the statute. And so, it was the case was dismissed in the Northern District of Illinois.

That's the basic holding of the case and it's really very significant if it holds because as I said, the interpretation in Reg B about prospective applicants and discouragement has been in there for decades.

Lori Sommerfield:

About 50 years actually.

Chris Willis:

Yeah, right.

Lori Sommerfield:

Since the Fed issued that interpretation and the regulations under Reg B.

Chris Willis:

It's almost as old as I am.

Lori Sommerfield:

Just taking onto what you said earlier, Chris, too, when the court was looking at this issue and they were performing their Chevron analysis of ECOA, the Chevron analysis, as you know, dates back to the case that was, let's say Chevron versus National Resource Defense Counsel, which basically is a statutory interpretation that allows courts to defer to agency interpretations of their own rules. So, when the court was doing its own Chevron analysis of ECOA, the court pointed out that the word applicant is found 26 times in ECOA, and the statute doesn't prohibit or discuss conduct that occurs prior to the filing of an application toward prospective applicants, just as you said. So, the court found that the text of ECOA was unambiguous and owed no deference to the definition of applicant under Regulation B to include prospective applicants.

Chris Willis:

We seem to be in an era now where court deference to agency interpretation of statutes is at sort of a low point compared to what I regarded as kind of a high point under Chevron. I feel like Chevron has been quietly shuffled off to the side, if not explicitly overruled, which it hasn't been, but I feel like people just don't do Chevron anymore in the federal court system, and this is a great example of it. What do you think, Lori?

Lori Sommerfield:

I agree. Certainly, the federal courts have routinely deferred to federal agencies' interpretation of their own rules under Chevron since 1984, but it does seem that especially with the efforts under the Trump administration to appoint increasingly conservative judges, it seems that we are now finding a trend toward conservative courts becoming more skeptical about agency deference generally and beginning to retreat from that approach. As a result, I think we're going to continue to see this trend of eroding reliance on agency deference by courts going forward.

Chris Willis:

Yeah, that's interesting because we have another agency deference question to talk about in a minute, but before we get into that one, and it's about the same statute, the Equal Credit Opportunity Act and having given that teaser to the audience, let's finish talking a little bit about the implications of the holding in Townstone, which is you're not an applicant until you apply

essentially and the statute doesn't reach discrimination against people who didn't apply yet. Let's talk about the various dimensions of how that may impact the law and regulatory enforcement going forward.

First, let's talk narrowly about redlining. The Townstone case is basically a redlining case, a mortgage redlining case, which we've had lots of over the years from the CFPB, but before then by Department of Justice and the federal banking regulators. If the Townstone decision holds, Lori, is there going to be any ability for the CFPB to bring redlining cases under the Equal Credit Opportunity Act?

Lori Sommerfield:

I think it's going to be very limited. I mean, again, this is one decision by one court, but the precedent here I think could really have a chilling effect on the Bureau's desire to bring another case like this in the near future. It's my understanding that the CFPB spent years looking for the right set of facts to undertake a redlining enforcement action under ECOA, and clearly this was a best effort that failed. So, if this is going to fail, I would imagine that other redlining cases brought under a theory of marketing discrimination and ECOA would likely face a similar consequence. It's important to know that the CFPB only has authority of two assert redlining claims under ECOA, and they have no authority to directly bring claims under the Fair Housing Act. So, if this holding is more widely adopted among federal courts, it could force the CFPB at the end of the day to refer any redlining allegations or cases to the US Department of Justice in the future. I think that could be a potential consequence here.

Chris Willis:

Yeah, and let's talk about that because even though this could completely hobble the CFPB's ability to bring redlining cases because they only have authority under the Equal Credit Opportunity Act, the same isn't true of the Department of Justice. They have something else that they can rely on. Why don't you talk about that for a second, Lori?

Lori Sommerfield:

That's exactly right, Chris. The DOJ can still bring redlining cases because they have legal authority to do so under both ECOA and the Fair Housing Act because the Fair Housing Act isn't limited to applicants. They have this broader scope under which they could actually bring redlining cases, and I would absolutely expect that the DOJ would continue to do so, particularly under the aegis of the Combating Redlining Initiative that the DOJ announced in October of 2021. And we've seen a steady stream of redlining cases since then, as you know.

Chris Willis:

Yeah, we have to understand the Townstone decision isn't the death of redlining cases. It just may be the death of ECOA redlining cases brought by the CFPB.

Lori Sommerfield:

That's exactly right. That's how I would view it as well, Chris.

Chris Willis:

But let's talk about something else now. The CFPB has been very vocal in the last roughly year about the potential for ECOA violations based on targeted advertising on say, social media or web platforms, kind of similar to the targeted advertising claims that DOJ made in the Facebook case that was settled earlier in 2023, but those were also based on the Fair Housing Act, not ECOA. Lori, where would those ECOA based advertising claims be under the Townstone decision? Aren't they just blowing out of the water just like the redlining cases?

Lori Sommerfield:

Yes, I agree. I think they would be barred under the reasoning of the Townstone Court because those activities are geared toward prospective applicants, not applicants. The opinion states that the Bureau seeks to improperly expand the reach of ECOA to reach prospective applicants to regulate behavior before a credit transaction even begins, and to create affirmative advertising requirements which cannot be squared with the unambiguous language of the statute. Here again, the court is giving no deference whatsoever to Reg B's anti-discouragement provision that applies to prospective applicants. I really think the CFPB's allegations of discriminatory statements made during Townstone's podcast were a critical element in the CFPB being able to bring a redlining claim against Townstone under ECOA if the holding in this case stands and it would undermine the CFPB's ability to bring ECOA claims, I think, going forward, in redlining cases as well as marketing and advertising cases.

Chris Willis:

Yeah, I think so too. And I think what that does is it forces the CFPB if it wants to bring a discriminatory advertising claim, it forces it into the UAP mode that it announced in March of 2022, which is the idea that, well, something can be UDAAP if it is discriminatory, unfair, in particular, because it's discriminatory. And that announcement and the sort of accompanying amendment to the CFPB's UDAAP advertising manual explicitly noted advertising is one of the areas that would be covered by this announcement. But we're sitting here a year later and we haven't seen any instance of the CFPB actually using that authority. So, if the CFPB doesn't get to use ECOA for an advertising case, how well Lori, do you think they're fair if they're going to then switch over and rely on the unfair part of their UDAAP authority? Will that work?

Lori Sommerfield:

I think that is a possibility, and in fact, there were actually some UDAAP allegations in this redlining case against Townstone, but it's unproven at this point and we've seen no meaningful effort by the CFPB to actually operationalize that UDAAP examination guidance, which is basically UDAAP as discrimination. So, there is a path forward that the CFPB could reframe the Townstone case and other future marketing-based ECOA claims in terms of alleged violations

of UDAAP using their much broader authority. But I don't know that would be productive, but I would not put it past the CFPB to give that a try.

Chris Willis:

I definitely agree that they may try, but the thing is that UDAAP's discrimination theory is also subject to its own significant legal hurdles, and I think we are seeing those play out in the lawsuit filed by the US Chamber and a bunch of bank trade associations against the CFPB seeking to have a court hold that UDAAP manual amendment was outside the CFPB statutory authority because unfair in the UDAAP statute in Dodd-Frank can't fairly be read to encompass discrimination. That when Congress wants to prohibit discrimination, it knows exactly how to do it, and it says so, like for example, in the Equal Credit Opportunity Act. I think actually there's significant legal jeopardy for the CFPB if they rely on this UDAAP theory in a highly contested case. So, although I think you're right that they may use it, the path to success there is not any clearer that it was under ECOA, I don't think. What do you think?

Lori Sommerfield:

I think you're absolutely right. I think it would be an uphill battle for them to try to use the UDAAP authority to bring a redlining case in the future, but I guess it remains to be seen. Given the whole of government approach toward referring redlining cases to DOJ and bringing redlining cases seems to be well underway. The CFPB wants to be part of that activity, so I think they're going to try to find a way to be involved directly or as a plan B, to refer cases to the DOJ. That's my personal take on it.

Chris Willis:

Yeah, I think you're right. So, we talked a minute ago about Chevron deference or the absence of Chevron deference in today's judicial environment, and there's another closely related issue about the same word in the same statute, the word applicant in the Equal Credit Opportunity Act that I wanted to get your take on too.

There were two cases last year where district courts held that once your application has been approved and you've got a credit product, you've got a loan or a credit card or whatever, that you're no longer an applicant. And so, the courts in those two cases basically said that the requirements of ECOA, for example, to give adverse action notices don't apply to things that happen after your credit transaction has been opened. So, for things like credit line decreases or things like that. Both cases went up on appeal in two different circuits and the CFPB and the Federal Trade Commission filed amicus briefs in both of them. But what does this Townstone decision tell us about the potential for the word applicant to get squeezed in both directions? That is, you're not an applicant before you apply and you're not an applicant after you're approved. Where do you think that may be going?

Lori Sommerfield:

That's a really good question, Chris, and it's interesting to me that this has become such a point of focus in recent cases, but it goes to show I think that there is latitude within ECOA and Reg B

to further interpret this issue. And I think the CFPB certainly wants to have the more expansive interpretation, but given the fact that it's been on the trend here of losing cases, I think the trend is going to be to interpret the terms more narrowly, especially given the conservative nature of the judicial system in this day and age. But I'd welcome your thoughts on that too.

Chris Willis:

Well, to me, the applicant after your approved question at least has some arguable ambiguity to it because the statute says that you may not discriminate against an applicant in any aspect of a credit transaction. And so, one reading of that is any aspect including like servicing and collections, because those are aspects of a credit transaction.

Now, I think you can equally read it to mean any aspect of the credit transaction you're applying for like the interest rate, for example, or the credit line that you might get. Arguably that ambiguity could be a place where deference to an agency's interpretation could be warranted, right? Because if the statute's ambiguous, that's when you're supposed to defer to the agency, so I feel like the agency has at least some argument there. But you can easily see courts saying, "No, no, no. Any aspect of a credit transaction means like the interest rate and the term and your credit line and things like that." Because you can read it quite naturally to mean that without getting too tied up in a pretzel from an interpretive standpoint.

Lori Sommerfield:

That's exactly right. I think a lot of people have interpreted that language though in ECOA and Reg B as really applying to the credit life cycle or the loan life cycle instead, so I think there's also ambiguity on that point.

Chris Willis:

And certainly, the CFPB has taken that position because they've had servicing-related consent orders under the Equal Credit Opportunity Act, people who are way past having their credit transaction approved, and in fact, were in charge off collections. So, we know that Reg B takes that position and the CFPB takes that position, and again, it's a long-standing position in Reg B. The CFPB didn't make that up. That was in with the fad prior to the CFPB even existing or even dreamed of. But nevertheless, in an era where courts are going to look carefully at how far the agency goes outside this four corners of a statute, you've got to think that interpretation of applicant is also vulnerable.

Lori Sommerfield:

Agreed. And just as a point of clarification, and for those members of our audience who might not know this, the Federal Reserve was charged with implementing the first set of regulations to implement the Equal Credit Opportunity Act back in 1974, which they issued in 1976. The CFPB took over administration of Regulation B and having authority for enforcing ECOA in 2011 when that agency was stood up. So that's why we've been talking about the Fed and the CFPB both as having responsibility for interpreting ECOA as well as Regulation B.

Chris Willis:

Right. This is an issue that we're going to watch carefully. And I guess the last thing we should talk about going back to the Townstone case itself is do we think the CFPB is going to appeal? Because on the one hand, they have a really bad ruling out there now that everybody knows about, and we're talking about it on this radio show, so even more people know about it now. On the other hand, you appeal that case, and the Seventh Circuit goes the wrong way, now you don't just have one District court case. You've got a court of appeal. And so, do you have any thoughts, Lori, on whether the CFPB is likely to appeal? They haven't said one way or the other yet, but do you think they might or should?

Lori Sommerfield:

No. The CFPB hasn't indicated yet whether they're going to appeal this decision, and I think they're probably seriously weighing that choice because it could be fraught with consequences for the agency. There's an older case called Moran Foods versus Mid Atlantic Market Development that the Seventh Circuit decided back in 2007, which favored a narrower reading of the term applicant in ECOA. That could portend that the Seventh Circuit would be more favorable in terms of affirming the district court decision in Townstone. That is a possibility.

So, if that were the case than the CFPB would be faced with an unfavorable decision by the Seventh Circuit, then they would have to decide whether to appeal to the Supreme Court. That's an entire set of difficult choices and consequences. But one possible path for the CFPB would be to just let this decision stand and hope that it's more of an outlier type of decision, and then just refer the case to DOJ to decide whether to take it up as a referral for an alleged pattern or practice of discrimination under ECOA.

Chris Willis:

That makes sense. Assuming the statute of limitations hasn't already run.

Lori Sommerfield:

That's right.

Chris Willis:

In the years that the case has been pending, which has been what, two, two and a half years, something like that.

Lori Sommerfield:

Two and a half now.

Chris Willis:

That makes sense. But even if the CFPB does that and doesn't risk an adverse ruling from the Seventh Circuit by appealing the case, you've got to think that any enforcement target who's faced with a redlining or advertising related case is going to point to that decision and say, "I'm not settling this case with you. Why don't we litigate it again? Let's see how it comes out this time." Because certainly the existence of that decision would encourage a lot of enforcement targets to do that because they would see a very strong possibility of winning again.

Lori Sommerfield:

I absolutely agree with you, Chris. I think this is going to encourage enforcement targets and defendants to be much more litigious toward the CFPB.

Chris Willis:

Yeah. In turn, I wonder if that'll influence the CFPB's case selection in terms of fair lending cases to ones that are clearly within the ambitus ECOA like underwriting or pricing cases, for example.

Lori Sommerfield:

Right. And we haven't really seen the CFPB take up many of those cases in recent years.

Chris Willis:

No, the last one I remember was a hybrid with a redlining case against a bank. It had redlining plus discriminatory underwriting in it if I'm remembering. But that was like in 2018 or something.

Lori Sommerfield:

Yes, it's been at least three or four years I think since the Bureau has attempted a case like that.

Chris Willis:

Lori, I really appreciate you coming on the podcast to just talk with me about where we are with ECOA in light of this decision and where we might be going. I know the audience appreciated your insights, and I definitely did as well. Thanks for being on the podcast. And of course, thanks to our audience for listening in as well. Let me remind you to visit our blog, consumerfinancialserviceslawmonitor.com and hit the subscribe button so that you can get all of our daily updates about what's going on in the world of consumer finance. And while you're at it, go visit us at troutman.com and add yourself to our Consumer Financial Services email list. That way you'll get notices of our webinars and our client alerts that we send out. And of course, stay tuned for a new episode of this podcast every Thursday afternoon. Thank you all for listening.