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DOJ Comments Reveal Road Ahead for Mortgage Redlining

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For the last two years, the federal regulatory agencies have been waging a war on redlining by mortgage lenders — a war that shows no signs of abating.

At a fair lending conference in November, two representatives from the U.S. Department of Justice, one of the key agencies involved in redlining enforcement, shared remarks on the last two years and offered a look ahead.

The remarks, from Assistant Attorney General Kristen Clarke and Lucy Carlson, deputy chief of the Housing and Civil Enforcement Section, serve as a reminder to mortgage lenders that proactively monitoring for redlining risks, and taking appropriate corrective actions where necessary, is critical in today's environment.

In particular, we know that federal regulators are actively looking for redlining targets by analyzing Home Mortgage Disclosure Act data, and so mortgage lenders should be conducting those same analyses to address redlining risks before they become the subject of a redlining investigation or examination.

In November, the annual Community Reinvestment Act and Fair Lending Colloquium took place in Austin, Texas. Two officials from the DOJ discussed in detail the Combatting Redlining Initiative led by the DOJ using a whole-of-government approach, the current state of redlining investigations and the future direction of enforcement.

In prepared remarks,[1] Clarke stated, "We are proud of the work we have been able to accomplish in these past two years through the Combatting Redlining Initiative. But we are by no means done. We are also focusing on unlawful practices such as reverse redlining, and steering."

Since its October 2021 launch, the DOJ's initiative has resolved 10 redlining cases, securing over $107 million in relief for communities of color that have experienced lending discrimination.

On a panel about redlining, Carlson confirmed recent public statements by Attorney General Merrick Garland that approximately two dozen redlining investigations are underway at the DOJ.

She further highlighted two common trends the DOJ is seeing in redlining enforcement actions: lenders' awareness of redlining risks, sometimes for years, without taking corrective action; and evidence of discrimination

in employee or manager emails, i.e., disparaging descriptions of certain neighborhoods or overt animus toward protected groups.

Clarke offered guidance to lenders on how to avoid redlining practices, based on the DOJ's past two years of experience:

- Engage with regulators and promptly implement any recommendations following a fair lending examination: "Lenders that ignored regulators' recommendations that could have made a difference in identifying and addressing redlining risk are more often subject to investigation by the [DOJ]."
- Understand the full scope of the communities where the institution lends: "[S]ome lenders could have proactively identified risk if they had stepped back to determine whether there were communities of color adjacent to their lending areas that they could have reasonably served."
- Engage with community groups that have insight into the credit needs of local communities of color: "[C]ommunity groups are critical partners in connecting lenders to potential borrowers, as some of these groups provide services that are creating pathways to home ownership, such as credit counseling and matched savings programs."
- Ensure that the institution's compliance management system is accurately measuring redlining risk. The DOJ frequently sees institutions relying on insufficient metrics that give them a false sense of security.
- Use information from community credit needs assessments and discussions with community organizations to refine the institution's internal fair lending monitoring program.
  - In February 2022, the DOJ joined the Consumer Financial Protection Bureau, the U.S. Department of Housing and Urban Development, and prudential regulators in an interagency statement encouraging creditors to explore opportunities to develop special-purpose credit programs to better expand access to credit. Clarke noted that SPCPs can be an effective way to help mitigate redlining risk.

Clarke also noted that over the last 24 months, the DOJ has closed investigations without further enforcement action when it is clear that the lender promptly addressed redlining risk that it or its regulator identified — not as a reaction to an imminent referral to the DOJ, but because the institution was proactive in its efforts to do better.

Clarke also identified two other priority areas for the DOJ moving forward.

The first is addressing appraisal discrimination. The DOJ is one of 13 federal agencies on the Interagency Task Force on Property Appraisal and Valuation Equity (PAVE), a collaboration to develop a proactive, federal response to appraisal discrimination.

In 2022, PAVE issued[2] a report detailing specific agency commitments to address bias, including the DOJ's commitment "to expand fair lending enforcement and drive accountability in the industry."

The second is combating algorithmic bias and discrimination. According to Clarke,

The use of algorithms to underwrite loans – from mortgages to student loans to credit cards — has created a new playing field for obtaining credit. Lending institutions are responsible for ensuring that the playing field is level for applicants regardless of their race, sex, familial status or national origin. Lenders should proactively and consistently review and test their underwriting process – including their automated steps — to ensure that credit decisions do not turbocharge discrimination by disproportionately rejecting loans to applicants of color for reasons unrelated to creditworthiness.

Clarke noted that monitoring the use of algorithms is a priority given President Joe Biden's recent executive order on artificial intelligence, which assigns federal agencies the task of assessing the civil rights implications of artificial intelligence and other emerging technologies.[3]

Takeaways for Mortgage Lenders

As noted by Clarke in her remarks, the DOJ and the other federal agencies are clearly moving full speed ahead in pursuing redlining investigations and enforcement under the Combatting Redlining Initiative, which remains one of the signature fair lending efforts of the Biden administration and the federal government.

In preparation for future redlining examinations, lenders should ensure that their fair lending compliance risk management programs incorporate appropriate redlining analyses, including not only peer comparisons through the use of HMDA data, but also root cause analysis of shortfalls in applications and originations in majority-minority areas to identify which factors are driving risk and whether corrective action is needed.

And, because we know that the DOJ and other agencies now look at employee emails and instant messaging communications as a matter of course in redlining investigations, lenders would be well-advised to look at those same communications proactively to detect and correct any inappropriate conduct among loan officers or other employees.

Lenders should also note that the DOJ and federal agencies will continue to prioritize their efforts in addressing appraisal bias and algorithmic discrimination in underwriting and take steps to mitigate those risks.

The CFPB in particular has been highly focused on potential discrimination in credit underwriting models that use artificial intelligence or machine learning.

Developing such models using sound model governance practices, and with an emphasis on fair lending testing, is necessary to put a lender in the best position to defend algorithmic models against regulatory scrutiny.

[1] https://www.justice.gov/opa/speech/remarks-assistant-attorney-general-kristen-clarke-annual-community-reinvestment-act-and.

[2] https://pave.hud.gov/sites/pave.hud.gov/files/documents/PAVEActionPlan.pdf.

[3] https://www.consumerfinancialserviceslawmonitor.com/2023/11/biden-issues-first-executive-order-directing-federal-agencies-to-establish-new-standards-to-promote-safe-and-secure-use-of-ai/.

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