The Consumer Finance Podcast: Status of the DOJ's Combatting Redlining Initiative
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Guests: Lori Sommerfield
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Chris Willis:

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper's Consumer Financial Services Regulatory Practice. Today, we're going to be checking in on the status of the federal government and the Department of Justice's operation, Combatting Redlining Initiative, which has been going on now for a little over two years. And there's a lot of news to report and predictions for the future about that.

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Chris Willis:

Now, as I said, today, we're going to be checking in on the status of the Combatting Redlining Initiative, which is really being led by the Department of Justice, but where all the federal regulators are participating. The OCC, the FDIC, the CFPB. It's been going on ever since it was announced in October of 2021, in a sort of joint release among several of the federal regulators. Now, this initiative has been very seriously pursued by all the regulators involved, and we've seen a very large number of redlining cases brought by the Department of Justice over the past couple of years, with some very large numbers involved. There's been a total of $107 million in monetary relief in connection with those redlining settlements. In fact, there was also the largest ever single redlining settlement at $31 million, just in the past year or so. In fact, we also saw the very first redlining settlement with a non-bank mortgage lender by the federal regulators.

A lot of new ground has been plowed by this initiative. Today, to update us on the status of what's going on in the world of redlining, I'm joined by my partner, Lori Sommerfield. Lori is one of our fair lending experts. She's an expert in both the Fair Housing Act and the Equal Credit Opportunity Act, and she works very extensively on redlining matters, both in supervision with the federal banking regulators, and of course, if they escalate beyond that, as well. Lori, welcome to the podcast today. Thanks for being here.

Lori Sommerfield:

Thanks, Chris. Great to be with you again.

Chris Willis:

I guess it's probably appropriate for us to start the podcast, just with a definition of redlining. For those who might not be all that up on it, I'll just take a guess at it, and then get you to update us on where the federal regulators are with us. But historically, redlining has been a claim made under the Fair Housing Act and/or the Equal Credit Opportunity Act, which alleges that a mortgage lender is engaging in a discriminatory practice of avoiding making loans in neighborhoods, in a metro area that have high concentrations of minority people living in those neighborhoods.

The cases tend to be based, first and foremost, on an analysis of HMDA data that shows that a particular lender is not equal to its peer group, in terms of the number of applications it receives, and loans that it originates in majority-minority areas within a metro area. Frequently, you'll have evidence in these cases of things like the lack of a bank branch in the area, or a lack of diversity in mortgage loan officers, a lack of advertising into the minority areas, or even a CRA assessment area that's drawn to exclude the majority-minority areas. Those are the common elements we see in a lot of redlining cases.

Then, of course, recently, we've seen a lot of the sort of what I'll call bad emails, among the staff of the mortgage lender, where they make derogatory or racial statements about particular neighborhoods or things like that. I think that's a good working definition of what a redlining case is, at least as we've seen them come out in the past. But Lori, with that introduction, do you mind – let's give the audience a briefing on the Combatting Redlining Initiative. Let's just start with how many redlining enforcement actions has the Department of Justice brought under the initiative to date, either by itself or jointly with one or more of the other federal regulators.

Lori Sommerfield:

Well, Chris, the DOJ has brought 10 redlining enforcement actions, either on its own, or in conjunction with other federal agencies. This action is the strategy of the Combatting Redlining Initiative is truly unprecedented. We're seeing being brought to bear this whole of government approach, as you mentioned, and the DOJ, and the federal agencies are really taking this very seriously. Despite the fact that there's been this focus on the more nuanced forms of modern-day redlining, we're seeing, as you just mentioned, that a lot of these allegations seem to allege more traditional types of redlining violations, like avoiding marketing and outreach to majority-minority census tracts.

Chris Willis:

Yes, it's very interesting. The thing is you say there's been 10 enforcement actions. But in the historical context, 10 in two years is a lot. Because if you look back at the years preceding that, just sort of thinking back on the cases that were brought, it seems like you would see one or two a year. Now, we've had 10 in two years. That's really unprecedented.

Lori Sommerfield:

Yes, it is, Chris. I mean, I think, as we're saying, the DOJ has made this their signature issue. That's why they're putting all these resources behind it and really prioritizing redlining investigations and cases for enforcement during the Biden administration.

Chris Willis:

In addition to the high number of cases that we've seen come out in public settlements, essentially, do we have any information about how many redlining investigations are currently in the pipeline with the Department of Justice?

Lori Sommerfield:

Yes. As a matter of fact, we do, Chris. DOJ officials have publicly stated recently that there are about two dozen investigations that are currently pending. Attorney General Merrick Garland noted this in a couple of press releases that were issued this past fall in conjunction with announcements about particular enforcement actions, and that big press release that came out October 19, in which he announced the DOJ had secured over $107 million in relief for communities of color and redlining actions. Then, again, at a fair lending conference in November, Lucy Carlson, who is the Deputy Chief of the DOJ's Housing and Civil Enforcement section, confirmed his statements that there are about 24 cases in the pipeline right now.

Chris Willis:

Yes, which again, like in historical perspective, when you would see one or two of these cases a year, or even when we've seen 10 in two years, the fact that there's 24, in active investigation with the Department of Justice is a whopping number, I think.

Lori Sommerfield:

Absolutely.

Chris Willis:

But in addition to that, that's not even telling the whole story, because those are just the ones that have made it to the Department of Justice so far. We know from our own experience, and from talking to others in the industry, that there are numerous redlining cases being worked by the federal banking regulators in supervision, like the OCC and the FDIC. Those are sort of in the pipeline, potentially, to be referred to the Department of Justice for enforcement. The 24 number in DOJ Civil Rights Division doesn't count any of those that are sort of gestating with the federal banking regulators, right?

Lori Sommerfield:

That's correct. If you think of the three federal banking agencies, plus the CFPB, and all the potential redlining investigations or examinations that are occurring right now, I mean, that number could quadruple.

Chris Willis:

Yes, absolutely. The thing is, we've noticed, you and I have noticed in our supervisory experience with the federal banking regulators, that they are being, let's say, very aggressive in finding redlining, even in instances where my belief is the fact pattern would not have resulted in a finding of redlining in the past.

Lori Sommerfield:

Agreed, Chris. I think we're seeing some fact patterns where the regulators are focused on marketing and outreach, or loan penetration that is based on areas that are not part of a traditional CRA assessment area, but using more of a REMA theory - Reasonably Expected Market Area. And often requiring that additional mortgage loan origination and application volume be generated in majority-minority census tracts that are adjacent to those areas, which we typically not have seen in prior years.

Chris Willis:

Yes, that's right. What are some of the common trends the DOJ has said that it's seeing in cases where redlining activity is being alleged?

Lori Sommerfield:

Lucy Carlson from the DOJ recently highlighted two common trends that the DOJ is seeing in redlining enforcement actions when she spoke recently at that fair lending conference. She stated, first of all, that lenders' awareness of redlining risks sometimes is noted as sometimes being in existence for years about the fact that they needed to take corrective action, and yet failed to do so. That's one common trend they're seeing.

A second trend is evidence of discrimination in employee emails, sometimes even involving managers, where they're disparaging descriptions of certain neighborhoods, or even overt animus toward certain protected class groups. That was something that you mentioned earlier, Chris, at the beginning of our podcast. These are clearly important issues for lenders to be aware of because not taking corrective action when redlining risk is known, based on data analyses or information, is a huge red flag for regulators. As you and I both know, there's been this increasing trend among federal regulators, especially the DOJ and the CFPB, to use email and instant messages as a roadmap to finding compliance violations. I think we're going to continue to see these types of requests for electronic communications going forward, not only in redlining investigations, but also other types of civil investigative demands.

Chris Willis:

Yes. That's a great point, Lori. I think we should probably come back to that electronic communications point when we wrap up the podcast and talk about going forward implications for lenders. But before we get to that, at that same fair lending conference that you mentioned that Lucy Carlson spoke at, I think I also understood that Assistant Attorney General Kristen Clarke made some comments at that same conference and gave some sort of specific guidance to mortgage lenders to try to help them stay out of trouble from a redlining standpoint. Would you mind sharing that with the audience?

Lori Sommerfield:

Sure, Chris. Yes, you're absolutely right. Kristen Clarke gave basically five ideas that were designed to sort of guide lenders about how to avoid and address redlining risk. Her first suggestion was, engage with your regulator, and promptly implement any recommendations following a fair lending exam. She said that lenders that ignore regulators recommendations that could have made a difference in identifying and addressing redlining risk are more often subject to investigation by the DOJ. Her second suggestion was understand the full scope of the community that the institution serves and lends to. She said that some lenders could have proactively identified risks if they'd simply step back to look at whether there were any communities of color adjacent to their lending areas that could have been reasonably served. This exactly exemplifies that fact pattern that you and I were just talking about, which we see in enforcement cases, like Essa Bank & Trust.

Her third suggestion was engaging with community groups that have insight into the credit needs of local communities of color. Obviously, community groups are critical partners when lenders are seeking to connect with potential borrowers of color. Some of those groups provide services that can create a pathway to home ownership, like credit counseling, or match savings programs, and the like.

Clarke's fourth suggestion was to ensure that the institution's compliance management system is accurately measuring redlining risk. She noted that some institutions rely on insufficient metrics that give lenders a false sense of security about knowing and understanding their redlining risk when in fact, those metrics are off base. Then, her final suggestion was to use information from community credit needs assessments, as well as discussions with community organizations to refine the institution's fair lending monitoring program. One thing that she mentioned, Chris, in her remarks about that was using special purpose credit programs to expand access to credit, and that those types of programs can be one of the effective ways that lenders can address redlining risk. I think you and our listeners are aware of that back in February of 2022, the DOJ and various other federal regulators issued an interagency statement promoting the use of special-purpose credit programs under both ECOA and the Fair Housing Act.

Chris Willis:

Right. Despite the fact that the Fair Housing Act doesn't have a special purpose program provision in it, the federal regulators, HUD, DOJ, et cetera have all interpreted it to be permissible under the Fair Housing Act.

Lori Sommerfield:

That's right.

Chris Willis:

Thanks for that recap of Kristen Clarke's sort of to-do list for lenders. But let's take a crack at that ourselves. We know with very good evidence, and high assurance that redlining is one of the most critical risk areas for mortgage lenders right now. What would you say, Lori, to mortgage lenders in terms of what they should be doing in terms of their own analyses to detect and address any redlining risks that they may have?

Lori Sommerfield:

Well, Chris, I would say, first, any mortgage lenders should expect and prepare for a redlining examination. You can use the Interagency Fair Lending Exam Procedures as guidance for that, in preparation for receiving a redlining examination. But also, importantly, lenders should also routinely be performing various redlining analyses based on their own HMDA data, as well as peer data. Those are things like market penetration analyses, where you look at application volume, and mortgage loan denials, and origination rates. Particularly in majority-minority census tracts.

As I mentioned, you should also be looking at peer data and comparing those types of data, application volume, and mortgage loan denials, and origination rates. Also perform root cause analysis to identify which factors might be driving redlining risk, and whether any type of corrective action is needed. Along those lines, it's important to review your CRA assessment area to make sure that it doesn't exclude minority areas, look at branch locations, how you are looking at branch mortgage loan performance, and in your opening and closing decisions. You should also be evaluating marketing and outreach initiatives and looking at your geographic inclusion and exclusion criteria. As well as, of course, reviewing your policies and procedures and monitoring customer complaints, and any litigation, of course, that could involve redlining allegations. But there's a whole host of things that lenders should be doing to routinely evaluate and address whether redlining risk is present.

Chris Willis:

Well, it seems to me, also, we should come back to the point you made earlier about the use of emails, and instant messaging communications to kind of prove intent, or provide atmospheric facts. We've seen a number of recent redlining cases that contain, where the complaints, or the press releases, or both, contain extensive discussions or quotes from very poorly worded emails among members of a mortgage lender staff. So it seems to me, that since we know the regulators look for such communications in any redlining investigation, mortgage lenders would be well-advised to do that internal looking themselves. In addition to doing the more classic sort of HMDA-based and assessment area type analyses that you just mentioned. Surely, you don't want to discover that there's emails like that on your server when the DOJ requests them in a document request.

Lori Sommerfield:

You're absolutely right, Chris. I mean, this seems like something that every mortgage lender should be doing proactively through electronic communication surveillance, using keyword searches, terms and phrases that could potentially indicate overt discrimination in particular. But this is often the smoking gun that leads to the tipping point whenever there is redlining risk present. So I absolutely agree with you that it's important to proactively monitor electronic communication in different ways.

Chris Willis:

Yes. We're now in 2024. It's the final year of this presidential administration. We know why we have a lot of cases in the pipeline, both with the federal banking regulators and with DOJ. Would you care to make a few predictions about what we're going to see in terms of redlining in 2024?

Lori Sommerfield:

Sure, Chris, and I would welcome yours as well. As I mentioned, the Combatting Redlining Initiative is certainly a signature issue of the Biden administration. We've seen the federal agencies led by DOJ undertake this steady stream of redlining investigations and enforcement actions during the past two years. And as AAG Kristen Clarke recently stated at that fair lending conference, DOJ intends to move “full speed ahead” with pursuing this initiative. I fully believe that we're going to see several more redlining enforcement actions during 2024.

Of course, while President Biden remains in office, DOJ and the other agencies certainly have the political motivation to proceed expeditiously with this initiative. By tackling as many of those cases as they can that are in the pipeline in the remaining time that's left until the next presidential election. But I suspect we may also see several of these cases spill over into 2025.

Chris Willis:

Oh, sure. Definitely. What I would add, first of all, I completely agree with your prognostication of what's going to happen in the next year. I think we're going to see tons more activity here. I think one of the real questions is how much will the federal regulators try to move the traditional redlining analysis to be more aggressive and expansionist? You mentioned, Lori, the idea about these patterns of cases where the allegation is that you redlined by not making loans in minority areas that are sort of on the edge of and beyond your assessment area as a bank. We've seen one of those publicly with the ESSA case, and we know that there are several of those cooking with the federal banking regulators and with DOJ. But it'll be interesting to see what other innovations occur.

The other prediction that I'd share with the audience is, I think it's a mistake to think of redlining as purely an enforcement activity by the regulators. I think there's every reason to believe that in purely supervisory matters, the federal banking regulators, and potentially the CFPB will use the threat of a finding of redlining to push institutions to expand the number of loans they make in majority-minority census tracts, to expand their assessment areas, and to basically use the threat of a redlining finding, as a tool to force mortgage lenders to basically expand their operational footprints. We may never see evidence of that publicly, but I know we will see it in supervision in the coming year. That's the only thing that I would add to your prediction.

Lori Sommerfield:

I agree, Chris. I think we're also seeing evidence of that occurring in the supervisory context by the regulators, pushing institutions to take entire MSAs, rather than portions of them. We are definitely seeing an agenda of more of an expansionist approach in these rules in redlining and enforcing the fair lending laws.

Chris Willis:

Yes, that's right. Well, Lori, I'm really glad you joined me to talk to our audience about this today. Because as I said, think redlining is pretty much the number one most important and riskiest regulatory issue facing mortgage lenders right now. The fact that redlining cases are being so aggressively pursued, means that people can't rely on sort of their old understanding of, well, I'm not redlining because X, because I think the goalposts are moving in this area.

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